

**Ministry of Economics
Republic of Latvia**

**ECONOMIC
DEVELOPMENT
OF LATVIA**

REPORT

**RIGA
JUNE 2008**

Commentaries, questions or proposals are to be sent to:

Ministry of Economics, Republic of Latvia
Brīvības ielā 55, Rīga, LV-1519

Phone: 371-67013119

Fax: 371-67280882

E-mail: macro@em.gov.lv

Homepage: <http://www.em.gov.lv>

The Report was prepared by: O.Barānovs (overall compiling, 1., 4.1.1., 4.4., 6.1.), G.Piņķe (3.1., 3.2.1., 3.2.2., 3.3.1., 3.3.2., 3.5., 4.1.2., 4.1.3., 4.3.1., 4.3.2., 5.1.), E.Gergelevičs (2., 3.2.4.), A.Bessonovs (3.2.1., 3.2.2., 3.4.), M.Kubliņš (3.3.1., 3.3.2.), I.Skribāne (3.2.3., 4.3.3., 5.2.), D.Dravnieks (3.3.3.), J.Salmiņš (4.1.2., 4.1.3.), L.Stelmaka (4.2.), Č.Grībovskis (5.1.), J.Ušpelis (5.3.), G.Silovs (6.2.1.), A.Gulbis, D.Klinsone, L.Stauvere, S.Pizika, M.Paņkova, G.Ābele, (6.2.2.), O.Bogdanova, G.Jēgere (6.2.3.), T.Grīnfelds (6.3.1.), D.Merirands, D.Eberšteina (6.3.2.), E.Gulbinska (6.3.3.), A.Andriksone, I.MežECKA, I.Grīnberga, M.Paņkova (6.3.4.), I.Beināre, I.Benga (6.4.), U.Vanaga (6.5.), L.Neiders, I.Eglītis (6.6.), K.Šuste (6.7.), M.Stenders, G.Tentere (6.8.), M.Purviņa (6.9.), I.Ozoliņa (6.10.), L.Zemīte, B.Vītoliņa (6.11.), E.Skribnovska, J.Strīpnieks, J.Maurāns, E.Beļskis (6.12.), D.Jirģena, N.Kovolenko, K.Lore, I.Mūrniece (6.13.), I.Lipovska (6.14.), I.Bērziņa (6.14., 6.15.3.) D.Kalnāre (6.15.1., 6.15.2.).

All the numerical information and data unless otherwise indicated were provided by the Central Statistical Bureau of the Republic of Latvia. Data of the Bank of Latvia and the Financial and Capital Market Commission have been used in characteristics of the Balance of Payments and the banking and monetary indicators of Latvia. The Treasury of the Republic of Latvia data is used in the characteristics of financial indicators of Latvia.

Cover design: SIA „ABC JUMS”

Printed:

SIA „ABC JUMS”

Rūpniecības iela 3, Aizkraukle, LV-5101

Phone: 371-65122888, phone/fax: 371-67142383

ISSN 1407-4109

© Ministry of Economics, Republic of Latvia, 2008

Reference mandatory in case of reprinting and quoting.

Dear reader,

Experts of the Ministry of Economics have prepared the 28th **Report on Economic Development of Latvia**. The first Report was published in September 1994 and the following reports since 1995 were published traditionally twice a year in June and December. The present Report, like the previous ones, evaluates the economic situation in Latvia and progress of reforms, as well as offers economic development forecasts.

The fastest economic growth in the European Union was observed in Latvia for several years. Within the period from 2005 to 2007, GDP grew on average by 11%. This GDP growth has indisputably reduced backwardness of our country from the old EU member states. Notwithstanding the considerable rise in prices, income of the population has also substantially risen.

Since the middle of 2007, the growth rates have started to fall. In the 1st quarter of 2008, the amount of GDP as compared to the 1st quarter of 2007 has grown only by 3.3%. The decrease of the growth rate was determined by both, the internal (weakening of domestic demand incentives), and external processes (decrease of the global growth rates) influencing economics.

Taking into account the current economic development tendencies in both the world and in Latvia, the government has set the main task – not to allow rapid decline of the growth and ensure conditions for sustainable growth.

The main directions of action of the government in the sphere of economic stabilisation are reflected in the *Informative Report on the Measures for Stabilisation of Macroeconomic Situation for 2008-2009* adopted on April 15 this year. The main emphasis in it is on the initiated fiscal consolidation, increase of budget efficiency and improvement of tax policy, promotion of productive capacity, especially in trade sectors, as well as on implementation of the policy directed towards knowledge-intensive economics.

In order to support entrepreneurship, it is planned to make substantial amendments to the existing tax policy regulations – channelling tax burden from investments. Amendments to the Law on Corporate Tax are introduced in order to establish reinvestment incentives.

Intensive work is taking place in order to improve business environment, promote business start-up, access to finances, export, as well as ensure fair competition. The government has approved the annual *Action Plan for Improvement of Business Environment for 2008*. The 32 measures included in it envisage simplification and improvement of construction process, simplification of the registration process of real estate, improvement of the state administration services, etc.

In order to promote business start-up and access to finances, the government approved *Support*

Programme for Improvement of Competitiveness of Enterprises on May 13, which will facilitate finding funding of small and medium-sized enterprises for investments in technologies or current assets. The enterprises orientating to international market, ensuring production or providing services with high added value, technologically-intensive production enterprises, as well as establishment of new enterprises will be particularly supported. The total amount of investments of the programme will reach LVL 200 million, inter alia in 2008 – nearly LVL 50 million. That will ensure an opportunity to provide support to at least 300 enterprises.

An investment fund with the total amount of investment of EUR 200 million is being established, which will make investments in guarantees, high-risk loans, venture capital funds and other financial support instruments in order to provide access of the small and medium-sized enterprises to funding for business start-up and development, as well as guarantying export credits. It is planned to sign an agreement with the European Investment Fund, which will manage this fund planned to sign already in July this year, but application for resources of the Investment Fund will be begun at the end of this year.

The mentioned measures will stabilise and promote the economic growth in the next two years.

The third direction, in which return is expected within a medium-term period, is related to the set of measures aimed at promotion of knowledge-intensive economics, i.e., promotion of knowledge and technology transfer in production in order to ensure manufacture of higher value added products. The set of measures for reaching this goal is very extensive, therefore I will mention only some of them.

Upon attracting funding of EU Structural Funds, it is planned to start implementation of the *Competence Centre Programme* in 2008. The purpose of the Programme is promotion of competitiveness of enterprises by facilitating co-operation of research and industrial sectors in implementation of development projects of industrial studies, new products and technologies. The total funding of the programme is LVL 54.8 million.

The Ministry of Economics has also started to implement the *Development Programme of Innovation Centres and Business Incubators*. It is aimed at promotion of improvement of innovation infrastructure, support of innovation centres, and establishment and operation of business incubators, as well as at provision of innovation centre and business incubator services to new enterprises. 11 projects of innovation centres and business incubators are supported within the framework of the programme.

Upon attracting the funding of EU Structural Funds, this year it is planned to start implementation of the State support programme *Development of New Products and Technologies*. The goal of the Programme is to support development of new or substantially improved products, services or technological processes by ensuring support also to introduction of

successfully developed new products, services or technological processes into production. The total funding for the programme for 2008–2013 is LVL 162.2 million.

One of the main challenges of the Ministry of Economics for the next years will also be implementation of energy development policy in order to improve safety of energy supply and reduce dependence on imported energy resources.

In order to achieve the set goals, we will continue the dialogue with our social partners (entrepreneurs and non-governmental organisations representing them). This is the only way of how to ensure sustainable growth in the long-term perspective.

In the Report, you will find information both on the development of main economic and social indicators, growth of national economy sectors and external economic environment, and on the government's economic policy for promotion of growth and employment, foreign trade policy, utilisation of the EU Structural Funds and the Cohesion Fund, innovation and entrepreneurship policy and other economic reforms. In the conclusion, the authors of the Report give recommendations for improvement of the national economic policy.

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

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

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

June 2008



Kaspars Gerhards
Minister of Economics

CONTENTS

| | |
|--|-----------|
| Abbreviations | 7 |
| 1. Economic Situation: Brief Overview | 9 |
| 2. Development of World Economy | 13 |
| 3. Growth and Productivity | 16 |
| 3.1. GDP Dynamics and Productivity | 16 |
| 3.2. GDP Expenditure | 17 |
| 3.2.1. Aggregate Demand | 17 |
| 3.2.2. Private and Public Consumption | 18 |
| 3.2.3. Investment | 19 |
| 3.2.4. Exports and Imports | 21 |
| 3.3. Contribution of Sectors | 25 |
| 3.3.1. Structure and Dynamics of the Economy | 25 |
| 3.3.2. Manufacturing | 27 |
| 3.3.3. Energy Sector | 38 |
| 3.4. Development of Regions | 40 |
| 3.5. Forecasts | 42 |
| 4. Macroeconomic Stability | 45 |
| 4.1. State Finances | 45 |
| 4.1.1. Fiscal Policy and Public Debt | 45 |
| 4.1.2. Budget Revenues | 49 |
| 4.1.3. Budget Expenditures | 51 |
| 4.2. Prices | 53 |
| 4.2.1. Consumer Prices | 53 |
| 4.2.2. Producer Prices | 57 |
| 4.3. Balance of Payments | 58 |
| 4.3.1. Current Account | 58 |
| 4.3.2. Financial Flows | 60 |
| 4.3.3. Foreign Direct Investment | 61 |
| 4.4. Financial and Capital Markets | 63 |
| 4.4.1. Monetary Policy and the Exchange Rate | 63 |
| 4.4.2. Market Structure and Development | 65 |
| 4.4.3. Deposits and Loans | 66 |
| 5. Labour Market | 72 |
| 5.1. Employment and Unemployment | 72 |
| 5.2. Labour Costs | 74 |
| 5.3. Employment Policy | 76 |

| | |
|---|------------|
| 6. Economic Policy and Priorities of Structural Policy | 80 |
| 6.1. National Lisbon Programme of Latvia for 2005-2008 | 80 |
| 6.2. Integration of Latvia in the Economic and Structural Policy of the EU | 86 |
| 6.2.1. Utilisation of the European Union Structural Funds and Cohesion Fund | 86 |
| 6.2.2. Foreign Trade Policy | 92 |
| 6.2.3. EU Internal Market | 98 |
| 6.3. Sector-Specific Development Policies | 99 |
| 6.3.1. Industrial Policy | 99 |
| 6.3.2. Energy Policy | 101 |
| 6.3.3. Construction Policy | 103 |
| 6.3.4. Tourism Policy | 106 |
| 6.4. Business Environment | 110 |
| 6.5. Innovation and New Technologies | 112 |
| 6.6. Information Society | 114 |
| 6.7. Small and Medium-Sized Enterprises | 117 |
| 6.8. Competition Policy | 122 |
| 6.9. Regulation of Public Utilities | 125 |
| 6.10. Export Promotion Policy | 127 |
| 6.11. Protection of Consumer Interests and Market Surveillance | 129 |
| 6.12. Quality Assurance | 135 |
| 6.12.1. Quality Structural Policy | 135 |
| 6.12.2. Standardisation, Metrology, Accreditation | 136 |
| 6.13. Privatisation | 139 |
| 6.14. Public Private Partnership | 143 |
| 6.15. Advisory Councils of the Ministry of Economics | 145 |
| 6.15.1. National Economy Council | 145 |
| 6.15.2. Council of the Small and Medium-Sized Enterprises and Crafts | 147 |
| 6.15.3. Advisory Council of Public Private Partnership | 148 |
| 7. Recommendations | 150 |

ABBREVIATIONS

Abbreviations

| | | | |
|--------|---|--------|---|
| CEE | Central and Eastern Europe | IMF | International Monetary Fund |
| CF | Cohesion Fund | ISPA | Instrument for the Structural Policies for Pre-accession |
| CHP | Thermal power station | IT | Information technologies |
| CIS | Commonwealth of Independent States | IUVI | Import unit value index |
| CRPC | Consumer Rights Protection Centre | JSC | Joint stock company |
| CSB | Central Statistical Bureau | LEPP | Latvian Export Promotion Programme |
| CSMEC | Council of the Small and Medium-Sized Enterprises and Crafts | LGA | Latvian Guarantee Agency |
| DDA | Doha Development Agenda | LIDA | Latvian Investment and Development Agency |
| DPI | Producer price index for products sold in the domestic market | LLC | Limited liability company |
| EAGGF | European Agricultural Guidance and Guarantee Fund | LVS | Limited liability company "Latvijas standarts" |
| EC | European Commission | ME | Ministry of Economics of Latvia |
| ECB | European Central Bank | NATO | North Atlantic Treaty Organisation |
| EEA | European Economic Area | NEC | National Economy Council |
| EMU | Economic and Monetary Union | NPP | Nuclear Power Plant |
| ERDF | European Regional Development Fund | PHARE | The Economic assistance programme of European Union for countries of Central and Eastern Europe |
| ERM II | European currency rate mechanism | PPI | Producer price index |
| ESA | European System of National Accounts | PPP | Public and private partnership |
| ESF | European Social Fund | RSE | Riga Stock Exchange |
| EU | European Union | SJSC | State Joint Stock Company |
| EU-15 | European Union before enlargement on May 1, 2004 | SME | Small and medium-sized enterprises |
| EU-25 | European Union after enlargement on May 1, 2004 | SOLVIT | Efficient Solving of Internal Market Problems |
| EU SF | European Union Structural Funds | SPD | Single Programming Document |
| FCMC | Financial and Capital Market Commission | SRS | State Revenue Service |
| FDI | Foreign Direct Investment | TDI | trade defence instruments |
| FIAS | Foreign Investment Advisory Service | TEN-T | Trans-European Transport Network |
| FIFG | Financial Instrument for Fisheries Guidance | UN | United Nations |
| FTA | Free Trade Agreement | USA | United States of America |
| GDP | Gross domestic product | WTO | World Trade Organisation |
| HPS | Hydroelectric power station | XPI | Producer price index for exported products |
| ICT | Information and communication technologies | | |

State Abbreviations

| | | | |
|----|----------------|----|----------------|
| AT | Austria | IE | Ireland |
| BE | Belgium | IT | Italy |
| BG | Bulgaria | LT | Lithuania |
| CZ | Czech Republic | LU | Luxembourg |
| CY | Cyprus | LV | Latvia |
| DE | Germany | MT | Malta |
| DK | Denmark | NL | Netherlands |
| EE | Estonia | PL | Poland |
| EL | Greece | PT | Portugal |
| ES | Spain | RO | Romania |
| EU | EU-27 states | SE | Sweden |
| FI | Finland | SI | Slovenia |
| FR | France | SK | Slovakia |
| HU | Hungary | UK | United Kingdom |

Measures

| | | | |
|-----------|---|-----|--|
| EUR, EURO | Euro, single currency of the EMU | SDR | Special drawing rights, IMF approved currency |
| LVL | Latvian lats (national currency of Latvia) | | |

Conventional designations

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

1. ECONOMIC SITUATION: BRIEF OVERVIEW

High growth has been observed in Latvia during 2005-2007, which is characterised by annual average increase of GDP of 11%, and in 2007 – by 10.3%. Such high growth rates were mostly ensured by domestic demand. Both, private consumption and investment considerably increased. Expansion of export opportunities played a smaller role in the growth. Contribution of net exports to the growth was negative in the last three years.

Since the mid-2007, the growth rates have started to decline, both, due to the processes influencing internal (weakening of domestic demand stimuli) environment and external (decrease of the growth rates globally) environment.

In the 1st quarter of 2008, the GDP has increased only by 3.3% as compared to the 1st quarter of 2007. It means that economic growth has started to slow down considerably.

The main reason influencing economy **is the rapid fall of domestic demand**, because banks started to implement crediting policy more cautiously, especially mortgage crediting. It should be mentioned that households started to plan their spendings more carefully, as well.

Among external factors, **decrease in the growth rates of the world economy** has to be noted as well, which is first determined by instability in the US financial markets, as well as rise in prices for fuel and food products. It has negative impact on the main export market of Latvia, namely, the EU. For example, the average growth rates of GDP in the EU-27 have decreased from 3.3% in the 1st quarter of 2007 to 2.7% in the 1st quarter of 2008. Particularly, substantial decrease of the growth rates in the 1st quarter of 2008 has been observed in Estonia, where the GDP grew only by 1% compared to the respective period of the previous year.

Decrease of domestic demand directly referred to opportunities of increasing production volumes in different sectors. So far, it has most substantially influenced trade, construction and real estate market. Contribution of these three sectors to the growth was only by 1.7% in the 1st quarter of 2008. Last year the growth of these sectors ensured increase of GDP almost by 6% or more than a half of the total growth.

Output of manufacturing is gradually decreasing. Decline of the growth rates of production output of this sector begun at the end of 2006, but in the second half of 2007, decrease of the output volumes was already observable. Production volumes of manufacturing in the 1st quarter of 2008, as compared to the respective period of 2007 have decreased by 4.1%. Decrease of manufacturing output is determined by not only the decrease of domestic demand, but also by weaker demand in our trade partner countries, as

well as gradual decrease of Latvian competitiveness, which is related to rapid rise in labour costs.

However, the situation in manufacturing in the breakdown by sub-sectors is not equal. The growth rates of production volumes in the beginning of the year have increased in paper manufacture and polygraphy, chemical industry, manufacture of metals and metal products, as well as manufacture of electric and optical equipment.

The situation in construction may not be unequivocally assessable, either. The amount of new orders in the 1st quarter of 2008 lags behind the level of the respective period of the previous year by only a little. The new orders in construction of apartment buildings have considerably decreased, whereas they have increased in construction of non-residential buildings. However, it should be noted, that the point of view of construction companies themselves regarding development of the sector is rather pessimistic. Moreover, such pessimistic views are in the whole EU.

Financial intermediation, as well as transport and communication services still develop very good in Latvia. In the 1st quarter of 2008, they grew by 11.6% and 9.6% respectively. Development of transport services is largely connected with the growth of transit services. The latter may provide substantial contribution to the growth of Latvia within the next years.

It is not predictable in the nearest future, that the factors influencing domestic demand may change substantially. The consumer confidence indicator also shows that. Therefore, the existing decrease tendencies of domestic demand dynamics are likely to remain by becoming stable gradually. The rise in prices, increase of indebtedness of households, slower growth of income, position of the government to implement a strict fiscal policy will determine slower growth of private and public consumption to a great extent. Such demand item as investment is uncertain in the near future.

Several substantial risks of further economic development exist, which are mainly related to development of the situation in the global financial markets, as well as fuel and food overall price dynamics. Two tendencies have clearly appeared at present in the international financial market, which will maintain their meaning in the nearest future, – such as cooling of real estate market and decrease of access to credit resources.

Taking into consideration the abovementioned, **the Ministry of Economics forecasts that the growth in 2008 may be on the level of 2-2.5%, but in 2009 it can increase a little – by 2-3%.**

Along with the rapid growth, economic disproportions developed and intensified – a substantial inflation growth and high current account deficit. Since 2004, inflation exceeds 6%, in 2007 it increased even higher, as a result the annual average inflation reached 10.1%. The level of inflation in Latvia is determined by several, often mutually unrelated factors, including changes of structural nature in connection with the EU membership, both an overall rise in energy resource prices, and changes in administratively regulated prices, and the most essential factor affecting inflation – the rapidly growing domestic demand.

Consumer price inflation in the first half of 2008 remains on a high level due to strong supply side factors: administratively regulated prices for electricity, natural gas and heat rose, fuel prices increased, excise tax for tobacco products and fuel grew, and prices for food products rose. The total rise in consumer prices in May 2008 as compared to May of 2007 reached 17.9%, which was twice as high as in the previous year (8.2%).

However, it should be mentioned that the influence of producer prices on the consumer prices decreases, because since 2007 they rise at a slower pace than consumer prices. The decrease tendencies of producer price dynamics indicate that in the second half of 2008 the consumer price inflation must go down, unless there are strong supply side impulses

(overall rise in fuel and food prices, rise in administratively regulated prices).

In the second half of 2008, increase in natural gas tariffs is expected (in October by 65% on average for households) and accordingly increase in heat tariffs (in October by 30%). In the end of 2008, 12-month inflation may reach 16% and the annual average inflation – 16.7%.

In 2006, the current account deficit of the balance of payments rapidly grew, which reached the level of 22.5% of GDP. In 2007, it remained high in the amount of 22.9%. It should be noted that the current account deficit is covered by foreign direct investments and long-term loans. Reserve assets of the Bank of Latvia increase and the net foreign reserves completely cover the monetary base.

Decline of domestic demand, starting with the 3rd quarter of 2007 has decreased the external imbalance. The current account deficit shrinks – in the 1st quarter of 2008 it was 19.3% of GDP (in the respective period of the previous year – 26.6%). In the nearest future, the current account deficit will continue to go down, as domestic demand will decrease. It is positively that the growth rate of exports has not fallen at the same time. Exports of Latvian goods and services show good growth rates, despite the fact that the growth rates of the economy fall. The total amount of exports of goods and services in the 1st quarter of 2008 was by 6.5% higher than in the 1st quarter of 2007.

Table 1.1

Latvia: Key Indicators of Economic Development

| | 2004 | 2005 | 2006 | 2007 | 2008 f |
|--|-------|-------|-------|-------|--------|
| (growth compared with preceding year, per cent) | | | | | |
| Gross domestic product | 8.7 | 10.6 | 12.2 | 10.3 | 2.2 |
| Private consumption | 9.8 | 11.2 | 21.2 | 13.9 | 2.1 |
| Public consumption | 2.1 | 2.7 | 4.9 | 4.8 | 2.3 |
| Gross fixed capital formation | 23.8 | 23.6 | 16.4 | 8.4 | 4.2 |
| Exports | 9.4 | 20.3 | 6.5 | 11.1 | 1.2 |
| Imports | 16.6 | 14.8 | 19.3 | 15.0 | -8.0 |
| Consumer prices | 6.2 | 6.7 | 6.5 | 10.1 | 16.5 |
| (per cent of GDP, unless indicated otherwise) | | | | | |
| Central government budget fiscal balance | -1.0 | -0.4 | -0.2 | -0.04 | 0.1 |
| Central government debt | 14.9 | 12.4 | 10.7 | 9.7 | 9.2 |
| Current account balance | -12.8 | -12.5 | -22.3 | -23.0 | -15.0 |
| Foreign direct investments received within a year in Latvia | 4.6 | 4.5 | 8.1 | 7.0 | 7.0 |
| Employment rate (% of economically active population, 15-64 years) | 62.3 | 63.4 | 66.3 | 68.4 | 68.5 |
| Unemployment rate (proportion of job seekers % of economically active population, 15-74 years) | 10.4 | 8.7 | 6.8 | 6.0 | 6.5 |

f – forecast

In order to achieve balanced development of the national economy, the government has

committed to ensure a budget surplus in 2008, as well as in 2009 and 2010. The Saeima has accepted

the budget of 2008 with a surplus of LVL 163 million¹, which is 1% of GDP. A budget surplus is planned also in further years – in the amount of 1.2% of GDP in 2009 and in the amount of 1.5% of GDP in 2010.

The weak economic growth may hamper fulfilment of the government goal – to provide a budget surplus in 2008, if the currently observable tendencies in tax collection remain, particularly in relation to the value added tax.

Taking into account the macroeconomic situation in the country and assessing revenue forecasts of the state budget for 2008, the Cabinet of Ministers in the extraordinary meeting of July 10, 2008 adopted amendments to the budget. According to these amendments, it is foreseen to ensure a minimal budget surplus of 0.05% of GDP.

Along with the economic growth, income of population is also growing. Despite the considerable rise of prices, the real wages of employees have increased by 38.6% over the period from 2005 to 2007. Old-age pensions have also increased, although not as fast as wages.

Increase of wages in Latvia has been affected by two main conditions. Firstly, the demand for labour force increased due to the fast economic growth. Secondly, opening of labour markets in such highly developed countries as Ireland and the United Kingdom increased competition in the Latvian labour market (supply of labour force decreased due to the growing emigration), which caused a big pressure on wages. Furthermore, wages of employees in Latvia were considerably lower in comparison with the EU average – 15-20% of the EU average in most sectors until 2006. Thus, increase of wages is a result of the convergence process.

The rapid rise of wages in the preceding periods has considerably increased the unit labour costs, which affect competitiveness of the export-oriented sectors the most, especially such labour-intensive sectors as textile industry and some metal processing industry sectors.

Along with decrease of the economic growth rates, the changes of the rise in wages in 2008 are forecasted to be more moderate than in the two preceding years. Thus, at the end of 2008 the average gross wages may be LVL 520-530 or by about 10% higher than in December 2007 (when wages increased by 25% in the respective period of the preceding year). Such increase of wages will not raise the unit labour costs so considerably, and from the point of view of competitiveness of the national economy, the situation will not worsen.

Economic development in Latvia in the recent years has a positive impact on the situation in the labour market. Over the period of 2005-2007, the number of employed grew by 3.2% on average annually, while the unemployment rate went down

from 8.7% in 2005 to 6% in 2007. At the same time, a great number of vacancies emerged in several sectors (construction, trade, in some manufacturing sectors). One reason for the tightened labour market was the high emigration rate, as many inhabitants of Latvia have gone to work in the Western Europe, mostly in the United Kingdom and Ireland.

Decrease of the growth rates are weakly reflected in the employment indicators at present, because employment is still growing. In the 1st quarter of 2008, as compared to the respective period of the previous year, it has grown by 4.5%. The unemployment rate in the 1st quarter of 2008 – 6.5% was also lower than in the 1st quarter of 2007 – 6.9%. In the beginning of 2008, the number of economically active population has grown considerably, which can be partially explained by increase of motivation to be employed (considerable increase of wages along with the rise in the cost of living). However, if the economic growth rates do not increase or continue to fall, the demand in the labour market may decrease, and amount of the unemployed will grow more rapidly. Changes of the employment rate in terms of time always lag slightly behind the changes of economic activities. Decrease of vacancies testifies the possible change of tendencies. At the end of the 1st quarter of 2008, the number of vacancies had decreased to 15.3 thousand, which formed 1.5% of all work places (at the end of the 1st quarter of 2007 – 21.8 thousand or 2.1% of all work places).

The economic growth potential is best characterised by the growth of investments. In the period of 2005-2007, investments in fixed assets increased by 81% (by 22% on average annually). Investments were fostered by several factors, especially such as financial stability, continuous improvement of the business environment, high domestic demand, rather low real interest rates, influx of foreign capital, etc. At the same time, a relatively low tax burden and increased sales of products due to the growing demand made a positive impact on the financial situation of enterprises thereby increasing opportunities to make investments.

After Latvia's accession to the EU, the volume of incoming foreign direct investments (FDI) has substantially increased. Over the period of 2005-2007, foreign entrepreneurs have invested almost four times more than over the period of 2001-2003. Moreover, the volume of investments in 2006 and 2007 was twice higher than in 2005.

At the end of 2007, foreign direct investments accumulated in Latvia amounted to LVL 4992 million, which was by 25% more than at the end of 2006. In the sectoral structure of accumulated FDI, investments in service sectors make a bigger share. Almost half of FDI attracted in this period are invested in the sector of commercial services. Three-fourths of FDI are related to EU member states and the biggest investors are entrepreneurs of Sweden, Estonia, Germany and Denmark.

¹ Combined budget deficit according to the cash principle.

In the beginning of 2008, the investments remained on the previous level and in comparison with the 1st quarter of 2007 increased by 5.1%. Taking into account the changes of import structure, in which the proportion of investment goods decreases, the rise of investment volumes is greatly related to construction

activities in non-residential buildings and other engineering structures, which is largely connected also with the use of EU structural funds. At the same time, uncertainty in the behaviour of private investors remains.

The reforms implemented in the previous decade have strengthened the private sector, conditions favourable for development have been created and business environment is improving. Accession of Latvia to the EU has a particularly positive impact on development of the Latvian economy. Main growth risks are related to high inflation, rapid increase of wages and external imbalance. External risks are related to prices of energy resources, instability of the global financial market and the situation in the Latvian trading partner countries. Growth in 2008 and 2009 is expected to be more moderate than in the previous years. It will be determined by more moderate growth rates of domestic demand. It is foreseen, that the annual GDP growth may be 5-7% in the medium term.

2. DEVELOPMENT OF WORLD ECONOMY¹

The pace of the global economical growth is decreasing due to conditions of significant financial crisis. More explicitly it is apparent in the developed countries, especially in the USA, where the real estate market adjustments have formed tense situation in the financial markets. In the same way, growth pace is decreasing in Western Europe as well, however the situation in Japan remains practically unchanged.

In countries of growing economies like China and India increase pace in 2007 has remained high but with slight decrease trend (Table 2.1).

Table 2.1

| GDP Growth (in% compared to the previous year) | | | | | |
|---|-------------------------|------|------|--------|--------|
| | 2003-2005 on average | 2006 | 2007 | 2008 f | 2009 f |
| World | 4.3 | 5.0 | 4.9 | 3.7 ↓ | 3.8 ↓ |
| USA | 3.1 | 2.9 | 2.2 | 0.5 ↓ | 0.6 ↓ |
| Japan | 2.0 | 2.4 | 2.1 | 1.4 ↓ | 1.5 ↓ |
| EU | 2.1 | 3.3 | 3.1 | 1.8 ↓ | 1.7 ↓ |
| CIS | 7.5 | 8.2 | 8.5 | 7.0 | 6.5 ↓ |

Source: "The World Economic Outlook", April 2008, International Monetary Fund, <http://www.imf.org>
f – forecast; ↑/↓ trend of changes of forecasts in comparison with the December 2007 report.

Meanwhile, the level of inflation is increasing in entire world, which is mainly impacted by rapid growth of food and energy resource prices.

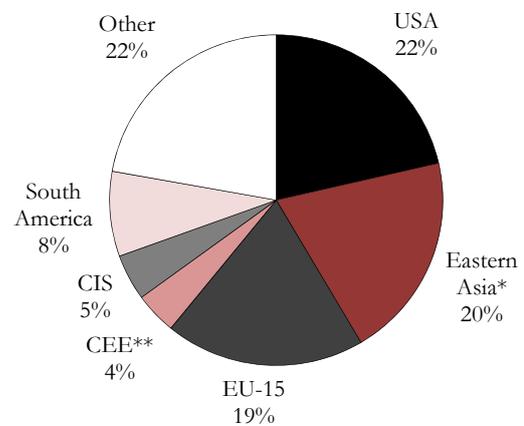
The most rapid price increase is observed in growing economies and this trend is related to increase in demand due to rapid development. It is determined

by relatively high proportion of energy resources and food in total consumption.

In 2008, the pace of inflation has started to increase also in the developed countries regardless of the decrease in the economic development pace.

Figure 2.1

**World GDP Ratio by Groups
of Countries in 2007**
(structure, GDP by purchasing power units)



Source: "The World Economic Outlook", April 2008, International Monetary Fund, <http://www.imf.org>

* Japan, China, South Korea, Malaysia, Singapore, Thailand, Philippines

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

Table 2.2

Main Macroeconomic Indicators of Several Countries
(percentage)

| | GDP growth | | | | Consumer prices | | | | Current account deficit (% of GDP) | | | |
|----------------------------------|------------|------|--------|--------|-----------------|------|--------|--------|---------------------------------------|------|--------|--------|
| | 2006 | 2007 | 2008 f | 2009 f | 2006 | 2007 | 2008 f | 2009 f | 2006 | 2007 | 2008 f | 2009 f |
| Euro zone countries of which: | 2.8 | 2.6 | 1.4 | 1.2 | 2.2 | 2.1 | 2.8 | 1.9 | -0.1 | -0.2 | -0.7 | -0.9 |
| Germany | 2.9 | 2.5 | 1.4 | 1.0 | 1.8 | 2.3 | 2.5 | 1.6 | 5.0 | 5.6 | 5.2 | 4.9 |
| France | 2.0 | 1.9 | 1.4 | 1.2 | 1.9 | 1.6 | 2.5 | 1.7 | -1.3 | -1.3 | -2.4 | -2.5 |
| United Kingdom | 2.9 | 3.1 | 1.6 | 1.6 | 2.3 | 2.3 | 2.5 | 2.1 | -3.9 | -4.9 | -4.8 | -4.4 |
| USA | 2.9 | 2.2 | 0.5 | 0.6 | 3.2 | 2.9 | 3.0 | 2.0 | -6.2 | -5.3 | -4.3 | -4.2 |
| Japan | 2.4 | 2.1 | 1.4 | 1.5 | 0.3 | 0.0 | 0.6 | 1.3 | 3.9 | 4.9 | 4.0 | 3.9 |
| China | 11.1 | 11.4 | 9.3 | 9.5 | 1.5 | 4.8 | 5.9 | 3.6 | 9.4 | 11.1 | 9.8 | 10.0 |

Source: "The World Economic Outlook", April 2008, International Monetary Fund, <http://www.imf.org>
f – forecast.

¹ In this chapter, data from "World Economic Outlook", International Monetary Fund, October 2007 were used, unless indicated otherwise.

In 2007, growth in the **United States of America** considerably decreased and the lowest point was reached in the 4th quarter (0.6%). It was negatively impacted by decrease of investments in the field of real estate, which decreased growth by one percentage point. The financial crisis of last August is still unfavourably impacting availability of credits, thus determining that the decrease of consumption and inflation continues to increase.

It is expected that in 2008 the growth pace in the USA will decrease significantly, however, starting with 2009 they will begin to stabilise and continue to grow but slightly slower than it was forecasted.

At the end of 2007, economy of **Japan** developed steadily and taking into account fall of global development it was mainly due to the high level of export, which increased due to the significant demand in Asia and Europe and investments in fixed assets. In 2008, it is planned that growth of Japan will be 1.4% that is slightly weaker than in 2007. However, starting with 2009, the growth pace will begin to increase. The main reasons, which will influence the growth in 2008 could be the decrease in pace of export as well as private consumption. However, at the end of the year Japan's economy could be positively influenced by investments in housing. Like before the decrease of the global development pace is regarded as a risk.

During the second half-year of 2007, the economic development in the developed countries of Asia with its leader **China** was still at a high level, but the first signs of the development decrease were already observed. It has to be noted that a large contribution in the development of China was ensured by very rapid increase in investments and export even though the pace of the export already started to decrease slightly at the end of the year. Like in other regions inflation has started a slight increase in China, too.

It is expected that in 2008 the growth pace of China could decrease to 9.3%. To a large extent, the decrease of the export pace will be compensated by increasing investments.

Almost throughout the year 2007 a high development pace was maintained in **the old EU member states** and it formed 2.6%, which was only a slightly lower rise than the very good indicators of 2006. At the basis of the stable domestic demand was the increase of employment and active process of investment based on secure enterprise balance-sheet indicators and high demand in global markets.

In 2008, growth in old EU member states will decrease to 1.4% and in 2009 – even to 1.2%. Growth of export at the beginning of the year will remain stable, but already at the end of the year its pace could decrease, mainly due to weak global demand and high exchange rate of euro.

At the end of 2007, economical development of **Germany** slightly decreased, mainly due to the private consumption. One factor to be mentioned as

facilitating the growth is high costs on investments, which determined increasing demand for machinery products and equipment.

Growth in Germany was relatively stable, but lower than in 2007. In 2009, it will increase slightly. Private consumption could have a positive impact, but decrease of investment pace could have a negative impact.

In 2007, development in France was slightly weaker than a year before but it was close to its potential. It was mainly based on stable domestic demand however it was negatively impacted by significantly negative net export.

Continuously high inflation and unfavourable conditions in the financial markets will have a negative impact on the development of France in 2008 as well as in the first half-year of 2009. Stable domestic demand is being given as the main factor, which facilitates the development.

In 2007, growth in **the Great Britain** was on a very good level, regardless problems in the banking sector. Growth was facilitated by stable private consumption.

It is being forecasted that in 2008 growth of the Great Britain will decrease considerably – to 1.6% that could be impacted by unfavourable conditions in financial and housing markets.

In 2007, growth pace in **the new EU member states and candidate countries** decreased by almost 1 percentage point. The most considerable fall was observed in Hungary, Turkey, Estonia and Latvia. However, already for 6 years in a row the growth in the region considerably exceeds paces of the old member states by decreasing economic backwardness. The main growth stimulus in the region still is domestic demand, which exceeds production pace still worsening the current account situation of the balance of payment.

In the new EU member states growth pace could further decrease, for a large part of states – to the potential level, which will be impacted by the decrease of domestic demand as well as decrease of external demand.

In **the Baltic States** rapid development continued till 2007 even though at the end of the year pace of the development decreased considerably. Mainly such fall in the development pace could be explained by stricter financial conditions. Inflation in the region continues to grow and this fact will not allow adopting euro in close future. Inflow of foreign capital in the region has decreased and due to enforcing of parent bank conditions amount of credits issued is decreasing considerably.

In 2008, growth in the Baltic States is planned almost by half lower than a year before – 4.8% in comparison to 8.7% in 2007. Fall of the pace was mainly caused by decrease of domestic demand. However, starting with 2009 the domestic demand and increase of net export could be the main factors for the further development of the economy.

Table 2.3

Main Macroeconomic Indicators of the New EU Member States and Candidate Countries
(percentage)

| | GDP growth | | | | Consumer prices | | | | Current account deficit (% of GDP) | | | |
|----------------|------------|------------|------------|------------|-----------------|------------|------------|------------|---------------------------------------|-------------|-------------|-------------|
| | 2006 | 2007 | 2008 f | 2009 f | 2006 | 2007 | 2008 f | 2009 f | 2006 | 2007 | 2008 f | 2009 f |
| Total | 6.7 | 5.8 | 4.4 | 4.3 | 5.4 | 5.7 | 6.4 | 4.3 | -6.3 | -6.6 | -7.2 | -6.9 |
| Estonia | 11.2 | 7.1 | 3.0 | 3.7 | 4.4 | 6.6 | 9.8 | 4.7 | -15.5 | -16.0 | -11.2 | -11.2 |
| Latvia | 11.9 | 10.2 | 3.6 | 0.5 | 6.5 | 10.1 | 15.3 | 9.2 | -22.3 | -23.3 | -15.0 | -10.5 |
| Lithuania | 7.7 | 8.8 | 6.5 | 5.5 | 3.8 | 5.8 | 8.3 | 6.1 | -10.8 | -13.0 | -10.5 | -8.8 |
| Czech Republic | 6.4 | 6.5 | 4.2 | 4.6 | 2.5 | 2.8 | 6.0 | 3.5 | -3.1 | -2.5 | -3.0 | -2.8 |
| Hungary | 3.9 | 1.3 | 1.8 | 2.5 | 3.9 | 7.9 | 5.9 | 3.5 | -6.5 | -5.6 | -5.5 | -5.1 |
| Poland | 6.2 | 6.5 | 4.9 | 4.5 | 1.0 | 2.5 | 4.1 | 3.8 | -3.2 | -3.7 | -5.0 | -5.7 |
| Slovakia | 8.5 | 10.4 | 6.6 | 5.6 | 4.4 | 2.8 | 3.6 | 3.8 | -7.1 | -5.3 | -5.0 | -4.7 |
| Slovenia | 5.7 | 6.1 | 4.1 | 3.5 | 2.5 | 3.6 | 4.0 | 2.4 | -2.8 | -4.8 | -4.8 | -4.9 |
| Malta | 3.4 | 3.8 | 2.2 | 2.0 | 2.6 | 0.7 | 3.4 | 2.5 | -6.7 | -6.2 | -6.1 | -5.8 |
| Cyprus | 4.0 | 4.4 | 3.4 | 3.5 | 2.2 | 2.2 | 4.0 | 2.9 | -5.9 | -7.1 | -7.7 | -7.1 |
| Bulgaria | 6.3 | 6.2 | 5.5 | 4.8 | 7.4 | 7.6 | 9.7 | 6.0 | -15.6 | -21.4 | -21.9 | -18.9 |
| Romania | 7.9 | 6.0 | 5.4 | 4.7 | 6.6 | 4.8 | 7.0 | 5.1 | -10.4 | -13.9 | -14.5 | -13.0 |
| Croatia | 4.8 | 5.8 | 4.3 | 4.0 | 3.2 | 2.9 | 5.5 | 3.5 | -7.9 | -8.5 | -9.0 | -8.7 |
| Turkey | 6.9 | 5.0 | 4.0 | 4.3 | 9.6 | 8.8 | 7.5 | 4.5 | -6.1 | -5.7 | -6.7 | -6.3 |

Source: "The World Economic Outlook", April 2008, International Monetary Fund, <http://www.imf.org>
f – forecast.

In 2007, growth in group of the **Commonwealth of Independent States** (CIS) was maintained on the level of 8.5% due to the extremely high domestic demand, which in its turn is based on high prices of stock products, expansive macroeconomics policy, large-scale capital inflow in the region as well as rapid crediting amount development. However, as the result of rapid import development in the region the current account surplus has decreased in countries exporting energy resources and in countries with negative current account deficit has increased. In several countries unused residuals of production capacity have decreased and salaries have increased due to the high development pace. Many countries have been impacted by instability of global financial markets.

High oil prices are still continuing to support economy of exporting countries but on the contrary worsening global economy and fall of crediting pace could cause stagnation of the growth of several economies. In general it is planned that in 2008 growth pace will decrease to 7% but in 2009 – by another 0.5 percentage points. In Russia regardless of the slight

decrease in the growth pace the main factor of the growth will be consumption, which will be facilitated by rapid rise of real income and increase of investments.

Table 2.4

**Main Macroeconomic Indicators
in the Group of CIS Countries**
(percentage)

| | 2006 | 2007 | 2008 f | 2009 f |
|---------------------------------------|------|------|--------|--------|
| GDP growth | 8.2 | 8.5 | 7.0 | 6.5 |
| of which in Russia | 7.4 | 8.1 | 6.8 | 6.3 |
| Consumer prices | 9.5 | 9.7 | 13.1 | 9.5 |
| of which in Russia | 9.7 | 9.0 | 11.4 | 8.4 |
| Current account balance (% of GDP) | 7.5 | 4.5 | 4.8 | 2.4 |
| of which in Russia | 9.5 | 5.9 | 5.8 | 2.9 |

Source: "The World Economic Outlook", April 2008, International Monetary Fund, <http://www.imf.org>
f – forecast.

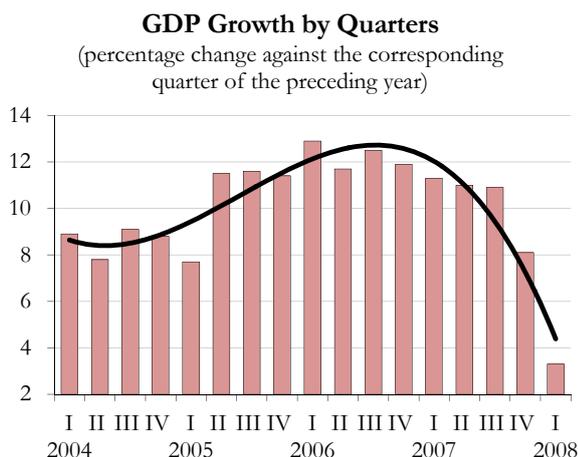
Furthermore, there is a forecast envisaging that there will be a growth pace divergence in the world economy among the developed and developing countries, where the growth pace of developed countries are assessed as below the potential level. Development is negatively impacted by conditions of financial market in the USA and Western Europe. However, regardless a small growth pace decrease positive investment is still given by the developed countries. In general, in 2008 the global growth is assessed in the amount of 3.7%, but starting from 2009 it could increase and reach 3.8%. There are the following risks: growing tension of inflation, increasing oil prices and global imbalance.

3. GROWTH AND PRODUCTIVITY

3.1. GDP Dynamics and Productivity

Rapid economic growth has been observed in Latvia for several years. Over the last four years (2004-2007), GDP increased by 10.5% on average annually.

Figure 3.1

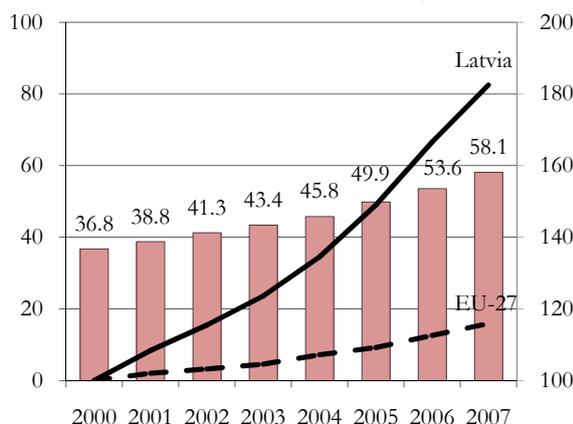


Growth was especially notable in 2005 and 2006 – by 10.6% and 12.2% respectively. The high growth rates were mostly ensured by stable dynamics of the domestic demand.

Figure 3.2

Dynamics and Level of GDP in Comparison with EU Average (in Purchasing Power Standards)

(2000 = 100%, curves – right axis; EU-27 = 100, columns – left axis)



Source: Eurostat

Since the second half of 2007, the growth rates began to decrease, which was determined by the processes influencing both, internal (weakening of domestic demand incentives) and external (decrease of growth rates globally) environment.

Increase of the GDP in Latvia was mainly fostered by the productivity growth and, to a smaller extent, by the increase of employment. The growth of productivity over the last two years has decreased a little in comparison with the preceding years (2004-2005) and was 6.9% in 2006 and 5.8% in 2007.

Table 3.1

Productivity by National Economy Sectors – Value Added per Person Employed

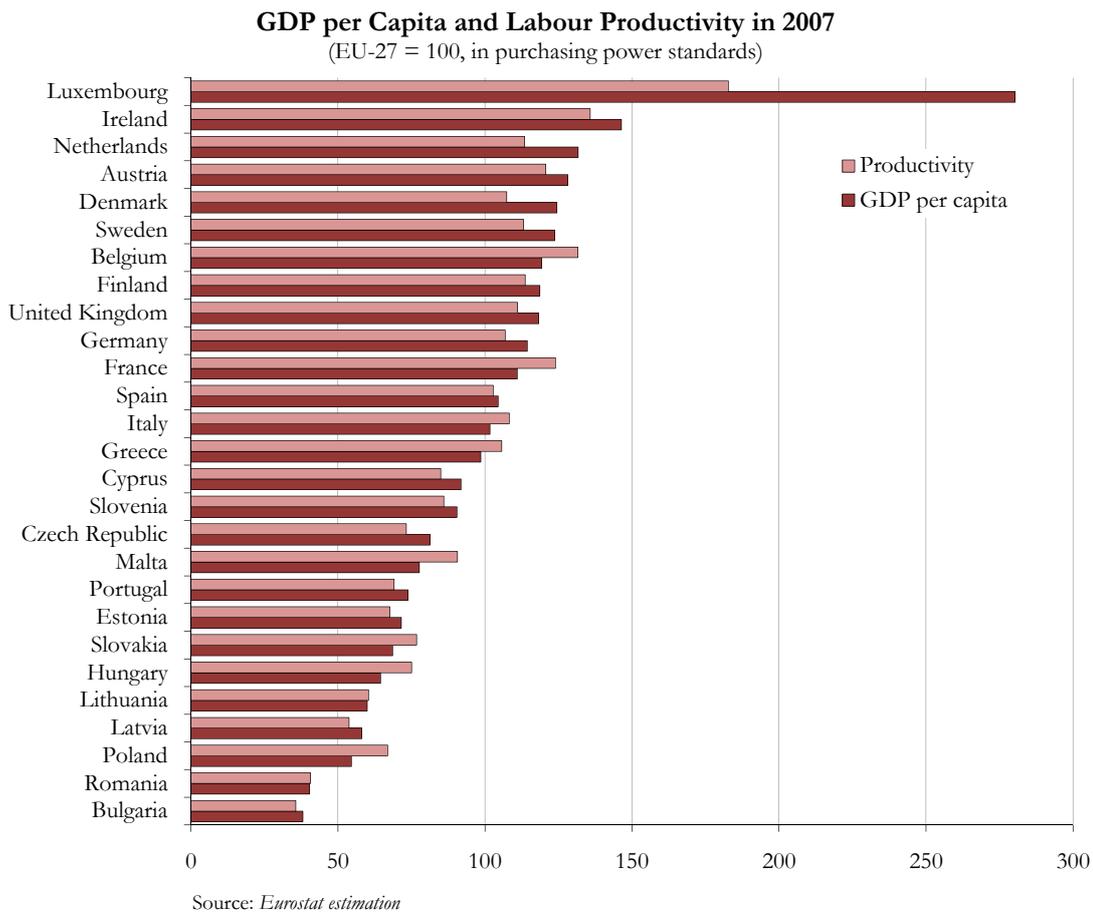
| | Annual average real changes in the period of 2004-2007 (%) | Level in current prices in 2007 (LVL per person employed) |
|-------------------------------|--|---|
| Primary sectors | 9.0 | 3893 |
| Manufacturing | 5.1 | 8018 |
| Electricity, gas and water | 8.1 | 21269 |
| Construction | -0.01 | 8090 |
| Trade, hotels and restaurants | 8.4 | 12390 |
| Transport and communications | 7.0 | 13046 |
| Other services | 8.0 | 21516 |
| Public services* | 4.2 | 8217 |
| Total national economy | 7.3 | 11061 |

* Public administration with healthcare and education

Productivity is increasing faster in agriculture and fishing, electricity, gas and water supply sector, as well as in trade and commercial services sectors. Productivity in manufacturing and construction has increased poorly, where the GDP growth was fostered mainly by the increase of employment over the last two years. It should be also noted that the productivity level of these sectors is still lagging behind the indicators of several service sectors. For example, the productivity level in financial services is by 2.7 times higher than in manufacturing.

GDP per capita is calculated according to purchasing power standards. In 2007 it was 58.1% of the EU-27 average in Latvia according to the assessment of the Eurostat. In comparison with 2004, the backwardness from the average EU level has been successfully reduced by 12.3 percentage points.

Figure 3.3



3.2. GDP Expenditure

3.2.1. Aggregate Demand

demand, whereas in 2007 gradual decline of domestic demand growth rates was observed.

The main impulse to the fast growth over the last periods was substantial increase of the domestic

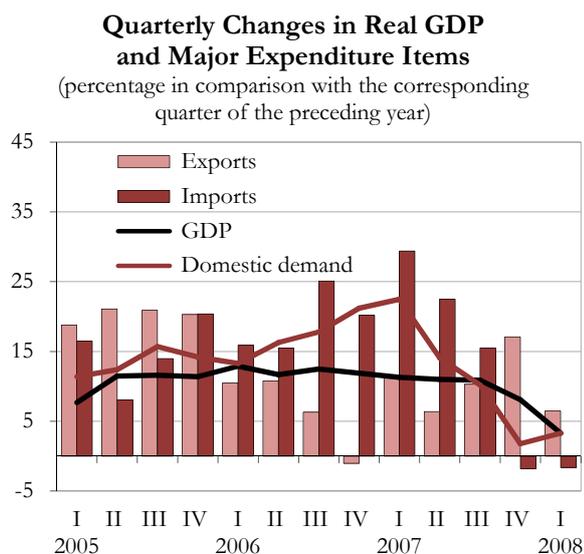
Table 3.2

Expenditure of Latvian GDP
(percentage)

| | 2006 | | | 2007 | | | 1 st quarter of 2008 against 1 st quarter of 2007 | | |
|-------------------------------|------------|--------------|------------------------|------------|--------------|------------------------|---|--------------|------------------------|
| | structure | growth rates | contribution to growth | structure | growth rates | contribution to growth | structure | growth rates | contribution to growth |
| Gross domestic product | 100 | 12.2 | 12.2 | 100 | 10.3 | 10.3 | 100 | 3.3 | 3.3 |
| Private consumption | 65.2 | 21.2 | 13.6 | 64.8 | 13.9 | 9.6 | 68.1 | 2.3 | 1.6 |
| Public consumption | 16.6 | 4.9 | 0.8 | 18.2 | 4.8 | 0.7 | 20.1 | 4.7 | 0.6 |
| Gross fixed capital formation | 32.6 | 16.4 | 5.8 | 32.5 | 8.4 | 3.1 | 28.9 | 5.1 | 1.5 |
| Inventories | 7.1 | – | 0.7 | 4.7 | – | 1.8 | 0.1 | – | -4.2 |
| Net exports | -21.5 | – | -8.6 | -20.4 | – | -4.8 | -17.2 | – | 3.7 |
| – exports | 44.9 | 6.5 | 2.9 | 44.4 | 11.1 | 4.7 | 46.7 | 6.5 | 2.7 |
| – imports | -66.3 | 19.3 | -11.5 | -64.6 | 15.0 | -9.5 | -63.9 | -1.6 | 1.0 |

The domestic demand, which ensured rapid growth during the previous years and which was maintained by great financial support, has run out. That is related to several factors, mainly to the more cautious attitude of banks towards mortgage crediting affected by the global financial crisis, as well as the measures implemented by the government for restriction of crediting. A more realistic attitude of households toward their expenditures should be mentioned as well.

Figure 3.4



Along with the decline of the growth rates of private consumption and investment, decrease of imports is observed while the increase of exports continues. As a result, there is high net exports contribution to growth.

3.2.2. Private and Public Consumption

The disposable income of households¹ in the last years in Latvia amounts to about 60% of GDP. Private consumption expenditures were on average at the level of 62%, but in 2007 reached 65.3%, therefore the net savings are negative (see Table 3.3).

Due to the rapid growth of wages, the disposable income of households in 2007 increased faster than private consumption, therefore the negative balance of the net savings has decreased.

¹ Disposable income – income in cash and the cash value of goods and services obtained in kind, received in a form of wages and salary, other income for work (after deduction of taxes), transfers, net income (income after deduction of production costs) from entrepreneurial activity and agricultural production, income from property, rent, etc.

Table 3.3

Disposable Income and Final Consumption Expenditures of Households, Net Savings

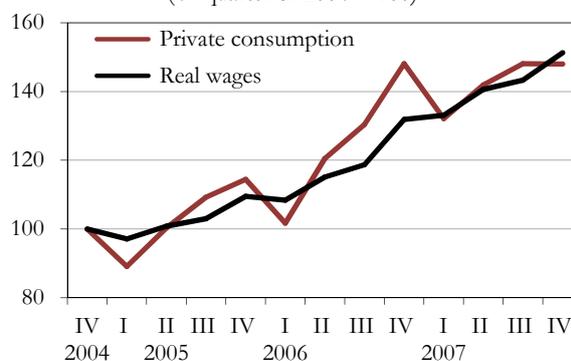
| | 2004 | 2005 | 2006 | 2007 e |
|---|------|------|------|--------|
| Disposable income of households (changes in % in comparison with the preceding year) | 17.7 | 20.3 | 23.3 | 27.6 |
| Final consumption expenditures of households (changes in % in comparison with the preceding year) | 17.6 | 20.9 | 28.5 | 24.4 |
| Net savings in % of disposable income | -3.0 | -3.8 | -8.2 | -5.3 |
| Net savings in % of GDP | -1.8 | -2.3 | -4.9 | -3.3 |

e – estimation by the Ministry of Economics

Unlike the preceding years, when households tended to increase consumption more rapidly than their real wages rose, the growth of private consumption is approximately equal to the growth of real wages in 2007. It shows, that consumers try to balance their expenditures with the real income (see Figure 3.5).

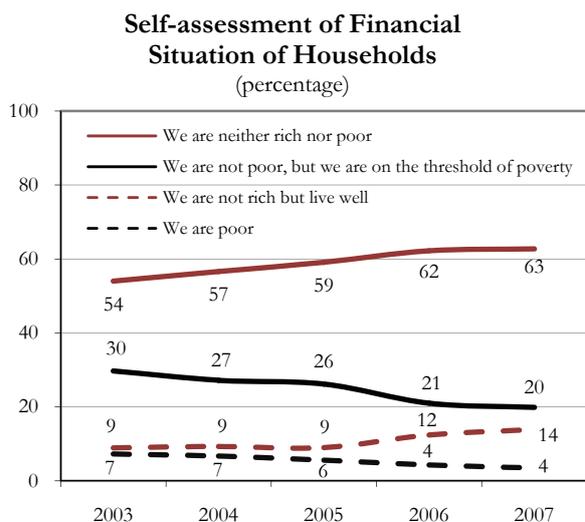
Figure 3.5

Growth of Real Wages and Private Consumption, Quarterly Profile (4th quarter of 2004 = 100)



The data of the Household Budget Survey made by the CSB on self-assessment of financial situation of households in 2007 show that the dominant subjective opinion “we are neither rich, nor poor” is expressed by 62.7% of respondents, which is a little more than in 2006 (62.2%). A positive trend could be observed over the five years, namely the number of those respondents, who expressed the opinion “we are not rich, but live well”, has increased. In 2007, the share of those respondents amounted to 13.9%. At the same time, over the last two years the share of those respondents, who consider that they are poor or are on the threshold of poverty, substantially decreased (see Figure 3.6).

Figure 3.6



3.2.3. Investments

Rapid dynamics of investments¹ and a significant share of investments in GDP expenditure were characteristic for Latvia in the last years. Within the period from 2004-2007, the investment volumes in Latvian national economy have increased nearly twice. As indicated by *Eurostat* data, the average annual growth rates of investments exceeded the average indicator in EU states almost four times.

Considering the investment amount per one employee, Latvia substantially lags behind the EU average; however this backwardness is annually decreasing. In 2004, the amount of investments per one employee was EUR 3000 (30% of the EU average), but in 2007 they increased to EUR 6000 (50% of the EU average).

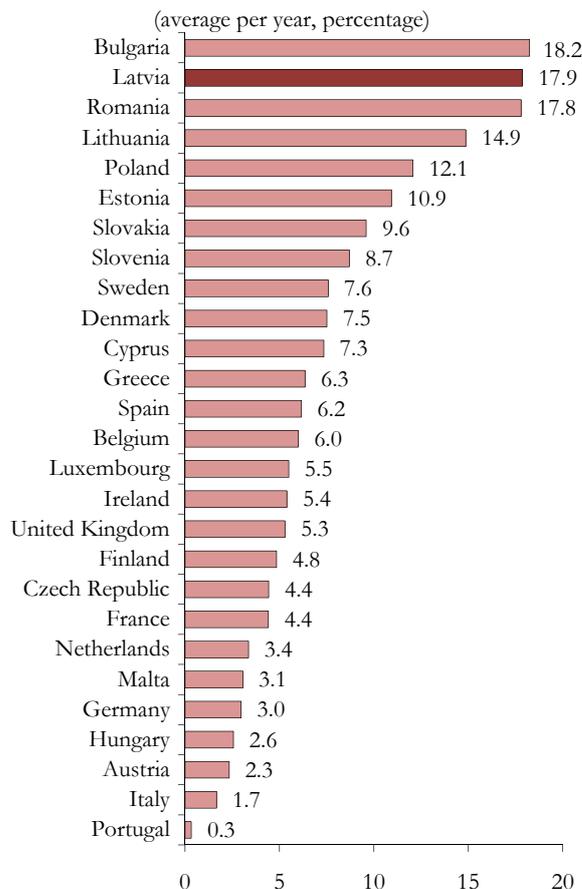
The basis for the rapid dynamics of investments was availability of cheap financial resources, which was determined by both, the intensified influx of foreign capital since Latvia's accession to the EU, and improvement of financial position of enterprises due to the relatively low tax burden and high domestic demand.

Investments increased by 8.4% in 2007, which is by 8 percentage points less than in 2006. The share of investments in GDP reached 32.5%. Investments in fixed assets began to decrease starting with the 1st quarter of 2007 and this trend was more pronounced in the 4th quarter of last year when the investment amount exceeded the level of the respective period of the preceding year only by 2.6%.

Considerable decrease of investment rates began in the 4th quarter of 2007. That was to a great extent determined by shrinkage of economic activities caused by weakening of domestic demand. In the 1st quarter of 2008, the investments were in greater amount by 5.1% in comparison with the respective period of the preceding year.

Figure 3.7

Growth Rates of Investments in EU member states from 2004-2007



Source: *Eurostat*

Table 3.4

Gross Capital Formation

| | 2004-2007 (average per year) | 2006 | 2007 | 2008 I-III |
|---------------------------------|------------------------------------|-------------|-------------|---------------|
| Real growth in per cent | | | | |
| GDP | 10.4 | 12.2 | 10.3 | 3.3 |
| Gross capital formation | 15.6 | 18.2 | 13.0 | -6.8 |
| - gross fixed capital formation | 18.0 | 16.4 | 8.4 | 5.1 |
| % of GDP | | | | |
| Gross capital formation | 37.9 | 39.7 | 37.2 | 28.9 |
| - gross fixed capital formation | 31.2 | 32.6 | 32.5 | 28.9 |
| - changes in inventories | 6.7 | 7.1 | 4.7 | 0.1 |

Since 2004, rapid dynamics of investments has been in both public¹ and private sector. Over the last four

¹ The public sector includes enterprises and organisations of the central and local governments, business companies with the share of the central or local governments or their enterprises in equity capital in amount of 50% or more, social and religious organisations and enterprises owned by them, and budgetary institutions.

years investments in the private sector annually increased on average by 15% and amounted to almost 70% of the total investments, whereas investments in the public sector increased on average by 18% per year. It should be noted that in 2007, the investment volumes increased by almost 40% in the public sector, whereas the investment volumes in the private sector were more moderate than in the preceding years, which was to a great extent determined by investment volumes in the enterprises belonging to non-residents, and which were less than in 2006. In the 1st quarter of 2008, investments in the private sector decreased by 3%, including in the enterprises belonging to residents – by 14%. In 2008, still positive dynamics of investments remained in the public sector. In comparison with the 1st quarter of 2007, investment volumes rose by 11%.

Sectoral structure of investments¹. Rapid growth of investments within the period of 2004-2007 was observable in such sectors as construction, hotels and restaurants, immovable property transactions, financial intermediation, health protection and education.

Figure 3.8

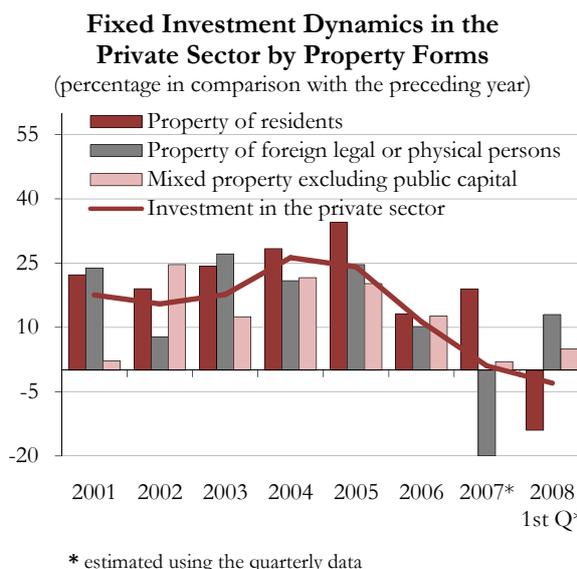


Table 3.5

Fixed Investment by Sectors
(excluding investment in individual construction, %)

| | Growth | | | Structure | | |
|------------------------------------|-------------------|-------------|----------------------------------|-------------------|------------|----------------------------------|
| | Average 2004-2007 | 2007* | 1 st quarter of 2008* | Average 2004-2007 | 2007* | 1 st quarter of 2008* |
| Primary sectors | 13.1 | 0.5 | 30.3 | 4.6 | 4.1 | 4.4 |
| Manufacturing | 15.6 | 2.0 | 13.6 | 16.0 | 15.1 | 18.7 |
| Electricity, gas, and water supply | 9.4 | 32.0 | -36.3 | 7.5 | 7.2 | 9.2 |
| Construction | 32.5 | 29.0 | 1.3 | 4.5 | 5.3 | 4.4 |
| Trade | 9.0 | -3.1 | 20.0 | 13.9 | 12.0 | 16.0 |
| Transport and communications | 8.8 | 5.0 | 15.4 | 14.1 | 13.5 | 14.1 |
| Other commercial services | 17.8 | -2.1 | -17.0 | 22.6 | 21.7 | 18.4 |
| Public services | 30.5 | 65.7 | 23.7 | 16.8 | 21.1 | 14.9 |
| Total | 16.4 | 13.0 | 2.0 | 100 | 100 | 100 |

* estimated using the quarterly data

In 2007, as compared with 2006, the dynamics of investments decreased a little, but in the trade sector and in the sector “real property transactions” the investment volumes fell by 3% and 9% respectively indicating sensibility of investors to domestic demand fluctuations. Pursuant to provisional data, in the 1st quarter of 2008, investment volumes in financial intermediation and real property transactions were by almost 40% less than in the respective period of the preceding year.

Since Latvia’s accession to the EU (2004-2007), investment volumes increased by 70% in the production sphere and by 86% in the services sphere. It should be noted that in the first two years dynamics

of investments in production spheres was in general, more rapid than in the spheres of services, but since 2006, annually lags behind on average by 6 percentage points, whereas in the 1st quarter of 2008, investments in production spheres were by 5% less than in the respective period of the preceding year, which is related to almost half as much investment volumes in the energy sector. Dynamics of investments in other industries were positive.

Since Latvia’s accession to the EU, the annual investment volumes have increased by 80% in manufacturing, although decrease of investment growth rates has been observable since 2006.

In terms of investment volumes, production of other non-metallic products, chemical industry, production of electric and optical equipment, and production of transport vehicles were the sectors that are the most attractive for the investors in

¹ Investment in breakdown by sectors is presented according to the non-financial investment statistics that do not include all investment in fixed assets.

manufacturing. Average annual investment volumes in these sectors in four years (2004-2007) have increased more than twice in comparison with three years before accession to the EU, of which in production in other non-metallic products – almost five times.

Volumes of investments for the light manufacturing have declined considerably. Investments in

the light manufacturing accounted for 7.1% of the total investment volume in manufacturing in 2003 and mere 2.9% in 2007. In 2007, investments in this sector decreased by 19 % but in the 1st quarter of 2008 – by 34%. Such dynamics of investment indicates essential decrease of competitiveness of the light manufacturing.

Table 3.6

Dynamics and Structure of Investment in Manufacturing

(%)

| | Growth rates | | | Structure | | |
|---|-------------------|-------|----------------------------------|-------------------|-------|----------------------------------|
| | Average 2004-2007 | 2007* | 1 st quarter of 2008* | Average 2004-2007 | 2007* | 1 st quarter of 2008* |
| Food industry | 0.8 | -23.3 | -9.5 | 24.4 | 19.2 | 14.8 |
| Light industry | -17.0 | -18.8 | -34.0 | 3.0 | 2.9 | 1.4 |
| Wood processing | 6.8 | -20.6 | 28.3 | 24.9 | 22.9 | 20.3 |
| Paper industry and publishing | 29.5 | 41.2 | -73.5 | 7.6 | 9.0 | 4.6 |
| Chemical industry and related industries | 37.0 | 49.5 | 126.8 | 8.0 | 10.4 | 22.5 |
| Production of other non-metallic mineral products | 79.0 | 63.9 | 150.8 | 12.1 | 16.8 | 19.6 |
| Production of metals and metal articles | 11.6 | 7.5 | 56.5 | 6.6 | 6.3 | 8.4 |
| Production of machines and equipment | 12.6 | 49.2 | 34.5 | 2.2 | 2.3 | 2.6 |
| Production of electric and optical equipment | 8.5 | -11.1 | -18.6 | 2.6 | 2.0 | 2.2 |
| Production of transport vehicles | 11.4 | -33.1 | -23.0 | 2.3 | 2.0 | 1.4 |
| Other industries | 36.2 | 51.4 | -67.5 | 6.2 | 6.3 | 2.3 |

* estimated using the quarterly data

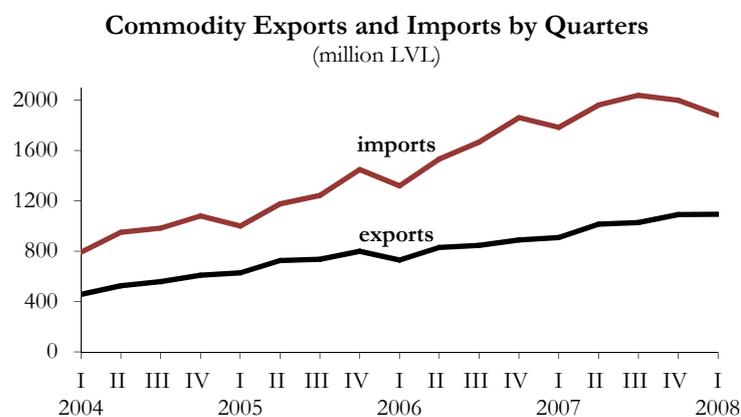
Overall, since 2004, investments in manufacturing sectors of high and medium technologies are growing most rapidly: by 30% on average annually in high technology sectors, by 38% in medium technology sectors and by 5.5% in low technology sectors. In 2007, investments in high technology sectors grew by 26% and constituted 13% of the total investments in manufacturing. Such trends may indicate certain capital saturation in low technology sectors and drain their development potential, which is also greatly affected by the producer price competition pressure from cheap labour countries.

3.2.4. Exports and Imports

Exports and imports of commodities

In terms of current prices, exports of Latvian commodities in 2007 was by 22.7% higher than in 2006, whereas in terms of constant prices – by 8.3%. Also at the beginning of 2008 (January-May) exports of commodities considerably exceeded the level of the respective period of the preceding year (by 18.3% in current prices).

Figure 3.9



Imports increased slightly slower in 2007 in current prices – by 22%, but import prices grew at a

considerably slower pace and therefore, in comparison with the growth of exports, the volume of

imports in constant prices increased more rapidly – by 15.4%. In January-May 2008 the growth of imports was considerably more moderate than it was for exports (by 2.8%).

In 2007, the commodity exports were influenced favourably by the changes of trade conditions, and export unit value index increased by 13%, but import unit value index – by 5.7%. The growth of the export unit value was affected most substantially by the rise of export prices in the groups of wood processing and metal processing goods.

Commodity exports in 2007 went up in almost all groups of goods, especially agricultural and food products that accounted for almost one-fifth of the total growth of exports, as well as growth of wood exports (22.6% of the total growth of exports), but it should be noted that this growth was affected to a great extent by the rise of wood price in the world market. Prices of Latvian wood and wood products have increased by 1.3 times during 2007.

Growth of exports of metalworking and machinery products in January-May 2008 ensured more than two-fifths of the total growth, as well as the growth of agricultural and food products (15% of the total growth).

Figure 3.10

Commodity Exports by Months (million LVL)

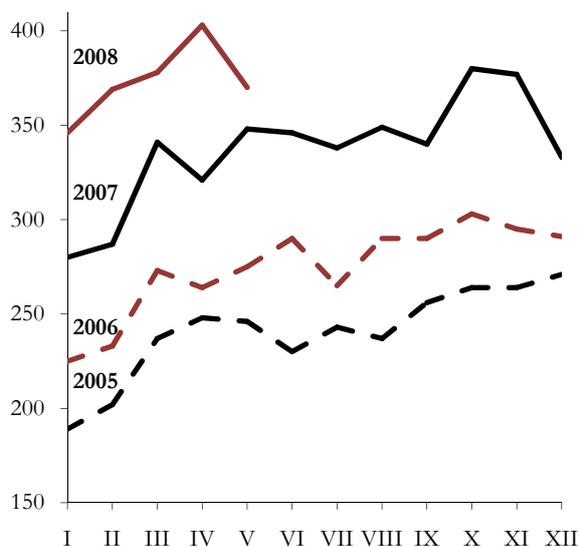


Table 3.7

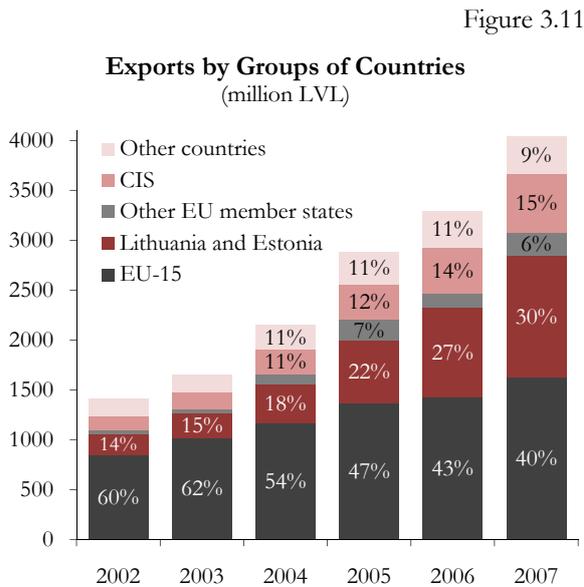
Exports by Main Groups of Commodities (%, current FOB prices)

| | 2007 | | January-May 2008 | |
|--|------------|--|------------------|-----------------------------------|
| | structure | increase in comparison with the preceding year | structure | increase against January-May 2007 |
| Total including: | 100 | 22.7 | 100 | 18.3 |
| wood and wood products (IX) | 22.5 | 22.8 | 18.9 | -2.0 |
| metals and metal articles (XV) | 14.6 | 20.8 | 17.1 | 27.3 |
| light industry products (VIII; XI-XII) | 7.3 | 1.1 | 6.5 | -5.8 |
| agricultural and food products (I-IV) | 14.4 | 33.6 | 15.0 | 37.3 |
| products of chemical industry and allied industries, plastics (VI-VII) | 10.4 | 29.8 | 10.4 | 20.3 |
| machinery (XVI) | 11.0 | 37.1 | 11.6 | 33.5 |
| mineral products (V) | 4.1 | -9.2 | 4.1 | 13.8 |
| transport vehicles (XVII) | 7.0 | 41.7 | 8.0 | 40.5 |
| other commodities (X; XIII-XIV; XVIII-XXII) | 8.7 | 14.2 | 8.4 | 14.2 |

Exports to EU-27 countries in 2007 were by 24.4% higher than a year before. Similarly like with the total Latvian exports, also exports to EU-27 member states increased in almost all groups of commodities. The wood products (27.3% of the total exports to EU-27 member states) and metalworking products (14.9%) accounted for the biggest increase in exports to EU-27

member states. Light industry products were exported to EU-27 member states in similar volumes.

In January-May 2008, exports to EU-27 member states have increased by 16.2% in comparison with the previous year, where the biggest contribution was ensured by the increase of exports of food products.



Exports to CIS countries in 2007 kept growing at the usually rapid pace – by 27%. The biggest increase was observed for exports of machinery, metalworking, and food industries.

In January-May 2008, exports to CIS countries was by 22.4% higher than a year ago, and similarly like with the exports to EU countries, the biggest contribution was made by the exports of food products.

Increase of **commodity imports** in 2007 was observed in all groups of commodities, the biggest

increase was in the groups of machinery (25.8% of the total increase of imports) and transport vehicles (19%).

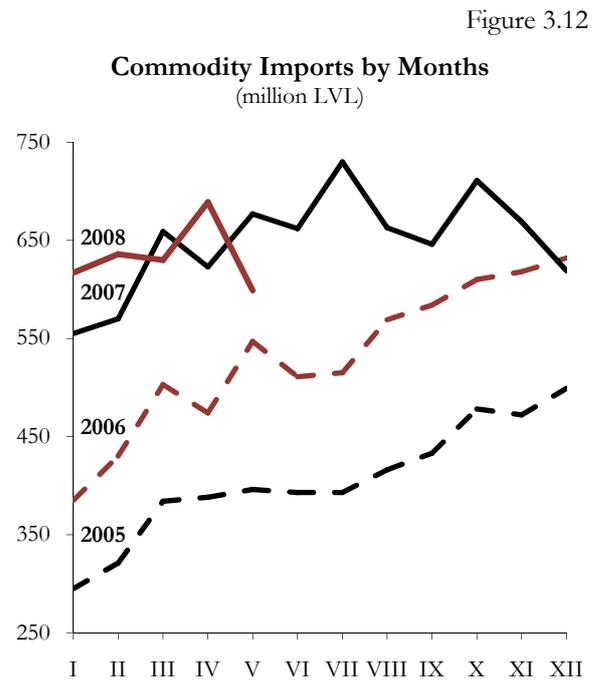


Table 3.8

Imports by Main Groups of Commodities
(%, current CIF prices)

| | 2007 | | January-May 2008 | |
|--|------------|--|------------------|-----------------------------------|
| | structure | increase in comparison with the preceding year | structure | Increase against January-May 2007 |
| Total including: | 100 | 22.0 | 100 | 2.8 |
| wood and wood products (IX) | 3.4 | 62.9 | 2.3 | -37.3 |
| metals and metal articles (XV) | 9.6 | 23.3 | 9.9 | 2.7 |
| light industry products (VIII; XI-XII) | 5.5 | 16.0 | 5.7 | 1.9 |
| agricultural and food products (I-IV) | 11.2 | 23.4 | 13.1 | 24.0 |
| products of chemical industry and allied industries, plastics (VI-VII) | 12.9 | 17.6 | 14.7 | 14.4 |
| machinery (XVI) | 20.8 | 28.8 | 18.4 | -10.8 |
| mineral products (V) | 11.5 | 4.9 | 13.9 | 37.4 |
| transport vehicles (XVII) | 14.6 | 30.8 | 12.5 | -13.4 |
| other commodities (X; XIII-XIV; XVIII-XXII) | 10.5 | 16.3 | 9.5 | -2.5 |

As viewed in classification of the broad economic categories, the imports have not changed much over the last years – imports of consumption and

intermediate goods have increased slightly slower than the total imports of goods (see Figure 3.13).

Figure 3.13

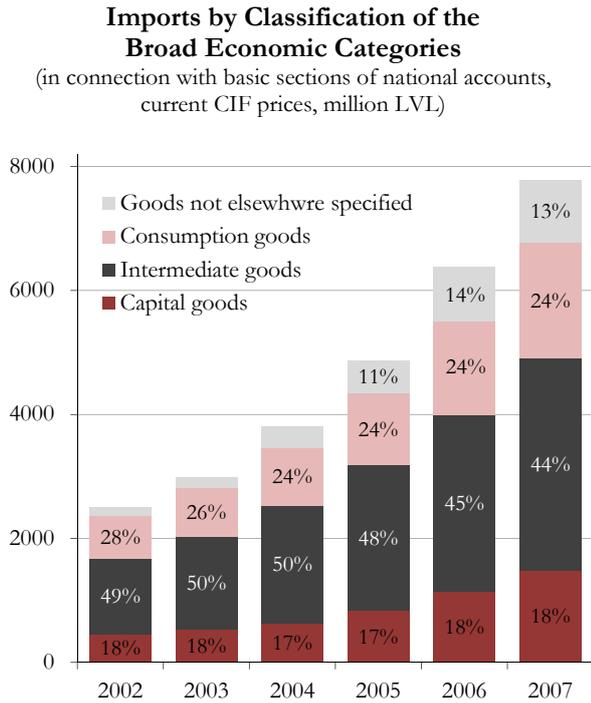
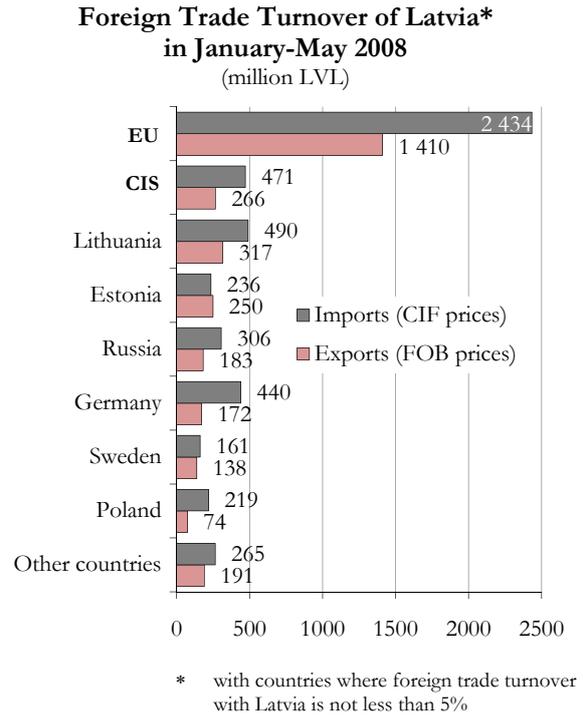


Figure 3.14



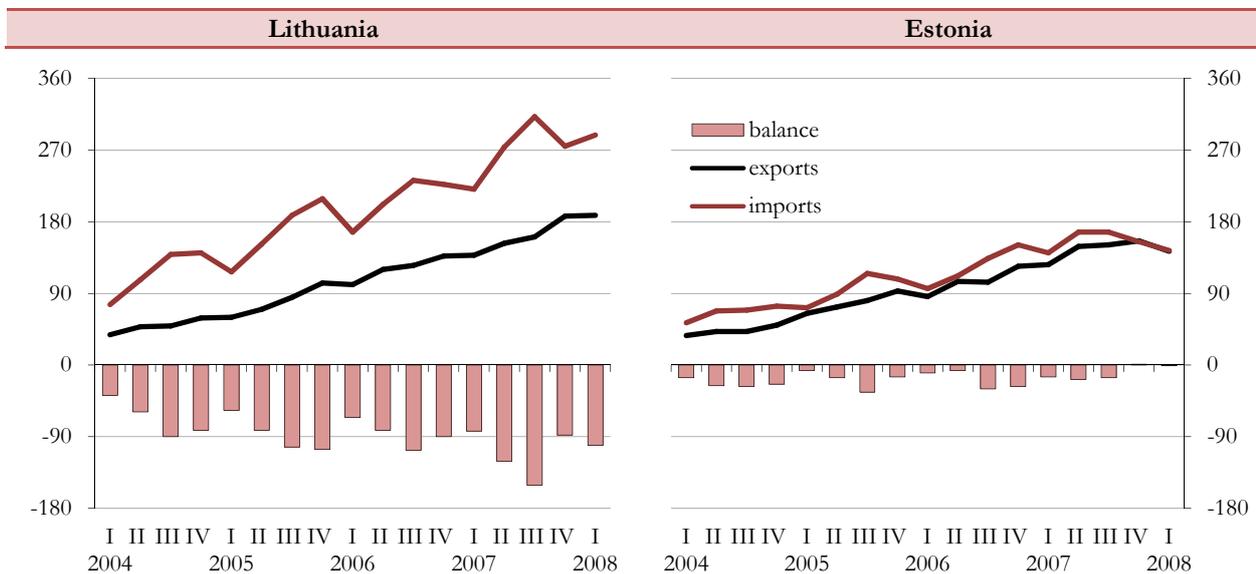
The main **trading partners** of Latvia in January-May 2008 were Lithuania (17% of the total foreign trade turnover), Estonia (13.4%), Russia (9.8%), Germany (9.2%), Sweden (7.4%), United Kingdom (4.4%), as well as Poland (4%).

After accession to the EU, foreign trade of Latvia with **Lithuania** and **Estonia** has continued growing rapidly. In comparison with 2003, Latvian foreign trade with these countries has increased three times and already constitutes more than 30% of the total trade with EU member states.

As Figure 3.15 shows, the foreign trade balance with Estonia has remained neutral within the last quarters, but with Lithuania it remains considerably negative. In January-May 2008, imports from Lithuania exceeded exports by 54.6%, while exports to Estonia exceeded imports by 5.9%. The main groups of commodities exported to Estonia are food and chemical industry products, while the main imported commodities are transport vehicles and food industry products. Similarly like with Estonia, main commodities exported to Lithuania are food and chemical industry products, while the main imported are mineral products and food products.

Figure 3.15

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



Exports and imports of services

The clearly negative balance of commodity trade of Latvia is partly covered by the positive balance of services. Data of the balance of payments for 2007

indicate that the balance of services has slightly deteriorated, as exports of services grows at a slightly more moderate pace than imports (see Table 3.9).

Table 3.9

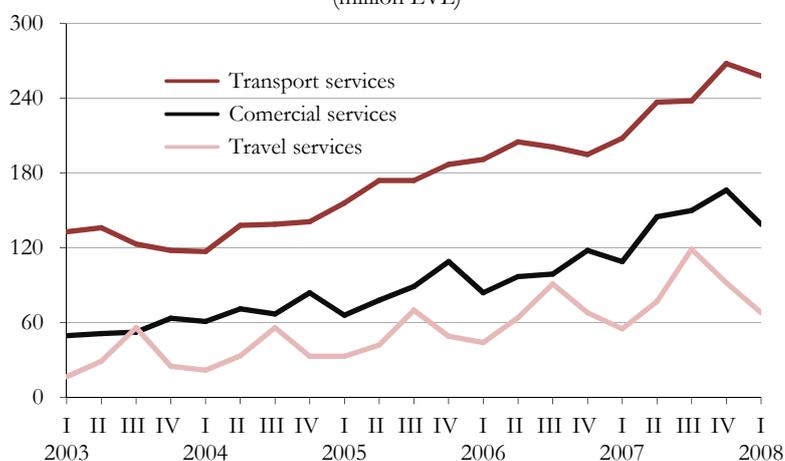
Exports and Imports of Services in 2007

| | Million LVL | | | Structure (%) | | Changes in comparison with the the preceding year (%) | |
|-------------------------|---------------|---------------|--------------|---------------|------------|---|-------------|
| | exports | imports | balance | exports | imports | exports | imports |
| Services – total | 1889.2 | 1375.2 | 372.3 | 100 | 100 | 27.9 | 24.5 |
| including: | | | | | | | |
| Transport services | 950.9 | 398.2 | 434.4 | 50.3 | 29.0 | 20.2 | 11.6 |
| – sea transport | 363.1 | 95.0 | 228.7 | 19.2 | 6.9 | 15.9 | 12.4 |
| – air transport | 140.1 | 132.5 | -19.8 | 7.4 | 9.6 | 33.9 | 6.5 |
| – other transport | 447.7 | 170.7 | 225.4 | 23.7 | 12.4 | 19.9 | 15.3 |
| Travel | 342.8 | 474.2 | -125.0 | 18.1 | 34.5 | 28.3 | 20.9 |
| Commercial services | 571.0 | 480.1 | 60.9 | 30.2 | 34.9 | 43.5 | 42.5 |
| Other services | 24.5 | 22.7 | 2.0 | 1.3 | 1.7 | 21.3 | 24.7 |

Slightly more than a half of the exports of services is made by the revenues from transit haulage. 2006 was a rather successful year for transit business, as cargo turnover in ports increased and volumes of rail and road transport services grew.

Growth of revenues from incoming tourists and increase of commercial services are significant. It must be noted that the amount of expenses by foreign tourists in Latvia continue approaching the amount of expenses by Latvian travellers abroad.

Figure 3.16

Exports of Services by Quarters
(million LVL)

3.3. Contribution of Sectors

3.3.1. Structure and Dynamics of Economy

After 2000 the structure of the perspective of sectors in Latvian economy has changed in favour to service sectors. Their proportion in the added value has increased up to 74.7% in 2007 in contrast with 71.8% in 2000. Economy structure according to employment significantly differs from that of the

added value due to explicitly different productivity levels in various sectors of economy.

Over recent years significant growth of economy was ensured mainly by increase of domestic demand, which was directly influenced by the rapid development of several service sectors, but increase of industrial manufacturing volumes was mainly based on the increase of exports.

Table 3.10

| Structure of Economy (%) | | | | |
|-----------------------------------|----------------|------------|------------------------|------------|
| | By value added | | By number of employees | |
| | 2000 | 2007 | 2000 | 2007 |
| Primary sectors | 4.8 | 3.6 | 14.5 | 10.4 |
| Manufacturing | 13.7 | 10.8 | 17.9 | 14.9 |
| Electricity, gas and water supply | 3.6 | 2.4 | 1.9 | 1.3 |
| Construction | 6.1 | 8.4 | 5.9 | 11.5 |
| Trade, hotels and restaurants | 17.9 | 22.2 | 17.7 | 19.8 |
| Transport and communications | 14.0 | 10.8 | 8.3 | 9.2 |
| Other commercial services | 23.0 | 27.8 | 12.4 | 14.3 |
| Public services | 16.9 | 13.8 | 21.4 | 18.6 |
| Total | 100 | 100 | 100 | 100 |

After acceding to the EU (2004-2007) half of the increase was insured by the growth of the trade sector (wholesale and retail) and other commercial services. Investment of manufacturing is considerably smaller and is also behind the input of construction and transport and communication sectors in the growth.

The manufacturing ratio in the economy of Latvia is explicitly low and it is significantly lagging behind the average level of the EU in this field – a lower level of manufacturing in the EU is observed in such

countries as Cyprus and Luxemburg with large ratio of exported services in the economy.

The rapid pace of the service sector development – relatively slow growth of exportable sector – cannot replace manufacturing and it is expressed as much higher increase of product import than increase of export that is one of the reasons for the disproportion of Latvian economy – high inflation and large current account deficit of the payment balance.

Table 3.11

| GDP Growth (%) | | | | | | |
|------------------------------------|----------------------|-------------|---------------------------|------------------------|-------------|---------------------------|
| | Growth rates | | | Contribution to growth | | |
| | Average 2004-2007 | 2007 | 1 st Q 2008 | Average 2004-2007 | 2007 | 1 st Q 2008 |
| Primary sectors | 4.8 | 8.7 | -2.0 | 0.9 | 0.3 | 0.0 |
| Manufacturing | 4.6 | -0.3 | -4.1 | 2.8 | 0.0 | -0.4 |
| Electricity, gas, and water supply | 3.7 | 4.9 | 0.2 | 0.5 | 0.1 | 0.0 |
| Construction | 16.2 | 14.4 | 9.1 | 5.6 | 1.2 | 0.5 |
| Trade, hotels, and restaurants | 14.9 | 12.3 | -0.7 | 15.1 | 3.0 | -0.2 |
| Transport and communications | 9.8 | 9.8 | 9.6 | 6.5 | 1.5 | 1.0 |
| Other commercial services | 4.3 | 4.6 | 4.8 | 2.8 | 0.6 | 0.5 |
| Public services | 12.8 | 13.5 | 8.1 | 14.6 | 3.5 | 1.9 |
| GDP | 10.5 | 10.3 | 3.3 | 48.8 | 10.3 | 3.3 |

As forecasted at the end of 2007 growth pace started to decrease. In the fourth quarter of 2007 it fell down to 8.1% in comparison with 11% increase for the corresponding period of the preceding year as it was on average in the previous three quarters of the year.

According to evaluation of CSB on GDP its growth pace in the 1st quarter of 2008 has decreased to 3.3%.

Decrease of the domestic demand is directly reflected on the increase possibilities of sector production amounts – retail has become narrower, the pace of construction growth has fallen, there are fewer

activities in the real estate market. The investment growth in these three sectors of the first quarter of 2008 was only 1.7%. However, in the preceding year growth of these sectors ensured increase of GDP by almost 6% or more than a half of the total growth.

The second factor is output decrease for the main export sector – manufacturing, which was determined not only by lower domestic demand and weakening demand in the trade partner countries, but also by gradual decrease of competitiveness of the Latvian manufacturing as related to the rapid increase of labour costs.

3.3.2. Manufacturing

Gradual decrease of the growth rates of manufacturing production volume began at the end of 2006, but in the second half of 2007, decrease of output volume have been already observed.

Figure 3.17

Monthly Growth Dynamics of Manufacturing
(level of 2000 = 100)

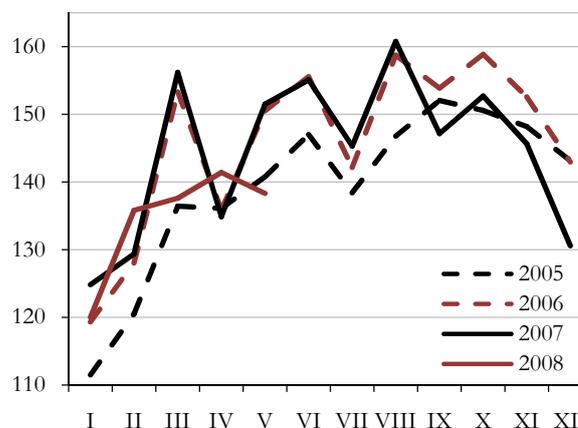


Table 3.12

Growth of Manufacturing*
(per cent)

| | Average annual growth 2004-2007 | Growth in 2007 compared to 2006 | 1 st quarter of 2008 against 1 st quarter of 2007 |
|--|---------------------------------|---------------------------------|---|
| Manufacturing – total | 4.1 | -1.0 | -4.1 |
| Food industry | 3.8 | -1.1 | -4.0 |
| Light industry | 3.8 | -1.2 | -11.7 |
| Wood processing | 0.2 | -5.8 | -0.8 |
| Paper industry and publishing | 5.8 | -0.3 | 2.3 |
| Chemical, rubber and plastic industry | 14.6 | 2.7 | 3.7 |
| Manufacture of other non-metallic mineral products | 9.6 | -1.5 | -21.1 |
| Production of metals and metal articles | 6.6 | 9.1 | -6.2 |
| Production of machinery and equipment | 1.0 | -6.8 | -15.6 |
| Production of electrical and optical equipment | 7.6 | 6.7 | 10.3 |
| Production of transport vehicles | 1.6 | 0.4 | 30.7 |
| Other industries | 3.7 | -5.1 | -20.7 |

* according to operational statistics

Deterioration of the situation in manufacturing in 2007 and particularly in the beginning of 2008 has been determined by the following factors:

- change of conditions in both the internal and external market as a result of decrease of the demand. There was a rapid decline in domestic demand at the end of 2007 upon weakening of demand incentives (reduction of crediting). Decrease of the global growth rates is strongly affected by instability in the US financial markets. Furthermore, decrease of the growth and also demand of the nearest and biggest trade partner countries – Lithuania and particularly Estonia should be noted, as well;
- substantial changes in the labour market, because of considerable increase of labour

costs. In 2006 and 2007, wages rose by 29% and 23.5% respectively. Thus, they have increased by more than one and a half times within two years. It has a very unfavourable influence on competitiveness of several sectors, especially textile industry, as well as some machinery subsectors. Therefore some enterprises stopped their activities in Latvia and production units had been moved to other countries;

- increase of intermediate consumption costs in relation to the high inflation of the previous three years in Latvia, as well as the rapid increase of the world prices for energy resources.

Table 3.13

Structure of Manufacturing in 2007
(%)

| | By value added* | By number of employees | Share of exports in sector's sales |
|--|-----------------|------------------------|------------------------------------|
| Manufacturing – total | 100 | 100 | 48.4 |
| Food industry | 18.6 | 20.2 | 24.0 |
| Light industry | 6.8 | 12.7 | 76.3 |
| Wood processing | 22.4 | 19.1 | 65.0 |
| Paper production and publishing | 8.3 | 7.6 | 24.4 |
| Chemical, rubber and plastic industry | 8.9 | 5.6 | 55.9 |
| Manufacture of other non-metallic mineral products | 6.9 | 5.1 | 18.3 |
| Production of metals and metal articles | 10.3 | 8.5 | 64.0 |
| Production of machinery and equipment | 3.2 | 4.1 | 71.2 |
| Production of electrical and optical equipment | 5.2 | 4.6 | 61.5 |
| Production of transport vehicles | 3.3 | 4.3 | 74.7 |
| Other industries | 6.2 | 8.3 | 53.3 |

* estimation of the Ministry of Economics according to operational data

In the 1st quarter of 2007, positive growth rates remained in manufacturing mainly due to the stable domestic demand, which had favourable influence on the sectors related to investments – production of construction materials and metal articles, as well as a good demand for food products, commodities of chemical industry and machinery in the CIS countries, as well as in the nearest countries in Lithuania and Estonia, but practically, without increase of demand in the EU-15 countries.

In the middle of the year, upon gradual decrease of domestic demand, the output volumes of manufacturing fell. This tendency continued also in the beginning of 2008.

Figure 3.18

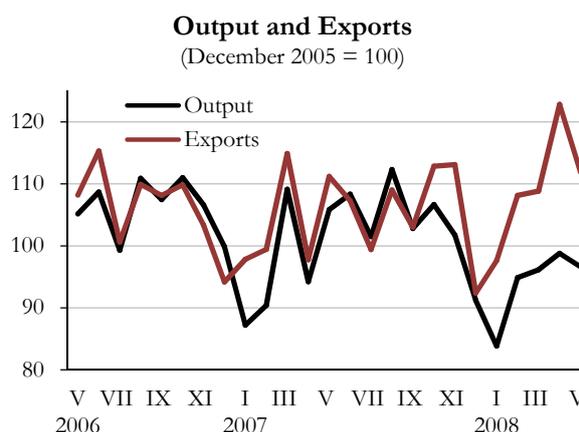
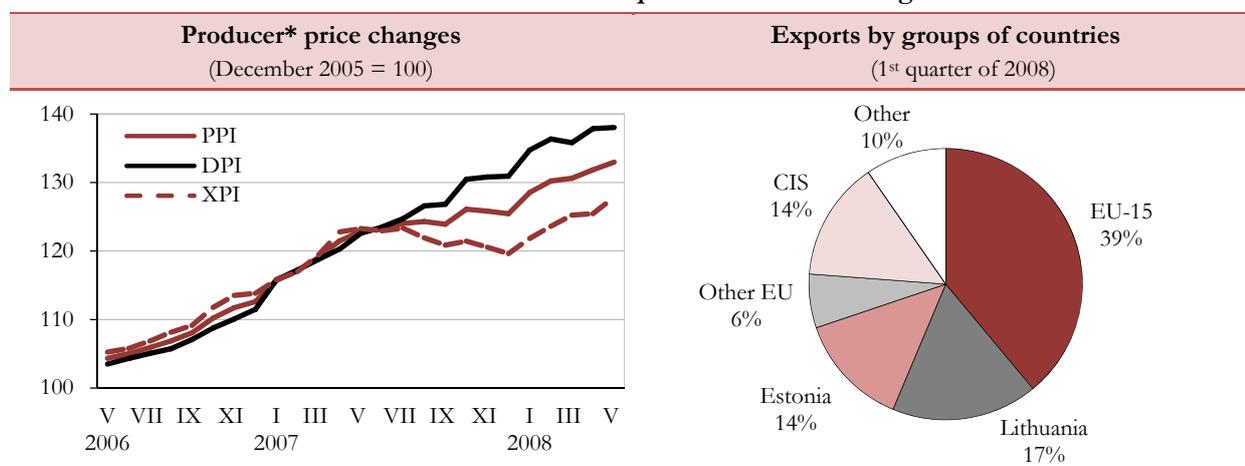


Figure 3.19

Producer Prices and Exports of Manufacturing



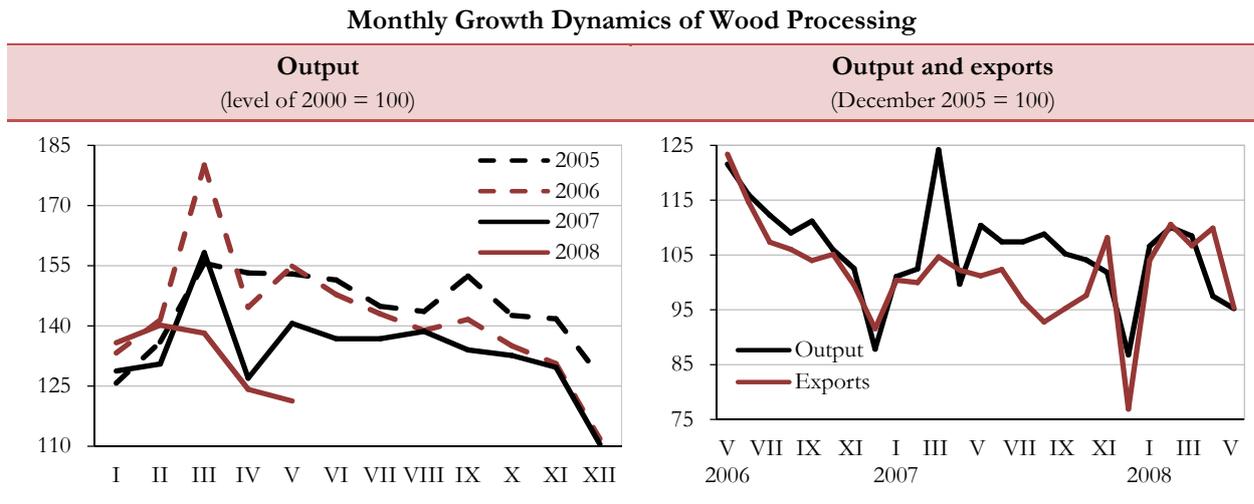
* PPI – producer price index, DPI – producer price index for products sold in the domestic market, XPI – producer price index for exported products

By June 2007, producer prices have increased considerably almost in all sectors. The prices for domestically sold products and for exported ones have increased equally, but further increase of prices has been observed mainly for domestically sold products.

The biggest part of exports of manufacturing products is connected with EU member states (almost 80%). A half of it goes to EU-15, 40% to Lithuania and Estonia and only 8% to the rest of the new EU member states.

Wood processing is the biggest sector of Latvian manufacturing. Its value added makes up almost one-fifth of the manufacturing output. This sector has shown the fastest growth since restoration of Latvia's independence, nearly tripling its output in this period. However, the growth of this sector has become more moderate during the last two years. Two-thirds of the wood processing output is exported.

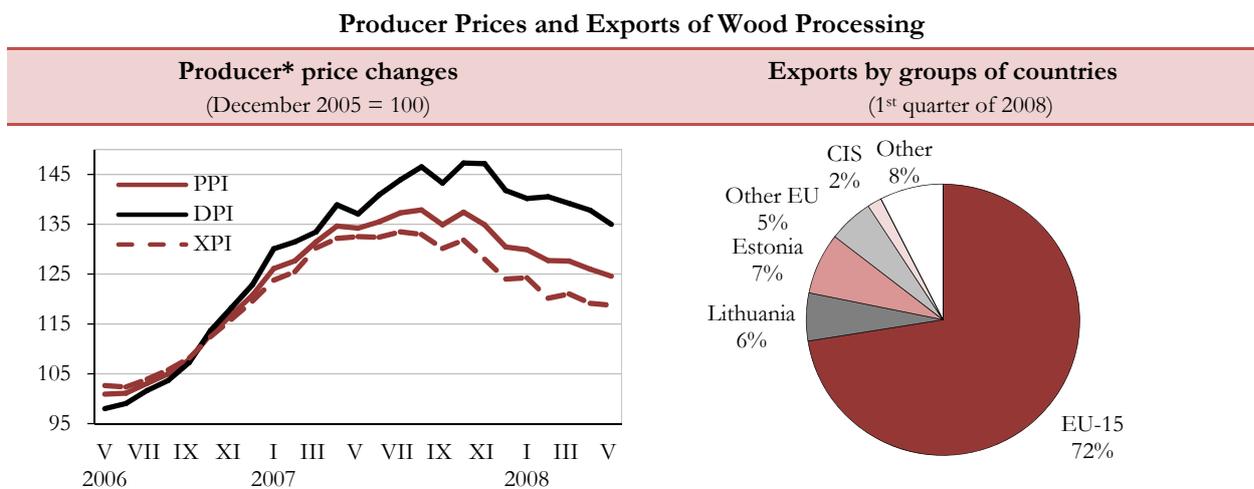
Figure 3.20



Decrease of output of the sector started already in the middle of 2006, when demand for wood processing products considerably fell in Europe. Its output decreased by 1.4% in 2006 and by 5.8% in 2007. In the beginning of 2008, the output decreased, as well. The output of January-May 2008 was by 3.7% less than in the respective period of the preceding year.

Nearly three-fourths of exported products are sold in the old EU member states. The decrease of exports of wood processing products to EU-15 was slightly compensated by its increase to Estonia and Lithuania, as well as to the other new EU member states.

Figure 3.21



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

Producer prices in wood processing grew equally rapidly for both domestically sold products and for

exported ones over the period of 2005-2006. In the beginning of 2007, the prices of products sold in

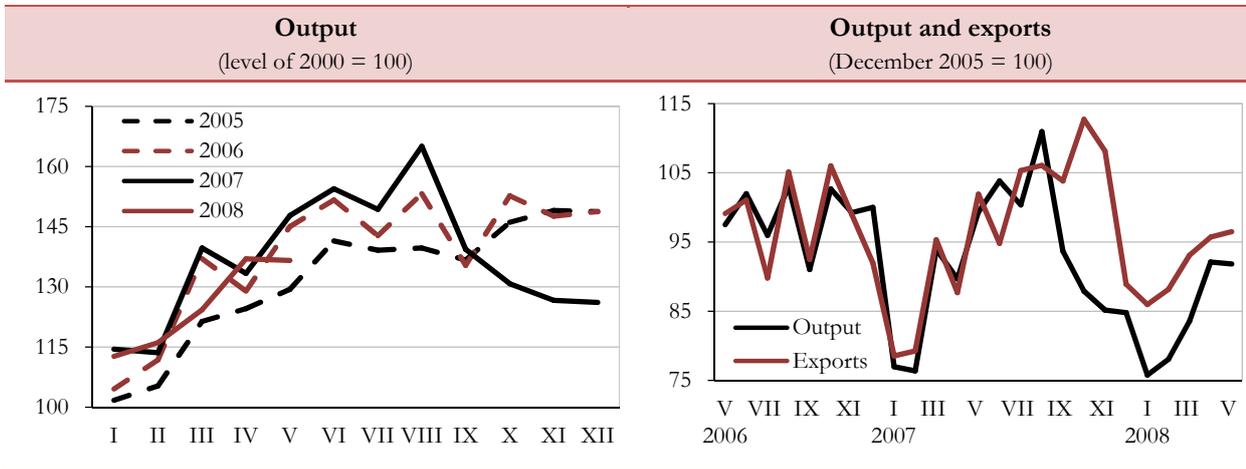
domestic market grew more rapidly, but at the end of 2007 and also in the beginning of 2008, the prices started to decrease. That is the reason for considerable decrease of competitiveness of this sector, taking into account also the substantial wage increase of the

previous years (by 36.3% in 2006 and by 30.2% in 2007).

Food industry is the biggest sector in Latvian manufacturing and accounts for one-fifth of the value added in manufacturing.

Figure 3.22

Monthly Growth Dynamics of Food Industry



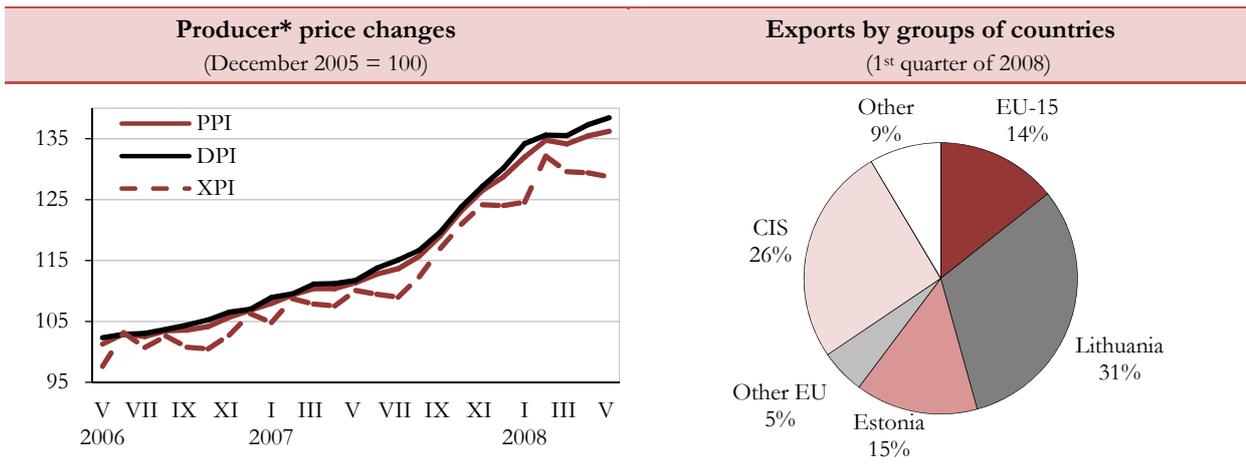
Approximately 75% of the total food industry output is consumed in the domestic market. The rest is exported mostly to Estonia, Lithuania and Russia. With accession to the EU, the demand for Latvian food products increased in all trade directions – both to Russia and other CIS countries and to the EU. Exports to the EU member states rose more than 1.5 times mostly due to the increased demand in Estonia and Lithuania. Exports of food products to

Lithuania and Estonia constitute 70% of the total exports of Latvian food products to the EU member states.

In the beginning of 2007, the food industry output continued to increase, but at the end of the year it substantially decreased due to both domestic and foreign demand. In the beginning of 2008, the food industry output was slightly below the level of 2007.

Figure 3.23

Producer Prices and Exports of Food Industry



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

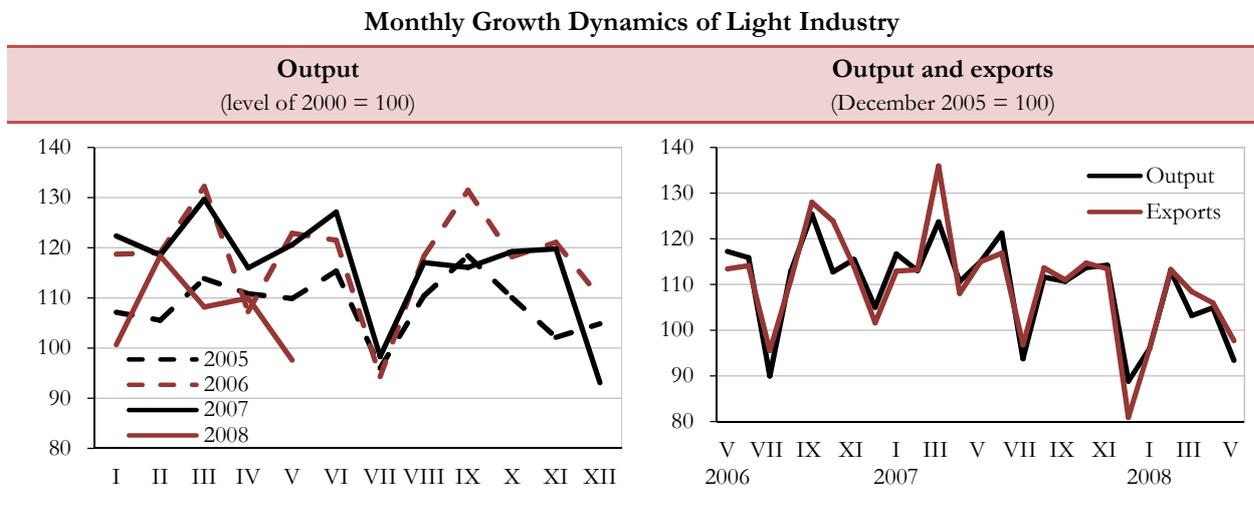
Export prices for food products rapidly increased in 2006 and 2007. The prices of exported products rose at a more moderate pace and began to decrease slightly in March 2008. Notwithstanding the rapid

price rise of the products in 2006 and 2007, competitiveness of the sector has decreased, because the rise of labour costs increased two times more.

Light manufacturing (production of textile and leather products) accounts for approximately 7% of the total value added in manufacturing. Only about

one-fourth of the light manufacturing output remains in Latvia. Most of the output (two-thirds of exports) is exported to the EU member states.

Figure 3.24

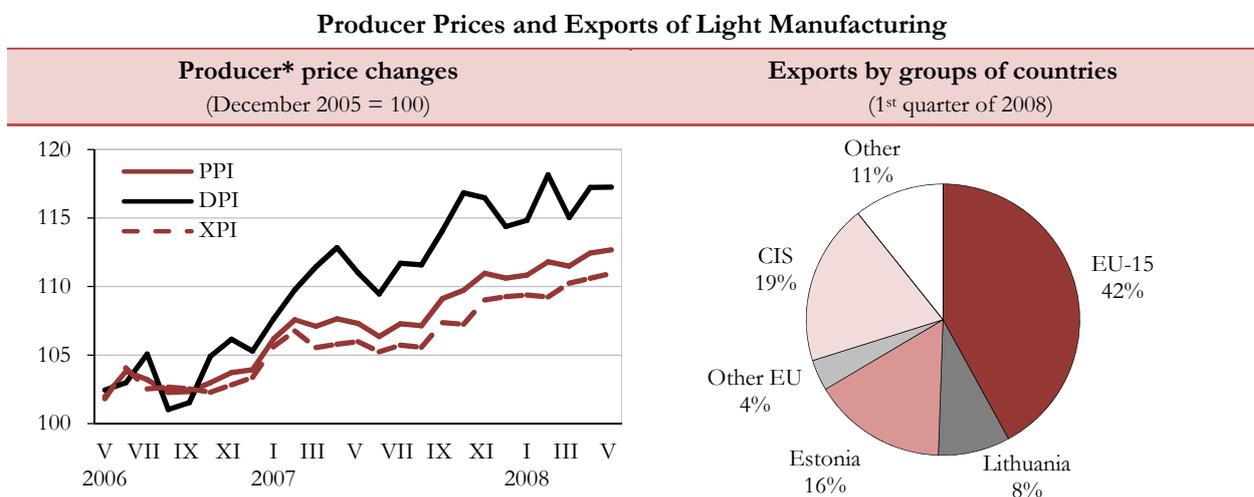


After the slight increase of output in 2006, the sector output continued to decrease. The main sales markets for Latvian textile industry are in the old EU member states. It is hard for Latvian producers to expand production volumes due to the poor demand in EU member states and high competition in the sector despite the rapid rise of prices in the last years.

The output amount of 2006 exceeded the previous level by 8.5% mainly due to increase of exports to the

CIS countries, as well as to Lithuania and Estonia. The exports to the old EU member states did not rise within this period, whereas in 2007, exports of textiles to EU-15 countries considerably decreased and this decrease was even not compensated by increase of exports to Lithuania and Estonia, as well as to other countries. Therefore, production volumes decreased. This tendency continues also in the beginning of 2008.

Figure 3.25



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

Producer price increase of light manufacturing sectors (by 3.8% in 2006 and by 5.6% in 2007) can not compensate the rapid increase of wages (by 32% in 2006 and by 20.8% in 2007). Moreover, the price increase for exported products is considerably smaller

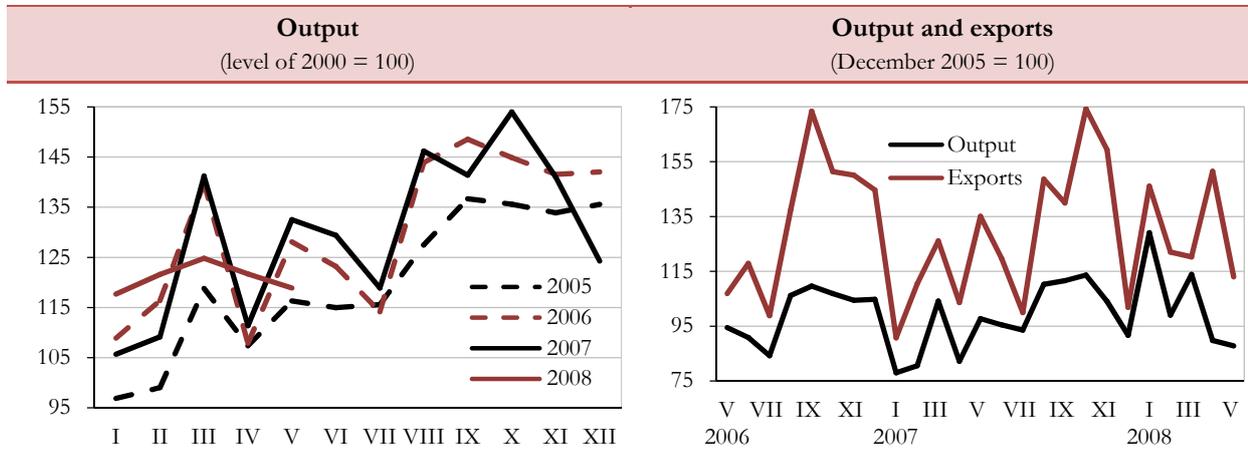
than for domestically sold ones. Since these sectors are markedly labour-consuming, such substantial increase of wages considerably decreases competitiveness of Latvian light manufacturing.

Production volumes grew substantially in *paper industry and publishing* in 2005 and 2006, which resulted in considerable growth of exports to the nearest neighbouring countries Lithuania and Estonia,

as well as to the CIS countries, and also due to the increase of domestic demand. The production volumes in 2007 practically did not increase, but in the beginning of 2008, the rapid growth renewed.

Figure 3.26

Monthly Growth Dynamics of Paper Industry and Publishing

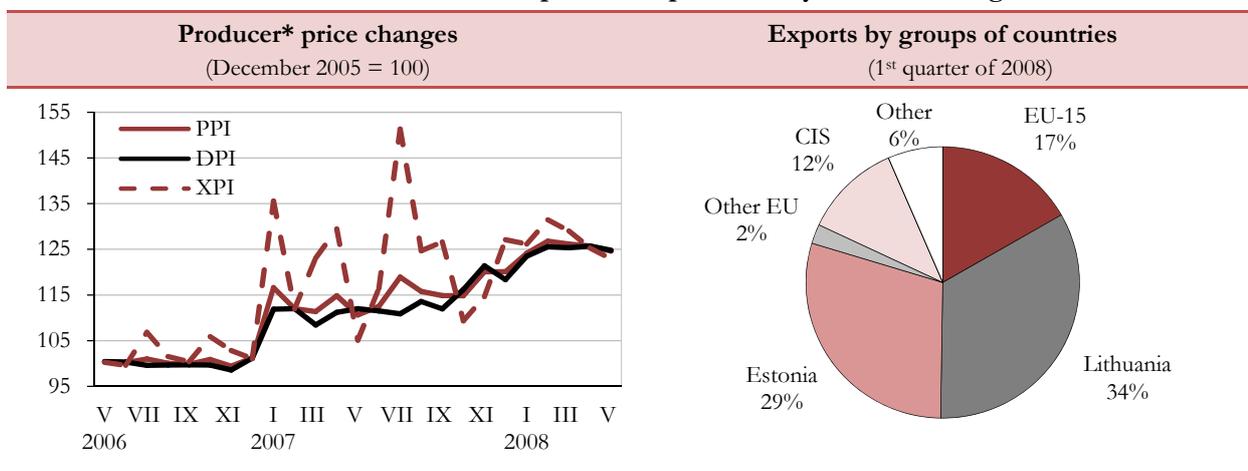


Although the sales markets of the sector are not closely connected with export opportunities, the increase of export opportunities is still an important

growth incentive. The main sales markets of exported products are in Lithuania and Estonia. In 2008, exports to the EU-15 increased substantially.

Figure 3.27

Producer Prices and Exports of Paper Industry and Publishing



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

Producer prices of the sector increased substantially in 2007, when they rose by 14.7%, mostly

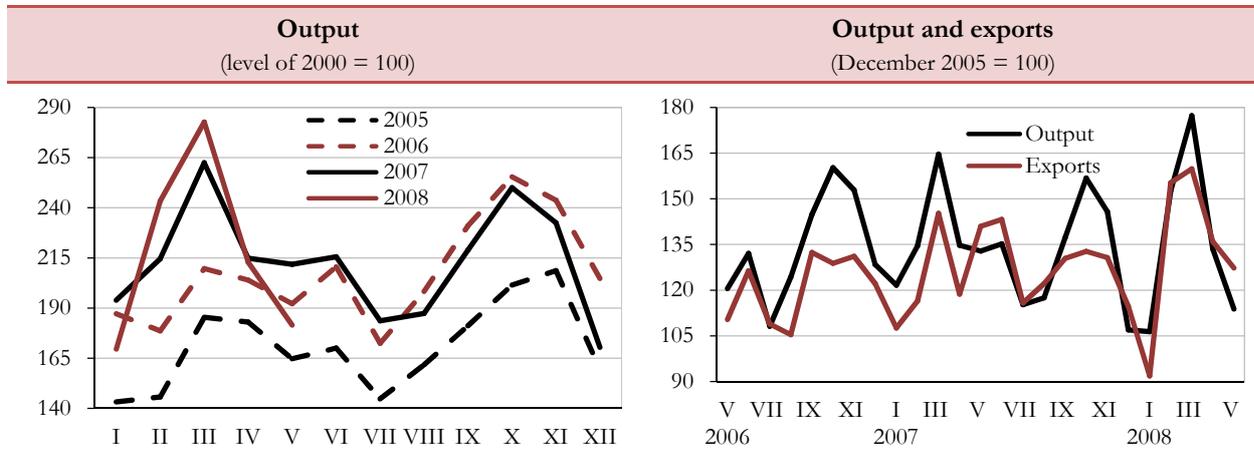
by the growth of exported products. In the beginning of 2008, the prices practically did not increase.

Chemical industry in Latvia has stable traditions, highly skilled specialists, long history of producing a wide range of products both for the final consumption

and for the intermediate consumption. Chemical industry accounts for approximately 9% of the total value added of manufacturing.

Figure 3.28

Monthly Growth Dynamics of Chemical Industry



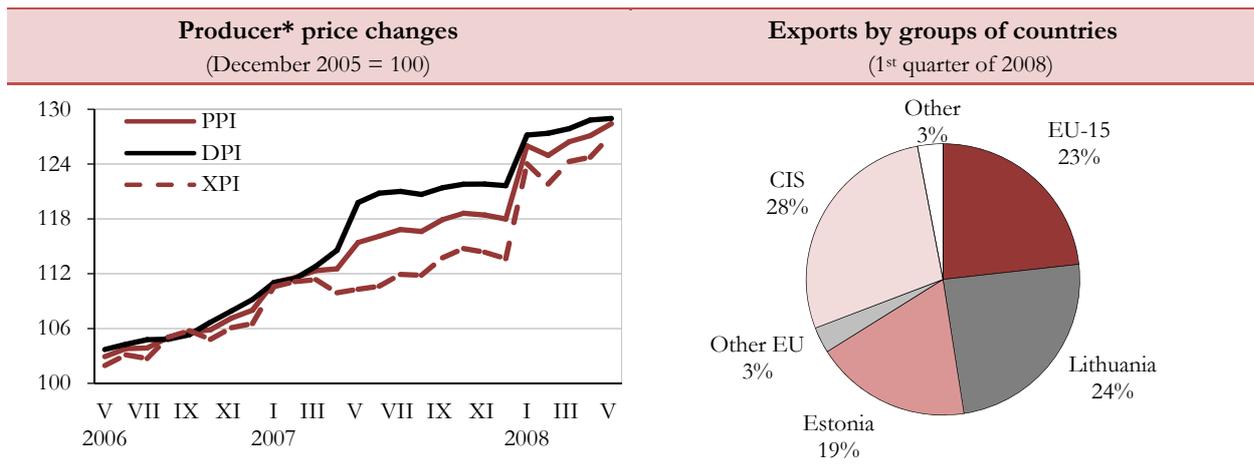
A slightly more than a half of the output is exported. Traditional sales markets for Latvian chemical industry products are mainly in the CIS countries, Lithuania and Estonia. Market shares in the old EU member states do not increase. The sector shows poor competitiveness in markets of the developed countries. Exports to Lithuania and Estonia make up about two-thirds of exports to the EU member states.

Growth of the sector has not been stable over the last 5 years. There have been periods of decrease, for

example, after the considerable increase of production volumes in 2002. In 2003 they decreased, whereas in 2004 they increased especially fast again – almost by 20%, mainly due to the growth of demand in the CIS countries. Thus, period of increase continued in 2005 and 2006, when the growth accounted for 15.4% and 21.4% respectively. The growth rate of 2007 decreased and it was 2.7% and in the beginning of 2008 production volumes even decreased slightly.

Figure 3.29

Producer Prices and Exports of Chemical Industry



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

The decrease of growth rates and production volumes in 2007 and 2008 was determined mainly by the decrease of demand in the internal market, whereas the volumes of exports continued to increase. In 2007, export substantially increased in all directions – both to

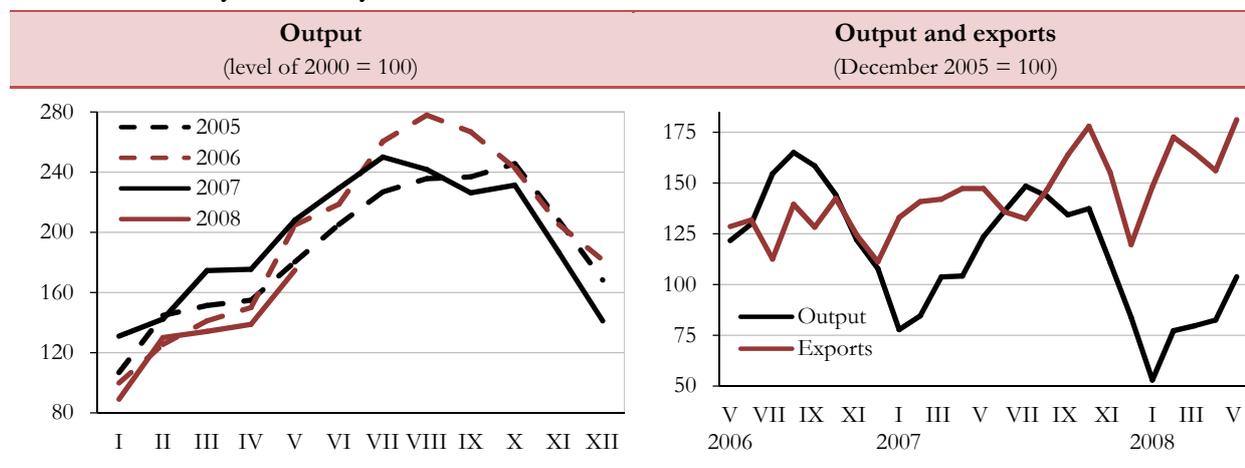
the EU member states and to the CIS countries. In the beginning of 2008, exports increased more rapidly directly to the old EU member states. Producer prices also gradually rise due to slight increase of the domestically sold products.

Manufacture of other non-metallic mineral products (mostly construction materials) depend on

fluctuations of domestic demand to a great extent, mainly in relation to demand for construction materials.

Figure 3.30

Monthly Growth Dynamics of Manufacture of Other Non-Metallic Mineral Products

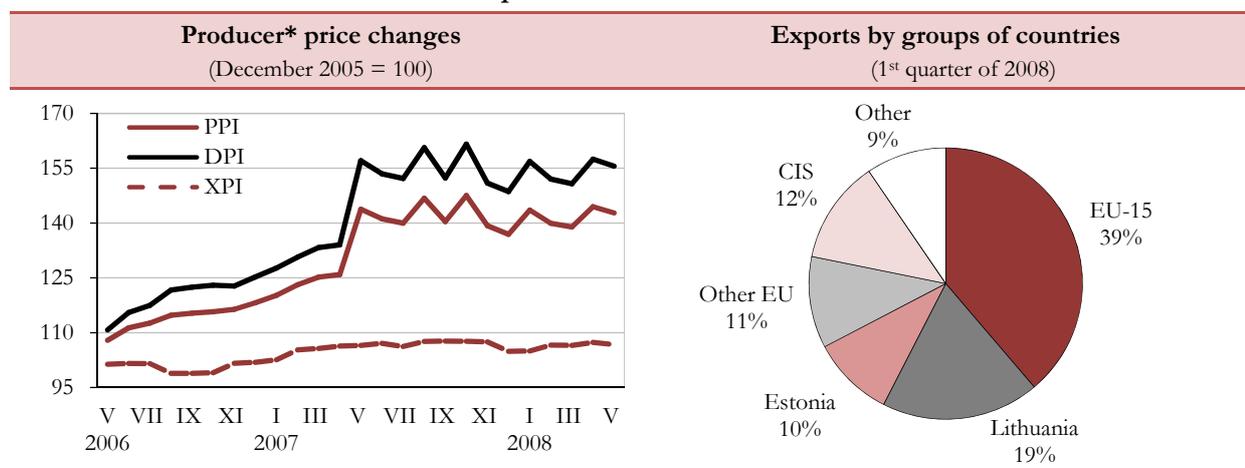


The output volumes of the sector were high in the beginning of 2006 and 2007, but in the middle of 2007 they decreased due to decline of construction of

buildings. Exports remained at a high level. Almost one-fifth of the output is exported.

Figure 3.31

Producer Prices and Exports of Other Non-Metallic Mineral Products



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

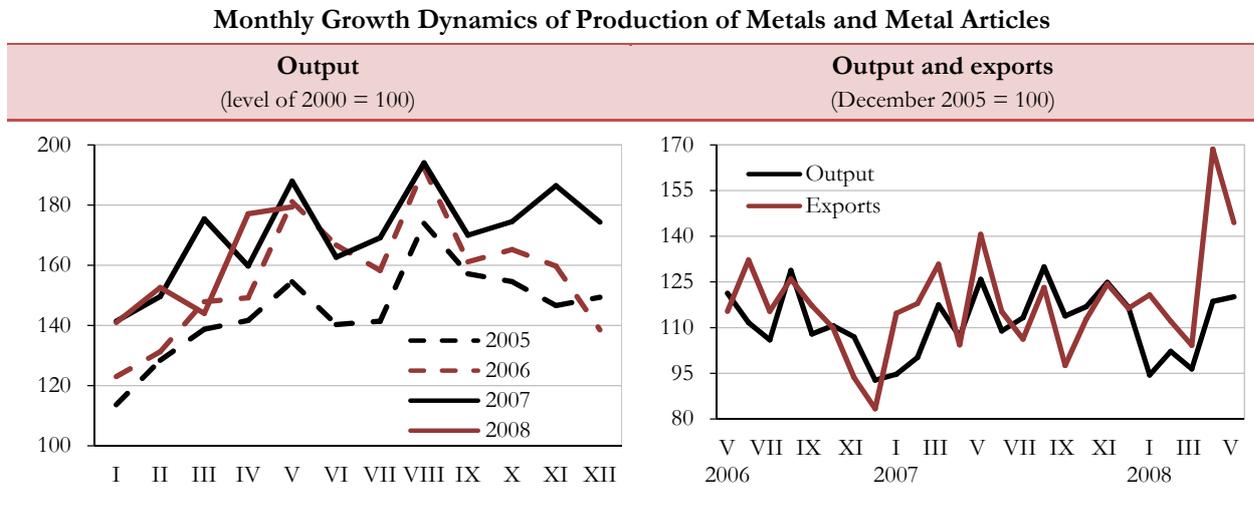
The main trade partners are EU member states. In 2007 and 2008, exports mainly increased to EU-15 countries, Lithuania and CIS countries, but decreased to Estonia.

In order to compensate the rapid wage increase and considering the good conjuncture, the producer prices of the sector rose rapidly in May 2007, but further practically remained unchangeable.

Sectors of *production of metals and metal articles* constitute approximately 8.5% of the total value added of manufacturing. Exports account for 64% of the total sold products of these sectors. Within

the rapid development years of construction, in 2006 and 2007, the domestic market share increased in realisation of products.

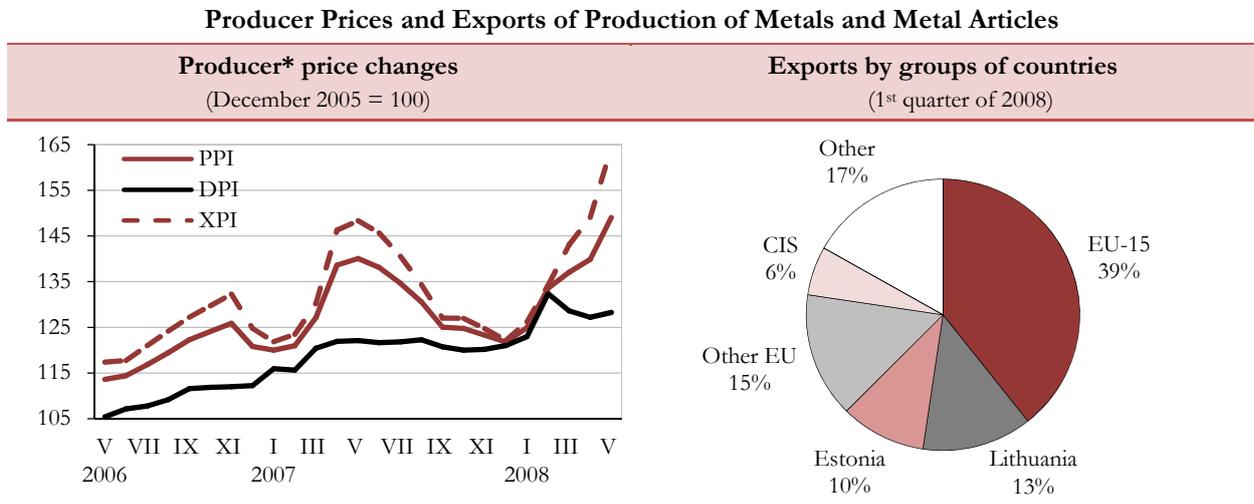
Figure 3.32



Metals and metal articles produced in Latvia are highly competitive around the world. The most export part of the output is exported to EU member states (almost 80% of the exports), besides, nearly a half of the exported products is sold to the old EU member states.

2006 and 2007 were favourable years for the sector, with increased production volumes by 7.7% and 9.1% respectively. In the beginning of 2008 there was a slight decline of production volumes, mainly due to the decrease of domestic demand.

Figure 3.33



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

Producer prices in the sector have substantially increased over the last years both for domestically sold products and exported products and especially rapidly

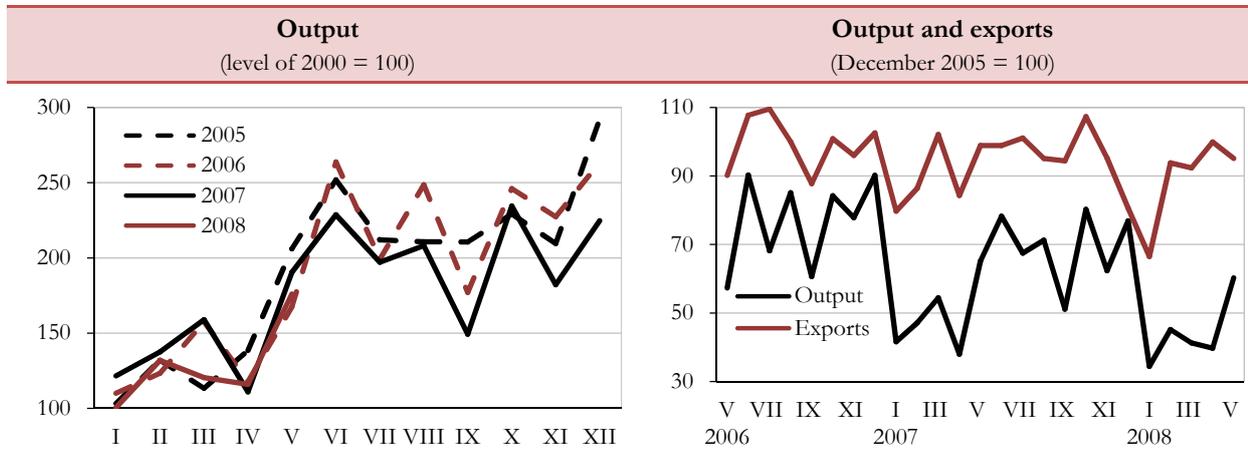
for exported products, which largely allowed to compensate the increase of production costs, including the increase of labour costs.

Production of machinery and equipment was a rapidly growing sector until 2004, i.e., until accession to the EU. Within the period from 2000 to 2004, its

production volumes had almost doubled. That is a typically export-oriented sector, as almost two-thirds of its products are being exported.

Figure 3.34

Monthly Growth Dynamics of Production of Machinery and Equipment



After accession to the EU, its growth was not so rapid, and in 2005 it was only 3.1%, whereas in the beginning of 2006, 2007 and 2008, the production volumes decreased.

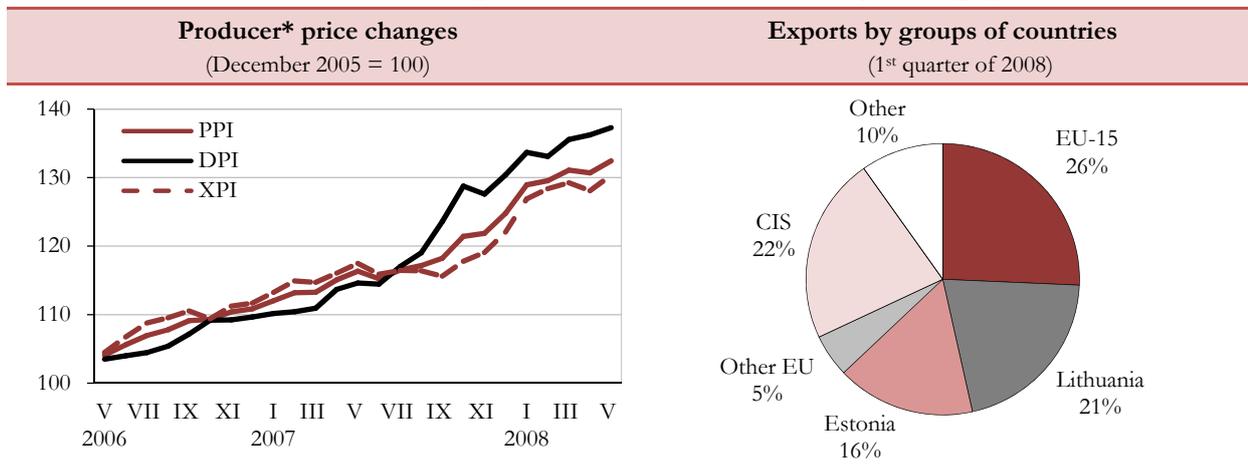
The main sales markets of the sector are EU member states, besides more than a half of the products for exports to the EU are directed to Lithuania and Estonia. A relatively big share of the

sector's exports is related to the markets of CIS and other countries.

Upon increasing of demand in the domestic market, the prices of the domestically sold products have rapidly risen over the last years, whereas the export prices of the output increased at a more moderate pace.

Figure 3.35

Producer Prices and Exports of Production of Machinery and Equipment



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

The main problems of the sector are related to the rapidly growing labour costs, which partially determined gradual decrease of the sector's production volumes. The decrease of domestic

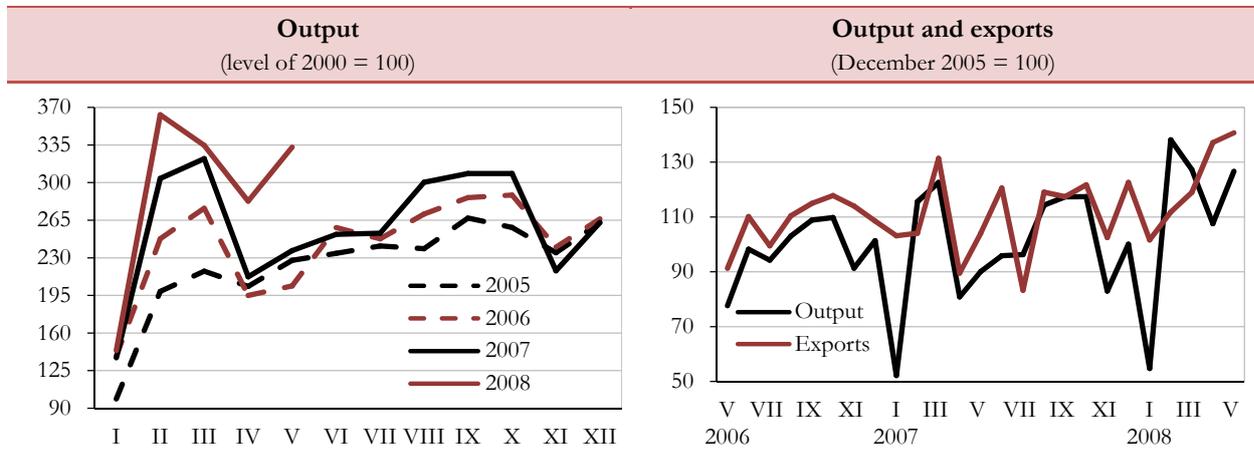
demand had a negative influence on production volumes at the end of 2007 and in the beginning of 2008.

Production of electrical and optical equipment has been developing rapidly over the last years, especially in 2002 and 2003. In 2003, production volumes of the sector exceeded the level of the previous year by 60%. After accession to the

EU, the growth rates decreased but remained on a stable level (6-8% annually). However, the share of the sector within the total value added of manufacturing is still small – 4.6%.

Figure 3.36

Monthly Growth Dynamics of Production of Electrical and Optical Equipment

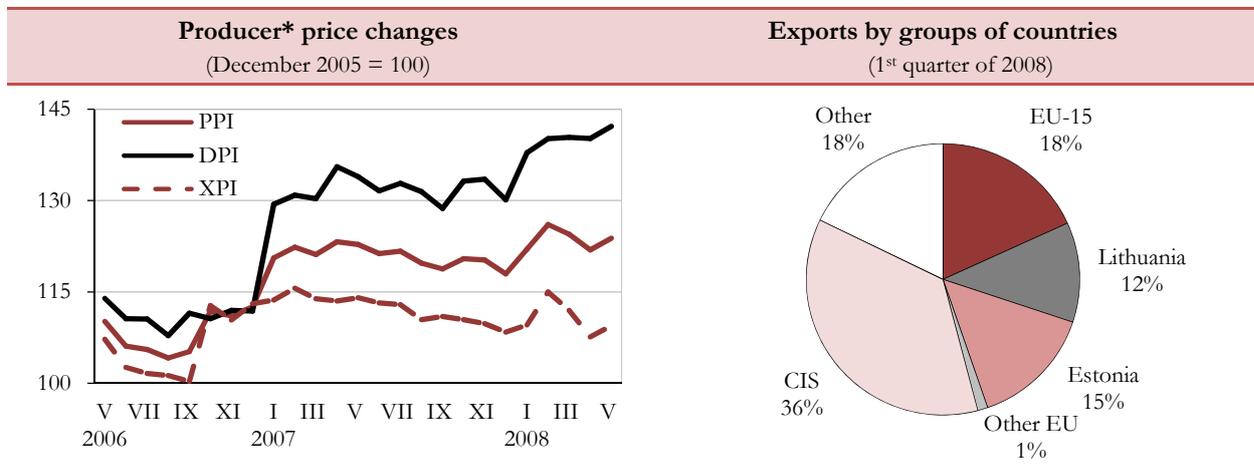


The sector had high growth rates also in the beginning of 2008, despite the decline in domestic demand.

As regards trade of the sector, it has stable trading partners in the CIS countries and Estonia, but exports to developed countries has particularly grown over the last year, including to EU-15 countries.

Figure 3.37

Producer Prices and Exports of Production of Electrical and Optical Equipment



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

The sector exports about two-thirds of its products, besides the domestic market share has increased more rapidly in 2006 and 2007, as well as

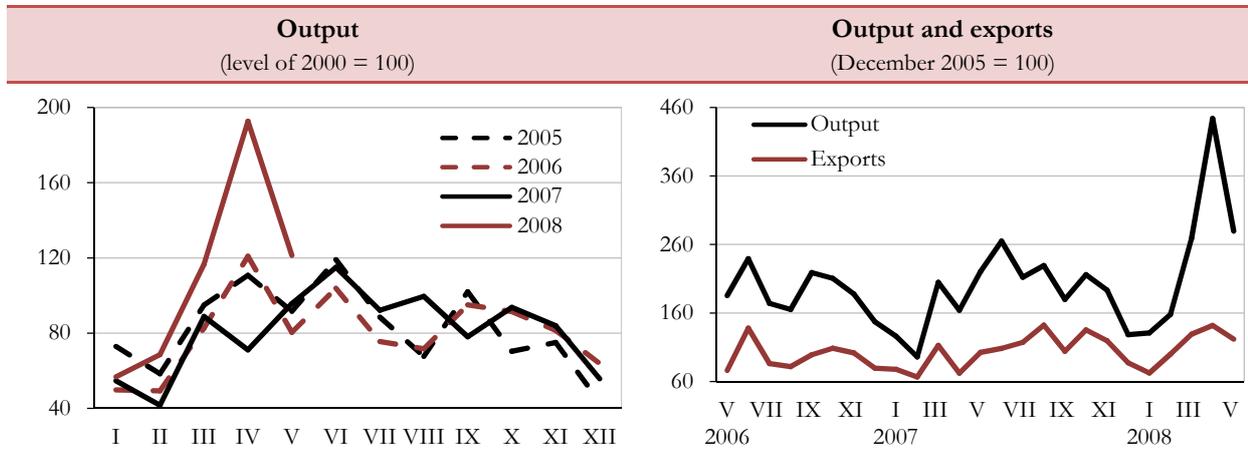
the increase of producer prices for products sold in the domestic market was higher.

Production of transport vehicles is the only manufacturing sector, which has not managed to increase production volumes, and the indices are

lower by almost one-fifth in comparison with 2000. The years of slight growth change with the years of decrease of production volumes.

Figure 3.38

Monthly Growth Dynamics of Production of Transport Vehicles

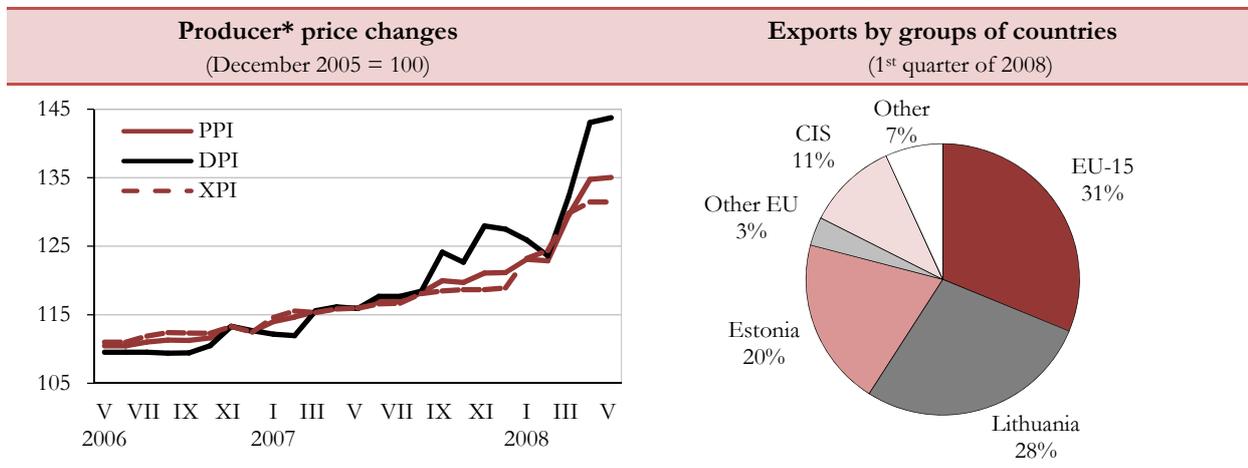


In 2007, production volumes practically remained at the level of the preceding year, whereas in the beginning of 2008 (January-May), the output exceeded the level of the respective period of the previous year for one and half times, due to the fulfilment of big orders.

Majority of products of this sector is being exported. Export markets are distributed rather evenly in various sale directions – both to the EU member states, among them Lithuania and Estonia, and to the CIS countries and other countries of the world.

Figure 3.39

Producer Prices and Exports of Production of Transport Vehicles



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

The share of domestically sold output increases over the years in realization of products, but the prices for domestically sold products and exported products increase almost equally, except in the second half of 2007 and in the beginning of 2008, when the prices of domestically sold output increased more rapidly.

3.3.3. Energy Sector

Both, the imported (natural and liquefied gas, oil products, coal) and local energy resources (wood and

peat) are used in Latvia to provide fuel, electricity and heating to national economy sectors, commercial consumers and population. A section of electricity is generated by Latvian HPPs and CHPs, whereas the rest is imported. Mainly the imported fuels (natural gas and oil) and local fuels (wood) are used in heat generation.

In 2007, the total energy consumption of Latvia was 211.2 PJ, and 63% of this consumption was ensured by imports of energy resources, mostly from Russia: (natural gas comprising – 29%, heavy oil –

2.3%, other oil products – 32.7%, coal – 1.9%. Among local energy resources, wood was used the most (firewood, remainders of woodworking, wood chip, wood briquettes and granules), comprising 23.1% of

the total energy consumption. A part of the electricity generated by Latvian HPPs and wind power stations in the total energy consumption was 4.7 per cent.

Table 3.14

Consumption of Energy Resources in Latvia¹
(thousand tons of equivalent fuel – ktce²)

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|--|-------------|-------------|-------------|-------------|-------------|-------------|
| Energy resource consumption – total | 6226 | 6514 | 6648 | 6770 | 7021 | 7206 |
| of which: | | | | | | |
| natural gas | 2050 | 2138 | 2114 | 2155 | 2233 | 2158 |
| light fuel products and other oil products | 1717 | 1857 | 1950 | 1995 | 2225 | 2442 |
| heavy oil, oil shale | 230 | 166 | 132 | 113 | 77 | 59 |
| firewood, peat, coke and other types of fuel | 1537 | 1655 | 1719 | 1722 | 1725 | 1691 |
| coal | 99 | 90 | 87 | 107 | 116 | 145 |
| electricity (HPPs, wind generators and imported from abroad) | 593 | 608 | 646 | 678 | 645 | 711 |

¹ Source: CSB and the Ministry of Economics.

² 1 ktce = 0.02931 PJ.

Volume of *electricity* generation depends directly on the flow of the Daugava River. Electricity imports from Russia, Estonia and Lithuania also play a rather substantial role in the electricity supply.

In 2007, the state JSC Latvenergo generated 53% of the required electricity, 39% was supplied by other

countries and 8% was purchased from small producers of electricity. In comparison with the preceding year, the electricity consumption has increased by approximately 5 per cent.

Table 3.15

Electricity Supply in Latvia¹
(billion kWh)

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Total electricity supply | 6.323 | 6.608 | 6.786 | 7.053 | 7.399 | 7.771 |
| Electricity generation – total | 3.975 | 3.975 | 4.689 | 4.905 | 4.891 | 4.771 |
| of which: | | | | | | |
| HPPs ² | 2.433 | 2.216 | 3.044 | 3.267 | 2.661 | 2.668 |
| CHPs ³ | 1.238 | 1.363 | 1.225 | 1.278 | 1.740 | 1.452 |
| other CHPs | 0.263 | 0.298 | 0.306 | 0.255 | 0.407 | 0.532 |
| small HPSs | 0.030 | 0.050 | 0.065 | 0.058 | 0.037 | 0.066 |
| wind generators | 0.011 | 0.048 | 0.049 | 0.047 | 0.046 | 0.053 |
| Imports of electricity | 2.348 | 2.633 | 2.097 | 2.148 | 2.508 | 3.000 |

¹ Source: state JSC Latvenergo, Ministry of Economics, CSB (Central Statistical Bureau)

² Daugava cascade and Aiviekste HPP (HPP of state JSC Latvenergo)

³ CHP of state JSC Latvenergo

The consumption structure of the *centralized heat supply* has not changed in the recent years, with central heating comprising 65-70% and hot water supply constituting – 30-35%. Of the total amount of sold heat energy, 2.3% was sold to the industrial sector, 73.4% to households and 24.3% to other consumers.

The biggest consumers of natural gas are CHP's and heat supply enterprises of Latvenergo (56.3%), industrial sector (20.8%), and other consumers – (22.9%). Riga region accounts for 80% of the total natural gas consumption in Latvia. Natural gas is not used in Latgale region, with the exception of cities of

Daugavpils and Rēzekne and the district of Preiļi. In Kurzeme region, natural gas consumption is the biggest in Liepāja and it reaches ~11% (by JSC “Liepājas siltums” and JSC “Liepājas metalurģis”), while in Zemgale region it amounts to 4% (in Jelgava city and Bauska district).

Oil products are used both as the heating fuel and liquid fuel. Prices in the oil product market are liberalised and competitive in regard to other types of heating fuel. Free market principles function in the area of oil product deliveries in Latvia.

Oil products have an important place in Latvian market of energy resources with the market share slightly higher than 30%, including the share of heavy fuel in oil fuel balance constituting up to approximately 2.2%. The biggest consumers of heavy oil are heat supply (65%) and industrial sector (27.5%). Complying with above-mentioned requirements of EU Directive 1999/32/EC, the Cabinet of Ministers has adopted Regulation No. 125 “Regulation on the Limitation of Sulphur Content in Certain Liquid Fuels” on March 2, 2004. It is expected that the heat supply companies that used heavy oil for heat generation will replace this type of fuel with other energy resources.

Solid fuels used in Latvia are coal imported from CIS and local fuels (firewood and peat). The forecast of firewood consumption depends on the extent to which regions will manage to change from the extensive use of firewood to its rational use. In the total fuel consumption, the share of firewood is already rather substantial and has reached 29-30%. The biggest consumers of firewood are households (62.3%), heat supply companies (14.7%), industrial sector (mainly wood processing companies) and other consumers (23%). Firewood and coal are used evenly across all regions of Latvia. Use of peat in the energy sector keeps decreasing.

3.4. Development of Regions

There is a marked difference between Riga and other regions of Latvia in terms of economic activities (see Figure 3.40). Difference between other regions is not so pronounced.

In 2005, the biggest part of Latvian GDP (57.3%) was produced in Riga. The second biggest region by contribution to GDP was Pierīga (vicinity of Rīga) (11.1%).

In 2005, GDP per capita in Riga was by 1.8 times bigger than in the country on average, while this indicator in Latgale amounted to mere 48.5% of the country average.

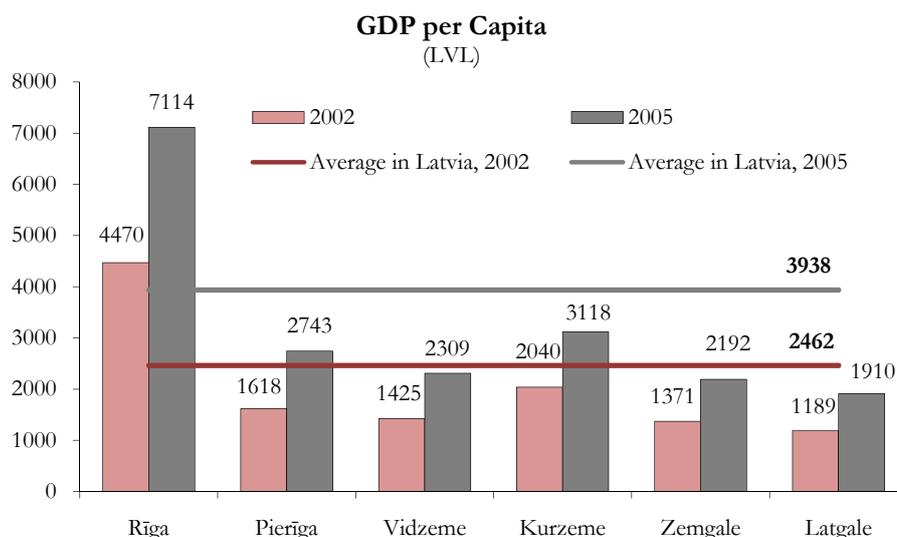
Over the period of 2003-2005, GDP per capita in Pierīga increased faster than in the country on average. The growth was almost equal in Rīga and Vidzeme, but it was unequal in the other regions.

Table 3.16

Area, Population and Population Density of the Statistical Regions of Latvia at the Beginning of 2007

| | Area (% of the total) | Population (% of the total) | Number of inhabitants per km ² |
|---------|-----------------------|-----------------------------|---|
| Latvia | 100 | 100 | 35.3 |
| Rīga | 0.5 | 31.7 | 2 353.4 |
| Pierīga | 15.7 | 16.4 | 36.8 |
| Vidzeme | 23.6 | 10.5 | 15.8 |
| Kurzeme | 21.1 | 13.4 | 22.5 |
| Zemgale | 16.6 | 12.5 | 26.5 |
| Latgale | 22.5 | 15.5 | 24.4 |

Figure 3.40



The number of **active statistical units** (self-employed persons, sole proprietors, commercial companies, agricultural and fishing farms) is growing

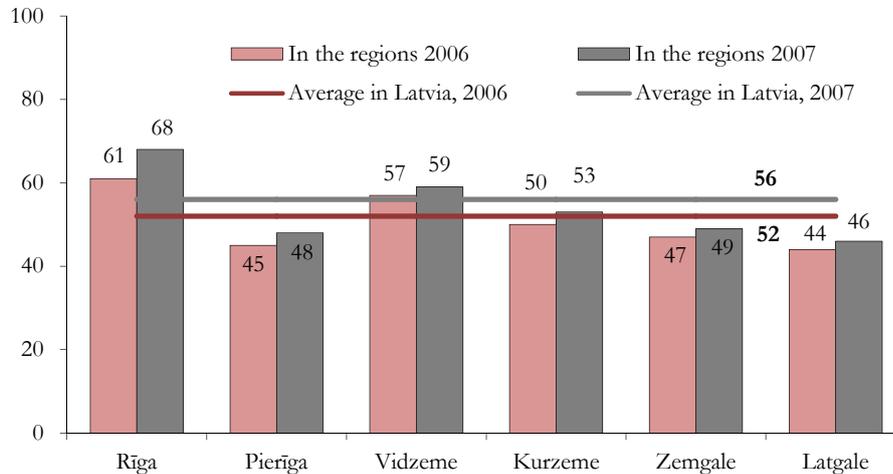
gradually in Latvia. The number of active statistical units per 1000 inhabitants increased by about 4 units in 2007. This indicator is approximately the same in

the regions of Pierīga, Kurzeme, Zemgale, and Latgale, amounting to 46-53 units per 1000 inhabitants. This indicator is above the country average in Rīga and Vidzeme regions, although it should be noted that the level of active statistical units in Vidzeme region is

higher mainly due to the big proportion of agricultural farms and self-employed persons. Contribution of these units to formation of GDP is markedly smaller than contribution of commercial companies.

Figure 3.41

Economically Active Statistical Units* of the Market Sector per 1000 Inhabitants**



* Statistical units of the market sector are: self-employed persons, sole proprietors, commercial companies, agricultural and fishing farms.

** Provisional data for 2007.

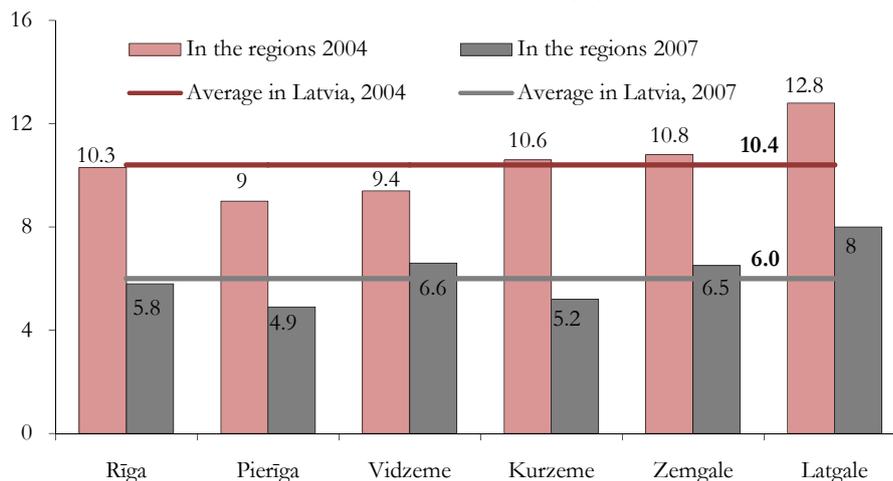
Decline in the number of **unemployed people** was observed in 2007. Demand for labour force increased substantially in the rapidly growing economy since accession to the EU, therefore the unemployment rate fell to a record low level. During

three years, the share of job seekers decreased by 4.4 percentage points to 6% on average in the country (See Figure 3.42). In 2007, the unemployment rate in the regions of Vidzeme, Zemgale and Latgale was higher than the average of the country.

Figure 3.42

Unemployment Rate in 2004-2007

(share of job seekers in % of economically active population aged 15-74)



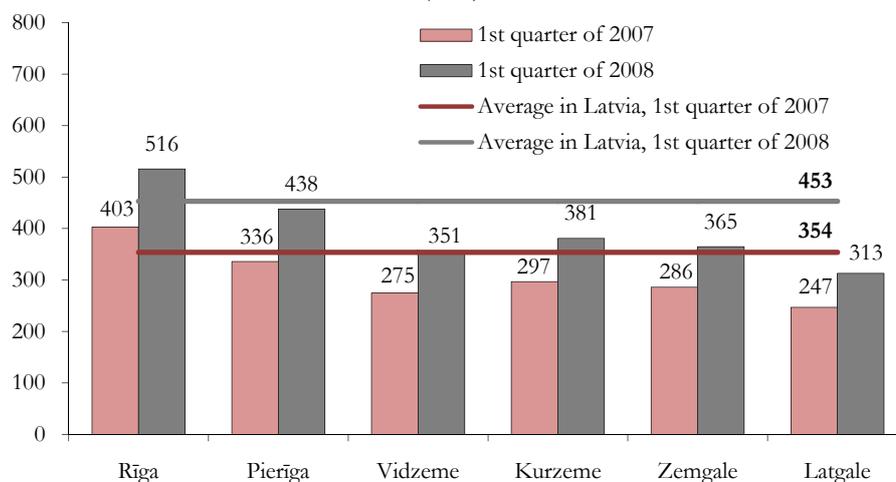
The unemployment rate in the Latgale region remains high in comparison with the other regions. In 2007 it amounted to 8%.

Wages kept growing rapidly in 2007 in all regions. Wages in 2007 were on average by one third higher than in the preceding year in the country. In the 1st

quarter of 2008, high rise of wages still remains in all regions amounting about 28-30% to the 1st quarter of the preceding year. Due to the rapid increase in 2007, the average gross wage has almost doubled over the last three years.

Figure 3.43

Average Monthly Gross Wages of Employed Persons in the 1st Quarter of 2008 (LVL)

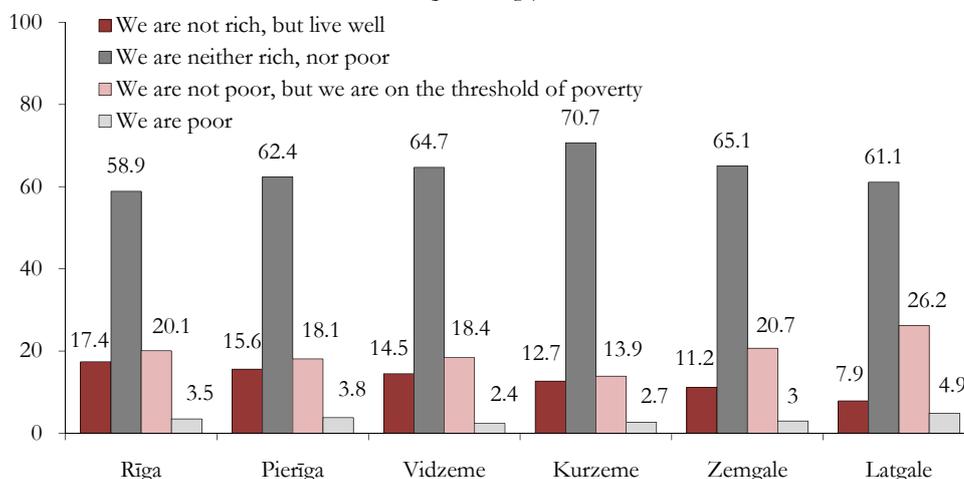


The data of the Household Budget Survey made by the CSB on self-assessment of financial situation of households show that **household self-assessment** is different. Results of the study show that the greatest share of households, which provided the answer “We are not rich, but we live well”, is in Rīga and Pierīga, 17.4% and 15.6% respectively (see Figure 3.44). The

highest share of households expressing the opinion that they are poor or are on the threshold of poverty is in Latgale (31.1%). At the same time, the share of households in Vidzeme, Kurzeme and Zemgale, who consider that “we are neither rich, nor poor”, is considerably higher.

Figure 3.44

Self-Assessment of Financial Situation of Households in Latvian Regions in 2007 (percentage)



3.5. Forecasts

The Ministry of Economics has developed two forecast scenarios of economic development for the medium-term period (until 2013): the slow development scenario and the dynamic development scenario.

These two scenarios are developed in relation to alternatives of further economic growth. The current uncertainty of economic growth is linked with three main conditions that determine development:

- how successfully the economy will overcome those disproportions that formed during the fast growth of previous 3 years (inflation, current account deficit of the balance of payments, fast development of the demand-driven service sectors against stagnation of export-capable sectors);
- significant rise of prices for fuel and food products that hinders decrease of inflation rate

and substantially changes relative prices, as well as influences competitiveness of sectors;

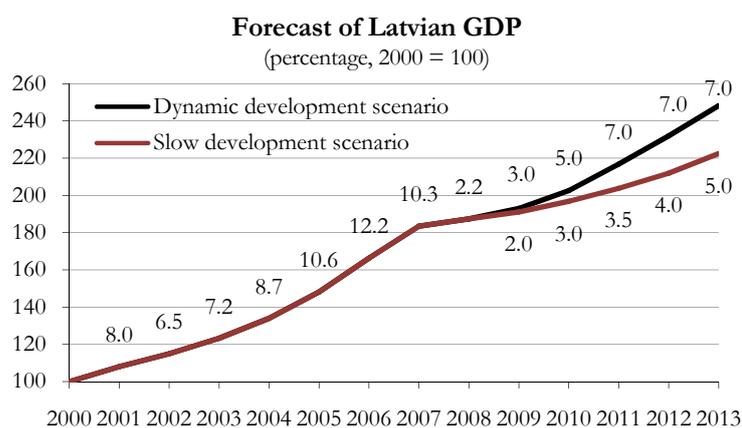
- how processes in international financial markets will affect the capital price and the external demand of Latvia;
- impact of globalisation processes on competitiveness of Latvian industry, which was decreased by the substantial increase of labour costs during the previous years.

The government's policy aimed at reduction of inflation (mainly reduction of the domestic demand), as well as the more cautious policy of commercial banks with regard to mortgage lending will decrease the domestic demand and processes in the international financial markets – external demand, therefore decreasing also the growth rates in 2008 and 2009. The most important issue in this situation is – how deep and long these processes will remain and how much it will be possible to correct them.

Both development scenarios worked out by the Ministry of Economics correspond to moderate and gradual decrease of the domestic demand. The dynamic growth scenario will come true, if Latvian manufacturing regains the growth rates of at least 2004-2006 level, i.e., the decrease of growth of output in the sectors based on cheap labour and natural resources (light industry, wood processing, food industry) will start to compensate with faster growth rates of other sectors, and in the result manufacturing output will increase on the whole.

There is a small probability that the pessimistic development scenario might come true that characterizes with the decline of domestic demand, which would be determined by inability of Latvia to overcome the existing disproportions and long-lasting development of negative processes in the world financial markets. No detailed forecasts are worked out for such growth scenario, because there is a big uncertainty in this case and probability of such development scenario is small, as mentioned above.

Figure 3.45



Development prospects for 2008

GDP growth rate in 2008 may be at the level of 2-2.5%. Decline of the growth rate is mainly due to decrease of growth of the domestic demand (private

consumption and investment), as the growth of construction, trade and commercial service sectors go down in comparison with the fast growth rates in the previous three years.

Table 3.17

Forecast of Latvian GDP by Sectors
(growth in per cent over the previous year)

| | 2007 | 2008 | 2009-2013 * (annual average) |
|-----------------------------------|-------------|------------|---------------------------------|
| Gross domestic product | 10.3 | 2.2 | 3.9 / 6.5 |
| Primary sectors | 8.7 | -1.4 | 3.6 / 4.4 |
| Manufacturing | -0.3 | -1.2 | 2.6 / 6.2 |
| Electricity, gas and water supply | 4.9 | -0.5 | 3.0 / 3.0 |
| Construction | 14.4 | 6.2 | 5.2 / 8.7 |
| Trade, hotels and restaurants | 12.3 | -0.1 | 3.7 / 6.2 |
| Transport and communications | 9.8 | 3.6 | 6.1 / 10.0 |
| Other commercial services | 13.5 | 6.5 | 4.2 / 6.4 |
| Public services | 4.6 | 2.3 | 1.3 / 2.7 |

* slow development scenario in the numerator, dynamic development scenario in the denominator

The growth rates of investment and construction will decrease not so rapidly as crediting, because the increase of road construction and repair volumes will maintain them at a relatively high level.

It is forecasted, that private consumption and investment will increase almost at the same rate as GDP, so in the result so rapid increase of imports is

not expected as it was in the previous years. The volume of imports may even decrease.

Development prospects for 2009-2013

The main risks to growth are associated with events in the international goods and financial markets and with ability of the Latvian economy to adjust to them.

Table 3.18

Forecast of Latvian GDP by Expenditure Category

(per cent, in comparison with the previous year)

| | 2007 | | 2008 | | 2009-2013 * (annual average) | |
|-------------------------------|------------|-------------|------------|-------------|---------------------------------|------------------|
| | structure | growth rate | structure | growth rate | structure (in 2013) | growth rate |
| Gross domestic product | 100 | 10.3 | 100 | 2.2 | 100 | 3.9 / 6.5 |
| Private consumption | 64.8 | 13.9 | 64.2 | 2.1 | 62.9 / 64.4 | 3.5 / 6.7 |
| Public consumption | 18.2 | 4.8 | 19.0 | 2.3 | 15.5 / 14.6 | 1.0 / 2.1 |
| Gross fixed capital formation | 32.5 | 8.4 | 30.8 | 4.2 | 30.6 / 30.8 | 5.2 / 7.6 |
| Changes in inventories | 4.7 | – | -0.2 | – | 0.2 / 0.1 | – |
| Exports | 44.4 | 11.1 | 41.1 | 1.2 | 44.3 / 44.6 | 5.6 / 8.1 |
| Imports | -64.7 | 15.0 | -54.9 | -8.0 | -53.4 / -54.5 | 3.7 / 6.2 |
| Export-import balance | -20.3 | – | -13.8 | – | -9.1 / -9.9 | – |

* slow development scenario in the numerator, dynamic development scenario in the denominator

Two trends that will maintain their importance in foreseeable future have clearly developed in the international financial markets at present, namely, cool-down of the real estate market and decline of access to credit resources. Thus, Latvia has to take into consideration that the period of cheap and easily available foreign capital (determined by a long-lasting cycle of low global interest rates, abundance of liquidity, high risk tolerance of investors and search for profitability) is over, and price of the capital available in the future will be higher than previously. Global growth risks should be also taken into account, and if they come true, Latvia will have to count with much poorer external demand and intensification of price competition in the global product markets. These processes create significant challenges to further development of Latvia. On the one hand, in the case of decreasing domestic demand – export sectors will have to play their role of a driving force for growth in order to ensure healthy economic growth. On the

other hand, the previous competitiveness of industry was based on relatively cheap labour and low general costs, but if growth of labour costs continues in Latvia and the global price competition intensifies, the determinant role will be played by adequate rise of productivity and growth of complexity of export products, which will enable Latvia to compete in the international markets more successfully.

The growth rates may decrease also in 2009, taking into account the decline trends of the external demand. The growth rates may start increasing as from 2010, if Latvian macroeconomic stabilisation policy and the policy for capacity building and promotion of structural improvements of the national economy (especially the increase of capacity in tradable sectors) is sufficiently effective, which will promote competitiveness and growth of manufacturing, as well as export-oriented services (transport services, logistics, etc.).

4. MACROECONOMIC STABILITY

4.1. Public Finances

4.1.1. Fiscal Policy and Public Debt

Latvia implements a fiscal policy directed towards stable macroeconomic growth, simultaneously ensuring a successful fiscal consolidation. In the previous periods, the main task of the fiscal policy defined by the government was the creation of a balanced budget. The goal of the next planning period is to generate a surplus in general government budget.

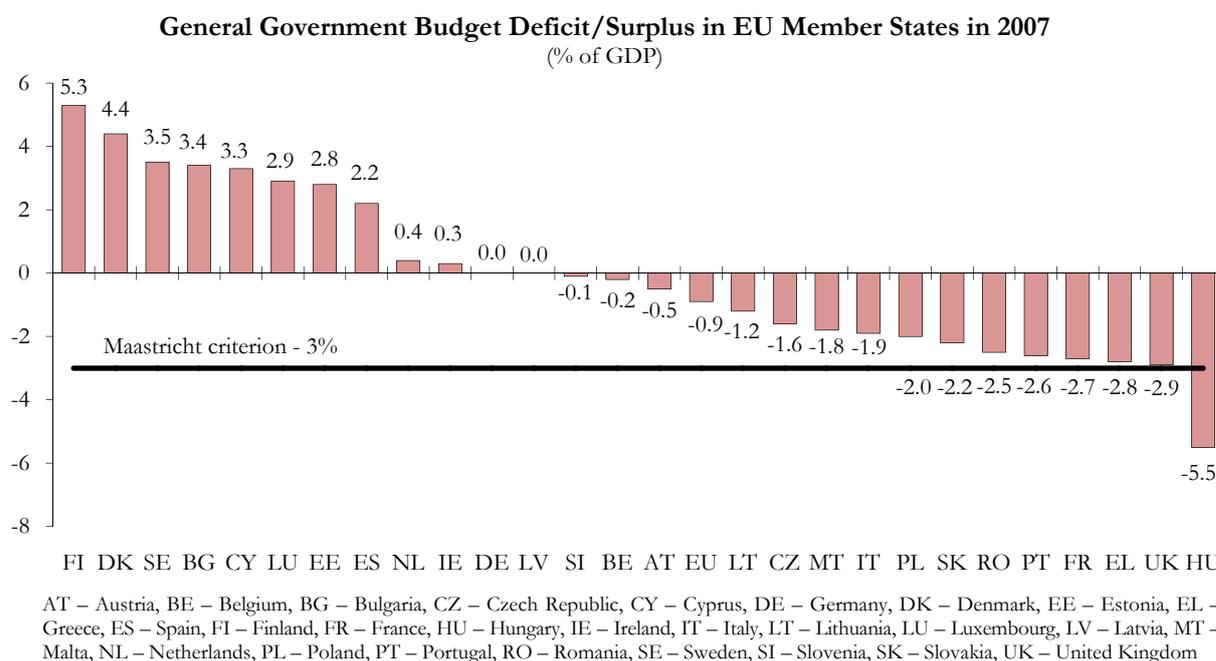
As can be seen in Table 4.1, the deficit of general government¹ in Latvia is lower than 3% of GDP allowed by the Maastricht criterion on budget deficit. General government budget has the tendency to improve: in 2003, the deficit of general government budget was 1.6% of GDP, however, with gradual improvement of financial situation, there was a

budget deficit in the amount of 0.04% of GDP in 2007.

Table 4.1

| General Government Budget | | | | | |
|-------------------------------|--------|--------|--------|--------|--------|
| | 2003 | 2004 | 2005 | 2006 | 2007 |
| Revenues (million LVL) | 2120.2 | 2583.2 | 3191.6 | 4213.0 | 5297.9 |
| (% of GDP) | 33.2 | 34.7 | 35.2 | 37.7 | 38.0 |
| Expenditures (million LVL) | 2223.6 | 2659.6 | 3224.1 | 4237.1 | 5303.6 |
| (% of GDP) | 34.8 | 35.8 | 35.6 | 37.9 | 38.0 |
| Balance (million LVL) | -103.5 | -76.5 | -32.3 | -24.1 | -5.7 |
| (% of GDP) | -1.6 | -1.0 | -0.4 | -0.2 | -0.04 |

Figure 4.1



As displayed in Figure 4.1, the average level of budget deficit of EU member states in 2007 was 0.9% of GDP (1.4% of GDP in 2006 and 2.5% of

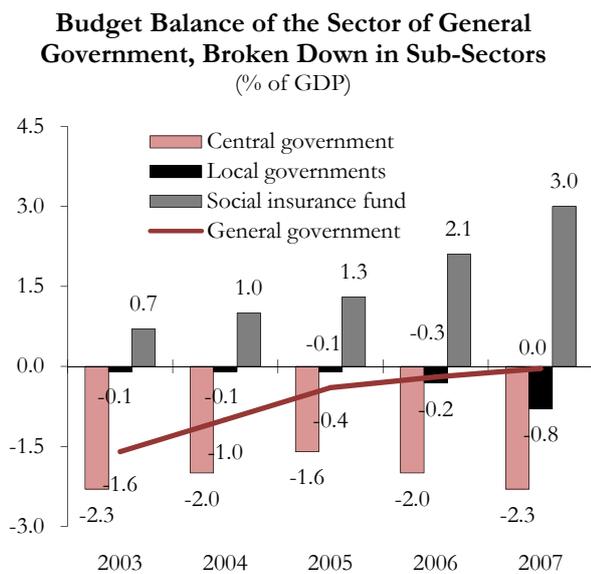
GDP in 2005). All the states that had a budget deficit, except for Belgium, Greece, France, Lithuania, Romania and Great Britain, experienced an improvement of public balance in 2007. The highest general government budget deficit against GDP in 2007 was recorded in Hungary (-5.5%), Great Britain (-2.9%), Greece (-2.8%), France (-2.7%) and Portugal (-2.6%). Eleven EU member states had a surplus of general government budget in 2007. The states with the largest surplus against GDP were

¹ According to the methodology of European System of Accounts ESA 95. Taking into account that EU member states follow the Maastricht criteria regarding government budget deficit and debt, their notification results are used according to the methodology of European System of Accounts ESA 95. The rates calculated by applying such methodology are defined according to the so-called accrual concept. Ministry of Finance calculations of general budget deficit are defined by applying to the cash basis.

Finland (+5.3%), Denmark (+4.4%), Sweden (+3.5%), Bulgaria (+3.4%) and Cyprus (+3.3%).

The deficit of general government budget is mainly determined by the deficit in central government budget that has a tendency to grow (see Table 4.2). The financial situation of social insurance budget has improved significantly over the past years: in 2003, it had a surplus of 0.7% of GDP and in 2007 it has reached already 3% of GDP. The balance of local government budget, however, is significantly influenced by the building of the Southern Bridge in Riga.

Figure 4.2



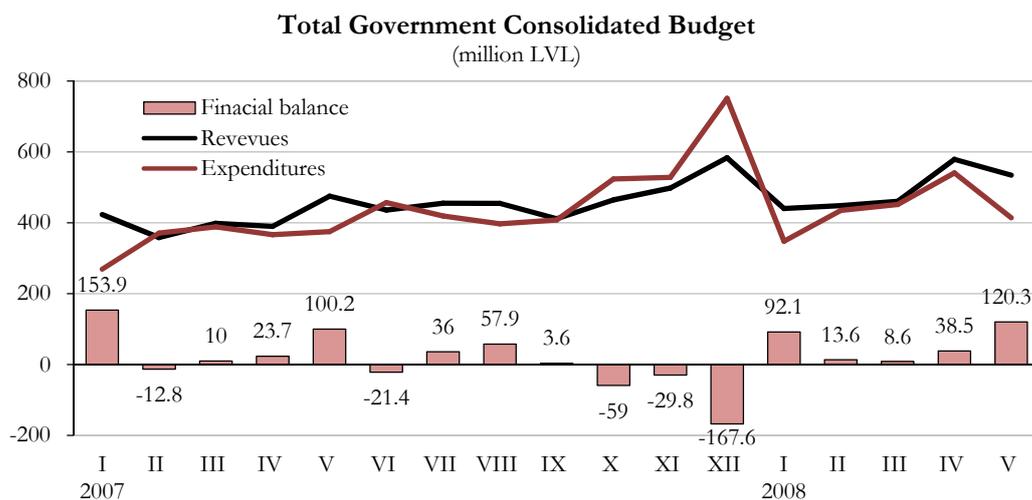
The Saeima has accepted the **budget for 2008** with a surplus of LVL 163 million, which is 1% of GDP. The budget for the following years is also planned with a surplus – 1.2% of GDP in 2009 and 1.5% of GDP in 2010.

The government budget for 2008 is developed as an accrual budget that limits the expenses up to the maximum, freezes growth of wages in public institutions along with the limiting the increase of workplaces. In order to limit the rapid growth of wages for those employed in the public sector, the Cabinet of Ministers decided on September 25, 2007 not to increase the wage fund for public institutions in 2008, except for those, where employees' wage is lower than the average wage in the public institutions (LVL 400 per month). This exception also includes teachers, medical workers, cultural workers and public (civil) servants of special ranks.

In the first quarter of 2008, the surplus of total consolidated budget was LVL 114.3 million, i.e., at 3.3% of GDP, which is by 2 percentage points less than in the first quarter of 2007. The surplus of total consolidated budget in 2008 was LVL 152.7 million.

The local government budgets are in a better situation than the government budget, since LVL 149.1 million surplus of the total consolidated budget is formed by the surplus of consolidated budget of local governments.

Figure 4.3



After taking into account the macroeconomic situation in the country and estimating budget revenue forecasts for 2008, the Cabinet of Ministers has accepted "Amendments to the Law on Government Budget for 2008". These amendments should provide a surplus of 0.05% of GDP. To ensure the surplus of government budget, the ministries and other central government institutions have prepared the suggestions

about reducing the budget expenditures by 5.91% from the total sum of expenditures. The reduction includes budgetary program and sub-program expenditures for implementation of EU policy instruments and other foreign financial aid joint-financed projects, social allowances and pensions, interest rate payments, current payments into European Community budget, funds for unforeseen

circumstances, as well as expenditures from paid services and other personal revenues, transfers and other expenditures indicated in information. The reduction will involve the current expenditures that include compensation of expenditures, goods and services, subsidiaries and grants, and expenditures for creating the basic capital, paying special attention to vacant workplaces and transforming and optimizing the expenditures for government purchases.

A new fiscal policy tool has been introduced in 2008 called **long-term stabilization reserve**, the purpose of which is to:

- reduce general economic risks;
- provide financing for long-term investments and structural reforms;
- help to avoid a socio-economic crisis or reduce it;
- provide funds for unforeseen circumstances.

It is foreseen that the reserve includes government budget revenues that exceed the annual revenues defined by the Law on Budget and privatisation

revenues. The Cabinet of Ministers decides on the method for use of funds of such reserve, upon a suggestion by the Ministry of Finance.

According to the Order No. 220 of the Cabinet of Ministers of April 22, 2008 on establishment of a long-term stabilization reserve “Program of Using the Means of State Property Privatisation Fund for 2008”, it is planned to take LVL 20.6 million from the State Property Privatisation Fund in 2008. The balance of an account opened at the Bank of Latvia to create a long-term stabilization reserve by July 19, 2008 is equalled to LVL 7 million. The Treasury places long-term stabilization funds into the Bank of Latvia, transferring the interest revenues from the arrangement of funds to a long-term stabilization reserve account.

In order to increase the efficiency of budget spending, the medium-term budget planning and strategic planning at ministries have been gradually introduced (see Box 4.1). Thus, the formation of budget is based on the goal of current policy and financing of the result.

Box 4.1

Medium-term budget planning

At the meeting of August 22, 2006, the Cabinet of Ministers has approved a concept project “*On Inclusion of Strategic Planning and Medium-Term Budget Planning in the Public Administration*”. The concept states that starting from 2008 the introduction of government budget medium-term planning will take place, which will provide the preparation of the medium-term budget framework formed and determined by the Law on Budget for one year and by the maximum permitted amount of expenditures for two years arranged to ministries.

Medium-term budget planning provides the definition of government budget expenditures priorities. Such priorities for the three upcoming years defined in the Cabinet of Ministers Order No. 157 of March 21, 2007 “*On Medium-Term Budget Planning and Priority Directions of Development from 2008 to 2010*”. It is defined that the budget aim for the period of 2008-2010 is to achieve the goals set by the National Development Plan of Latvia, such as:

- establishment of knowledge-based society;
- balanced economic development;
- provision of health, spiritual, and social needs of an individual;
- long-term development of the state.

To ensure that the funds of government budget are used rationally and accordingly to the established goals, the Ministry of Finance in cooperation with the State Chancellery has prepared a project “*The Guidelines on the System of Result and Indicators*”, approved by the government on June 17, 2008. The System of Result and Indicators provide a possibility to measure and estimate the degree of achieving the goal and, if necessary, to correct actions (by increasing and decreasing investments) in order to meet the needs of society as much as possible. This system provides supportive information for informing the government about feasibility of policy financing amount, ensures the provision of objective information about the necessary investments and revenues received. Results and resulting indexes provide an understanding about the quality of public services provided by public administration institutions and the amount of the services provided.

The Guidelines introduce two new policy estimation stages: preliminary estimation and post estimation. Public administration institutions carry out a preliminary estimation of a policy during the development of a policy-planning document and post estimation of the policy after implementation of the policy-planning document.

In order to improve the **tax policy** of Latvia and stimulate the economic development, it is planned to develop *The Guidelines on the System of Taxes and Fees*, involving such international experts and institutions as *International Monetary Fund* and applying to the analysis of existing tax systems, as well as taking into account the international experience.

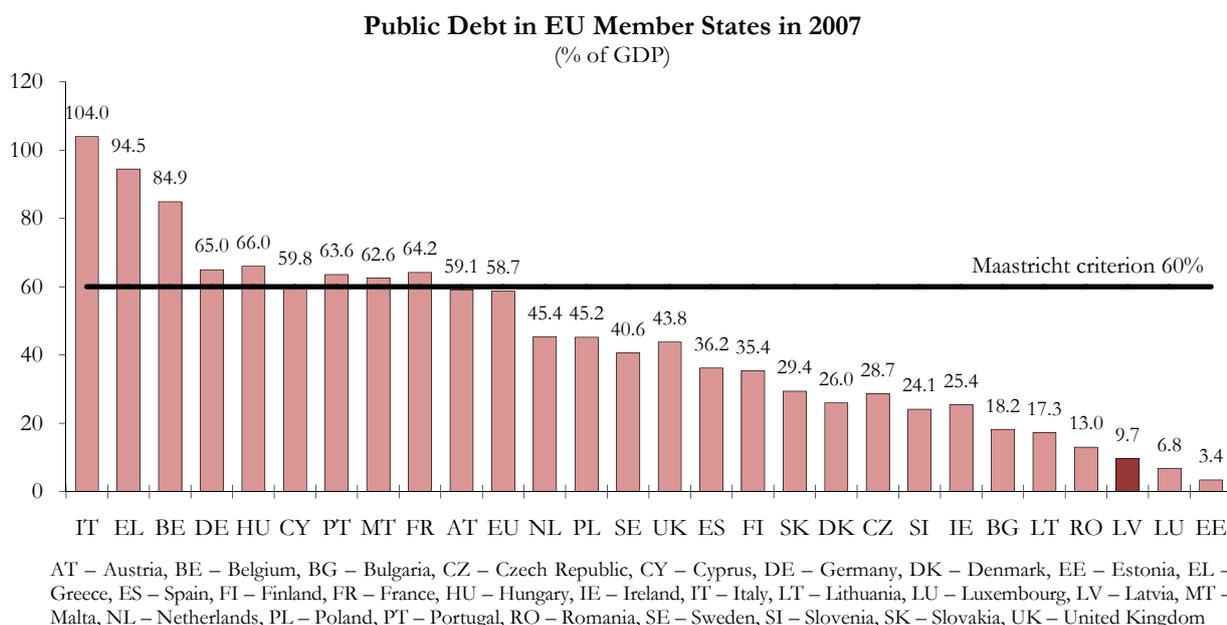
In order to support the government structural policy, it is planned to introduce significant amendments to the existing tax policy regulations. They include:

- alleviation of taxes from investments. The amendments for the “Law on Corporate Income Tax” are being developed in order to stimulate re-investment. The amendments are to be submitted to the government in the third quarter of 2008 as a part of 2009 budget legislative project;

- new edition of the Law on Personal Income Tax that defines a well-thought and fair taxation of the income gained from capital. A new edition of the Personal Income Tax will be developed in the fourth quarter of 2008, by extending the tax base that includes the income gained from capital;
- increase of the untaxed minimum in order to provide the possibility for residents with low income to increase their net income while keeping the labour costs of the employer on the previous level.

The level of **public debt** (according to the methodology of European System of Accounts ESA 95) in Latvia is one of the three lowest in the EU (see Figure 4.4). The average level of public debt in EU in 2007 was 58.7% of GDP (61.2% of GDP in 2006, 62.6% of GDP in 2005). Eight EU member states had public debt exceeding the Maastricht criterion of 60% of GDP in 2007. The highest public debt against GDP in 2007 was observed in Italy (104%), Greece (94.5%), Belgium (84.9%), but the smallest one – in Estonia (3.4%), Luxembourg (6.8%) and Latvia (9.7%).

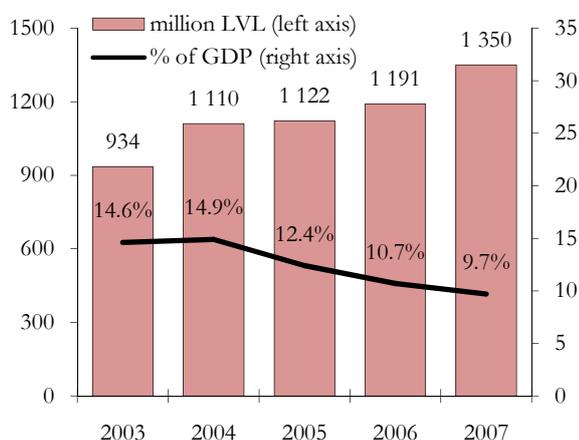
Figure 4.4



In the past years, public debt in Latvia increased from LVL 934 million at the end of 2003 to LVL 1350 million at the end of 2007. However, in relation to GDP it has decreased respectively from 14.6% to 9.7% of GDP (see figure 4.5.)

Figure 4.5

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



The fiscal policy implemented in Latvia is directed towards creation of surplus in the government budget and therefore it is expected that the level of public debt will stay considerably below the Maastricht criterion on public debt (60% of GDP) during the medium-term.

To finance budget performance and re-finance debt, the resources are attracted from internal and external capital markets by using different financial instruments.

The issue of Eurobonds¹ is an effective financial instrument for attracting large amount of resources by increasing the existing issued volumes or by issuing the new ones. On February 29, 2008, Latvia has issued Eurobonds in the amount of EUR 400 million with the date of maturity of 2018.

Taking into account the forecast for general government budget as the basis and assuming that debt bonds are repaid, it is possible, that public debt will have a falling tendency in relation to GDP during the medium-term and will decrease to approximately 6% of GDP by 2010. Thus, by assuming that local

¹ Up to now, Latvia has issued Eurobonds on the international capital market in 1999, 2001 and 2004. In 2004, Latvia issued the largest amount of Eurobonds so far, EUR 400 million with a longer repayment period (10 years).

government's debt outside the Treasury will keep its current development trend and will not generate a significant growth during the medium-term, it is expected that the government's and local government's debt will keep the same tendency during the medium-term and will not exceed the rate of 7% of GDP in 2010.

4.1.2. Budget Revenues

The general revenues of total consolidated government budget in 2007 were LVL 5350.1 million, which is by 33.2% more than in 2006. The general revenues for the period of five months of 2008 were LVL 2463.2 million, which exceeds the level of the respective period of the previous year by 20.4% despite the decrease in the growth of economy.

Table 4.2

| Budget Revenues* (% of GDP) | | | | |
|---|-------------|-------------|-------------|------------------------------------|
| | 2005 | 2006 | 2007 | 1 st quarter of 2008 |
| General government sector revenues | 35.3 | 35.9 | 38.3 | 39.3 |
| I Tax revenues | 28.1 | 29.5 | 31.3 | 33.0 |
| 1. Indirect taxes | 11.2 | 11.8 | 12.0 | 12.7 |
| – value added tax | 7.5 | 8.3 | 8.6 | 8.8 |
| – excise tax | 3.5 | 3.3 | 3.2 | 3.7 |
| – customs duties | 0.2 | 0.2 | 0.2 | 0.2 |
| 2. Income taxes and property taxes | 8.3 | 8.8 | 9.8 | 9.9 |
| – corporate income tax | 2.0 | 2.3 | 2.9 | 2.6 |
| – personal income tax | 5.6 | 5.9 | 6.4 | 6.9 |
| – real estate tax | 0.7 | 0.6 | 0.5 | 0.3 |
| 3. Social security contributions | 8.3 | 8.6 | 9.1 | 10.0 |
| 4. Other taxes | 0.3 | 0.3 | 0.4 | 0.4 |
| II Non-tax revenues | 7.2 | 6.4 | 7.0 | 6.3 |

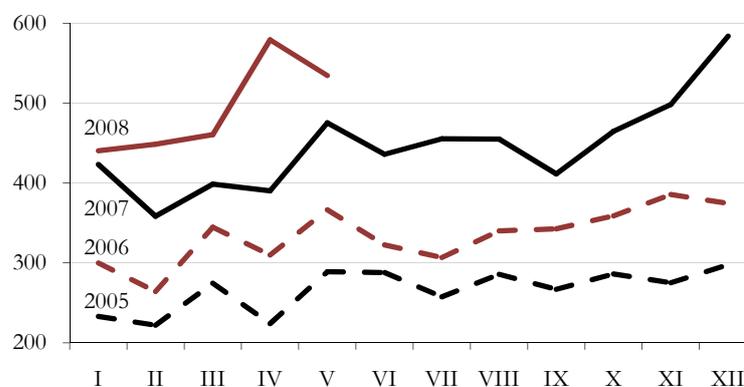
* according to the official data of the Treasury

The tax revenues in 2007 amounted to LVL 4363 million, exceeding the tax collection of 2006 by 32.3%. The growth of tax revenues has been ensured in the most essential way by increasing the collection of value added tax (contribution to the general tax collection by

8.2%) and by increasing social security contributions (by 7.9%) along with the revenues from personal income tax. The main factor determining the rapid growth of tax revenues was the growing domestic demand, inflation and the rise of wages.

Figure 4.6

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



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

The growth pace of tax revenues has slowed down in 2008. The general tax revenues for the period from January to May of 2008 were higher by 16.9% than in

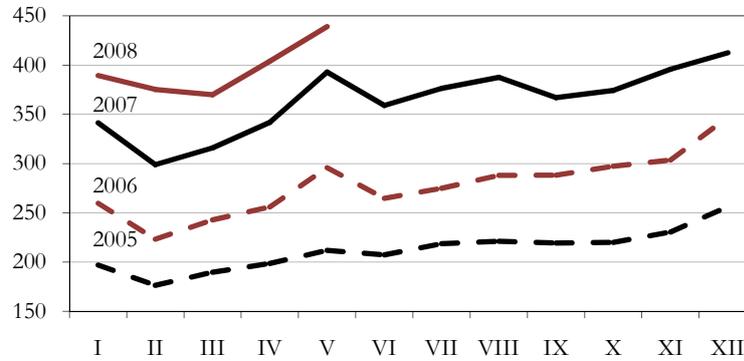
the respective period of the previous year. However, not all the tax groups experienced an equal increase. The value added tax that makes up the largest part of

the total budget revenues has experienced only a slight increase – by 5.4%. Such relatively low increase of value added tax revenues occurred due to rapid

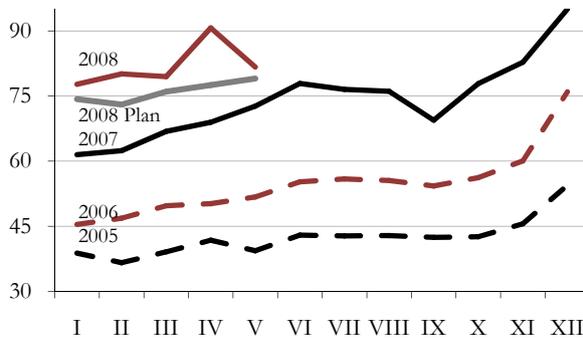
decrease in the growth rate of private and public consumption and due to retail turnover decrease at the beginning of the year.

Figure 4.7

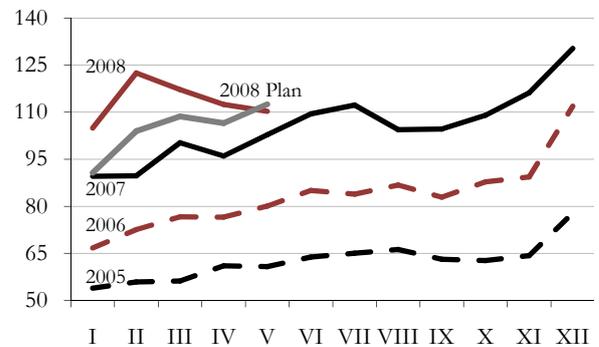
Tax Revenues by Months*
(million LVL)



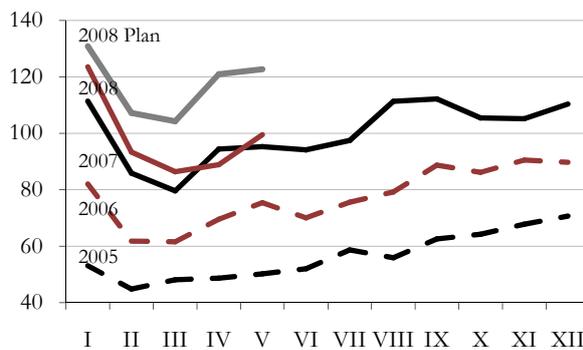
Personal Income Tax



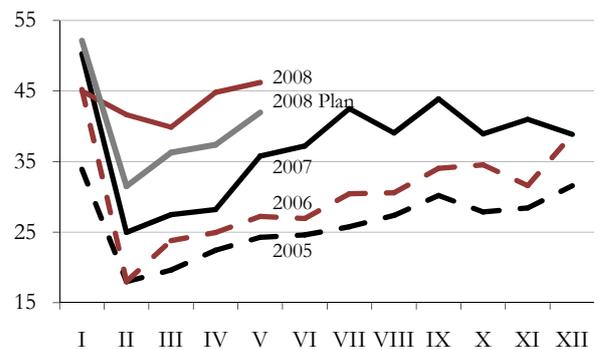
State Social Security Contributions
(without state-funded pension scheme assets)



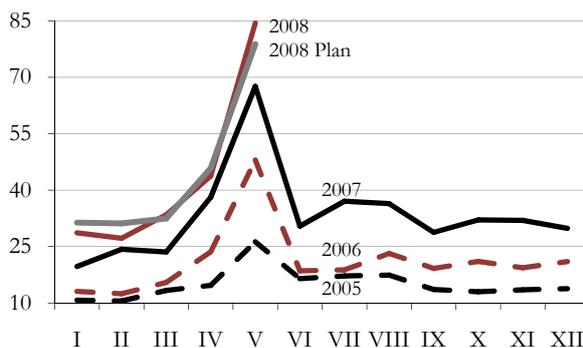
Value Added Tax



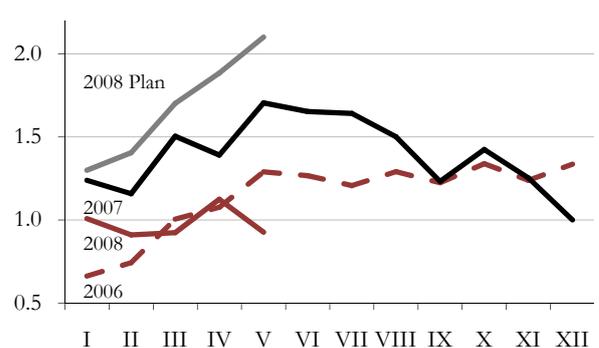
Excise Tax



Corporate Income Tax



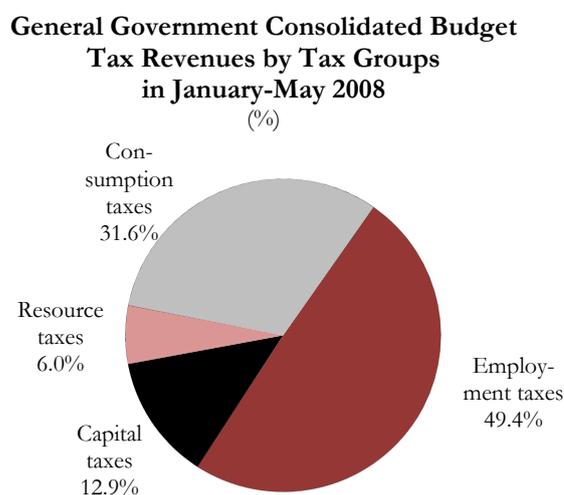
Real Estate Tax



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

Employment-related taxes (social security contributions and personal income tax) make up almost a half of the collected tax. A rapid collection's increase of employment-related taxes (by 33.3% in 2007 and by 20.5% for the period of five months of 2008) was caused by significant increase of wages and the number of employed.

Figure 4.8



The second biggest tax group is the group of consumption taxes (value added tax, customs duties, excise tax for alcohol, tobacco, non-alcoholic beverages and coffee, as well as taxes for automobiles and motorcycles). The percentage of this tax in the tax structure has reduced almost by 2 percentage points in comparison with 2007.

In 2007, still growing domestic demand together with high inflation were the main factors stimulating the growth of consumption taxes. With decrease of economic activity in 2008, however, the growth of consumption tax collections has slowed down as well. In 2007, the amount of the collected value added taxes was LVL 1202.9 million, which exceeded the collection of 2006 by 29.3%. As for 2008, the amount of collected value added taxes reached LVL 491.7 million, which exceeded the revenues received in the respective period of the previous year by merely 5.4% and the value added tax amount by 16.1% less than the amount expected at the beginning of the year.

Growth of the revenues from the excise tax, which is a part of consumption tax, by 51.9% in the beginning of the year just like in 2007 was influenced by the increase of excise tax rate, especially for tobacco products.

The revenues from motorcycles and automobiles have increased very rapidly during the previous years. However, the fall of activity in the market of new and used automobiles slowed down the growth of tax revenues. They have only increased by 22.1% in 2007 in comparison with the previous year. As for the period from January to May of 2008, they have reduced by 30% in comparison to with the respective period of the previous year.

Capital tax group includes corporate income tax and real estate tax. In 2007, the rapid growth of revenues from corporate income tax, which was characteristic for the last years, remained the same (the amount of tax collected is LVL 399.8 million, which is by 57.5% higher than the amount of 2006). In spite of general economic tendencies, the corporate income tax has also grown relatively rapidly during five months of 2008 (by 25.5%).

On the contrary, the revenues from the real estate tax, despite the great activity in the real estate market during the previous years, were LVL 74.2 million in 2007, which is only by 11.9% higher than in 2006. As for the period from January to May 2008, the tax revenues remained on the level of the previous year on the whole (increase by 0.3%).

Resource tax group includes excise tax for oil products, natural resources tax and electric energy tax. The share of this tax in the total tax revenues continued to decrease for the past year.

The amount of collected excise tax related to oil products was LVL 114.1 million for the period of five months, exceeding the amount of the previous year by 15.7%. It was mainly encouraged by the growth of price for oil products and the rate of excise tax.

The rest of the resource taxes have a very small share in the total tax collection. The amount of collected natural resources tax for the period from January to May 2008 was LVL 4.9 million, which is by 3.3% less in comparison with the respective period of 2007.

4.1.3. Budget Expenditures

The amount of government consolidation budget expenditures for the period of 5 months of 2008 was LVL 2190.1 million, exceeding the level of the respective period of the previous year by 23.7%. The amount of government consolidation budget in 2007 was LVL 5255.4 million (37.7% of GDP), which grew by 29.1% in comparison with the expenditures of the previous year.

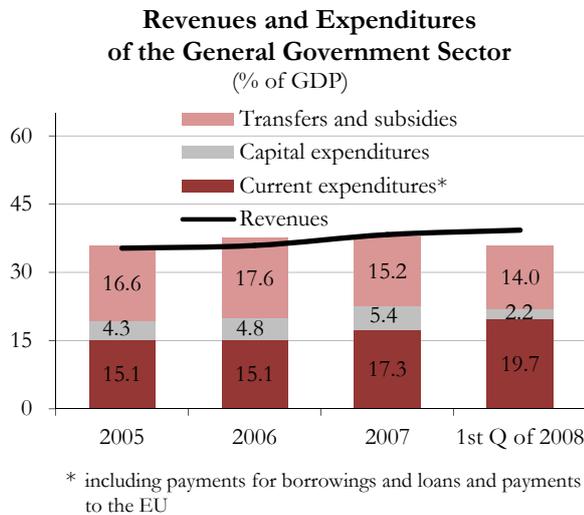
The surplus of government consolidation budget was 3.3% of GDP in the first quarter of 2008, which was by 2 percentage points less than in the respective period of 2007.

The surplus of consolidated general budget during the first five months of 2008 was LVL 273 million. Local government budget is currently in a better situation compared to the government budget, as LVL 149.1 million of the consolidated general budget surplus represent the surplus of local government consolidated budget surplus.

The highest share of government expenditures for the period from January to May 2008 was maintained by the current expenditures – 57% and by transfers to the private sector – 37%. As for the capital expenditures, those amounted only to 7% or LVL 179.9 million. If comparing with the respective period

of 2007, the current expenditures have grown by 39.1%, the transfers to private sector – by 21.6% and capital expenditures – by 18.7%.

Figure 4.9



The highest share of general expenditures regarding government functions for the period from January to May of 2008 belonged to education

(22.7%), social security (21.5%) and general government services (15.3%). The fastest increase was observed in management of municipal areas and housing (by 105.3%), environmental protection (by 56.7%), defence (by 50.7%), recreation, culture and religion (by 42.6%), as well as in education (by 49.4%).

Figure 4.10

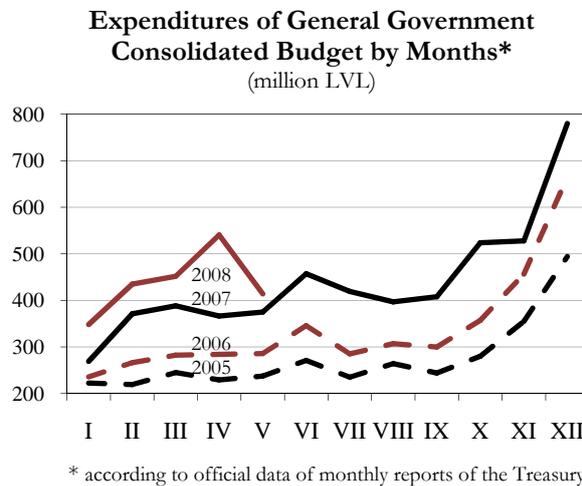


Table 4.3

Expenditures of the General Government Sector by its Functions* (percentage)

| | 2007 | | 1st quarter of 2008 | |
|---|------------|-------------|---------------------|-------------|
| | structure | of GDP | structure | of GDP |
| Expenditures – total | 100 | 38.5 | 100 | 36.0 |
| General government services | 14.1 | 5.4 | 16.3 | 5.9 |
| Defence | 3.7 | 1.4 | 3.0 | 1.1 |
| Public order and safety | 6.2 | 2.4 | 5.5 | 2.0 |
| Economic activity | 16.6 | 6.4 | 16.6 | 6.0 |
| Environmental protection | 2.4 | 0.9 | 1.4 | 0.5 |
| Management of municipal areas and housing | 3.7 | 1.4 | 2.4 | 0.8 |
| Health | 8.8 | 3.4 | 7.6 | 2.7 |
| Recreation, culture, and religion | 4.2 | 1.6 | 3.8 | 1.4 |
| Education | 19.8 | 7.6 | 20.7 | 7.5 |
| Social security | 20.6 | 7.9 | 22.8 | 8.2 |

* according to the official data of the Treasury

According to the expenditure classification of the economic categories for financing the government fixed budget expenditures, the highest share in 2008 is foreseen for maintenance expenditures. More than a half of the current expenditures are planned to be directed towards remuneration for employment. In comparison with 2007, it is planned to increase the expenditures by 16.6% or LVL 128.3 million in 2008. The growth is expected to achieve the following:

- Increase of minimum monthly wage from LVL 120 to LVL 160 starting from January 1, 2008;
- Increase of wages in public administration institutions with the average wage lower than

the average wage set in the public administration institutions (LVL 400 per month);

- Wage increase by 10% for public (civil) servants of special ranks, teachers, cultural workers, judges, juridical workers, etc.

The second most important expenditure position of maintenance expenditures are subsidies, grants and social benefits with LVL 1535.5 million or 40.6% from prescribed maintenance expenditures. This amount has increased in comparison with 2007. A significant increase is made by the expenditures for health care, expenditures for co-financed projects of EU Structural

Funds and Cohesion Fund and expenditures for government social benefits, etc.

Public demand is formed by the government expenditures or the public services, the cost of which is determined by the amount of the provided public

services and public investments, which are the capital investments from budget funds. Public demand makes up approximately one fifth of the aggregate domestic demand.

Table 4.4

| | % of GDP | | | | Growth over the previous year (%) | | | |
|--------------------------------------|-------------|-------------|-------------|-------------|-----------------------------------|-------------|-------------|-------------|
| | 2004 | 2005 | 2006 | 2007 | 2004 | 2005 | 2006 | 2007 |
| Public demand | 22.6 | 20.8 | 21.3 | 23.9 | 7.6 | 5.9 | 13.5 | 12.4 |
| <i>Public consumption</i> | <i>19.5</i> | <i>17.4</i> | <i>16.6</i> | <i>18.2</i> | <i>2.1</i> | <i>2.7</i> | <i>4.6</i> | <i>4.8</i> |
| – central government* | 11.2 | 10.6 | 9.5 | 10.7 | -3.0 | 9.6 | -2.2 | 7.9 |
| – local governments | 8.4 | 6.8 | 7.1 | 7.5 | 9.8 | -6.6 | 15.3 | 0.8 |
| <i>Gross fixed capital formation</i> | <i>3.1</i> | <i>3.4</i> | <i>4.7</i> | <i>5.7</i> | <i>43.9</i> | <i>21.2</i> | <i>49.1</i> | <i>33.7</i> |
| – central government | 1.7 | 2.1 | 3.1 | 2.7 | 59.2 | 38.0 | 57.0 | -4.4 |
| – local governments | 1.4 | 1.3 | 1.6 | 3.0 | 28.8 | 0.6 | 35.6 | 108.1 |

* Central government including social insurance funds

The amount of public services is growing slower than GDP and domestic demand. Public demand has grown by 13.5% in 2007, but the average growth from 2004 to 2007 was 10.6%. Due to utilization of EU

structural funds, the public sector expenditures for gross fixed capital formation have increased and since 2004 were 34.2% each year.

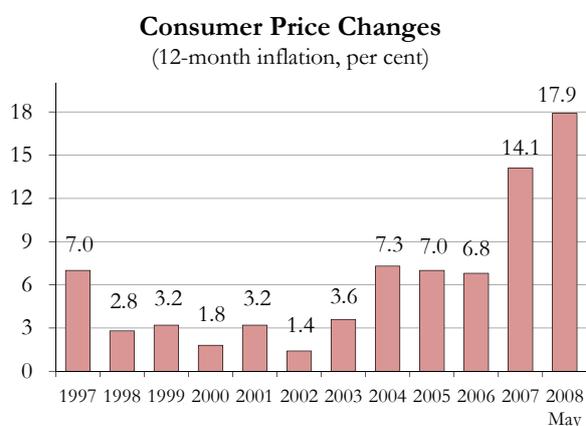
4.2. Prices

4.2.1. Consumer Prices

For the period from 1998 to 2003 the growth of consumer prices in Latvia was close to the inflation level of the developed countries and one of the lowest among the countries of Central and East Europe.

Nevertheless, starting from 2004 growth of inflation has accelerated significantly to become one of the highest among the EU member states.

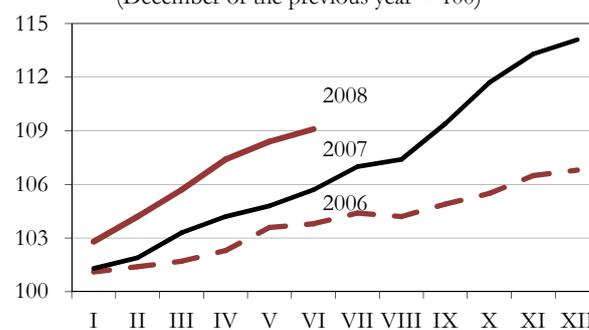
Figure 4.11



The prices have grown particularly high in 2007 due to doubling of the pace of inflation growth. The beginning of 2008 was also marked by acceleration of the pace of inflation.

Figure 4.12

Consumer Price Changes by Months
(December of the previous year = 100)



The high rate of price growth in 2007 is determined by:

- the secondary effect of the considerably high level of inflation (inflation momentum) for the preceding year, stimulated by high volumes of mortgage lending and significant increase in employment salary;
- the leap of the prices for food products, determined by the significant acceleration of the price growth pace in comparison with the changes of three preceding years. This was mainly related to general tendencies of changes in prices in international markets, as well as with the growth of prices related to local manufacture and manufacturers, which is connected with a

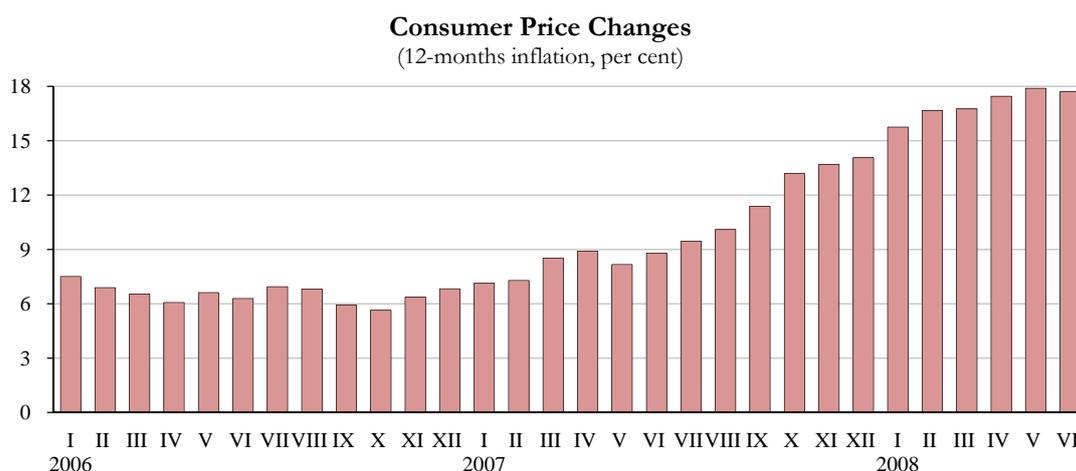
significant increase of manufacture and production costs for the preceding period;

- *the growth of the administratively regulated prices.* The prices for public utilities have grown in 2007 – water supply and sewerage have become more expensive, the costs for electrical energy and waste management have become higher and the prices for rent and thermal energy have risen. For the period of just one year the following prices have accelerated the most: water supply (+29.3%) and sewerage (+28.9%), thermal energy (+27.4%) and rent (+21.5%);

- *growth of world oil prices,* which significantly influenced growth of prices for fuel inside the country: +21.6% (for December and in comparison to December of the preceding year).

The general increase of consumer prices in July of 2008 was 17.7% in comparison to June of the preceding year, which is two times greater than the year before (8.8%). For the period of one year the prices have increased for both services (+17.6%) and goods (+17.7%).

Figure 4.13



The main accelerators of the price growth of 2008 are the following supply factors – growth of the administratively regulated prices (for electricity, natural

gas and heating) and prices for fuel, the increase of excise tax for tobacco products and fuel and growth of prices for food products.

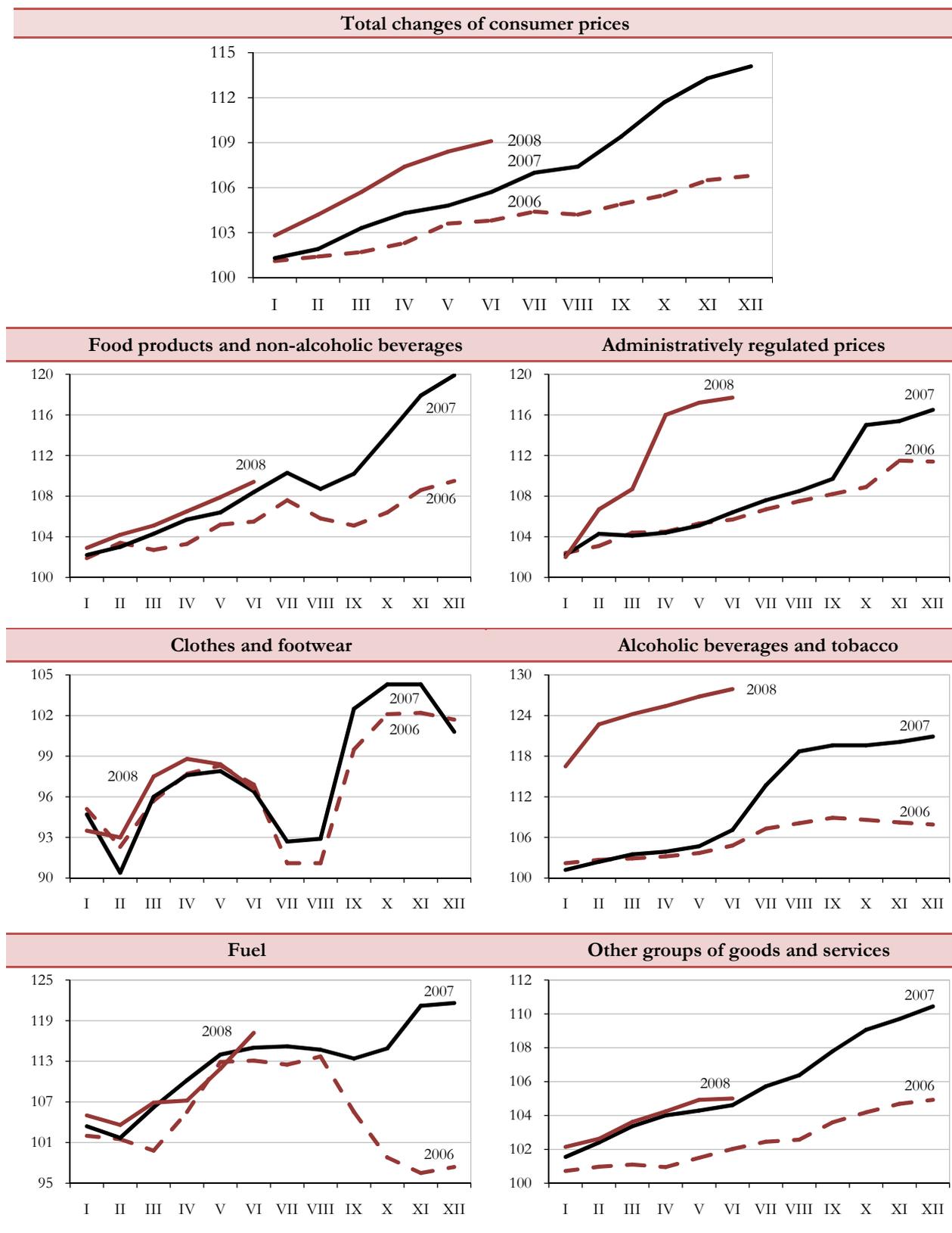
Table 4.3

Consumer Price Changes in Latvia by Months
(price changes, per cent)

| Year | Month | Compared with the previous month | Compared with the respective month of the preceding year | Annual average |
|------|-----------|----------------------------------|--|----------------|
| 2007 | January | 1.3 | 7.1 | 6.5 |
| | February | 0.5 | 7.3 | 6.5 |
| | March | 1.4 | 8.5 | 6.7 |
| | April | 0.9 | 8.9 | 6.9 |
| | May | 0.6 | 8.2 | 7.1 |
| | June | 0.9 | 8.8 | 7.3 |
| | July | 1.2 | 9.5 | 7.5 |
| | August | 0.4 | 10.1 | 7.8 |
| | September | 1.9 | 11.4 | 8.2 |
| | October | 2.2 | 13.2 | 8.9 |
| | November | 1.4 | 13.7 | 9.5 |
| | December | 0.7 | 14.1 | 10.1 |
| 2008 | January | 2.8 | 15.8 | 10.8 |
| | February | 1.3 | 16.7 | 11.6 |
| | March | 1.5 | 16.8 | 12.3 |
| | April | 1.5 | 17.5 | 13.0 |
| | May | 0.9 | 17.9 | 13.8 |
| | June | 0.7 | 17.7 | 14.6 |

Figure 4.14

Changes of Consumer Prices in Groups and Subgroups
(December of the preceding year = 100)

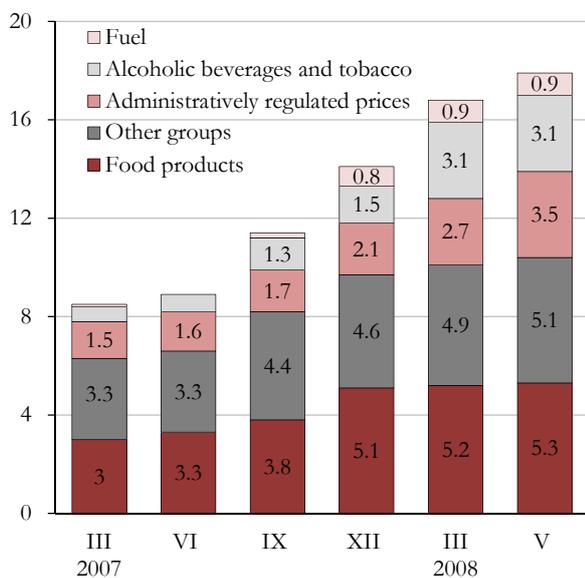


In 2008, the level of prices of 6 months-period rose by 9.1% and that significantly overpasses the

growth of prices during the respective period of the preceding year (January-June of 2007 – 5.7%).

Figure 4.15

Influence of Separate Groups of Goods and Services on Total Changes of Consumer Prices
(12 months of inflation, percentage points)



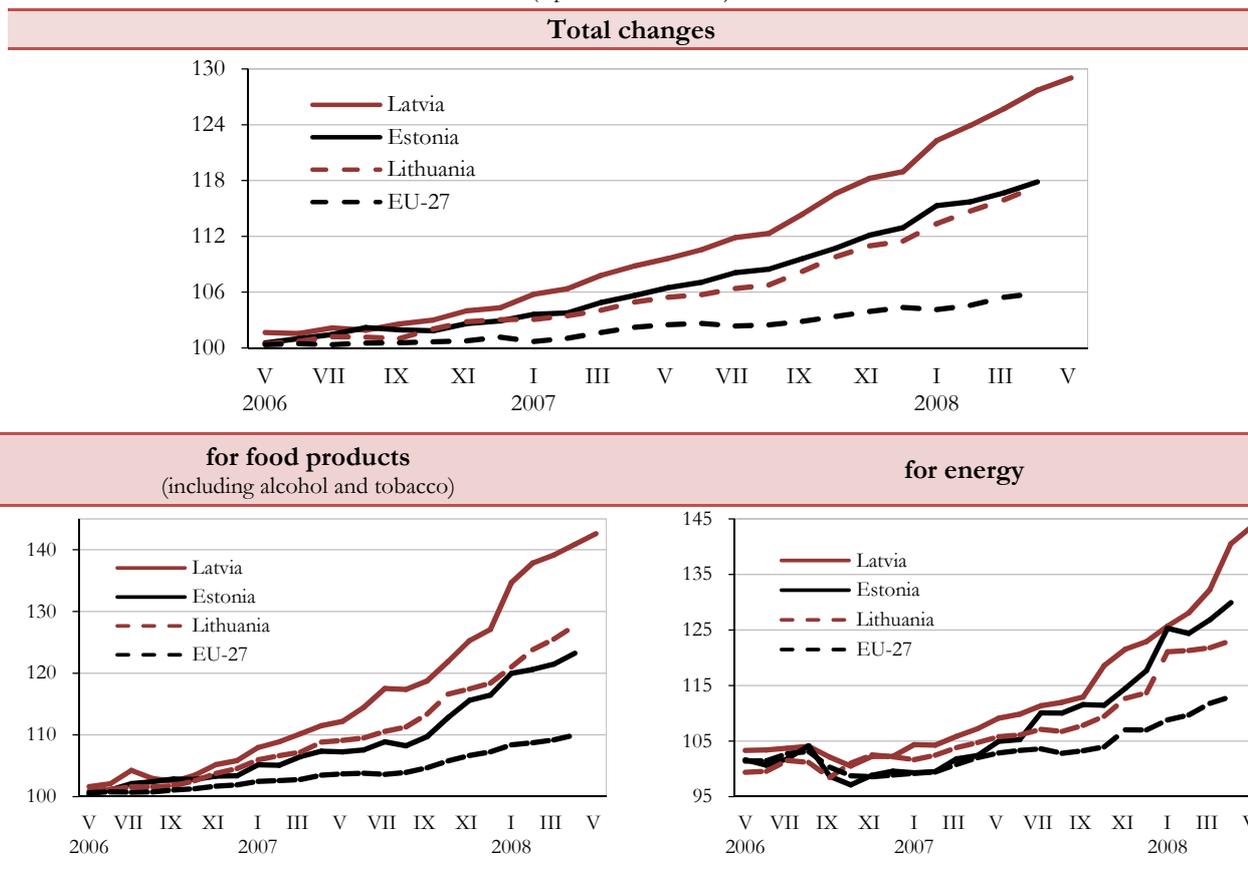
In comparison with the preceding year, this year administratively regulated prices and prices for tobacco products have grown faster. The price increase for these two groups has increased the level of total prices of 2008 by 3.9% in comparison to December of the preceding year (by 1 percentage point in 2007). The prices for other groups and services nowadays are growing more rapidly than in the preceding year, but not as significantly as mentioned above.

That is why there is a reason to assume that in the second half of the year, with the deceleration of growth of administratively regulated prices and food product prices, the pace of inflation will slow down.

Significant growth of prices starting from March of 2007 could be observed all over EU. Nevertheless, as well as in the preceding periods, in April of 2008 Latvia had the highest consumer prices inflation in EU.

Figure 4.16

Coordinated Changes of Consumer Prices by Months
(April of 2006 = 100)



The inflation rate in neighbouring countries was at comparatively high level during the period from January to April, but, nonetheless, it was lower in comparison to Latvia: Estonia – 4.3%, Lithuania – 5.3%, Latvia – 7.4%. Thereby total rate of inflation for

12 months was: 11.8% in Estonia, 12.5% in Lithuania and 17.5% in Latvia.

At the beginning of 2008 growth of prices in Latvia has been the highest in almost all the groups of goods and services in comparison with other Baltic states.

Growth of prices in Latvia was the fastest for goods, services and especially food products with increase in prices by 10.4% (+7.7% in Lithuania and +5.7% in Estonia).

The fastest growth of prices at the beginning of the year could be observed for energy. Its prices in Latvia increased by 13.8%, in Estonia – by 10.2% and in Lithuania – by 8.3% (the average price for EU-27 energy increased by 5.5%).

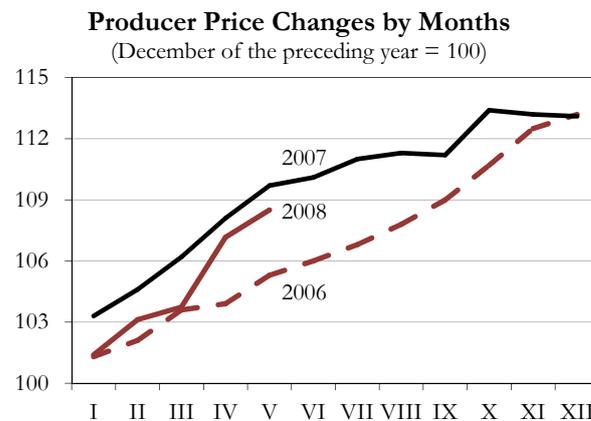
4.2.2. Producer Prices

Producer prices from 2000 to 2003 were growing slowly. The fluctuations were mainly related to changes in currency rate, since the changes of price for export production were to a great extent determined by dynamics of total producer prices.

Just like with the consumer prices, growth of producer prices has increased rapidly in 2004, at first staying behind the PCI pace but already exceeding it in 2006. According to the data of 2007, growth of producer prices was greater in comparison with the

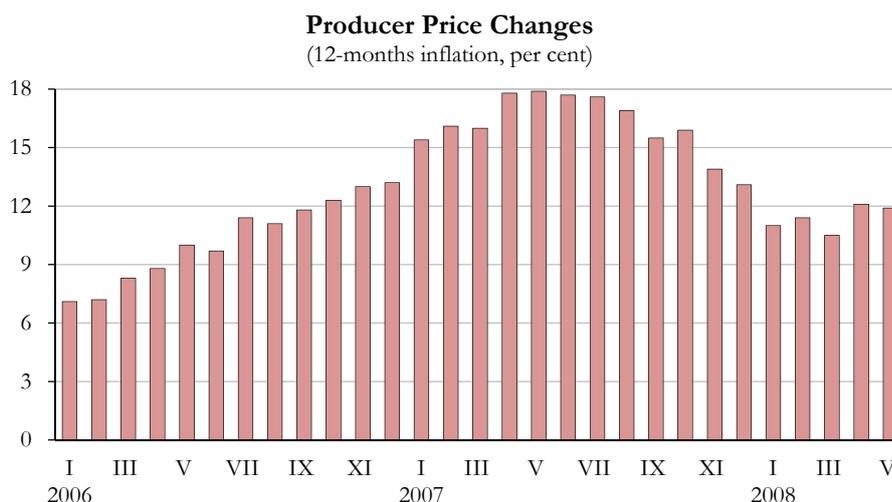
preceding year, but in the second half of the year, growth of prices has slowed down significantly.

Figure 4.17



Total growth of producer prices in May of 2008 was 11.9% in comparison with the preceding year, which is less than it was in the preceding year (17.9%).

Figure 4.18



The pace of production price growth began to decrease already in the middle of 2007 along with the gradual decrease of economic growth pace. Significant increase of producer prices in April of 2008 (growth by 3.3% for March of 2008) is mainly related to increase of electricity tariff. Growth of producer prices in manufacturing in April was only 1%.

In 2007 and 2008, price growth for the products sold at the domestic market was the same, but at the beginning of 2008, the export prices have grown faster.

The producer price dynamics in manufacturing slightly differs from the general dynamics of EU. The manufacturing prices of EU began to grow rapidly in autumn of 2007, when growth of these prices in Latvia began to slow down. The high rates of producer prices in EU remained the same also at the beginning of 2008.

Figure 4.19

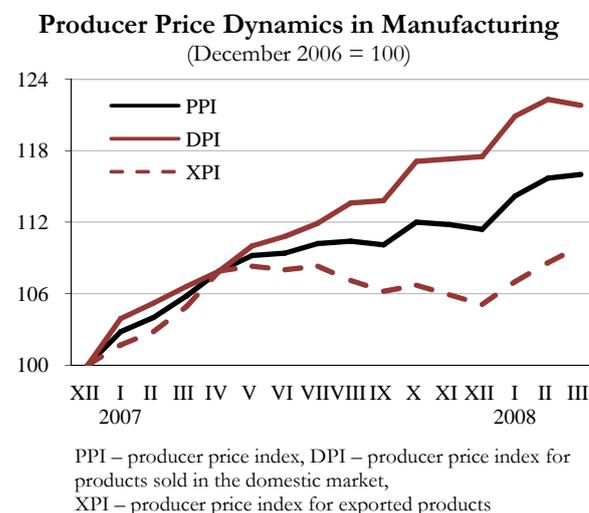
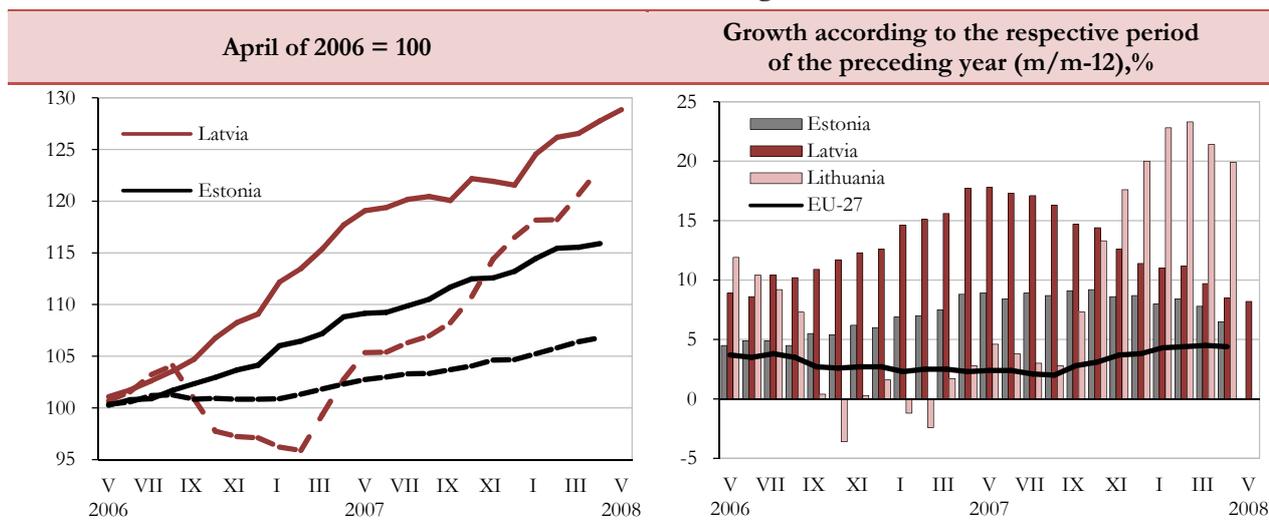


Figure 4.20

Producer Price in Manufacturing in Months



Nevertheless, different price change dynamics do not improve competitiveness of Latvian producers,

since growth of the producer prices is, nonetheless, faster than that of average in EU.

4.3. Balance of Payments

4.3.1. Current Account

Latvia typically has a relatively big current account deficit of the balance of payments. The main reason for that is the notably negative trade balance. About one-seventh of this balance is covered by the positive balance of services. The negative current account balance is covered mostly by foreign direct investment and other long-term capital flows. The reserve assets of the Bank of Latvia are growing.

Along with the rapid growth of domestic demand, a substantial deterioration of the current account of the balance of payments has been observed since 2006. It grew from 12.5% of GDP in 2005 to 26.6% in 2007.

In the second half of 2007, due to the slowdown of the domestic demand, a new tendency appeared – exports of goods increased more rapidly than imports of goods, as a result of which the current account deficit of the balance of payments decreased to 17.7% of GDP in the 4th quarter of 2007. The data of the 1st quarter of 2008 also confirm improvement of the current account due to decrease of the trade deficit (see Table 4.4).

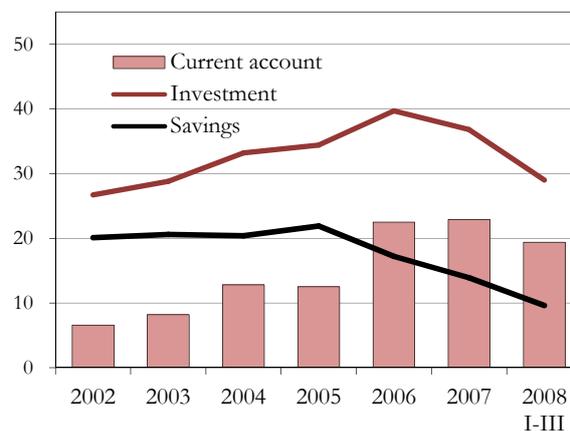
Domestic demand in Latvia is higher than GDP, creating the current account deficit. It means that also foreign savings should be used to finance domestic investment.

As Figure 4.21 shows, by 2006 the domestic savings were on average at the level of 20% of GDP. In 2006, they decreased to 17.2% and in 2007 – to 13.7% due to excessive borrowing of households and substantial increase of private consumption. The level

of investment is also high in Latvia, which reached almost 40% in 2007.

Figure 4.21

Current Account, Investment and Savings (percentage of GDP)



The steadily high growth of the domestic demand was based on several factors. Inflow of foreign capital, which stimulated increase of crediting mostly through the financial sphere, should be noted especially. Unfortunately both, the attracted foreign capital and the domestic savings were predominantly channelled to investment in real estate, and, to a lesser extent, for development of production sectors. It means that production of goods poorly competes with other sectors in terms of capital attraction, especially with the real estate sector.

Table 4.4

| Latvian Balance of Payments (percentage of GDP) | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|
| | 2005 | 2006 | 2007 | 2007 I-III | 2008 I-III |
| A. Current account | -12.5 | -22.5 | -22.9 | -26.6 | -19.4 |
| Trade balance | -18.9 | -25.6 | -24.5 | -27.4 | -21.1 |
| <i>exports</i> | 33.5 | 30.7 | 29.9 | 34.1 | 32.5 |
| <i>imports</i> | -52.4 | -56.3 | -54.4 | -61.5 | -53.6 |
| Balance of services | 3.8 | 3.3 | 3.7 | 3.0 | 3.2 |
| Net income | -1.1 | -2.7 | -3.6 | -2.7 | -3.3 |
| Current transfers, net | 3.7 | 2.4 | 1.5 | 0.4 | 1.8 |
| B. Capital account | 1.3 | 1.2 | 2.1 | 2.1 | 1.1 |
| C. Financial account* | 16.3 | 30.5 | 27.1 | 31.6 | 26.1 |
| Direct investment | 3.6 | 7.5 | 7.2 | 8.9 | 7.1 |
| <i>abroad</i> | -0.8 | -0.9 | -0.8 | 0.3 | -0.1 |
| <i>in Latvia</i> | 4.4 | 8.3 | 8.0 | 8.6 | 7.2 |
| Portfolio investment** | -1.3 | 0.2 | -0.7 | -2.5 | 9.4 |
| <i>assets</i> | -1.3 | -1.3 | -1.3 | -3.6 | 1.5 |
| <i>liabilities</i> | 0.0 | 1.5 | -0.2 | 1.1 | 7.8 |
| Other investment | 14.0 | 22.6 | 20.6 | 24.4 | 8.8 |
| <i>assets</i> | -2.7 | -9.7 | -22.3 | -27.9 | 13.4 |
| <i>liabilities</i> | 16.7 | 32.2 | 43.0 | 52.4 | -4.7 |
| D. Net errors and omissions | -1.9 | 0.6 | -2.7 | -5.4 | -2.0 |
| E. Reserves | -3.2 | -9.9 | -3.6 | -1.6 | -5.9 |

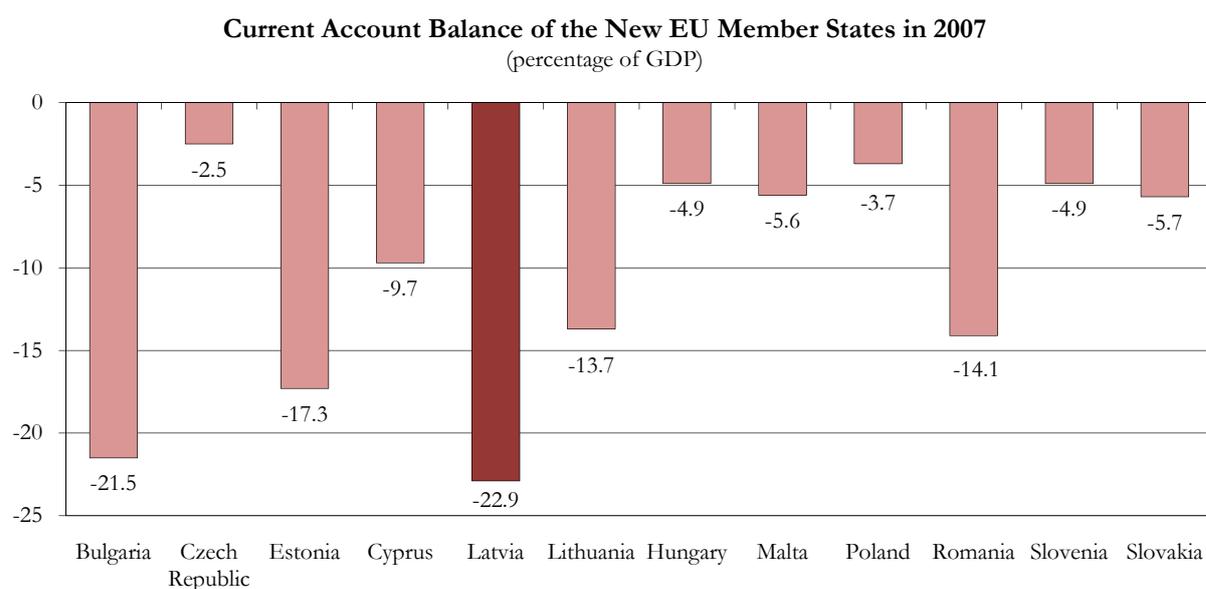
* without reserve assets

** portfolio investment and financial derivative instruments

There is a negative savings – investment balance in all new EU member states, which is mostly related to the high level of investment. Domestic savings are not sufficient enough in order to implement restructuring and modernisation of the national economy.

Latvian current account deficit in percentage of GDP was still the highest among the new EU member states in 2007 (see Figure 4.22).

Figure 4.22



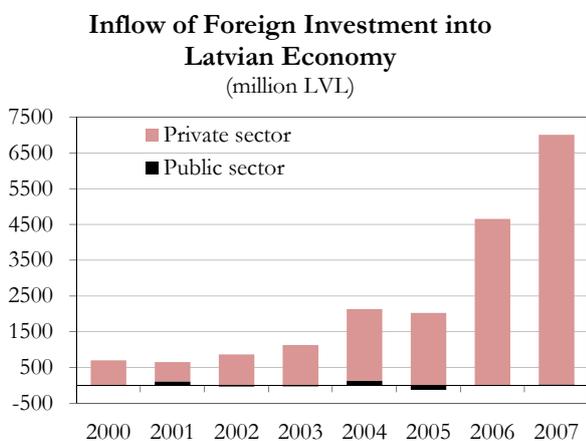
Source: Eurostat estimation

4.3.2. Financial Flows

In order to balance the external sector in case of a high current account deficit, it is important to look at the nature of coverage of the current account deficit and financial flows.

Since transition started in Latvia, there was high inflow of foreign capital, ensured by liberalisation of financial flows. There are no limitations to conversion of the national currency in Latvia. Foreign companies may freely withdraw their investment and profit after paying taxes. Also every resident of Latvia is free to use financial services of any foreign company. There are no restrictions for transactions with securities. Buying and selling of real estate is not restricted as well.

Figure 4.23



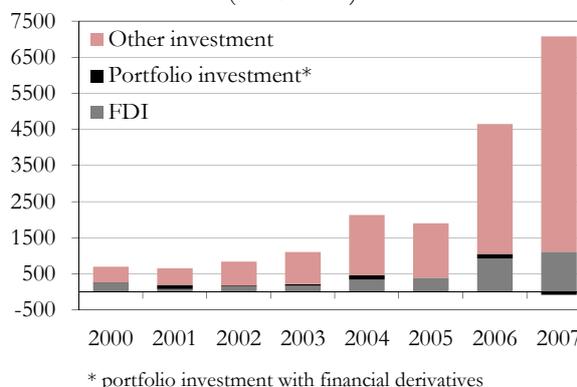
Foreign investment is mainly attracted by the private sector. As from 2004 foreign investment increased rapidly and its volume even rose by one and a half times in 2007 compared with 2006, but as compared to 2004, they have increased almost by 3.5 times, whereas in the 1st quarter of 2008, much slower investment inflow intensity was observable and in comparison with the respective period of the preceding year, foreign direct investment remained at the same level.

Foreign direct investment has also substantially increased, especially in 2006 and 2007. During three years (2005-2007) its volume has tripled, and it covered 35-37% of the negative current account balance.

The share of portfolio investment in the incoming financial flows is small and does not exceed 10% in the last three years. The balance of portfolio investment was strongly positive in the 1st quarter of 2008, because Latvian government attracted funding in bonds and securities.

Figure 4.24

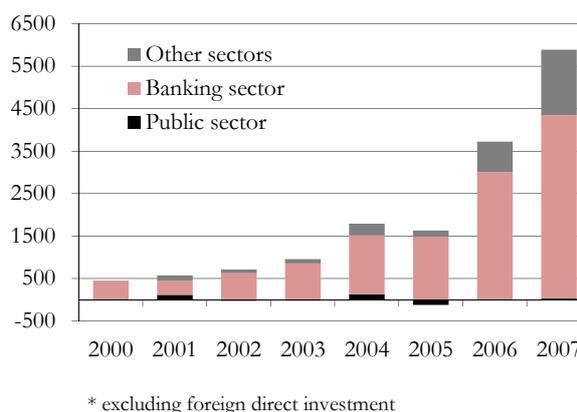
Inflow of Foreign Investment into Latvian Economy by Types of Investment (million LVL)



A major part of total foreign investment consists of “other investment”, namely, financial transactions that are not included in direct and portfolio investment. These are trade loans, other credits and borrowings, cash and deposits, etc. In 2006 and 2007, the volume of foreign financial resources attracted by the private sector (including commercial banks) substantially increased in the form of loans. They increased by 4.4 times during three years, whereas in the 1st quarter of 2008, a negative flow of “other investments” was observable for the first time over last four years. It was mainly affected by decrease of non-resident deposits in monetary financial institutions and decline of the level of private sector loans. It should be noted that in 2007, approximately 80% of all loans were of a long-term character.

Figure 4.25

Net Foreign Investment Flows by Sectors* (million LVL)



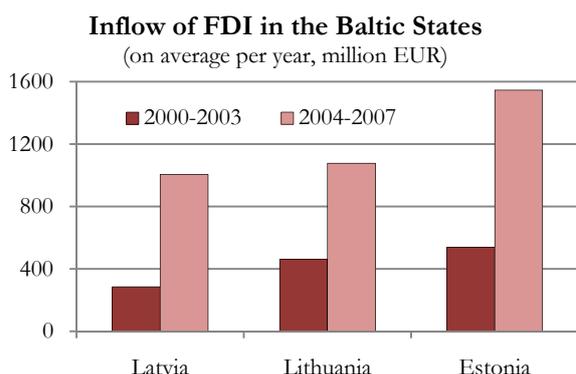
The attracted capital in 2007 exceeded the volume of GDP by 63%, but the debt of Latvia to the rest of the world was 126%, including 5.6% of the government. However, the sum which the rest of the world owes to Latvia amounts to 84% of GDP.

4.3.3. Foreign Direct Investment

Since restoration of Latvia's independence, foreign direct investment (FDI) has had substantial importance in the growth of Latvian economy. In accordance with the data of 2006, the range of goods and services produced by companies with participation of foreign capital amounted to 54.5% of GDP, and formed 55.4% of the Latvian exports volume, as well as employed 12.5% of the number of employed persons. Thereby, successful attraction of foreign direct investment has direct positive influence on macroeconomic stability and competitiveness of Latvia.

After Latvia's accession to the EU, the intensity of foreign direct investment increased. Over the last four years (2004-2007) investments of foreign entrepreneurs into Latvian economy in the form of direct investment exceed the level of 2000-2003 by almost three times. Such tendencies are characteristic for all the Baltic states conforming the significance of geopolitical condition in attraction of FDI.

Figure 4.26



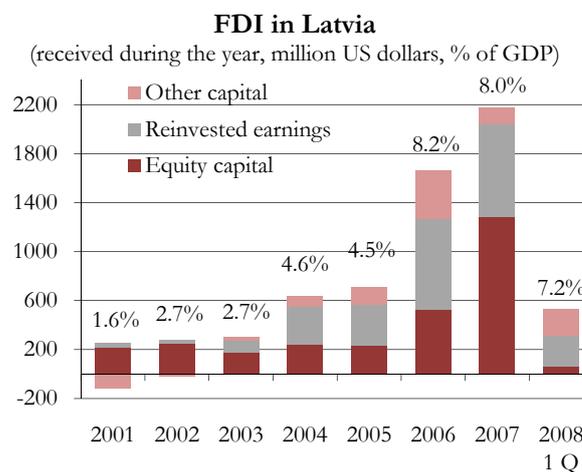
Latvian investors have also become more active abroad. Since 2004, Latvian entrepreneurs have invested in the form of direct investment EUR 124 million on average annually, i.e., almost six times more than before accession to the EU. At the end of the 1st quarter of 2008, FDI stock of Latvia abroad reached LVL 432.4 million, in comparison with the respective period of the preceding year they have increased by 74%. Almost a half of Latvian investment is made in Switzerland (mostly in trade sector) and Lithuania (trade and financial intermediation). Recently, Latvian entrepreneurs have become more active also in Russia. Latvian investments in Russian economy amounted to 10% of the Latvian FDI at the end of the 1st quarter of 2008.

Volume of the FDI inflow reached LVL 1116.8 million (USD 2172.5 million) in 2007, while FDI flows (mostly in the form of equity capital and reinvested earnings) in 3 months of 2008 exceeded the flows in the corresponding period of previous year by 14.6%.

In accordance with the balance of Latvian international investment, the FDI stock in Latvian

economy amounted to LVL 5297.8 million or almost 38% of GDP at the end of 2007. It should be noted that the share of FDI in the structure of the accumulated foreign capital decreases every year, which is related to faster inflow of foreign capital in the form of other investment (mainly bank loans). In the end of 2007, the share of FDI in assets of non-residents in Latvian economy made up 23%.

Figure 4.27



Geopolitical structure of the FDI stock in Latvia has not changed substantially since 2004: this is mostly investment of EU member states. At the end of 2007, investments of EU member states constituted 78.5% of the total FDI stock, one-third of it are investments of the new EU member states.

The biggest amounts of investment are received from Sweden, Estonia, Germany and Denmark. FDI stock of these four countries comprised 61.5% of the total FDI stock in Latvian economy at the end of March 2007. Markedly dominant sectors exist in all mentioned countries. Swedish FDI are focused in the sectors of financial services (45%), almost 70% of Estonian FDI are also in financial services. German entrepreneurs have mainly invested in the energy sector (31% of German FDI in Latvian economy).

Since Latvia's accession to the EU, the FDI stock both in goods and services more than doubled. In the sphere of production of goods, FDI growth was especially fast in the energy sector (almost 5 times) and in construction (more than 5 times). FDI growth was less rapid in manufacturing (it increased by 1.5 times).

The highest share in the sectoral structure of the FDI stock belonged to the commercial services sector until the end of 2004. As from 2005 the leading positions in attraction of FDI are taken by financial services. The share of this sector in the structure of the FDI stock was 31% at the end of March 2008.

In 2007, the FDI stock increased by 27%, of which by 3% in the sphere of production of goods and by 31% in the sphere of services. Also in the 1st quarter of 2008, more rapid growth of FDI was in the field of services. The biggest volumes of foreign investment are

still attracted by two sectors – financial mediation and real estate transactions. In 2007, FDI in these sectors constituted almost 70% of the FDI received within a year. Big investments were made in trade, where the

FDI stock increased by 17.7% in 2007 and by 13% in the 1st quarter of 2008. Steadily high FDI growth rate (38% in 2007 and 17% in the 1st quarter of 2008) remained in the construction sector.

Figure 4.28

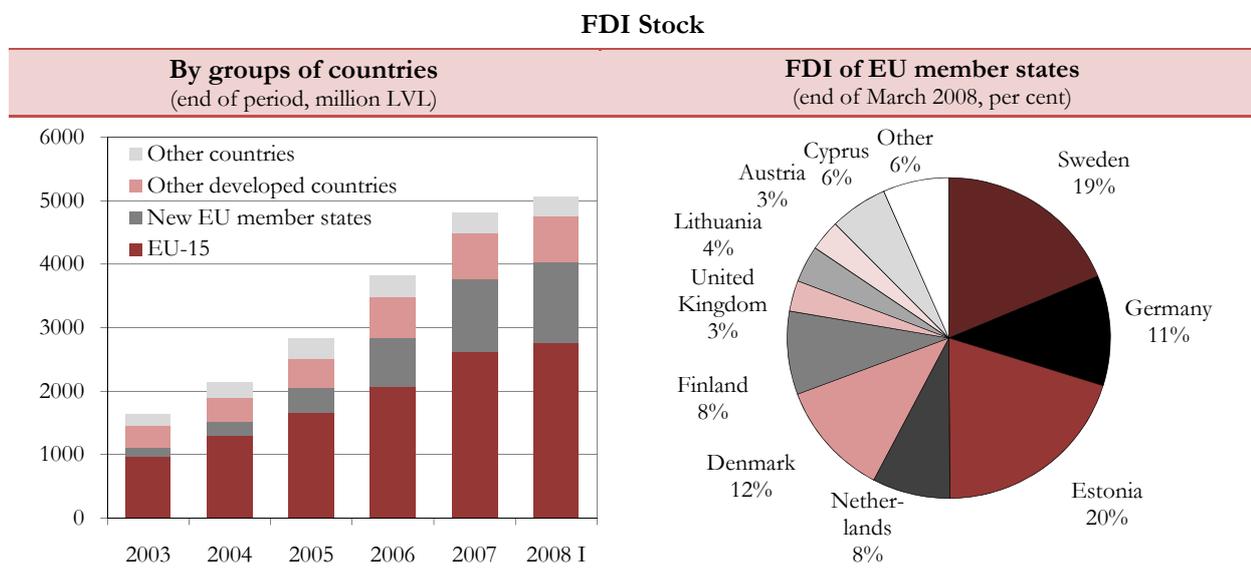
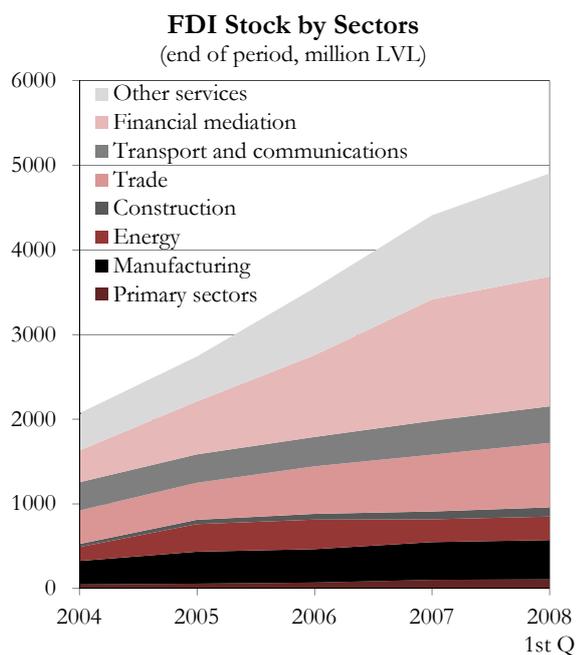


Figure 4.29



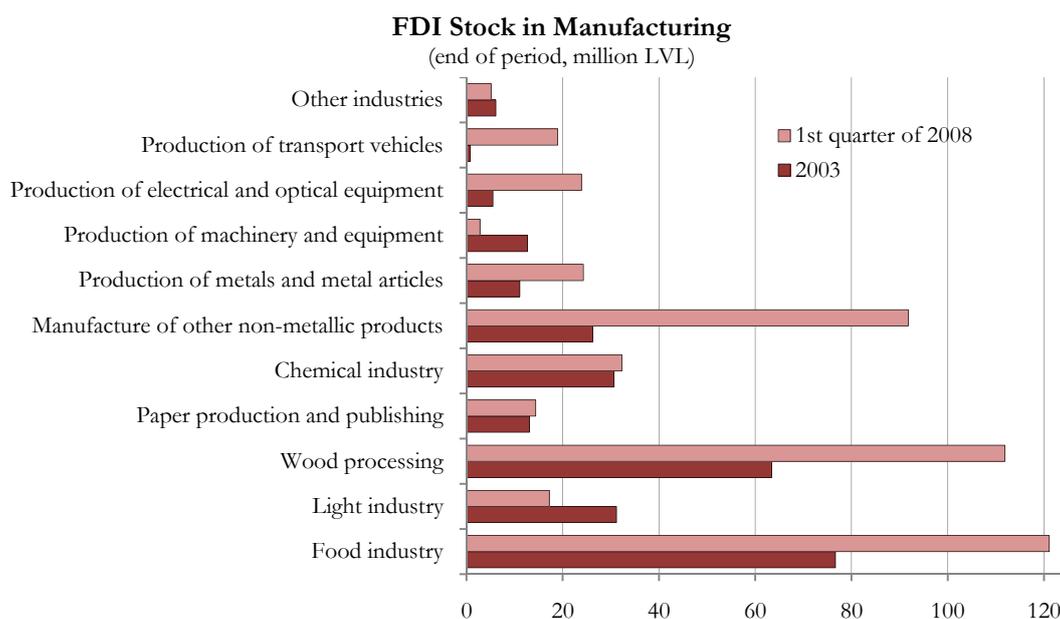
FDI growth rate in manufacturing is rather moderate. On the whole, there is no marked difference between FDI dynamics before and after Latvia's accession to the EU. At the same time, important changes in attraction of FDI are observed in sub-sectoral profile of manufacturing. In comparison with the end of 2003, the FDI stock in light industry and chemical industry decreased by almost one-half, while the FDI stock in production of machinery and equipment decreased more than five times. FDI has increased substantially in such industries as production

of electrical and optical equipment (by 4 times), manufacture of other non-metallic products (by 4 times) and production of transport vehicles (by 18 times).

The most attractive manufacturing sectors for foreign investors are food industry, wood processing and manufacture of other non-metallic mineral products. FDI stock in these sectors made up 70% of the total FDI stock in manufacturing at the end of March 2008. It should be noted that these are low and medium-low technology sectors, which indicates that the relatively low labour force costs and accessibility of natural resources are still important in attraction of foreign capital in Latvia. The biggest investment in manufacturing is made by investors of Denmark, Finland, Germany, Sweden and the Netherlands over the last four years.

A lot is being done in Latvia in order to improve the investment environment. Big role in this process is played by the Latvian Investment and Development Agency (hereinafter – LIDA) that was founded as a non-profit organisation state JSC Latvian Development Agency in 1993 and reorganised as a state agency in 2003. One of the most important priorities for operation of the LIDA in the sphere of investment attraction is attraction of such projects that are based on knowledge and technologies. The LIDA's strategy for attraction of investment is oriented to high-quality servicing of incoming investment projects and pro-active operation in attraction of investment projects, addressing potential investors in accordance with priorities set in the Development Strategy of the National Economy of Latvia.

Figure 4.30



The goal of the LIDA is to attract new foreign investment to Latvian economy within a year approximately in the amount of LVL 25 million, by creating about 500 new work places. During 2008, such investment projects attracted by the LIDA will start production:

- **LEAX Baltix** in Rēzekne: production of gear box parts for Volvo and Scania trucks; 120 work places, the volume of investments is EUR 5 million;
- **Brabantia Latvia** in Ģibūļi parish, Talsi district: production of Brabantia brand household appliances (ironing-boards and bread boxes), volume of investments – EUR 8 million, 77 work places in the first year with potential duplication of investment and work places in the future;
- **Heimdal Gruppen** in Ventspils Free Port: a production unit of module houses, 120 work places, volume of investments – EUR 15 million.

It should be noted that these are projects being under implementation, the work on them was started

in 2006-2007. Although LIDA currently works on several significant investment projects at the stage of investigation, it must be taken into account, that the wave of displacement of production units from Western Europe to Eastern Europe has considerably decreased. In the 1990s and in the beginning of 2000, the interest to invest in Latvia was mainly determined by the substantial difference of costs between Latvia and the old EU member states. However, over the last years, the conditions, which were previously attracting investors have substantially changed: the costs have risen, availability of labour force has substantially decreased. The reasons, why it would be beneficial for Latvia to attract FDI also changed. Previously, the main benefit was the established work places, but currently the main possible benefit would be transition from the so called “low income trap” to “intellectualization of economy”, namely, sectors with high value added ensuring highly paid work places and long-term competitiveness of economy. However, it should be taken into account that such projects are set as a priority in many other countries and competitive conditions are necessary for their attraction.

4.4. Financial and Capital Markets

4.4.1. Monetary Policy and the Exchange Rate¹

The “Law on the Bank of Latvia”² prescribes that the main goal of the Bank of Latvia is to maintain

price stability in the country. The central bank is an independent decision-making institution not subordinated to decisions or orders of the government or government institutions. The Bank of Latvia performs its functions under supervision of the Saeima.

¹ Data of the *Financial and Capital Market Commission* and the Bank of Latvia are used in this chapter.

² Bank of Latvia is the central bank of the state.

Since the middle of February 1994, the Bank of Latvia had unofficially pegged the exchange rate of the lats (LVL) to the SDR¹ basket of currencies (1 SDR = LVL 0.7997), thus *de facto* implementing the policy of fixed exchange rate regime. As from January 1, 2005 the peg of the lats to the SDR basket is replaced

with the peg to the euro (1 EUR = LVL 0.702804). The change of the lats' peg was determined by Latvia's plans to join the Exchange Rate Mechanism II (ERM II) and, after fulfilment of the required criteria (Maastricht criteria), to join the Economic and Monetary Union (EMU)² (see Box 4.2).

Box 4.2

Latvia's National Euro Changeover Plan

In order to ensure the technical and legal base for introduction of the euro at national level, an appropriate organisational structure of the euro introduction project was established in summer of 2005 and the Cabinet of Ministers approved the *Latvia's National Euro Changeover Plan* in 2006, which prescribes carrying out several measures in regard to adjusting the normative base and ensuring technical operation of the money and payment system, financial system, public debt management, budgetary accounting and statistics, business environment and consumer protection, taxes and social security, as well as informing the society.

Along with approval of the *Latvia's National Euro Changeover Plan*, the *Action Plan for Introduction of the Single European Currency in Latvia* was also approved, which is the Annex 1 of the former. The Action Plan incorporates general and practical measures for changeover to the euro, the responsible institutions and terms for implementation of the defined activities.

The timetable for introduction of the euro, approved by the Cabinet of Ministers, envisaged that Latvia will join the EMU on January 1, 2008. Taking into account that the set target has become unachievable due to high inflation, Latvian government reviewed the previous plans in September 2007 and decided to announce the target date for introduction of the euro not later than 24 months before the expected introduction of the euro – when the 3-year forecasts included in the *Convergence Programme of Latvia* will approach fulfilment of the Maastricht criteria. In accordance with information of the Ministry of Finance, introduction of the euro in Latvia is possible in the period of 2011-2013.

It should be noted that introduction of the euro in Latvia will be an issue of EU multilateral relations, affecting the common interests of all EU member states. Therefore the timetable for introduction of the euro, approved by the Cabinet of Ministers, will only get an official status after completion of all negotiations and other formal procedures. As soon as the European Council passes the decision on Latvia's readiness to participate in the EMU, the national currency of Latvia will be replaced with the euro and the Bank of Latvia will terminate implementation of independent monetary policy. Until then the lats will remain the national currency of Latvia.

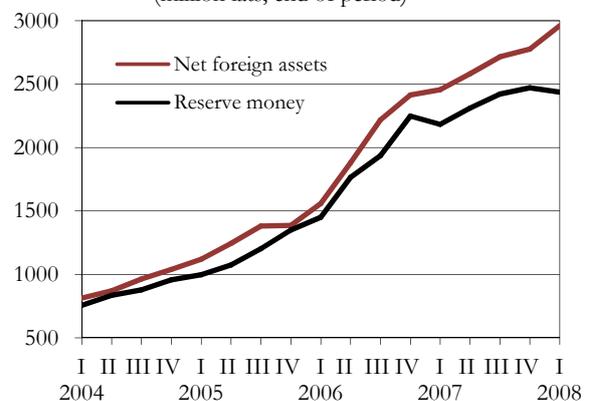
As from May 2, 2005, Latvia has joined the ERM II with the already existing exchange rate of the lats against the euro, namely, 1 EUR = LVL 0.702804. ERM II allows standard fluctuations of the exchange rate within +/-15% around the central or peg rate. However, Latvia resolves to unilaterally keep the exchange rate fluctuations within +/-1%, retaining the former width of the corridor of lats' fluctuations, which was usual to the financial market, when lats was pegged to the SDR in 1994. Thus, it had been kept when the lats was pegged to the euro on January 1, 2005.

The Bank of Latvia operates like the so-called currency board, freely buying and selling foreign currencies. The Bank of Latvia has managed to gain credibility without using the formal currency board system and to get experience, at the same time using 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. Up to now, no problems had been experienced with this regard in Latvia. Net foreign reserves of the Bank of Latvia constantly cover the reserve money and their amount equals to the value of goods and non-factorial services imported by the country in 3-4 months (see Figure 4.31).

Figure 4.31

Net Foreign Assets of the Bank of Latvia and Reserve Money, Quarterly Profile
(million lats, end of period)



The coverage of reserve money (currency in circulation and deposits in the Bank of Latvia) with net foreign assets and deposits in the Bank of Latvia) with net foreign assets was 123% at the end of 2007. Net foreign assets of the Bank of Latvia had gone up by 15% in comparison with the end of 2006.

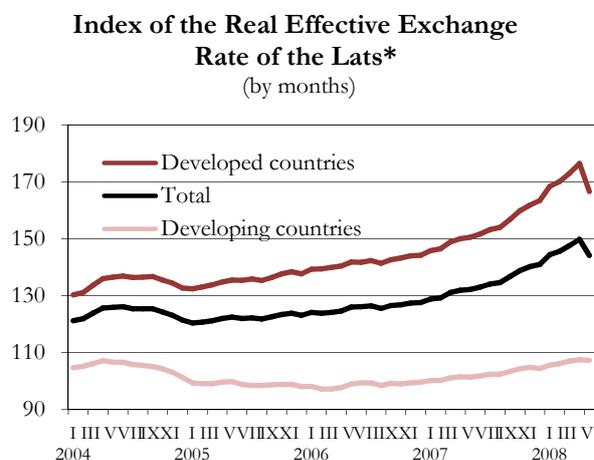
Foreign currency reserves are invested in safe and liquid financial instruments, mainly in debt securities issued by the governments of the USA, euro zone countries, United Kingdom and Japan, as well as by agencies of these countries and international organisations. Foreign reserves of the Bank of Latvia (including gold reserves) amounted to USD 5758 million at the end of 2007 (USD 4509 million at the end of 2006, USD 1535 million at the end of 2003).

¹ Special Drawing Rights – SDR; currency code according to the classification of currencies international standard ISO 4217 – XDR.

² Participation in the EMU is laid down in the EU Treaty of Accession, but Latvia can select its own timeline for introduction of the euro.

The Bank of Latvia calculates the real effective rate of the lats¹ against the currencies of 13 countries that are the main trading partners of Latvia². It shows the relative export competitiveness of Latvia in global markets (see Figure 4.32).

Figure 4.32



* Calculated by using consumer price index. December 1995 is the base of the real effective exchange rate index (1995 = 100).

Due to relatively high inflation, the real exchange rate of the lats tends to appreciate with regard to currencies of the developed countries since 2005 and also with regard to currencies of the developing countries since the mid-2006. Growth of the real effective exchange rate of the lats is not favourable for Latvian exporters.

4.4.2. Market Structure and Development

In the financial and capital market of Latvia, bank assets make the biggest share (96%) in the total assets.

21 bank and four branches of foreign banks operated in Latvia at the end of September 2007. Also credit institutions or their branches, which are registered in the European Economic Area (EEA) countries and have submitted applications to the Financial and Capital Market Commission (hereinafter – FCMC)³, may provide banking services in Latvia.

The Banking system of Latvia has stabilised during the process of biggest bank mergers and takeovers in 1998-2001. Almost all banks are in private hands. Only the *Mortgage and Land Bank of Latvia* is fully owned by

the state. Foreign shareholders own almost 78% of the total paid-up equity capital of banks.

Total amount of bank assets reached LVL 21.9 billion at the end of December 2007. (LVL 15.9 billion at the end of 2006). Loans issued to companies make up about half of the credit portfolio of banks, but 46% are the loans granted to households.

Commercial banks operate with profit. The profit was LVL 371.3 million in 2007 (non-audited data), which was by 40% or LVL 105.4 million more than in 2006. Return on assets (ROA)⁴ reached 2% at the end of December 2007, while return on equity (ROE)⁵ reached 24.2% (2.1% and 26.3% respectively at the end of 2006).

15 insurance companies, of which four were life insurers and 11 provided non-life insurance, as well as 7 branches of foreign insurance companies operated in Latvia at the end of December 2007. In Latvian financial and capital market, the share of insurance companies in the total assets is slightly below 2%.

Total of gross premiums signed in the insurance market amounted to LVL 306.8 million in 2007, which was by 50% more than in 2006, while the volume of paid gross indemnities was LVL 130.5 million or by 37% more than in 2006.

Accession to the EU has fostered increase of competition in this sector. Since May 1, 2004, non-bank financial institutions of EU member states no longer need to receive licence or open a branch in Latvia in order to offer their services in this country. Foreign companies now are allowed to insure assets of their subsidiaries in Latvia not only with local insurers, and this has reduced the growth of real estate insurance volumes in the Latvian market. 317 applications from insurance supervision bodies of 27 European Economic Area countries on the intention of insurers licensed in these countries to use the principle of service provision freedom in Latvia were received by December 31, 2007.

Securities market plays an important role in attraction of investment. At present, the necessary legal base for development of securities market has been created in Latvia, which complies with requirements of EU directives, and institutions required for functioning of this base have been set up. Yet, the stock market in Latvia is poorly developed, so its influence on the economic development of the country is small.

At the end of 2007, market capitalisation of Latvian companies at Riga Stock Exchange (RSE)⁶ was LVL 1475 million or 10.6% of GDP (LVL 1430

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

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

³ 181 notifications from EEA countries about willingness of banks of these countries to start providing financial services in Latvia without opening a branch were received by December 31, 2007.

⁴ ROA – ratio of profit/losses to assets.

⁵ ROE – ratio of profit/losses to capital and reserves.

⁶ Riga Stock Exchange is the sole licensed stock exchange in Latvia, which offers trade in securities in public circulation as well as quotation of securities and information services. In February 2008, the biggest US securities stock exchange *NASDAQ Stock Market, Inc.* completed the acquisition and merger transaction with the former owner of Riga Stock Exchange *OMX AB*, thereby establishing the biggest stock exchange company of the world *NASDAQ OMX Group, Inc.*

million or 12.8% of GDP at the end of 2006, LVL 1492 or 16.5% of GDP at the end of 2005, LVL 849 million or 11.4% of GDP at the end of 2004). 39 companies were listed on the stock exchange in the 1st half of 2008 (40 companies at the end of 2006).

The RSE capitalisation index *OMXR Rīga* (January 1, 2000 = 100) was 595 points (656 at the end of 2006, 676 at the end of 2005, 414 at the end of 2004). Last year the RSE capitalisation index *OMX Rīga* had a stable trend of increasing until the mid-September by the rise of asset prices and securities market in the Baltic states, when the index reached 764.5 points on October 5 – the highest value, which was by 16.6% more than in the beginning of the year. The situation in the global financial markets after the information regarding crisis in the US real estate market, as well as the macroeconomic situation of the Baltic states substantially affected Latvian securities market, as well: the prices of assets started to fall, and the overall trend in the market was reflected also by *OMX Rīga* index, which was below 600 points at the end of the year, and continued to decrease in the 1st half of 2008.

Latvian securities market is necessary for more rapid development, so that new, big companies would start the trade of stocks in the stock exchange, for example, “Lattelecom”. It is also important, so that the already quoted companies would increase the amount of stocks available for investors within free public circulation. The companies quoted in the stock exchange must also improve their corporate management and investor relations. Calculations of the RSE show that foreign investors have carried out not less than 60-70% stock acquisition and sale transactions in 2007, both through the assistance of the local and foreign partners.

As from July 1, 2001, supervision over the financial sector is being carried out by the **Financial and Capital Market Commission** (FCMC). FCMC took over the functions previously performed by the Credit Institutions Supervision Board of the Bank of Latvia, Securities Market Commission and State Insurance Supervisory Inspection. FCMC was established to promote protection of interests of investors, depositors and insured persons, as well as support development and stability of the financial and capital market.

Normative acts regulating operation of Latvian banks essentially comply with requirements of the EU banking directives. National regulations in some cases are even stricter, than required by the EU directives. For example, the minimum capital requirement is 10% (Directive 2000/12/EC states that the minimum level is 8%), whereas higher risk rates are established with regard to central governments and credit institutions in B zone countries. Banks and insurance companies prepare their annual reports in line with international accounting standards.

In accordance with the *Deposit Guarantee Law*, the maximum guaranteed amount of compensation to one

depositor for a deposit in one bank is being increased gradually (EUR 15 000 as from January 1, 2006 until December 31, 2007, EUR 20 000 from January 1, 2008). As from January 1, 2003, the compensation is also guaranteed to legal persons in the same amount as to physical persons.

LVL 66.6 million was accumulated in the *Deposit Guarantee Fund* at the end of 2007 (LVL 48.6 million – at the end of 2006). It has to be noted that, since the fund started operating, its resources have not been used to pay the guaranteed compensations, because no case of the inaccessibility of deposits in banks or savings-and-loans companies has occurred in Latvia during this period of time.

In order to guarantee protection of insured persons in Latvia, *Protection Fund for the Insured* was established in 1999. LVL 3.7 million was accumulated in the *Deposit Guarantee Fund* at the end of 2007 (LVL 2.5 million at the end of 2006). The *Investor Protection Plan* is in force since 2002, which stipulates that investors are entitled to receive compensation, if investment service providers (banks and broker firms) cannot fulfil their commitments.

4.4.3. Deposits and Loans

As from the 2nd half of 2007, decrease of the growth rate of monetary indicators was observed (see Table 4.5, Figures 4.33 and 4.34). The situation in the global financial markets after the information regarding crisis in the US real estate market, as well as the macroeconomic situation in Latvia, as well as the *Anti-Inflation Plan* adopted by the government in March 2007, has slowed down the rapid increase of the monetary indicators observable in the previous years.

The **volume of deposits** of companies and individuals drawn by residents increased by 17% at the end of 2007 in comparison with the end of 2006. The volume of deposits increased by 30-40% on average annually in 2004-2006.

A little more than 50% of all deposits drawn by residents are deposits in LVL, whereas the rest is deposited in foreign currencies. Dominant role in deposits is played by demand deposits, and their share in the total deposit structure was 54% at the end of 2007 (66% at the end of 2006).

The share of deposits of non-residents in the total volume of deposits is relatively high in Latvia. At the end of 2007, as compared to the end of 2006, this share increased by 53%, and the share of deposits of non-residents also increased accordingly in the total volume of deposits from 40% to 46%.

The relatively high share of short-term deposits and non-resident deposits is a certain risk factor. Dramatic decrease of deposits in case of economic shocks could seriously affect Latvian banking system on the whole. However, due to strict supervision and control of the banking system, such probability is small. Most of liabilities drawn by non-residents are

placed into liquid assets, and risks related to dynamic quantitative changes of these deposits are managed

well. Trust in banks is also enhanced by the *Law on Deposit Guarantees*.

Table 4.5

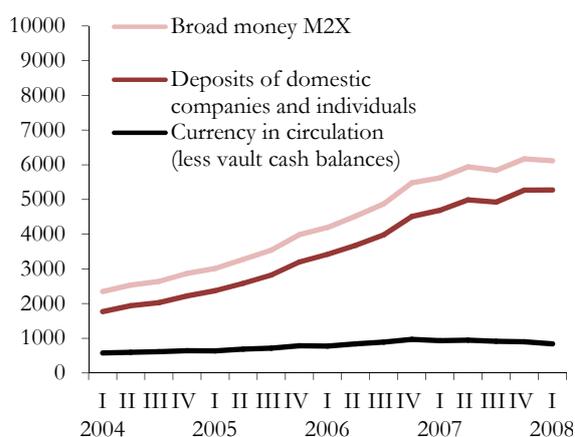
Monetary Indicators of the Banking System of Latvia
(end of period)

| | 2005 | 2006 | 2007 | 2008* |
|---|-------------|-------------|-------------|-------------|
| (million LVL) | | | | |
| Net foreign assets | -1326.6 | -2634.7 | -4482.8 | -4711.3 |
| Net domestic assets | 5311.2 | 8114.6 | 10654.1 | 10828.3 |
| Domestic loans | 6441.3 | 9877.4 | 13018.2 | 13210.8 |
| to government (net) | 266.3 | 100.5 | -87.4 | -348.5 |
| to companies and individuals | 6175.0 | 9776.9 | 13105.6 | 13559.3 |
| Other assets (net) | -1130.1 | -1762.8 | -2364.2 | -2382.6 |
| Broad money M2X | 3984.7 | 5479.9 | 6171.3 | 6117.0 |
| Currency in circulation (less vault cash balance) | 786.4 | 969.3 | 900.0 | 842.7 |
| Deposits of individuals and companies | 3198.3 | 4510.6 | 5271.3 | 5274.2 |
| of which: | | | | |
| demand deposits | 2020.2 | 2974.5 | 2864.9 | 2663.1 |
| time deposits | 1178.1 | 1536.1 | 2406.4 | 2611.1 |
| (changes against the preceding period, per cent) | | | | |
| Domestic loans | 63.1 | 53.3 | 31.8 | 22.9 |
| of which: | | | | |
| to companies and individuals | 63.6 | 58.3 | 34.0 | 25.3 |
| Broad money M2X | 38.9 | 37.5 | 12.6 | 8.7 |
| Currency in circulation (less vault cash balance) | 21.8 | 23.3 | -7.1 | -9.7 |
| Deposits of individuals and companies | 43.9 | 41.0 | 16.9 | 12.4 |
| GDP (in current prices) | 21.8 | 23.3 | 24.9 | 19.3 |

* end of March

Figure 4.33

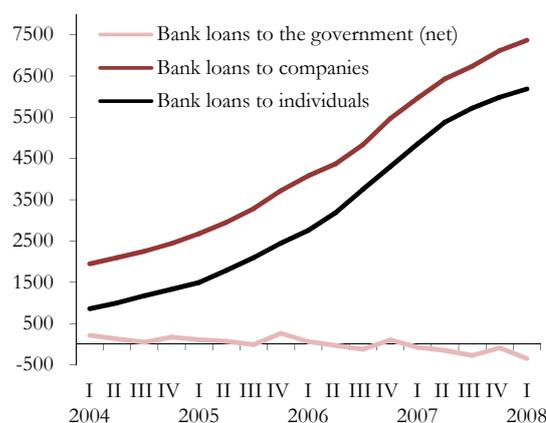
**Dynamics of Broad Money (M2X)
and its Components, Quarterly Profile**
(end of period, million LVL)



The volume of **loans** issued to companies and individuals increased by 50-60% annually in 2004-2006, which was fostered both by increasing economic activity and by inflow of foreign capital.

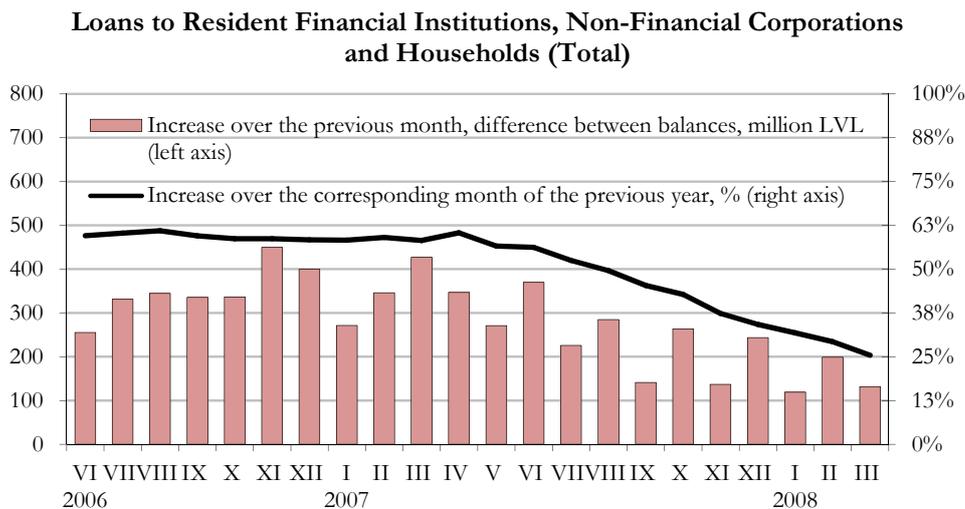
Figure 4.34

**Bank Loans to Domestic Companies, Individuals
and the Government, Quarterly Profile**
(end of period, million LVL)



Decline of the growth rate of crediting is observed as from the 2nd half of 2007 (see Figure 4.35). It is related to a more cautious crediting policy of the biggest Latvian commercial banks, affected by both deterioration of the situation in the global financial markets and implementation of the *Anti-Inflation Plan* adopted by the government in March 2007.

Figure 4.35



The *Anti-Inflation Plan* envisaged the following requirements with regard to crediting: for commercial banks and providers of leasing services to determine solvency of customers and grant loans only on the basis of their legal incomes; establish a single register of borrowers; determine a compulsory initial payment for loans to be granted in the amount of at least 10-15% of the loan; set the maximum amount of loan against the collateral; introduce a compulsory declaration of legal income in particular transactions and purchases for a sum above 100 minimum monthly wages, as well as stimulate savings.

Responding to the rising domestic demand, the Bank of Latvia has raised the refinancing rate and the reserve requirement several times since March 2004 in order to slow down the rapidly growing lending. However, the efficiency of these measures in Latvia has been limited by the fixed currency exchange rate regime and several specific factors, such as the relatively easy access by banks to foreign resources and a relatively high share of loans issued in foreign currencies in the total structure of loans.

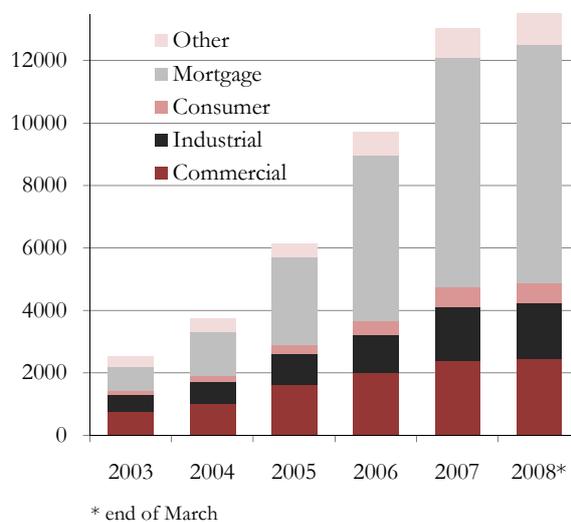
Upon the changing economic situation, the Bank of Latvia decided to reduce the reserve norm for bank commitments above 2 years from 8% to 7% and from 7% to 6% on January 17 and April 24, 2008. The government has also “softened” some of the measures, set in March 2007, as well as it has accepted the amendments to the *Credit Institution Law* and amendments to the *Consumer Rights Protection Law*, which envisages to cancel the compulsory initial payment of 10% for receipt of a loan.

Mortgage loans constitute the biggest share in the structure of loans issued to domestic companies and individuals. Their share in credit portfolios of banks has grown from 22% at the end of 2002 to 46% at the end of 2005 and 56% at the end of 2007. The share of commercial loans (to increase current assets of

companies) in the total credit portfolios of banks was 18% at the end of 2007, while the share of industrial loans (for acquisition of fixed assets and financing of long-term investment projects) – amounted to 13% (see Figure 4.36).

Figure 4.36

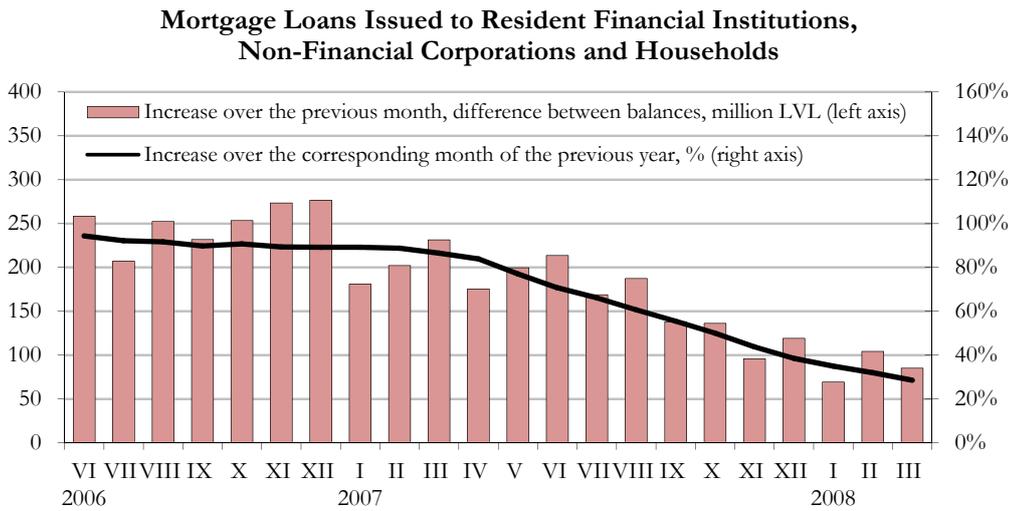
Volume and Structure of Loans to Domestic Companies and Individuals
(end of period, million LVL)



The volume of issued mortgage loans increased by 89% in 2006, whereas by 39% in 2007. As Figure 4.37 shows, decrease of the growth rate of mortgage lending is observed as from the 2nd half of 2007.

The most important factors hindering the increase of mortgage loans are expectations of further decrease of real estate prices, increase of indebtedness of households, which, to a great extent, is affected by the high interest rates on loans.

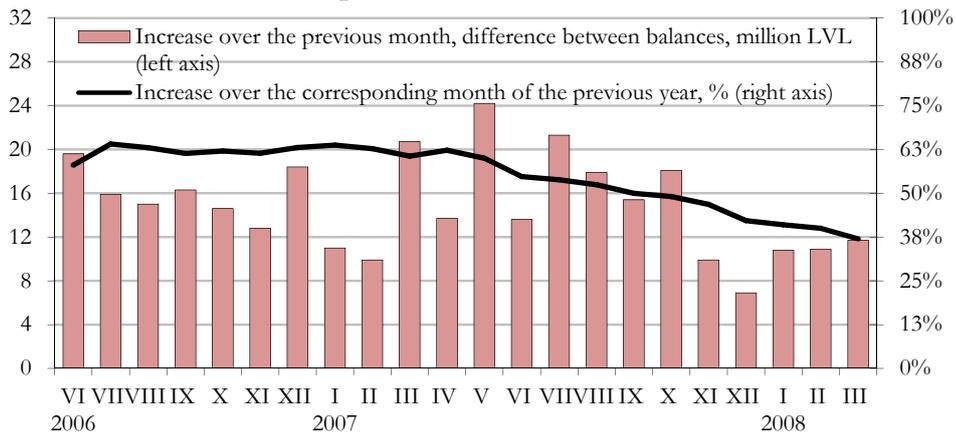
Figure 4.37



Growth rate of consumer lending also decreases (see Figure 4.38).

Figure 4.38

Consumer Loans Issued to Resident Financial Institutions, Non-Financial Corporations and Households



Dynamics of industrial and commercial loans issued to resident financial institutions, non-financial corporations and households is reflected in Figure 4.39.

Figure 4.39

Industrial and Commercial Loans Issued to Resident Financial Institutions, Non-Financial Corporations and Households

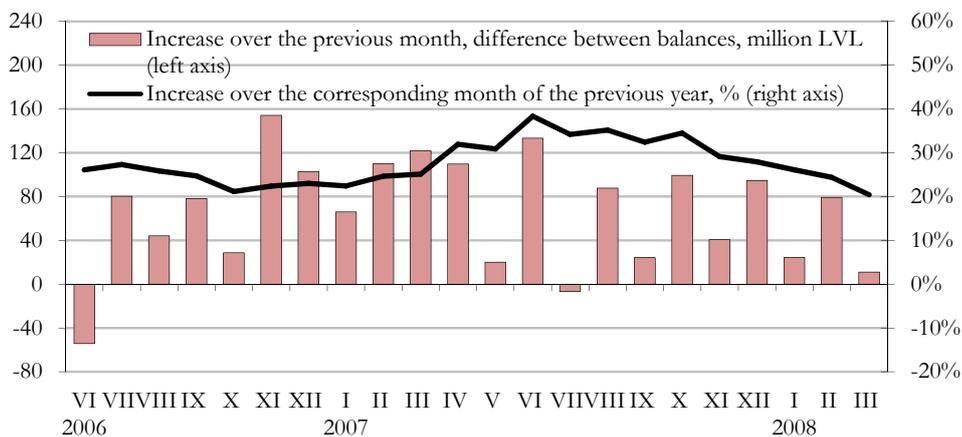
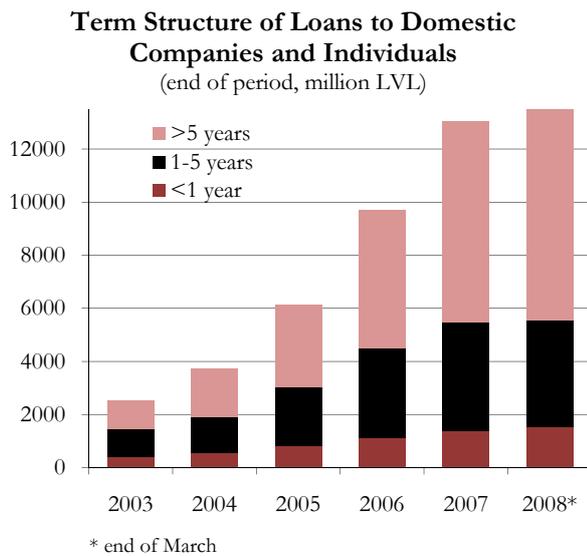


Figure 4.40



Some positive changes have taken place concerning the loan term and the quality of credit portfolio. The share of short-term loans in the total structure of loans decreases, while the share of long-term loans increases (see Figure 4.40). The share of long-term loans in the total credit portfolio was 58% at the end of December 2007 (54% at the end of December 2006).

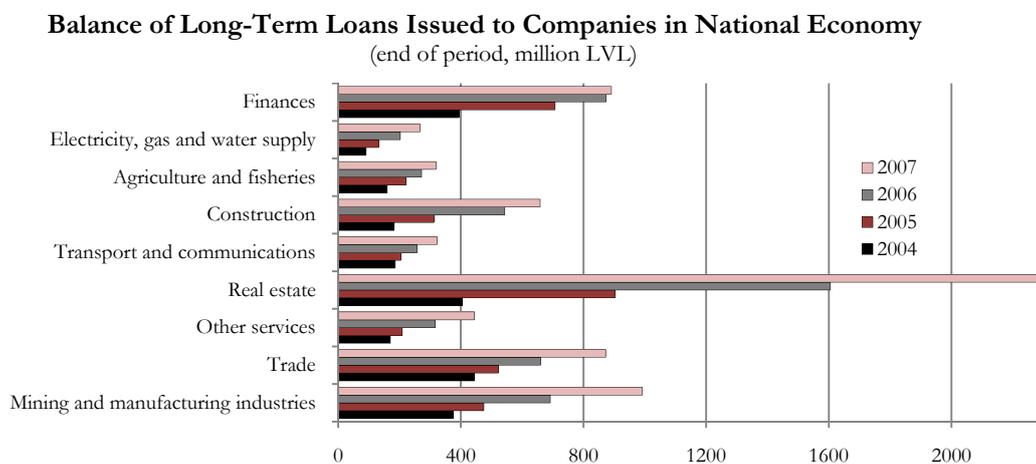
While the volumes of crediting increase, the quality of loans does not decrease. At the end of December 2007, the quality of loans issued by banks

was as follows: 99.2% of all issued loans were evaluated by banks as standard loans and only 0.4% were evaluated as loans generating no income (under standard, doubtful or lost)¹. In compliance with requirements of the Bank of Latvia, loans generating no income are secured by special savings, hence this category of loans does not present a serious threat to stability of banks. Special savings for claims against non-banks reached LVL 72.5 million at the end of 2007, exceeding the volume of loans generating no income by 30%.

At the end of 2007, the biggest volumes of loans had been issued by commercial banks to the following national economy sectors: real estate transactions, manufacturing, financial mediation and trade, which received 33%, 14%, 13% and 12% respectively of the total volume of loans to national economy sectors.

From the end of 2004 to the end of 2007, the balance of long-term loans increased most rapidly in the sector “Real estate transactions, lease, computer services, science and other commercial services” – 5.7 times, in construction – 3.6 times, in the sector “Electricity, gas and water supply” – 2.9 times, in mining and manufacturing industries – 2.6 times. In 2007, crediting grew fastest in mining and manufacturing industries (by 44%) and real estate transactions (by 43%) (see Figure 4.41).

Figure 4.41



Dynamics of interest rates on loans in a quarterly profile is shown in Figure 4.42. The interest rates on loans issued in lats have increased substantially in 2007.

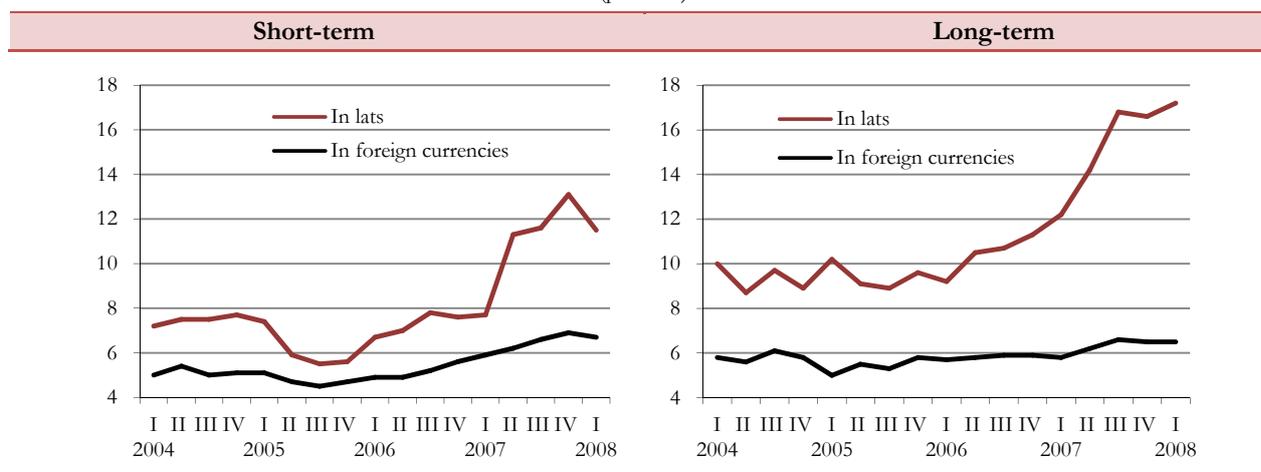
In the 1st quarter of 2008, the average weighted annual interest rate on short-term² loans in lats to companies and individuals was 11.5%, the interest rate on long-term loans in lats was 17.2%, while the interest rates for loans issued in euro were 6.7% and 6.5% respectively.

¹ To compare: 0.4% of all issued loans were evaluated as generating no income at the end of 2006, (0.7% at the end of 2005, 1.1% at the end of 2004, 1.4% at the end of 2003).

² Short-term with floating interest rate.

Figure 4.42

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

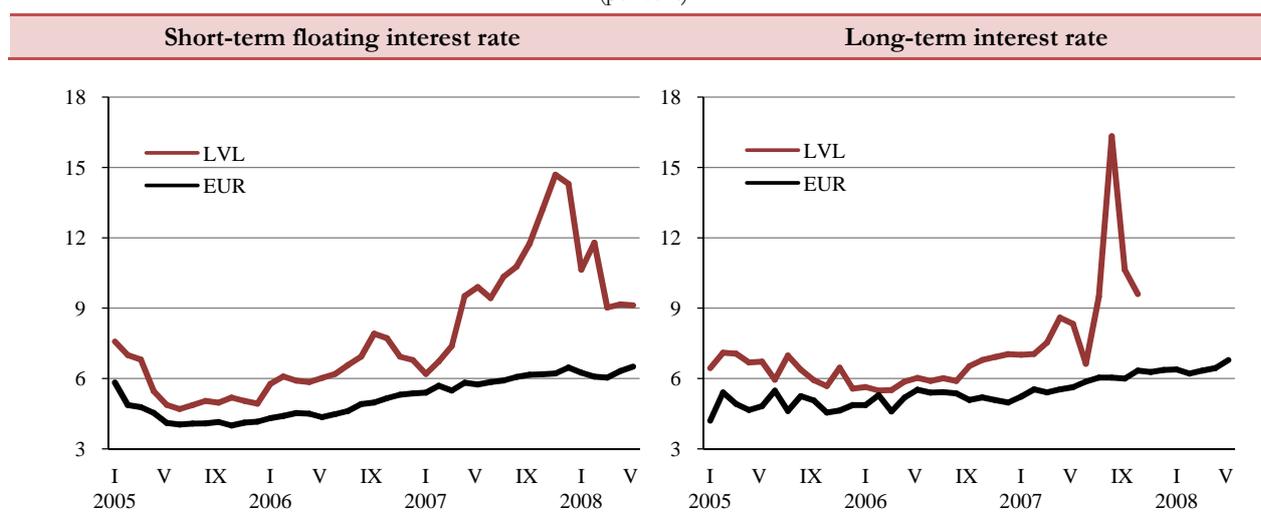


In the 1st quarter of 2008, the average weighted annual interest rate on short-term deposits in lats was 6.6%, the rate on long-term deposits in lats was 10.1%,

while the interest rates on deposits in euro were 4.2% and 4.9% respectively.

Figure 4.43

Average Weighted Interest Rates on Loans to Households for Purchase of Dwellings
(per cent)



Interest rates on loans issued in lats to households increased rapidly in 2007, while the growth of interest rates on loans in euro was much more moderate. During four months of 2008, a decrease of the

short-term floating interest rates could be observed regarding the loans issued to households in lats. The interest rates on loans in euro have stabilised after a moderate increase in the previous year.

5. LABOUR MARKET

5.1. Employment and Unemployment

Latvia's rapid economic development over the last four years has had a positive influence on the situation in the labour market – employment has increased, the unemployment rate has decreased and the number of economically active persons has increased. From 2005 to 2007 the number of employed persons increased on average by 2.9%, while the unemployment rate fell from 10.4% in 2004 to 6% in 2007. As a result, in 2007 the employment rate in Latvia reached 68.4%, which exceeds the EU-27 average by 2.9%.

The Lisbon Strategy has set a target to achieve an average EU employment rate of 70% by 2010 in the EU member states. This target has been achieved in Denmark, the Netherlands, Sweden, Austria, the United Kingdom, Cyprus and Finland. The employment target in Latvia set in the National Lisbon Programme of Latvia (see Chapter 6.1) for 2010 falls short of this level by 3%, i.e., 67%. The rate achieved in 2006 lagged behind the set target by a mere 0.7%, while in 2007 it exceeded the target set for 2010 by 1.3%.

Table 5.1

Key Indicators of Employment and Unemployment*

| Indicators | 2000 | 2005 | 2006 | 2007 |
|--|--------|--------|--------|--------|
| Population in the of 15-64 age group (thousands) | 1600.3 | 1583.8 | 1580.4 | 1573.4 |
| Economically active persons in the 15-64 age group (thousands) | 1074.7 | 1100.8 | 1126.1 | 1146.6 |
| Employed persons (thousands) | 917.6 | 1003.6 | 1047.3 | 1075.5 |
| Participation rate (%) | 67.2 | 69.5 | 71.3 | 72.9 |
| Employment rate (%) | 57.3 | 63.4 | 66.3 | 68.4 |
| Unemployed (job seekers) (thousands) | 158.3 | 99.1 | 79.9 | 72.1 |
| Unemployment rate (%) | 14.4 | 8.7 | 6.8 | 6.0 |
| Registered unemployed persons (end of period, thousands) | 93.3 | 78.5 | 68.9 | 52.3 |
| Registered unemployment rate (end of period, %)** | 7.8 | 7.4 | 6.5 | 4.9 |

* in the table and further in the text, indicators of employment are given for persons in the 15-64 years age group and indicators of unemployment are given for persons in the 15-74 years age group.

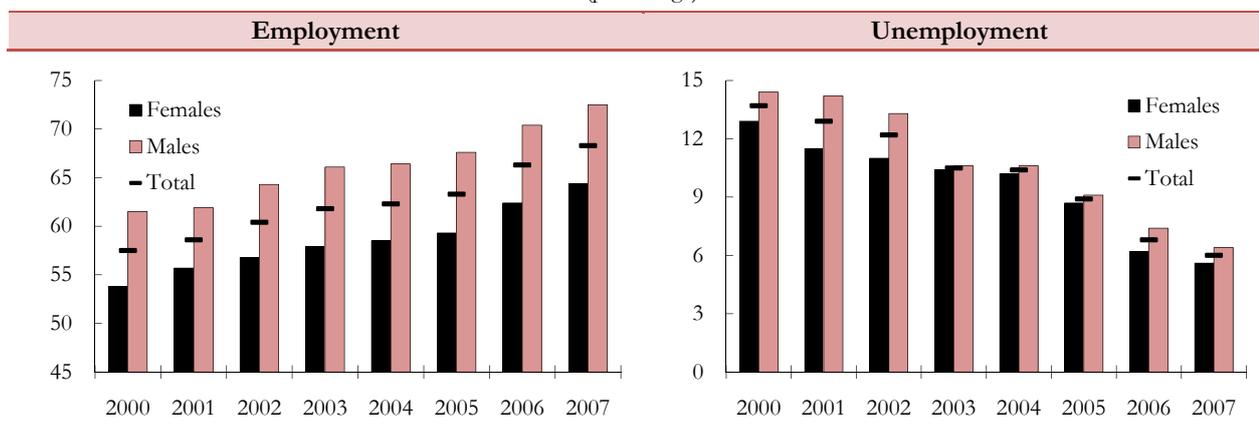
** percentage of the registered unemployed persons of the economically active residents since 2002, according to the new methodology

To compare the employment rate by gender, female employment in Latvia is higher than the EU-27 average, and this difference has a tendency to increase as the female employment rate in Latvia in 2004 exceeded the EU average by 3% and in 2007 by 6.1%.

Male employment in Latvia lagged behind the EU average in 2007 (by 4 percentage points in 2004 and by 1.2 percentage points in 2006), but taking into account the annual increase, it achieved the EU average (72.5%) in 2007.

Figure 5.1

Employment and Unemployment in Latvia
(percentage)



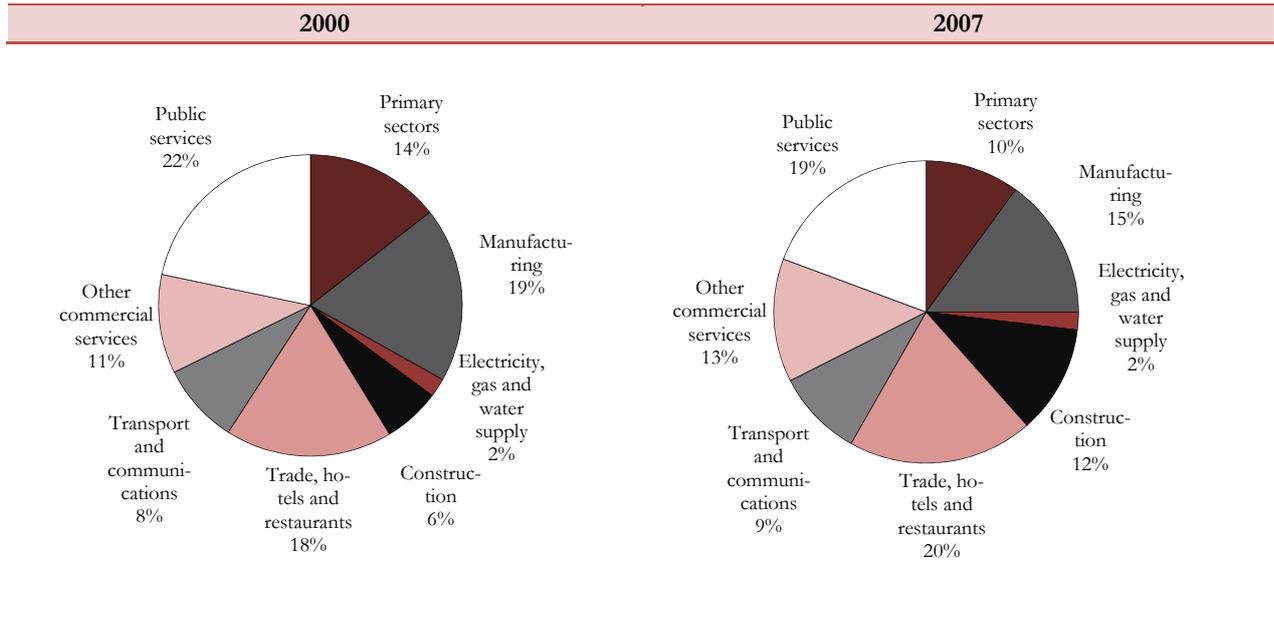
Of all employed persons in 2007, 70.5% were employed in urban areas and 29.5% were employed in rural areas. It must be noted that until 2007, the share of the employed persons in urban areas grew, but in 2007, an increase in the share of the employed persons in rural areas was observed. While it is too early to judge whether this trend will continue in the future, this fact testifies that development of business in rural areas and increased economic activity by the rural population leads to growth in the employment rate in

rural regions, which is a positive phenomenon. If this trend continues, regional inequality between urban and rural areas will decrease.

The structure of the employed persons in national economy sectors changed slightly in 2007 compared to 2000 (see Figure 5.2). The number of the employed persons in trade and construction increased at a faster rate, while the number of persons employed in agriculture, manufacturing, and public services sector decreased.

Figure 5.2

Structure of Employed Persons Broken Down by National Economy Sectors (%)

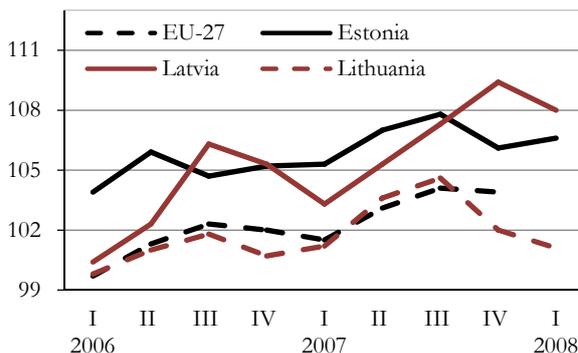


Source: Eurostat

In 2007, Latvia held 11th position among the EU-27 countries in terms of the employment rate, while Latvia's position in terms of the unemployment rate (12th position among the EU-27 countries) has improved considerably in comparison with the preceding years. The Netherlands, Denmark, Cyprus, Lithuania, Austria, Ireland, Estonia, Luxembourg, Slovenia, the United Kingdom and the Czech Republic had lower unemployment rates than Latvia.

Figure 5.3

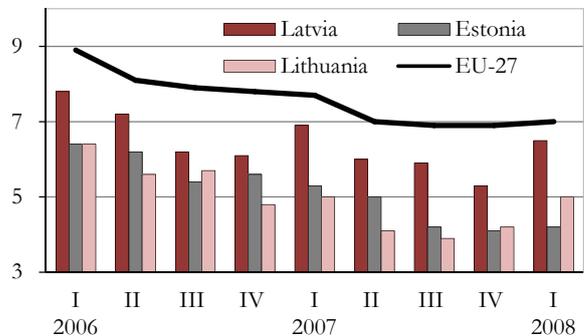
Employment Changes, Quarterly Profile (4th quarter of 2005 = 100, seasonally unbalanced data)



The rate of registered unemployment in Latvia has gradually decreased in recent years: it was 8.5% at the end of 2004, 7.4% at the end of 2005, 6.5% at the end of 2006 and 4.9% at the end of 2007.

Figure 5.4

Unemployment Level, Quarterly Profile (seasonally unbalanced data, %)



The lowest rates of registered unemployment are recorded in the cities of Riga and Jelgava and in the districts of Riga, Ogre, Saldus and Tukums (3.8%, 4.9%, 4.8%, 5%, 5.2% and 5.2% respectively).

The share of long-term unemployed persons (those who have not been able to find a job during one year) in the total number of unemployed persons was 26.4% in 2007 and 36.2% one year ago.

Latgale region still has the highest registered unemployment. At the end of 2007, it was 14.4% overall and exceeded 20% in two districts of Latgale (23.4% in Ludza district and 22.6% in Rēzekne district). The unemployment rate is high due to poorly developed business activity, poor self-employment and insufficient traffic infrastructure.

The majority of all unemployed persons are representatives of simple, low-skilled professions. The highest employment rate is among persons with tertiary education (87.1% of persons with higher education were employed in 2007). The majority of the unemployed in 2007 were among persons in the age group of 35-54 years.

The rapid decrease in unemployment since Latvia's accession to the EU is not only due to the increased employment rate. Since 2004, there has been labour outflow to some of the old EU member states, the labour markets whereof are open to citizens of the new EU member states. Therefore, labour shortage in several sectors of the Latvian labour market has developed.

Decrease of growth rate has weakly reflected on employment indices yet, because employment still growth.

Small decrease of people employed in the first quarter of 2008 compared to fourth quarter of 2007, is mainly connected with seasonal fluctuations, because the number of people employed always decreases a bit at the beginning of the year, and this year it happened in smaller amounts than in the first quarter of 2007.

Changes have taken place only in unemployment level – it has increased from 5.3% in the fourth quarter of 2007 to 6.5% in the first quarter of 2008. Such a

situation has came up because at the beginning of 2008 substantially increased number of economically active population, which can be partly explained by the increase of motivation to be employed (substantial wage increase along with increase of cost of living).

Still it must be noted that if the economic growth rate will not increase or it will continue to decrease, demand in the labor market can decrease and number of unemployed will grow faster. Changes in employment level always drop back, on average for two to four month, from changes in economical activities.

Figure 5.5



Number of free workplaces decreases fast. They had started to decrease from second quarter of 2007. That means, that already from the middle of 2007, majority of entities in Latvia has not planned increase of volume of production.

Taking all that in count, in the next years it will be important how effectively and successfully structural policy and active labor market policy measures will be implemented, as well as how education will meet labor market needs.

5.2. Labour Costs

Unit labour costs are one of the indicators, which characterise both the state in general and competitiveness of certain sectors. Dynamics of this indicator signifies that competitiveness position of Latvia in the EU is decreasing.

During the period from 2004 to 2007 the real ULC in Latvia increased by 20.3% and the real ULC in the EU decreased by 3.7%. Growth of the real ULC occurs if labour costs increase faster than productivity.

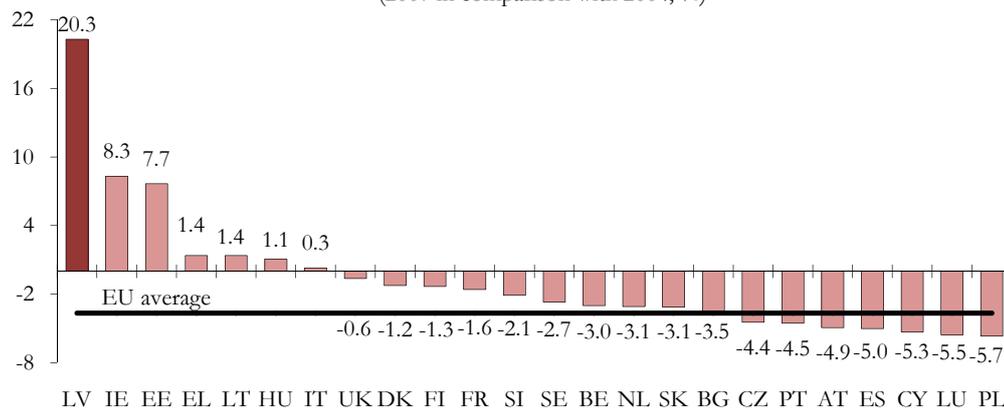
Real ULC increased due to higher salary increase, even though in recent years growth of productivity in Latvia is amongst the most rapid in the EU member states. Over a four-year period productivity in economy in general increased on average by 6% a year

or it was almost four times higher than in the EU member states. However the pace of labour cost increase in Latvia was seven times higher than on average in the EU member states.

Dynamics of salaries and productivity signify on unevenness of convergence process that can be partially explained by very low salary level in comparison to average indicators of the EU. In 2003, it was on average 17% of the EU level but in 2007 it reached 33%. Obviously productivity convergence process is slower and the general position of Latvia among the EU member states regarding the price competitiveness is becoming worse.

Figure 5.6

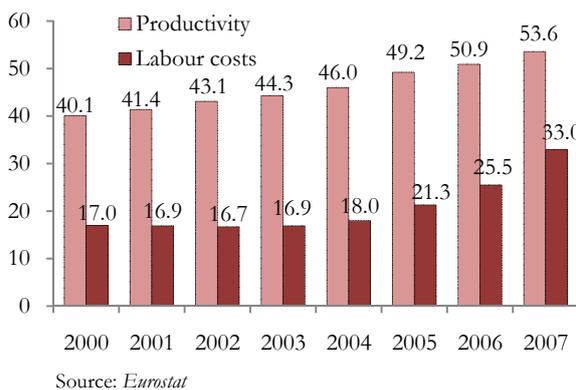
Changes of ULC-Real¹ in EU Member States
(2007 in comparison with 2004, %)



AT – Austria, BE – Belgium, BG – Bulgaria, CZ – Czech Republic, CY – Cyprus, DE – Germany, DK – Denmark, EE – Estonia, EL – Greece, ES – Spain, FI – Finland, FR – France, HU – Hungary, IE – Ireland, IT – Italy, LT – Lithuania, LU – Luxembourg, LV – Latvia, MT – Malta, NL – Netherlands, PL – Poland, PT – Portugal, RO – Romania, SE – Sweden, SI – Slovenia, SK – Slovakia, UK – United Kingdom
Source: Eurostat

Figure 5.7

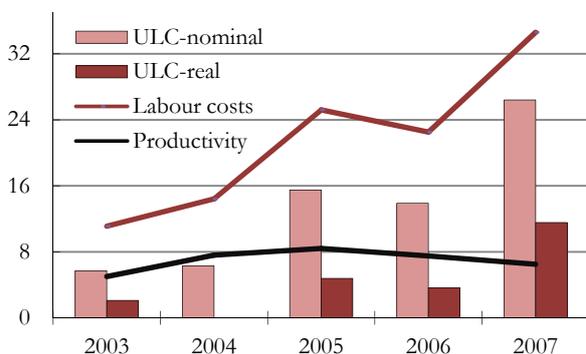
Convergence of Productivity and Labour Costs
(EU-27 = 100)



Source: Eurostat

Figure 5.8

Changes of Labour Costs
(percentage against the preceding year)

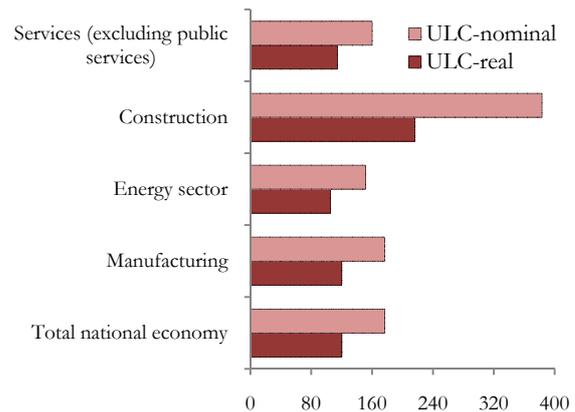


The rapid increase of labour costs is a consequence of Latvian labour force emigration and capital inflow, which is the result of deeper integration into the EU and world markets.

¹ nominal ULC deflated with GDP deflator

Figure 5.9

Changes of ULC-Real by Sectors
(level of 2003 = 100)



Source: Eurostat

In the economy in general the nominal ULC is increasing faster than real ULC because labour cost increase is partially compensated in prices of manufacturers. However, by comparing 2007 with 2006, the real ULC increased almost by two times more than in the previous two years. It means that due to the decrease of internal demand and increase of competitiveness, the effect compensating prices of manufacturers is gradually running out.

The unit labour cost dynamics vary among sectors. In all industries the pace of productivity increase is behind the pace of labour cost increase and the unit labour costs (both nominal and real) in 2007 exceeded the level of 2003.

In 2007, the most rapid increase of the real ULC was in construction (by 20.5%) and manufacturing (by 12.3%). It must be noted that unlike the previous years such ULC changes are related not only to increase of labour costs, but also to decrease of productivity. In 2007, even in service industries the general pace of ULC increase was almost two times higher than in the preceding years. However in the sectors of energy,

trade and financial services the real labour costs increased slower than productivity and the real ULC slightly decreased.

In general it must be concluded that in the previous two years unit labour costs were impacted not only due to significant increase of salaries, but also

due to decrease of the productivity growth pace. Therefore, along with unavoidable salary convergence it will be possible to maintain competitiveness in international markets at a fixed exchange rate only by increasing productivity, especially in the export sectors.

5.3. Employment Policy

The EU employment strategy and the long-term employment goals defined by the Council of Europe in Lisbon form the basis of the Latvian employment policy – to reach the average employment rate of 70% in the EU by 2010, including 60% for women and 50% for pre-retirement age persons of 55-64 years.

In order to achieve fulfilment of the main targets of the European employment strategy, the European Council adopted the Integrated Guidelines package in July 2005, where three priority lines of action are formulated:

- attract and retain more people in employment, increase labour supply and modernise social protection system;
- improve adaptability of workers and enterprises;
- increase investment in human capital through better education and skills.

According to the relevant situation, these lines of action are specified in the National Lisbon Programmes of the member states.

The National Lisbon Programme of Latvia for 2005-2008 (hereinafter – Programme) sets the following priorities of Latvian employment policy (see Chapter 6.1):

- promote an inclusive labour market by expanding the range of active employment measures;
- stimulate economic activities in the least developed regions;
- address the issue of undeclared work more intensively and stimulate the population to engage in the formal economy, by increasing net wages for low-paid employees and strengthening both the state control institutions and associations of social partners (trade unions, employee associations, etc.);
- expand opportunities of education and training.

The Programme envisages achieving the goals set by the European employment strategy or substantially approaching them and raising the employment rate to 67% (62% for women and 50% for persons in the age of 55-64 years) by 2010.

The rapid economic growth in the recent years is reflected also in the dynamics of the labour market indicators. The employment rate has increased in all target groups. The most important employment policy targets for 2008 set in the Programme were already

achieved in 2006, while the employment rate for women and persons in the age group of 55-64 years reached the target set for 2010 already in 2006. A trend of the rise of employment rate and decline of unemployment rate continued in Latvian labour market in 2007. With emigration of labour force to those old EU member states, which have opened their labour market, new changes have appeared in the labour market within the recent years. Relative shortage of labour force developed in several national economy sectors.

The State Employment Agency (hereinafter – SEA) implements the state policy in the areas of reduction of unemployment and support to unemployed persons and job seekers. In order to employ a higher number of people, the SEA organises **active employment measures**. Twice a year employer surveys are carried out on a regular basis within the framework of the short-term forecasting of labour market, professional training, retraining and improvement of professional skills, as well as other active employment measures for the unemployed are organised in accordance with the employers' demand.

The SEA implements such measures for reduction of unemployment as:

- professional training, retraining and improvement of professional skills of the unemployed;
- measures to raise competitiveness;
- measures for certain groups of persons.

Co-financing from the European Social Fund has allowed rapid increase in the number of unemployed persons involved in the active employment measures within the previous years. 54.6 thousand unemployed persons were involved in these measures in 2003, 179.6 thousand in 2005, 166.4 thousand in 2006 and 64.6 thousand were involved in 2007 (one unemployed person may be involved in several activities). Upon decrease in the unemployment rate, the demand for such measures has been accordingly decreasing, as well as their structure has changed, paying more attention to improvement of their efficiency.

The majority of participants are involved in the measures to raise competitiveness (48.6 thousand job seekers in 2007, 145.7 thousand in 2006). Other measures are implemented to the following extent: 3.9 thousand unemployed persons are involved in professional training, retraining and improvement of professional skills of the unemployed, 10.3 thousand

are involved in paid temporary works, and 1.8 thousand are involved in measures for certain groups of persons.

Career consultation services are provided to 44.3 thousand persons, 12.2 thousand of them were unemployed persons and job seekers.

Subsidised employment of the unemployed persons is implemented in the framework of measures for certain groups of persons. In 2007, an opportunity to acquire and improve professional skills at the workplaces established for a certain period of time was provided for 1405 unemployed persons in the framework of the measure. Subsidised employment of disabled – unemployed persons and unemployed persons from target groups is implemented, promoting finding regular work for unemployed persons of these groups. In 2007, a new active employment measure “Acquirement of working skills” is implemented with a goal to offer the unemployed persons an opportunity to test their professional adequacy at a particular workplace for duration of 3 months, as well as acquire the necessary skills that would facilitate finding regular work. The SEA pays for the work in the amount of a minimum monthly wage, while the employer covers social security payments and may make additional payments to wages.

Amendments to the Law for Support of the Unemployed and Job Seekers were adopted in June 2007, expanding the range of active employment measures. In order to promote inclusion of people in the labour market, measures to foster regional mobility will be carried out. New target groups of measures have been determined, such as economically inactive population, persons taking care of family members and persons with alcohol/drug addiction problems.

As from 2008, the SEA plans to offer training not only to the unemployed but also to the employed and self-employed persons in addition to the organised active employment measures. It will be possible for entrepreneurs and branch associations to improve skills of their employees by attracting co-financing from the European Social Fund. Furthermore, persons willing to start their small business will have an opportunity to apply for the support. The necessary training, as well as subsidies and loans for their first steps in business will be available for them.

For **inclusion of young people in the labour market**, the Professional Career Counselling State Agency (PCCSA) provided individual and group consultations in the choice of education and profession, determination of professional suitability and career planning. In order to help young unemployed people to integrate into labour market, they are being involved in a priority manner into the active employment measures organised by the SEA. Resulting from institutional changes, PCCSA is included in the SEA as from September 1, 2007 in order to concentrate professional career counselling services in the context of job seeking into one institution.

Promotion of youth employment is carried out in the framework of several projects. Several projects to raise competitiveness of young people are in the process of implementation with support of the European Social Fund, for example, the measure “Ensuring Work Practices for Unemployed Young People”.

The project “Employment Measures during Summer Holidays for Persons Acquiring Education in General, Special, or Professional Education Establishments” has been in process of implementation for several years. The aim of this measure is to promote summer employment of pupils and create an opportunity for them to gain work experience. In the project, SEA finances the wages for pupils from state budget resources in the amount of at least 50% of the minimum monthly wage determined in the country and covers expenses of the manager for the work practice. Expenses of the employers were constituted by pupils’ wages in the amount of at least 50% of the minimum monthly wage, tax payments, bonuses, lunches, etc. Approximately 7.8 thousand pupils were involved in this measure in 2007.

Latvia still has considerable reserves for **inclusion of women into employment**. Women often leave work or cannot start working due to inflexible work organisation, lack of childcare institutions or due to other reasons. Difference between female and male employment rate still exists, at the same time a notable difference between female and male wages also exists. The share of women employed in low-paid work is essentially higher than that of men. The measure “Raising Motivation and Professional Training of Unemployed Persons after Child Care Leave” is implemented in recruitment for employment of this target group.

The trends of the ageing society draw greater attention to prolongation of the working life. Significant thought is given to keeping or involving **older persons** in employment.

Although the employment rate has increased in all regions, considerable **regional differences** still exist. In 2007, the difference between regions with the highest and the lowest employment rates (Rīga and Latgale regions respectively) was more than 10 percentage points.

In the planning period of 2007-2013, a particular attention is devoted to reduction of regional differences, e.g., preference to local governments with high unemployment will be given in implementation of the activity “Support to implementation of local employment promotion plans”.

Due to the growing globalisation of economy, rapid development of technologies and negative demographic processes, an increasingly bigger attention to the issues of **flexicurity (labour market flexibility and employment security)** is paid in the European employment strategy. Already in March 2006, the European Council asked member states to pay more attention to implementation of the labour market reforms and social security policies.

Flexicurity contains 4 spheres of action that, by means of interaction, have to promote labour market flexibility and employment security. It is necessary to achieve that labour legislation and agreements are sufficiently flexible and correspond to the interests of both, employer and employee. In the case of necessity, active labour market policies have to promote efficient transition from one workplace to another or from the status of unemployed person to employment. It is necessary to improve the lifelong learning systems that would enable employees to be employed throughout the period of capacity for work. At the same time, a modern social security system has to be created, which would render adequate assistance to population in the case of unemployment, as well as would promote mobility and faster return to the labour market.

It is important to ensure modernisation of work organisation and safety at work. It should be noted that Latvia lags behind other EU member states in this regard. It is necessary to improve safety at work, the number of people injured in accidents at work is still high, and the number of persons suffering from occupational diseases tends to grow.

Latvia has a relatively high **rate of undeclared employment**, especially in construction, manufacturing, agriculture and transport services, which reduces the social security benefits and does not allow diminishing the burden of labour taxes. In order to address this problem more intensively and stimulate population to be engaged in the formal economy, net wages for low-paid workers are increased, raising the minimum wage and increasing the amount of non-taxable minimum, state control institutions are strengthened and co-operation with social partners (trade unions and employer associations) is activated.

For reduction of illegal employment, administrative capacity of the State Labour Inspectorate is increased. Formation of the register of employed persons has been started.

An essential role in the aspect of employment is played by **the educational system, accentuating the necessity of lifelong learning**. Investment in human capital is a determinant factor for increase of the productive capacity in order to promote transition to knowledge-based economy. This investment has to ensure substantial improvements in adaptability of the educational system to the changing demands of the labour market, improve availability of education at all levels, increase participation and responsibility of regional governments and employers in ensuring availability of professional education, and create an efficient system of lifelong learning.

The Lisbon Strategy envisages that at least 85% of young people in the age group of 20–24 years will complete secondary education by 2010. Situation in Latvia in this regard is better than in the EU on average. It is expected that this target set for 2010 will be achieved.

Considerable work for improvement of the educational system has been completed over the last years, and also resources of the EU structural funds are used for this purpose. Material and technical

provisions of professional education establishments are modernised and a set of measures to insure practice of students is established. In order to raise prestige of engineering sciences, natural sciences, medicine and other disciplines necessary for development of Latvia, more attention is paid to development and implementation of information campaign and to increasing the number of study places financed from the state budget in these disciplines.

A topical task is to reduce the number of students, who do not graduate or do not obtain professional education.

It is necessary to activate development of the lifelong learning system. According to the EU target, at least 12.5% of people in the age group of 25–64 years will be involved in activities of lifelong learning by 2010.

In February 2007, the Cabinet of Ministers accepted the *Lifelong Learning Policy Guidelines for 2007–2013*. This document formulates the basic principles, objectives, directions, and plans of action of lifelong learning policy. Attention is paid to recognition of informal education and to development of lifelong learning in regions. Lifelong learning programme for implementation of the guidelines in the nearest years is in the process of elaboration.

Changes in the labour market to timely balance the demand and supply of the labour market cause a necessity to develop the system of **labour market forecasting**. The Cabinet of Ministers has determined the Ministry of Economics, as the responsible institution for co-ordination of medium-term and long-term forecasting of the labour market in the country as from July 1, 2007.

The Ministry of Economics has started work and created the institutional framework to develop labour market forecasts. Labour Market Forecasting Co-ordination Division is established at the Ministry with the task to co-ordinate development and application of medium-term and long-term forecasts of the labour market.

To carry out the direct work, i.e., elaborate labour market development scenarios and medium-term and long-term forecasts, the Cabinet of Ministers accepted expansion of functions of the state agency “Latvian Institute of Statistics” (from July 1, 2007, the title of this agency was “Latvian Institute of Statistics and Labour Market Forecasting”).

In order to ensure more economical spending of the state budget expenditures and optimise performance of public administration functions, the Ministry of Economics initiated reorganisation of the state agency “Latvian Institute of Statistics and Labour Market Forecasting”. The Cabinet of Ministers accepted incorporation of the agency into the Central Statistical Bureau as from November 1, 2007 and takeover of the agency’s functions by the bureau.

At the beginning of 2008, the Advisory Council of Labour Market Forecasting of the Ministry of Economics started its work, in which the representatives of concerned institutions and social

partners are involved. The task of the Council is to ensure inter-institutional co-operation, assessing the prepared forecasts and searching for solutions of further action. In the first half-year of the operations, the Council has reviewed the prepared initial medium-term forecasts of the labour market by 2013, in the same way as the other documents prepared by the Cabinet of Ministers for implementation of Urgent Work Plan and related to labour market. Short-term forecasts of the labour market prepared by the Ministry of Welfare were reviewed in the meetings, as well as the analysis on migration issues prepared by the Ministry of the Interior in comparison with the both Baltic States. In order to obtain complete data characterizing the real labour market situation, the Central Statistical Bureau prepared proposals for the problem's solution. The most essential issues to be reviewed in the upcoming meetings this year refer to support of structural funds planned for labour market forecasting, activity of the State Employment Agency and Central Statistical Bureau in order to improve methodology of inquiries of employers necessary for development of short-term forecasts on labour market. In addition, it is planned to discuss the improvement opportunities of data collection used in forecasting the labour market by assessing the data collection methodology used by other institutions.

In order to work out scenarios and forecasts of labour market development, it is necessary to create an appropriate set of instruments for modelling. With the support of the European Social Fund, the Ministry of Welfare commissioned the study "Research of long-term forecasting system of labour market demand and analysis of its improvement opportunities". Results of the study include the set of modelling instruments necessary for development of medium-term and long-term forecasts of the labour market. The Cabinet of Ministers instructed the Ministry of Economics to begin implementation of the function of medium-term and long-term forecasting of the labour market, taking over the results of the mentioned study. After receiving the set of instruments at the end of June, the ministry has assessed its applicability and has conducted its approbation.

Preliminary medium-term forecasts of the labour market by 2013 are prepared after making the necessary improvements in the set of instruments. In June 2008, the Cabinet of Ministers accepted the informative report of the Ministry of Economics on the forecasts of conformity of labour force demand and supply within a medium-term also including these forecasts.

The main factors influencing the situation in the labour market in the medium term period by 2013 are as follows:

- dynamics and character of the growth of national economy, which will determine the increase and structure of the total labour market demand;
- unfavourable demographic development as a result of which the number of population decreases in terms of employment age;
- increase of the level of population involvement affected by both, economic growth rates, and the national employment policy.

The forecasts (3 scenarios of development – slow, moderate and dynamic development) are developed in the framework of 15 national economy sectors and 37 aggregated profession groups. The obtained results show the situation, which may develop in the labour market if changes are not made in the structure of education system.

In the case of slow and moderate development scenario, notwithstanding decrease of the number of population in employment age, the productivity growth, as well as gradual increase of the proportion of economically active population will ensure the total demand for labour force. In the case of dynamic development scenario a situation may appear, that labour force supply will not be sufficient for demand, unless the education system is properly adjusted, as well as incentives for further productivity growth.

In order to prevent the potential problems of the labour market revealing the forecasts, the main directions of activity should be as follows:

- corrections in the education system must be duly made, especially on the level of secondary and secondary vocational education, as well as in training of unemployed people and job seekers;
- implementation of the measures for increasing the level of economic activity of the population must be continued;
- operative and regular assessment of the labour market situation must be carried out for establishment and timely prevention of topical labour market problems;
- the measures for fostering re-emigration of Latvian population must be implemented.

6. ECONOMIC POLICY AND PRIORITIES OF STRUCTURAL POLICY

6.1. National Lisbon Programme of Latvia for 2005-2008

On October 19, 2005 the Cabinet of Ministers approved the *National Lisbon Programme of Latvia for 2005-2008* (hereinafter – Programme) aimed at promotion of national growth and employment. The Programme is a policy-planning document that shows how Latvia is going to achieve the Lisbon Strategy goals in 2005-2008 on the basis of the Integrated Guidelines approved by the European Council in July 2005¹.

The Programme is based on the policy-planning documents approved in Latvia and reflects the most essential problems of Latvia for achievement of the Lisbon Strategy goals, indicates main lines of action and activities to solve the problems as well as performance indicators for achievement of the goals.

National Lisbon Programme of Latvia for 2005-2008 prescribes that Latvian GDP per capita has to reach 51% of the EU average by 2008 and 54% by 2010. In order to reach this goal, annual GDP growth of 6-8% has to be ensured in 2005-2008.

Progress of implementation of the Programme² indicates that the principal goals set in it are achievable. Very fast growth is observed in Latvia in the recent years. GDP has increased by 10.4% on average annually since 2004. Rapid economic growth continues in 2007 as well. In the first 3 quarters of 2007, GDP increased by 11% in comparison with the respective period of 2006. Such rapid growth of GDP certainly decreases Latvia's backwardness from the old EU member states.

Indicators of employment also improve rapidly in Latvia. Employment rate reached 66.3% in 2006, i.e., it increased by 3 percentage points in comparison with 2005. It means that Latvia approaches the Programme's target to ensure employment rate of 67% in 2010.

Despite these achievements, Latvia is clearly aware of the existing problems and develops appropriate policies to solve them. Latvia supports decisions taken at the Spring meetings of the European Council in 2006 and 2007 and recommendations to the country. Measures to fulfil these decisions are being implemented.

The Programme points out five main economic policy directions to reach the Lisbon goals in Latvia, namely:

- securing macroeconomic stability;
- stimulating knowledge and innovation;
- developing favourable and attractive environment for investment and work;
- fostering employment;
- improving education and skills.

For each of the main economic policy directions, main tasks (priorities) are defined and specific measures with implementation terms are determined and, if the government has decided, also funding is set. The Programme takes into account the EU approach of the necessity to divide the economic growth from the resource use so that the economic and social progress is not achieved at the expense of excessive use of natural resources and deteriorated environmental quality.

Latvia has a goal to maintain a stable **macroeconomic environment** that is a necessary precondition for ensuring growth and workplaces. The Programme for 2005-2008 defines the following main tasks for maintaining the macroeconomic stability:

- to comply consistently with the fulfilment of the Maastricht fiscal criteria in Latvia and ensure gradual reduction of the government budget deficit;
- to introduce medium-term (3-5 years) budget planning and strategic planning in ministries and, in accordance with it, base the budget formation on financing the action policy goals and results;
- to promote coherent increase of wages and labour productivity in order to avert additional economic instability, at the same time taking into account the consequences of inflation;
- to ensure successful accession of Latvia to the euro zone.

¹ In March 2000 in Lisbon, the European Council approved the EU strategic development document (Lisbon Strategy) that sets as its main goal to achieve that the EU becomes the world's most competitive and dynamic knowledge-based economy in 10 years, which would ensure sustainable economic growth with more and better workplaces and greater social cohesion. In March 2005, the European Council approved the relaunched Lisbon Strategy, envisaging the necessity to focus its policy on growth and employment. It was decided that every member state has to develop a national reform programme for 2005-2008. In July 2005, the European Council approved the Integrated Guidelines for Growth and Jobs that combine the Broad Economic Policy Guidelines and the Employment Guidelines and constitute a base for development of national reform programmes.

² On October 9, 2007 the Cabinet of Ministers supported the *Report on Progress in Implementation of the National Lisbon Programme of Latvia for 2005-2008* that is developed by the Ministry of Economics and evaluates the progress in achieving the Lisbon Strategy goals.

One of the main economic development risks in Latvia is the high inflation rate and the high current account deficit caused by high domestic demand.

Government has worked out and started implementing the *Inflation Reduction Plan* that is directed at restriction of the domestic demand.

Fiscal consolidation successfully carried out already in the previous years continued in 2006, which ensured that the general government budget deficit was 0.3% of GDP in 2006. *Inflation Reduction Plan* prescribes that a balanced budget must be achieved in 2007 and 2008, while it is planned to form a budget with surplus in 2009 and 2010. However, by the Law “Amendments to the Law “On the State Budget for 2007””, the Saeima has approved the state budget for 2007 with a surplus of 0.4%, and the government plans to reach even bigger budget surpluses in 2008, 2009 and 2010 than in 2007 (see Chapter 4.1.1).

The Cabinet of Ministers has taken decision on the maximum permissible amount of the total expenditures of the state budget for 2008-2010. It is also envisaged to raise efficiency of the public sector without increasing the number of its employees. In order to ensure purposeful development and efficient spending of the state budget resources, ministries introduce the strategic planning and, as a result, budget formation is based on financing the action policy goals and results.

General government debt in Latvia is still among the lowest in the EU, and its level in the medium term is expected to remain considerably lower than the Maastricht criterion.

Assessment of sustainability of public finances of Latvia is positive and, in accordance with assessment by ECOFIN, Latvia is among countries at low risk with regard to sustainability of public finances.

Latvia's National Euro Changeover Plan is being implemented, which prescribes to carry out several measures with respect to alignment of laws and regulations for adjustment of the normative base of money and payment systems, financial system, management of state debt, budget accounting and statistics, business environment and consumer protection, tax and social provision and ensuring its technical operation as well as for informing the society. The Cabinet of Ministers approved the Latvia's National Euro Changeover Plan updated according the current situation in the country and its Appendix No. 1 “Action Plan for Introduction of the Single European Currency in Latvia” on September 25, 2007.

Economy based on **knowledge and innovation** is a precondition for development and competitiveness of the Latvian economy. The main tasks of the Programme in 2005-2008 are as follows:

- to increase public investment and foster private investment in research and development;
- to ensure renewal of the intellectual potential in science, improving the system of doctoral

grants and modernising the scientific infrastructure;

- to promote transfer of knowledge and technologies in production (including business incubators and technology parks);
- to increase internet availability and introduce electronic signature as well as ensure wider public services in e-environment.

The Programme sets the target that gross domestic expenditures on research and development have to reach 1.5% of GDP in 2010. In order to reach this target, according to the *Law on Scientific Activity* the annual increase of financing for scientific activity in the state budget is prescribed to be at least 0.15% of GDP or by LVL 10-15 million on average annually, at the same time improving the procedure of granting public funding for scientific activity, which is set out by normative acts. Substantial modernisation of scientific infrastructure in research institutes and higher educational establishments and reorganisation of state science institutes are envisaged.

Public financing for research and development amounted to LVL 29.8 million in 2006 and LVL 32.4 million in 2007.

National programme “*Support for Implementation of Doctoral Programmes and Post-Doctoral Research*” is being implemented for renewal of intellectual potential of scientific activity. In order to foster renewal and development of intellectual potential of scientific activity, it is envisaged to achieve increase of the number of new doctors to 500 doctors of science trained annually by 2013 (106 doctoral theses were defended in 2006).

According to provisions of the Programme, Latvia improves activities of measures related to technology transfer and strengthening co-operation between educational and research institutions and industries (see Chapter 6.5).

Commercial companies have the opportunity to submit projects to the Ministry of Education and Science to receive assistance for implementation of the projects in the framework of *EUREKA programme. Market-Oriented Research Programme* is being implemented and research projects aimed at fostering integration of science and production are being supported in its framework.

To promote transfer of technologies and knowledge, operation of technology transfer contact points at Latvian higher education institutions is supported and work of the *Innovation Relay Centre* is ensured.

Implementation of the *Innovation Centres and Business Incubators Development Programme* was started in 2007. Its goal is to promote improvement of innovation infrastructure as well as support innovation centres and formation and operation of business incubators. 11 projects of innovation centres and business incubators have been supported in the framework of the programme.

In the next financial perspective period (2007-2013), it is planned to implement new programmes directed to promotion of co-operation between industries and research institutions, such as support to competence centres, promotion of technology transfer, support to business incubators and continuing implementation of programmes for support to innovation in the private sector.

The government has set several tasks for faster development of the information society (see Chapter 6.6). The first, which has to be ensured, is free competition in the market of information and electronic communication services, and a lot is already done in this regard. Progress is reached in terms of the increase of the number of Internet users: 31% of households had Internet access in 2005, while 42% had it in 2006. 14% of households had broadband access to Internet in 2005 (23% in 2006). Internet was available for 80% of enterprises in 2006. Progress is smaller in terms of access to public services and use of these services by enterprises.

In order to develop and improve the infrastructure of electronic government and the range and quality of its services:

- integrated state information systems are being formed, which include electronisation of services and integration of information systems of institutions. State and local government registers are planned to be connected into united system in the future;
- unified state portal is being established, which will be the main channel of access to electronic services of the public sector;
- assessment of normative acts related to electronic signature and development of appropriate normative acts are continued. Since October 4, 2006 every inhabitant of Latvia is provided with opportunity to acquire means for creation of safe electronic signature, which are ensured by the state JSC “Latvijas Pasts” as accredited provider of certification services;
- electronic procurement system maintained by the *Electronic Procurement State Agency* is established;
- new public Internet access points are being developed and provision of information society services is being promoted, e.g., the project of digital library, expanding the opportunities of access to digital content for population.

Conditions for ensuring a **conductive environment for investment and work** improve every year. Reforms for improvement of business environment are evaluated positively in various surveys. In the survey “*Doing Business in 2008: How to reform*” conducted by the World Bank Group, business environment of Latvia takes the 22nd place among 178 countries, which is by 2 positions higher in comparison with the previous year, due to

achievements in the spheres of taxation, licensing and liquidation of enterprises.

The study *Global Entrepreneurship Monitor* conducted annually by the *Stockholm School of Economics in Riga* reveals that the proportion of young entrepreneurs (in the age of 18 to 34 years) grows rapidly in Latvian business: from 8% in 2005 to 11% in 2006. Young people in the age of 18 to 24 years represent 27% of all early-stage companies in Latvia.

The Programme sets the following main tasks as priority directions for creation of favourable and attractive environment for investment and jobs in 2005-2008:

- to promote entrepreneurial culture, lessen administrative obstacles and burden, create supportive environment for SMEs;
- to strengthen supervision of competition and ensure effective competition in public services;
- to improve and develop the transport infrastructure, increase the number of connections with other European infrastructure networks;
- to speed up the administrative territorial reform;
- to ensure effective, safe and sustainable energy supply, supporting decisions of the 2006 Spring European Council.

Latvia supports introduction of instruments for implementation of the EU *better regulation* initiative both at the European Community level and at the national level of EU member states.

For evaluation of the impact of administrative burden in Latvia, a system of annotations of normative acts is established under supervision of the *State Chancellery*. In the framework of the *better regulation* initiative, pilot projects for determination of administrative burden in such spheres as tax legislation, labour legislation, construction, real estate transactions, fuel market, etc. are being implemented in 2007.

Action Plan for Improvement of Business Environment is worked out annually since 1999. Problems included in the Action Plan and their solutions are identified through close co-operation with organisations representing entrepreneurs (see Chapter 6.4).

The Action Plan for 2007 includes 27 measures. The most important issues that are being solved in the framework of this plan are assessment of the rate of state social security payments, improvement of medium-term and long-term forecasting of the labour market, simplification of the procedure for assessment of requirements of labour environment, more efficient settlement of labour disputes, bringing into effect the real estate registration system and simplification of registration procedures, development of infrastructure of the State Land Service, creation of information system of planning and construction, development of the process of cadastral survey of buildings, improvement of exchange of information, etc.

On January 1, 2008 new *Insolvency Law* came into force. It provides legal conditions for balancing the interests of debtors and creditors by changing the applicable procedures, principles and goals in insolvency situations and prescribing more favourable legal conditions for restoration of insolvency of debtors and continuation of economic activity.

In the sphere of protection of competition (see Chapter 6.8), the priority up to now has been to fight the gravest violations of the *Competition Law* – conclusion of prohibited agreements and abuse of dominant position. This priority still remains in terms of importance of the violation, however, assessment of the impact of company merger on competition becomes increasingly topical because, in conditions of fast economic growth, intensive merger of companies to ensure competitiveness both in the domestic market and outside it, is observed. Amendments to the *Competition Law* have been developed, which introduce prohibition of abuse of essential influence.

In order to improve access to financing for SMEs (see Chapter 6.7), more attention is paid to allocation of financing for development of business activity in early stage and availability of finances in the form of risk capital as well as to co-financing for development projects of businessmen in territories requiring special assistance. Financial support to entrepreneurship and innovation from the structural funds is planned in the amount of EUR 480 million in the financial perspective period of 2007-2013.

Latvia supports the decision of the 2006 Spring European Council meeting regarding the **energy policy**. It is important to improve the security of energy supply and diversify energy sources thereby reducing the dependence of EU member states from one energy supplier. Latvia fully supports the idea to develop a common EU energy policy and use a co-ordinated approach in relations with third countries as well as establish a crisis management system. Latvia is particularly interested in integration of the Baltic States' energy market into the single EU energy market. At present, the energy market of the Baltic States is isolated from the EU energy market. Co-operation projects between the neighbouring countries are being developed or implemented in order to lessen the energetic isolation from other EU member states.

The government has accepted the *Energy Development Guidelines for 2007-2016* that envisage several strategic measures to reduce the energy dependence of the country, among them construction of a new power station in Latvia and increased use of renewable energy resources, especially biomass, in energy production (see Chapter 6.3.2).

Discussion of safe supply of natural gas in perspective is allowed by the fact that Latvia has a potential for underground storage of gas in the amount of up to 70 billion m³, which may be explored and used for storage of gas in the future.

Latvian electricity market is open for all consumers as from July 1, 2007. It is planned to open the

domestic gas market by 2010. Opportunities for competition in the energy market will be created in this way.

Taking into account the policy implemented by the EU in the field of climate change reduction and the energy supply security issue topical for Latvia, sustainable use of energy resources is one of priorities of the state. Therefore the government supports measures aimed at rise of energy efficiency and use of cogeneration and renewable energy resources as well as promotes development of environmental technologies. Latvia supports the decision of the 2007 European Council meeting in regard to setting the common EU target of renewable energy resources in the amount of 20% of the total EU consumption of energy resources by 2020 on condition that EU member states are fully involved in division of this target by member states. However, Latvia sees many risks from the economic, technical and environmental aspects and the aspect of sustainable development of resources.

It must be noted that, considering the Decision No. K(2007)3409 adopted by the European Commission on July 13, 2007 regarding amendments to the quota distribution plan of Latvian greenhouse gas emissions, the total decrease from the emission quota volume necessary and planned for Latvia reaches 55%. Latvian state has well-founded concern about development of the Latvian economy and growth of prices in regard to purchase of the necessary volume of quotas, and Latvia currently plans to bring an action in the Court of First Instance of the European Communities against the European Commission for repeal of the mentioned decision.

Although **employment** in Latvia has increased in the last years, which was affected by the economic growth, there are considerable regional differences in employment and unemployment, incompatibility of employee skills with labour market requirements, relatively high rate of undeclared employment, high unemployment rate among young people, persons after childcare leave, disabled persons, people with insufficient knowledge of Latvian language and other socially excluded risk groups in the labour market.

The Programme for 2005-2008 defines the following main tasks for fostering employment:

- to promote inclusive labour market;
- to encourage economic activities in the least developed regions;
- to reduce the undeclared employment.

Life-cycle approach to employment, improvement and diversification of active employment measures along with development of labour market institutions, employment partnerships and social dialogue are the basic elements that make up the set of employment policy measures of the Programme. Latvia has the target to reach employment rate of 65% in 2008 (including 61% for women and 48% for older people) and 67% (62% and 50%) respectively in 2010.

As already mentioned, labour market indicators in Latvia have considerably improved in the last years due to rapid economic development, improvement and diversification of active labour market measures and other factors. All most important employment policy targets planned in the Programme for 2008 and partly for 2010 (employment rate of women and people in the age group of 55-64 years) were reached already in 2006. However, the employment rate, level of participation of population and other labour market indicators still lag behind the level reached in several EU member states. At the same time, individual sectors of national economy start to face shortage of labour due to emigration of the labour force.

In order to employ the existing labour resources more completely, active labour market policy measures are being expanded. The total number of unemployed persons involved in active labour market policy measures financed by the state increases constantly (54.6 thousand in 2003 and 166.4 thousand in 2006), mainly at the expense of raising competitiveness of the measures.

Several new measures related to inclusion of young people, pre-pension age people and women after childcare leave as well as the disabled and people from other social exclusion risk groups in the labour market were expanded or started in 2006.

In order to improve competitiveness of population in the labour market, the SEA, in addition to the organised active labour market policy measures, plans to offer training not only to unemployed persons, but also to employed and self-employed persons as from 2008. Entrepreneurs and industry associations will be able to apply for co-financing from the European Social Fund for training of their employees. Also persons willing to start small business will have access to the necessary training and to subsidies and loans for the first business activities.

Support to development of business activity in territories requiring special assistance is provided both in the framework of national financing (*Regional Fund*) and by the use of EU financial resources, encouraging economic activities in these territories, creating new workplaces and maintaining the current ones.

The growing activity of entrepreneurs and the achieved performance indicators show growth of business activity in territories requiring special assistance. Therefore a new support programme for development of entrepreneurship in territories requiring special assistance is being worked out for the planning period of 2007-2013 in the framework of EU structural funds.

Latvia has a relatively high rate of undeclared employment. The Cabinet of Ministers has approved the *Action Plan for 2005-2009* in order to reduce illegal employment. The work is being done in three main directions – to raise the administrative capacity and improve the control of the *State Labour Inspectorate*, improve the co-operation of control institutions, and

carry out measures to inform the society and promote the legal culture.

One of the most efficient means to stimulate population to work in formal economy is raising the net wages of persons with low income. Thereby the government increased the minimum monthly wage, the monthly minimum not subjected to personal income tax and the monthly tax allowance for dependent persons both in 2006 and 2007. The minimum monthly wage has been raised to LVL 160 as from January 1, 2008.

Investment in human capital – **improvement of education and skills** – is a decisive factor for raising the productive capacity in order to promote progress towards knowledge-intensive economy.

The Programme envisages the following main tasks for improvement of education and skills in 2005-2008:

- to strengthen co-operation between public institutions, education institutions and employers in order to adjust the supply of educational system in accordance with labour market needs;
- to raise cost efficiency at all stages and forms of education;
- to improve availability of education at all levels and reduce the number of those students, who do not complete their studies or do not obtain professional qualification;
- to increase availability of life-long learning and motivation of population in this area;
- to raise the overall level of technological skills and natural science knowledge, improve the professional orientation system and ensure availability of professional orientation services for all population in the context of life-long learning.

Co-operation between public institutions, education institutions and employers for adjustment of the supply of educational system in accordance with labour market needs is strengthened, cost efficiency is raised at all stages and forms of education, availability of education at all levels is improved, the overall level of technological skills and natural science knowledge is raised, and the system of life-long learning is improved in order to ensure improvement of education and skills.

The Programme sets a goal to raise the education level of young people, which is quantitatively defined for 2010 – the share of young people (20-24 years) with at least a secondary education would reach 85%. This indicator corresponds to the target indicator set by the EU for 2010. Latvia already exceeds the respective EU average indicator of the share of young people (20-24 years) with at least a secondary education. This share reached 81% in 2006 in comparison with 77.7% in EU-25 member states.

Several measures are being carried out so that all children of the compulsory education age would be included in the education system (currently 95% on

average). Special equalising education programmes providing opportunity for schoolchildren, who finished the 9th grade with school-report to acquire certificate of basic education during one year were implemented in 2006/2007 academic year. The number of schoolchildren, who finish the 9th grade with school-report i.e. do not acquire basic education, is decreasing.

Both in 2005/2006 academic year and in 2006/2007 academic year, the number of places financed from the state budget was raised in conformity with the labour market needs in such thematic groups of education as engineering sciences and technology, natural sciences and mathematics, health, healthcare and social care.

Lifelong learning system that would provide opportunity for population to adapt to the conditions of the changing labour market is being created. The Cabinet of Ministers approved the *Lifelong Learning Policy Guidelines for 2007-2013* on February 13, 2007. Introduction of lifelong learning strategy is being carried out by offering to all Latvian inhabitants, who want to acquire education or have to acquire it compulsorily an education that ensures inclusion in the labour market, active participation in civic society and growth of personality. *Draft Action Programme for Implementation of Lifelong Learning Policy Guidelines 2007-2013 for 2007-2010* is worked out, which reflects the set of measures, planning of time for their fulfilment, and the current and necessary costs for their implementation.

Utilisation of structural funds of the European Union facilitates achieving the targets set in the Lisbon Strategy in Latvia. Approximately 60% of financial resources from structural funds in 2004-2006 planning period were channelled for implementation of priorities of the Lisbon Strategy. Likewise, in the 2007-2013 planning period of structural funds and the Cohesion Fund, it is planned to channel approximately 61% of the total granted financing for implementation of priorities of the Lisbon Strategy.

Priorities of Latvia for work in the next seven years are also clear, namely, raising competitiveness and development of a knowledge-based economy. The government has identified three main priorities for further development of the country in the period of 2007-2013, namely, educated and creative person, technological excellence and flexibility of enterprises, development of science and research (*National Development Plan of Latvia for 2007-2013*).

In order to provide **co-ordination and supervision of implementation of the Lisbon Strategy**, the government has developed the mechanism for monitoring of the implementation in Latvia and has established:

- the *Supervisory Board of the Lisbon Strategy*, in order to ensure fulfilment of the tasks set in the Lisbon Strategy in Latvia. The Board is chaired by the Minister of Economics approved by the

Cabinet of Ministers as the co-ordinator of the Lisbon Strategy's implementation and supervision. Ministers and representatives of the Saeima, local governments and social partners, who are linked to the Lisbon process, are included in the Board. Tasks of the Board are to co-ordinate development of the *National Lisbon Programme of Latvia* and involve public institutions, the Saeima, local governments and social partners in development of the Programme as well as supervise fulfilment of the Programme and inform the society about fulfilment of its tasks. It should be noted that the *Supervisory Board of the Lisbon Strategy* was expanded in 2007, including the Minister for Special Assignments in Managing EU Resources and a representative of the Commission of European Affairs of the Saeima;

- the *Advisory Working Group of the Lisbon Strategy*, in order to ensure development of the *National Lisbon Programme of Latvia* and its implementation at the inter-institutional level. The Working Group is chaired by the State Secretary of the Ministry of Economics. Senior officials of the ministries linked to the Lisbon process are included in the Working Group.

Meetings of the *Supervisory Board of the Lisbon Strategy* and of the *Advisory Working Group of the Lisbon Strategy* are held at least once per quarter.

The issues related to the Lisbon Strategy are discussed at commissions of the Saeima, at the National Economy Council, Latvian Council of the Small and Medium-Sized Enterprises and Crafts, Free Trade Union Confederation of Latvia, seminars, conferences, etc. The EU Information Agency organises discussions on Lisbon Strategy issues on a regular basis.

It should be noted that the assessment by the European Commission of implementation of the national Lisbon programme in Latvia as well as recommendations to Latvia were reviewed both at the meetings of the Advisory Working Group and at the meetings of the Supervisory Board of the Lisbon Strategy. Proposals for implementation of recommendations of the European Commission were discussed during these meetings.

In summer 2007, the Ministry of Economics commissioned the study "Assessment of Progress in Implementation of the *National Lisbon Programme of Latvia*" in order to assess progress in implementation of this programme for 2005-2008 and influence of its measures on reaching the Lisbon Strategy targets in Latvia, and to work out recommendations for new measures and further policy. Round table discussions were organised in the framework of this study, inviting experts, etc.

Social dialogue is important to achieve the goals of the *National Lisbon Programme of Latvia for 2005-2008*.

That is why the Programme foresees several measures for improvement of the social dialogue both at the national level and the regional level. Institutions involved in the employment partnership, among them the Employers' Confederation of Latvia and the Free Trade Union Confederation of Latvia, will be strengthened in the framework of the national programme “*Support to capacity-building for implementation of the labour market and gender equality policies in the responsible institutions, distribution of information and raising awareness*” co-financed from ESF. In the framework of the Programme, also capacities of Latvian local and regional governments and the Latvian Association of Local and Regional Governments are being built in

order to ensure development of employment partnership and social dialogue at the local and regional government level.

On December 12, 2007 the European Commission published the annual *Progress Report* that assesses the progress in implementation of the Lisbon Strategy in the EU and EU member states. This annual progress report contains also the European Commission's recommendations for every EU member state. Summary of the assessment of implementation of the Programme and recommendations to Latvia by the European Commission are reflected in Box 6.1.

Box 6.1

Assessment of implementation of the Programme and recommendations to Latvia by the European Commission

European Commission considers that the main challenges for Latvian economic policy are as follows:

- bigger attention should be paid to the development of more concrete measures to secure macroeconomic stability in the face of overheating pressures;
- priorities of the R&D strategy should be set, as well as private sector involvement should be increased;
- labour supply should be increased and the labour skills should be improved.

Recommendations of the European Commission to Latvia are as follows:

- to pursue a more restrictive fiscal policy, with a careful prioritisation of expenditures and wage developments that are in line with productivity, in order to contribute to correcting overheating pressures and reducing the risk of macroeconomic instability;
- make faster progress in the implementation of the research and innovation policy reforms, in order to meet the ambitious targets set. This concerns especially policies to stimulate partnerships between research and education institutions and businesses;
- within an integrated flexicurity approach, intensify efforts to increase labour supply and productivity by improving regional mobility and enhance the responsiveness of education and training systems to labour market needs by putting in place a lifelong learning system and pursuing active labour market policies.

In addition, Latvia should focus on: improving further the regulatory environment, notably by means of an explicit better regulation policy and improving access to childcare.

Consistently implemented economic policy directed towards establishment of a new, knowledge-based economy and fostering employment provides an opportunity for Latvia to achieve the targets set in the Lisbon Strategy.

During March 13-14, 2008, the Spring European Council, upon approving the *Integrated Guidelines for Growth and Jobs for 2008-2010* and country-specific recommendations of the EU Member States, started the new cycle of the Lisbon Strategy for 2008-2010.

Each EU Member State must update its national Lisbon programme and evaluate measures, which have been implemented during the previous cycle of the Lisbon Strategy (2005-2008), their efficiency, and the new tasks and measures for 2008-2010 must be set on the basis of the updated Integrated Guidelines and country-specific recommendations of the EU Member States. Updating of the *National Lisbon Programme of Latvia* has been started, which has to be submitted to the European Commission by October 15, 2008.

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

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

As an EU member state, Latvia has access to financial support from EU Structural Funds, which is an instrument for implementation of EU regional cohesion policy.

Latvia's goals regarding the planned use of support from the Structural Funds are set out under the

Development Plan or the Single Programming Document (*SPD*). The Single Programming Document for the Structural Funds Objective 1 programme 2004-2006 for Latvia was approved by European Commission decision C(2004) 2121 of June 17, 2004.

The total funds accessible within the framework of the Structural Funds, which beneficiaries can apply for, consist of financing from the EU Structural Funds and national financing (co-financing from the state budget

and budgets of local governments). The financing amount from the EU Structural Funds is 75%, while 25% comes from the state budget and budgets of the local governments. In order to apply for support from the Structural Funds, the beneficiary has to provide own financing.

Total financing accessible to Latvia under the framework of Structural Funds programmes in 2004-2006 amounts to EUR 845 million (EUR 625 million from the EU Structural Funds and EUR 220 million from the state budget).

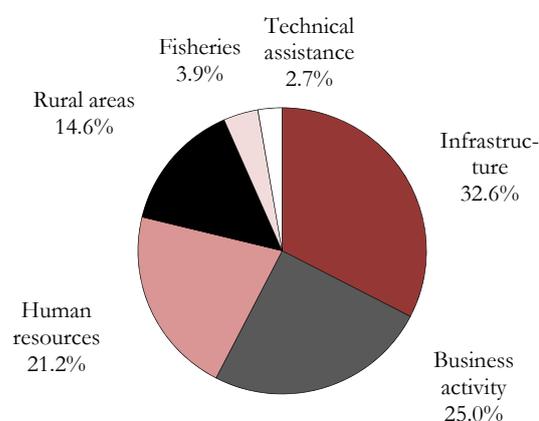
Financing of EUR 625 million from the EU Structural Funds consists of resources from the following funds:

- European Regional Development Fund (EUR 369 million);
- European Social Fund (EUR 139 million);
- Guidance Section of the European Agricultural Guidance and Guarantee Fund (EUR 93 million);
- Financial Instrument for Fisheries Guidance (EUR 24 million).

The breakdown of support from the Structural Funds by sectors shows that the biggest part of the financing (32.6%) is envisaged for infrastructure projects and projects for promotion of business development (25%).

According to the informative report of the Minister for Special Assignments in Managing EU Resources¹ on implementation of activities of the Single Programming Document and use of financing, up to March 31, 2008, LVL 304 million or 69% of the total accessible SF financing has been paid to the beneficiaries of financing from the EU Structural Funds or project implementers.

Figure 6.1
Breakdown of Support from the Structural Funds by Sectors for 2004-2006



Up to March 31, 2008, expenses of the Structural Funds declared by the European Commission amounted to LVL 268.9 million (61.2% of the total SF financing granted to the state). It should be specified that in the first quarter of 2008, only ERDF resources were declared by the EC to the amount of LVL 7.2 million or 2.7% of the total ERDF financing, therefore the total amount of declared resources of the Structural Funds in the first quarter of 2008 was low – 1.6% of the total financing from the Structural Funds. The EC has made repayments to the state budget of Latvia within the framework of ERDF to the amount declared by the EC. In addition, the EC repaid LVL 0.7 million (4.1% of FIFG financing) in the framework of FIFG in the first quarter of 2008, therefore the total increase of repayments made by the EC in the first quarter of 2008 was 1.8 percentage points or LVL 7.9 million.

Table 6.1

Absorption of EU Structural Funds by March 31, 2008

| | SF financing | | Paid to beneficiaries of SF financing | | Expenses of the Community declared by the European Commission | | Payments received from the European Commission | |
|--------------|---------------|---------------|---------------------------------------|---------------|---|---------------|--|--|
| | million LVL | million LVL | % of financing | million LVL | % of financing | million LVL | % of financing | |
| ERDF | 268.50 | 163.43 | 60.9 | 145.47 | 54.2 | 145.47 | 54.2 | |
| ESF | 89.50 | 64.93 | 72.6 | 56.43 | 63.1 | 50.76 | 56.7 | |
| EAGGF | 64.55 | 59.80 | 92.6 | 53.03 | 82.2 | 50.83 | 78.8 | |
| FIFG | 17.10 | 15.90 | 93.0 | 13.96 | 81.6 | 13.51 | 79.0 | |
| Total | 439.65 | 304.06 | 69.2 | 268.89 | 61.2 | 260.57 | 59.3 | |

In order to ensure repayment into the budget of Latvia of all SF resources allocated to Latvia, the EC must by the end of 2008 declare EUR 175.1 million (LVL 123.1 million) of ERDF financing, EUR 47.1 million (LVL 33 million) of ESF financing, EUR 16.4

million (LVL 11 million) of EAGGF financing, and EUR 4.5 million (LVL 3.2 million) within the framework of FIFG.

The progress of the current measures and priorities of the Development Plan under management of the Ministry of Economics is characterised in Tables 6.2 and 6.3.

¹ Informative report "On absorption of European Union financial resources (Structural Funds and Cohesion Fund)" of the Minister for Special Assignments in Managing EU Resources, May 13, 2008.

Table 6.2

Absorption of ERDF Activities under Management of the ME by March 31, 2008

| No. | Activity | Total financing of the activity, including liabilities, LVL million | Payments made by March 31, 2008, LVL million | Execution, % |
|-------------------|--|---|--|--------------|
| 1.1.4.1. | Improvement of heat supply systems by lowering the content of sulphur in heating fuel | 4.393 | 2.343 | 53.3 |
| 1.1.4.2. | Modernisation of heat supply systems in accordance with environmental requirements and energy efficiency increase for both manufacture and distribution of heat supply systems and end consumers | 12.195 | 6.575 | 53.9 |
| 1.1.5. | Efficient use of cultural heritage in the development of tourism | 10.214 | 3.287 | 32.2 |
| 2.1.2. | Support to developing samples and pilot models | 3.873 | 1.846 | 47.7 |
| 2.2.1.1. | Investment in private infrastructure for modernisation of production processes and products | 81.972 | 63.263 | 77.2 |
| 2.2.2. | Support to private infrastructure investments in common equipment (for testing, certification laboratories and similar activities) | 4.168 | 2.782 | 66.7 |
| 2.2.3. | Support to private infrastructure investments for ensuring access to public networks (roads, electricity, water etc.) | 4.215 | 2.296 | 54.5 |
| 2.3.1. | Support to participation of enterprises in international fairs and events | 3.697 | 0.850 | 23.0 |
| 2.3.2. | Financial support to SME external consultations for the use of services and exchange of experience | 2.565 | 2.647 | 103.2 |
| 2.4.1. | Loans (including microcredits) for starting business | 10.285 | 10.289 | 100.0 |
| 2.4.2. | Development of loan guarantee system | 3.618 | 3.614 | 99.9 |
| 2.4.3. | Risk capital fund | 10.285 | 4.114 | 40.0 |
| TOTAL ERDF | | 151.480 | 103.906 | 68.6 |

In order to level out the differences between the EU member states after accession to the EU, access to resources from the **Cohesion Fund** replaces the ISPA funds, which were available for Latvia before accession. Assistance from the Cohesion Fund is

available for those EU member states where GDP per capita is below 90% of the EU average. The main goals of the Cohesion Fund are to provide support to environmental protection measures and improvement of transport infrastructure.

Table 6.3

Absorption of ESF Activities under Management of the ME by March 31, 2008

| No. | Activity | Total financing of the activity, including liabilities, LVL million | Payments made by March 31, 2008, LVL million | Execution, % |
|------------------|---|---|--|--------------|
| 3.1.1.1. | Support to improvement of professional skills, retraining and further education of employees | 3.209 | 2.188 | 68.2 |
| 3.1.1.2. | Improvement of professional skills and retraining of employees providing training specific for the sector | 2.019 | 0.846 | 41.9 |
| 3.1.3. | Training, consultations and financial support for starting business and self-employed activity | 5.780 | 3.339 | 57.8 |
| TOTAL ESF | | 11.008 | 6.373 | 57.9 |

Similarly as in case of the Structural Funds, resources from the Cohesion Fund are only granted as co-financing for measures supported financially by the member state. The EU co-financing from this fund was set at 80-85%. Furthermore, the contribution from the EU may even reach up to 90% of the total

project costs if financing is also received from the Structural Funds. The total project costs have to reach at least LVL 7 million (EUR 10 million).

Utilisation of resources from the Cohesion Fund is set out within the Reference Framework Document co-ordinated with the European

Commission in December 2003. In contrast to the Single Programming Document, which only sets out the priority areas of support, the Reference Framework Document defines specific projects, for which financing will be granted. The Cohesion Fund has a broader range of financing in comparison with ISPA:

- transport sector – roads, railways, ports, airports, public transport;
- environmental sector – management of household waste (regional waste landfill sites), sewerage treatment, drinking water supply.

The total financing from the Cohesion Fund available for Latvia in the period 2000-2006 amounts to EUR 710 million, of which EUR 310 million

comprise the financing for projects currently under implementation (former ISPA projects), EUR 230 million are earmarked for Cohesion Fund project applications of 2004, and EUR 170 million comprise the financing for Cohesion Fund (CF) project applications to be submitted in 2005 and 2006.

EUR 435.9 million or 61.3% of the total financing from the Cohesion Fund have been requested by the EC by March 31, 2008. The EC has received EUR 415.5 million or 58.5% of the financing from the Cohesion Fund approved for Latvia within the programming period of 2004-2006, while EUR 365.9 million or 51.5% of the CF financing is paid to the project implementers within the framework of the concluded contracts.

Table 6.4

Absorption of the Cohesion Fund by March 31, 2008

| | Available financing | Projects approved by the European Commission (assumed liabilities) | | Paid to beneficiaries of CF financing | | Payments requested from the European Commission | | Payments received from the European Commission | |
|--|---------------------|--|--------------------------|---------------------------------------|--------------------------|---|-------------|--|-------------|
| | million EUR | million EUR | % of available financing | million EUR | % of assumed liabilities | million EUR | million EUR | % of available financing | million EUR |
| Ministry of Environment | | 353.2 | 49.7 | 163.7 | 46.4 | 196.7 | 55.7 | 184.0 | 52.1 |
| Ministry of Transport and Communications | | 353.9 | 49.8 | 201.1 | 56.8 | 237.6 | 67.2 | 230.1 | 65.0 |
| Ministry of Finance | | 3.7 | 0.5 | 1.2 | 33.9 | 1.5 | 41.9 | 1.4 | 38.1 |
| CF total | 710.8 | 710.8 | 100 | 366.0 | 51.5 | 435.9 | 61.3 | 415.5 | 58.5 |

Twenty Cohesion Fund projects have been approved in the environmental sector, including 17 infrastructure projects and three technical assistance projects with the total CF financing to the amount of EUR 217.6 million (the total financing of the projects constitutes EUR 366.2 million).

Fourteen Cohesion Fund projects have been approved in the transport sector, including 11 infrastructure projects and three technical assistance projects with the total CF financing to the amount of EUR 312.2 million (total financing of the projects is EUR 563.6 million).

Implementation of the Cohesion Fund projects is taking place steadily. Some of the projects have been completed while implementation of several projects has been delayed for two years. Implementation of several CF projects is planned by 2008-2009 in accordance with decisions or financial memoranda of the European Commission. The main problems in implementation of projects in the environmental and transport sectors are still arising from considerable price rises in the construction sector, which has increased the costs of a majority of the projects that were planned and started in the previous years. This substantial price rise is explained by the rapid growth

of prices of both fuel and construction materials, as well as by increased labour costs due to the total increase of demand in the construction sector. The substantial price rises are also promoted by lack of competition in the construction sector.

2007-2013 Planning period¹

Financing from all of the aforementioned financial sources was available in the 2004-2006 period. This multi-annual budget-planning period (also called financial perspective) running from 2000 to 2006 for the old EU member states expired in 2006, therefore the plans for EU expenditures, legislation and other documents determining the use of EU financial resources are no longer applicable for distribution and absorption of new funding after the end of 2006. The period of financial perspective usually lasts five to seven years. Preparation of documents is currently in progress in order to ensure utilisation of co-financing from EU funds for the next period from 2007 to 2013.

In order to ensure high-quality absorption of the Structural Funds and the Cohesion Fund, all necessary

¹ Source: Ministry of Finance

planning documents and normative acts, which would ensure commencement of absorption of SF and CF must be prepared. Latvia has had access to these resources starting from January 1, 2007, but development, co-ordination, and approval of the planning documents took a long time and this did not allow for the timely absorption of finances.

In order to start efficient absorption of SF and CF resources, it is proposed to carry out programming on three levels in accordance with draft general regulation of SF and CF (the EU level strategy or the *Community Strategic Guidelines*, the strategy of member states or the National Strategic Reference Framework Document and the *operational programmes* (hereinafter – OPs) of member states).

The *National Strategic Reference Framework Document* for the 2007-2013 period (hereinafter the NSRFD) is the main SF and CF planning document on the level of Latvia, which ensures the linkage of the cohesion policy with national priorities and substantiates the choice of these priorities, determines the funds absorption strategy and the management framework, and ensures co-ordination between OPs and other financial instruments.

The NSRFD was prepared, taking into account the goals and lines of action set out in the *National Development Plan* (the Ministry of Regional Development and Local Government is responsible for development of this plan) and in the National Lisbon Programme of Latvia (see Chapter 6.1), as well as considering provisions of the long-term conceptual document “The Growth Model for Latvia: People First” approved by the Parliament.

The general management framework and planning documents of SF and CF are worked out by mutually co-ordinating them with the institutions involved in management of EU funds and consulting with partners (social partners, representatives of regions, NGOs) about wording acceptable to all parties. The Ministry of Finance has been appointed as the institution responsible for implementation of the NSRFD, and starting from 2007, the Ministry has to submit quarterly informative reports on implementation of the NSRFD to the Cabinet of Ministers.

The NSRFD stresses that the most important task of the 2007-2013 period (to be fulfilled with the help of SF and CF) is to create the necessary preconditions and directly achieve changes that would ensure formation of a knowledge-intensive economy in the country. Hence, it is most essential to channel SF and CF investments in the 2007-2013 period in Latvia to those measures that develop knowledge as the main resource of growth and create favourable conditions of life for human being as the holder of this resource.

In order to reach this goal, SF and CF investments are planned in accordance with three thematic axes:

- development and efficient use of human resources;

- increase of competitiveness and progress towards a knowledge-intensive economy;
- improvements of public services and infrastructure as a precondition to balanced development of the country and its territory.

On June 19, 2007, the Cabinet of Ministers approved NSRFD, on which the distribution of the EUR 4.53 billion of financing from the SF and CF available for the Latvian state in the 2007-2013 period is based. The European Commission also approved it on September 20, 2007, and thus the absorption of the programme and resources could be started.

Balanced development of the territory, macro-economic stability, equal opportunities, sustainable development and information society are determined as the horizontal priorities.

In order to achieve these goals, it is planned to manage SF and CF investments by using three operational programmes that determine the beneficiaries of financing, as well as the activities and sectors to be supported in greater detail.

- Operational Programme “Human Resources and Employment” of the European Social Fund;
- Operational Programme “Enterprise and Innovation” of the European Regional Development Fund;
- Operational Programme “Infrastructure and Services” of the European Regional Development Fund and the Cohesion Fund.

All three operational programmes are approved both by the Cabinet of Ministers and by the European Commission, thereby allowing commencement of absorption of the available resources and promulgation of the support programmes.

The sources of financing of the OPs are the European Regional Development Fund (53.9% of the total assignment from SF and CF), the European Social Fund (12.1% of the total assignment), as well as the Cohesion Fund (34% of the total assignment (see Table 6.5). In addition to this, financing from the state budget and private co-financing has to be ensured.

Table 6.5

**Financing Available for Latvia
in the 2007-2013 Financial Period**
(million EUR)

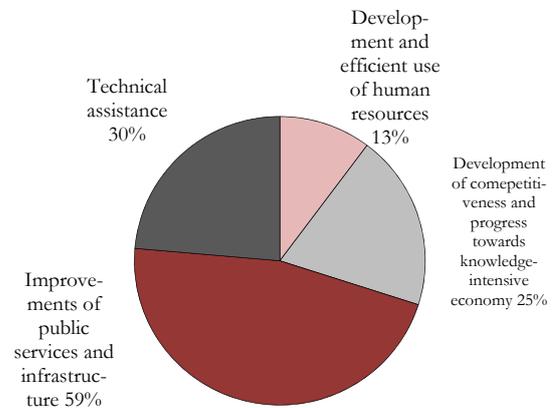
| Fund | Assignment | % of the total assignment |
|--------------|--------------|---------------------------|
| ERDF | 2 440 | 53.9 |
| ESF | 551 | 12.1 |
| CF | 1 540 | 34.0 |
| Total | 4 531 | 100 |

EUR 4.53 billion from the Structural Funds and Cohesion Fund financing is available to the Latvian state. The breakdown of the support by sectors shows that the biggest share of the financing (59%) is provided for infrastructure projects and business development promotion projects (25%) (see Figure 6.2).

The activities under the competence of the Ministry of Economics are summarised in Box 6.2.

Figure 6.2

Breakdown of Assignment from the EU Structural Funds and the Cohesion Fund by Thematic Axes and Measures of Draft National Strategic Reference Framework Document for the 2007-2013 Period



Box 6.2

Activities under competence of the Ministry of Economics

As one of the branch ministries, the Ministry of Economics is responsible for management of the measures and activities under its competence. The following measures and activities are under the responsibility of the Ministry of Economics:

1st Operational Programme “Human Resources and Employment”:

- Support to training of the employed for promotion of competitiveness of entrepreneurs – support to training organised in partnerships;
- Micro-loans for business starters in the framework of an investment fund;
- Support to training of the employed for promotion of competitiveness of entrepreneurs – support to individually organised training of entrepreneurs;
- Recruitment of highly skilled employees;

2nd Operational Programme “Enterprise and Innovation”:

- Competence centres;
- Technology transfer contact points and centres;
- Development of new products and technologies;
- Availability of financing;
- Attraction of strategic investors;
- Support to entrepreneurship and improvement of equipment;

3rd Operational Programme “Infrastructure and Services”:

- Tourism;
- Energy efficiency and availability of apartment houses;
- Energy.

The activities of the 2nd Operational Programme under the competence of the Ministry of Economics are aimed at provision of support to non-agricultural business activity. Resources within these priorities were allocated through state support programmes in accordance with provisions of the Law on Control of Aid for Commercial Activity.

Implementation of the support programmes under the competence of the Ministry of Economics is ensured by the Latvian Investment and Development Agency.

A total of LVL 555.14 million is available for the activities of the Ministry of Economics in the 2007-2013 period, which are divided as follows:

- 1st Operational Programme “Human Resources and Employment”: LVL 38.54 million;
- 2nd Operational Programme “Enterprise and Innovation”: LVL 373.51 million;
- 3rd Operational Programme “Infrastructure and Services”: LVL 143.09 million.

Eight regulations of the Cabinet of Ministers have been approved by the Cabinet of Ministers by May 19, 2008 on implementation of activities with the total financing in the amount of LVL 93.67 million, including:

- 63% of ESF financing;
- 13% of ERDF financing;
- 26% of CF financing.

Six draft regulations of the Cabinet of Ministers for total financing to the amount of LVL 169.1 million are currently in the stage of co-ordination.

6.2.2. Foreign Trade Policy

Common trade policy is implemented within the EU, with the European Commission representing a common EU position in negotiations with trade partners, both bilaterally and multilaterally on behalf of 27 EU member states, which is co-ordinated with member states through the committee on foreign trade policy issues or the so-called Article 133 Committee of the EU Council.

In order to allow the trade policy contributing into growth and creating new jobs in Europe, the external competitiveness strategy of the EC “Global Europe: Competing in the World” is being implemented.

In the first half of 2008, active work took place in all dimensions of the EU common trade policy in both multilateral relations and bilateral relations, in order to achieve the principal goals directed at general liberalisation of trade, increasing EU competitiveness, and strengthening traditionally democratic values, especially in the context of regional co-operation and development of developing countries:

- in multilateral relations, the EU maintains its priority of liberalisation of trade on multilateral level and still is the main driving force in multilateral negotiations of the WTO and in the process of entry of new member states;
- negotiations of EU member states regarding conclusion of new-generation extended Free Trade Agreements with third countries, as well as conclusion of Association Agreements and Economic Partnership Agreements;
- a high-level dialogue has been started with China on co-operation in strengthening trade relations to balance openness of EU market for Chinese exports with cancellation of high tariffs and tariff peaks concerning EU goods in the Chinese market;
- the renewed Market Access Strategy is actively implemented prescribing several measures for identification, prioritisation and prevention of obstacles to trade, thereby helping EU exporters in the markets of third party countries. Work is also continuing on implementation of initiatives of public procurement and intellectual property rights (IPR), in order to promote access for EU companies to public procurement orders of third party countries and protect IPR interests of the EU in the markets of third party countries;
- Initiatives of the Transatlantic Economic Council in order to extend economic relations of the EU and USA.

Multilateral relations

Strengthening the multilateral trade system within the framework of WTO is a priority of the common EU trade policy. By providing globally binding trade

rules, transparency of the international trade environment is promoted, which is important for sustainable development and stability of external EU competitiveness as well as the world economy.

Currently, work is continuing on the most substantial issues of the **round of multilateral trade liberalisation talks (DDA)** started in Doha, the capital of Qatar, in 2001 within the framework of WTO concerning improvement of overall trade conditions of global agricultural and industrial goods, as well as trade in services, trade promotion and other conditions.

From the point of view of DDA, development, it is positive that WTO member states have generally demonstrated political determination to complete the negotiations by the end of 2008. In order to accomplish this, it is important to reach an agreement on the elements of negotiations regarding access to the market for industrial and agricultural goods, where substantial differences between the viewpoints of developed countries and developing countries still remain. Within the negotiations relating to market access for industrial goods, it refers to the rates and remissions of the tariff reduction formula for developing countries, while the main open issues concerning negotiations on agriculture relate to decrease in domestic support for the developed countries and trade conditions for sensitive and tropical products.

Along with development of these fields of negotiation, achieving progress in other DDA elements is also relevant, including in relation to services, intellectual property rights, and trade rules. Currently, the greatest viewpoint convergence of WTO member states is on the issues of trade promotion (see Box 6.3), as well as the trade and environmental issues. Environmental issues are currently considered an important and integral element for future international trade taking into account global warming and climate change. The principal task of the WTO in this context is creating particularly favourable conditions for the international trade of environmentally friendly services and goods, as well as technologies used in their manufacture, for example tariff and non-tariff reduction in trade of environmental goods and services, and protecting development of intellectual property rights and standards, including marking of goods.

Several international organisations have made forecasts in relation to the prospective gains from DDA. Considering the current state of the negotiations, it is clear that the possible amplitude thereof could be rather considerable, depending on the agreement of WTO member states on the scope of reduction of measures distorting global trade.

In accordance with the study “*Winners and Losers: Impact of the Doha Round on Developing Countries*” conducted by the Carnegie Endowment for International Peace in 2006, distribution of the gains among WTO member states could be very unequal

given different scenarios of DDA development. Based on this research, it may be expected that the biggest winners from DDA will be the developing countries showing rapid economic growth, especially China and other Asian countries. Their potential gains may range within 0.8-1.2% of GDP, and about 90% of this will be achieved by improvement of market access conditions for industrial goods, while the prospective

gains for the developed countries from DDA will be relatively lower (approximately 0.5% of GDP), gaining more from the trade liberalisation of industrial goods and services. Similarly, it is stipulated in the framework of this research that in comparison with the current situation, upon completing DDA talks the poorest Sub-Saharan African countries will incur losses slightly below 1% of GDP.

Box 6.3

Trade promotion – an important instrument for promotion of international trade

Trade promotion is a comparatively new field of multilateral trade liberalisation talks included on the WTO agenda at the 4th conference of WTO Ministers held in 2001 in Doha. In accordance with Paragraph 27 of the declaration approved at this conference, the goal of these negotiations envisages agreement on the conditions, which would facilitate international trade flows of goods. In order to ensure this, improvement and interpreting of the existing WTO norms is currently taking place in relation to freedom of transit (GATT Article V), import and export procedures (GATT Article VII), administration and publication of the trade rules of WTO member states (GATT Article X), as well as increase of technical assistance and raising capacity in developing countries and the least developed countries, etc. Based on the results achieved in negotiations, development of a multilateral trade promotion agreement is taking place, which would comprise provisions regarding the aforementioned aspects.

Taking into account the role of international traffic in the state economy and future development potential thereof, trade promotion is one of Latvia's priorities in DDA talks. Therefore, in order to ensure development of international cargo transportation through the territory of the country and make Latvia a significant part of the transit corridor between the East and the West, within the framework of the WTO it is essential to obtain free and non-discriminatory access to transit roads and types of transport in third countries, especially in Russia, which is an important element of external competitiveness of the country. Therefore, it is essential also to achieve the definition of pipelines as a type of transport, the equalization of trade rules of WTO member states and ensure transparency in them.

In accordance with the aforementioned study, gains by the new EU member states, including Latvia, from DDA might be greater than the EU average, which would be facilitated by overall reduction of tariff and non-tariff barriers, more transparent setting of customs procedures and other trade procedures (rules of origin, import licensing procedures, investment restrictions, customs value assessment of goods etc.), as well as improvement of market access concerning markets of goods and services of third countries.

Improvement of market access conditions within the framework of the multilateral trade system is also ensured through the so-called **WTO accession processes**, under which candidate countries undertake the obligations corresponding to its requirements. Twenty-eight countries are in the process of admission to the WTO at present, among them important trade partners for Latvia such as Russia and Belarus. At the same time, it should be noted that upon completing admission negotiations, on May 16 of this year **Ukraine** legally became the 152nd WTO member state. Therefore, the current foreign trade relations of Latvia and the EU with Ukraine are based on the contractual foundation of the WTO, which is set as a precondition for extending mutual economic relations upon concluding an extended new-generation Free Trade Agreement by both parties.

Of the other candidate countries that are the most important for Latvia, Russia is the country closest to completing the WTO accession process.

Although **Russia** constantly affirms that it wishes to accede to the WTO in the near future, there are still several serious issues on which an agreement must be reached, both bilaterally with separate WTO member

states (Georgia and Saudi Arabia), and multilaterally with all WTO member states. The issues to be agreed on multilateral level are sanitary and phytosanitary measures, support for agricultural production etc. Within the framework of multilateral admission negotiations, the European Commission maintains that the issues of Russian discriminative tariffs for railway cargo transport and export levies for unprocessed timber must be resolved. Although officially bilateral negotiations on market access for goods and services were completed in 2004, owing to the close co-operation of Latvia and other EU member states, they are among the EU priorities in negotiations concerning the admission of Russia to the WTO. However, it should be specified that up to now the EU and Russia have not succeeded in reaching an agreement in relation to the amounts of export levies, and on April 1, 2008 Russia increased them again (it did this the first time on July 1, 2007), thereby negatively influencing the EU, including the international competitiveness of Latvian timber industry enterprises.

Bilateral relations within the framework of the EU common trade policy

The trade relations of Latvia with third party countries are regulated by agreements concluded by the European Union.

The EU has concluded several preferential agreements with third party countries:

- European Economic Area agreements with Iceland, Liechtenstein and Norway;
- Free trade agreements with the Faeroe Islands, Switzerland, and Mexico;

- Association Agreements with Chile, Mediterranean countries¹, and several overseas countries and territories;
- Customs unions with Turkey and Andorra;
- Stabilisation and Association Agreements with Macedonia, Croatia, Serbia, Montenegro and Albania;
- A Trade, Development and Co-operation Agreement with South Africa.

In addition to the previously commenced free trade agreement (FTA), negotiations with the Mediterranean region countries and with countries of the Gulf Co-operation Council² (hereinafter – *GCC*), Association Agreement talks with countries of the Southern

Common Market³ (hereinafter – *Mercosur*), and Economic Partnership Agreement (hereinafter – *EPA*) talks with countries of the African, Caribbean and Pacific Group of States (hereinafter – *ACP*), EU member states have agreed to start new-generation enhanced FTA negotiations with the Republic of Korea, Republic of India, and the Association of Southeast Asian Nations⁴ (hereinafter – *ASEAN*) and Ukraine, as well as begin negotiations on association agreements including FTA with Central American States⁵ and countries of the Andean Community⁶.

Member States of the European Community (hereinafter – Community) have also agreed to begin talks on conclusion of enhanced FTA with the Russian Federation after its accession to the WTO.

Box 6.4

Bilateral relations of the EU with third countries

The EU–Russia economic co-operation is regulated by a Partnership and Co-operation Agreement (PCA), for which the Parties agreed on extending the term of its validity on October 26, 2007 in Mafra, Portugal during the meeting of EU and Russian leaders. Development of a new EU-Russia framework agreement is taking place. FTA talks with Russia fully depend on the process of Russia's entry in the WTO. EU member states, including Latvia, support Russia joining the WTO as soon as possible, but the results of the talks are more important than the speed of the entry. Considering the position of the Community envisages only starting the process of FTA talks with Russia after the admission of Russia to the WTO, on May 26, 2008, the EU Council of Ministers approved a mandate for starting talks with Russia on conclusion of a new framework agreement. The new framework agreement will provide solutions to the issue of trade barriers between the EU and Russia by concentrating on normative regulations.

Along with the accession of **Ukraine** to the WTO, the precondition to initiate talks between the EU and Ukraine on conclusion of an Enhanced Agreement was fulfilled, which will replace the Partnership and Cooperation Agreement (PCA). The talks on this subject were initiated on March 5, 2007, within the framework whereof several informal rounds took place where the negotiators discussed mutual interests and agreed on the shape of the planned enhanced FTA in the framework of the Enhanced Co-operation Agreement. Formal talks on conclusion of an EU-Ukraine Enhanced Co-operation Agreement were commenced on February 18, 2008 in Kiev (Ukraine).

Latvia has particular economic interests regarding conclusion of an FTA between the Community and Ukraine, considering that such an agreement with Ukraine had existed before Latvia's accession to the EU and it fostered the development of transit and trade. Latvia is especially interested in substantial reduction of bureaucratic requirements and elimination of other non-tariff barriers for entry into the Ukrainian market.

Economic co-operation between the EU and USA takes place within the framework of the Transatlantic Economic Council Initiative. The EU and USA are together the world's largest trading partners, as well as the world's largest economies, comprising 57% of the global Gross Domestic Product. In order to strengthen the transatlantic economic relations, the EU-USA initiative to enhance economic integration and growth was accepted at the EU-USA summit on June 20, 2005. The initiative envisages promoting co-operation between the high-level regulators, building more open and more competitive financial markets, encouraging investment for long-term development, co-operating in protection of intellectual property (including third countries), supporting and stimulating innovation and technological development, enhancing security of trade, not limiting the trade flow and applying a visa-free regime to all EU member states, conducting negotiations in the aviation sphere on conclusion of a new agreement, strengthening co-operation in the sector of services, and ensuring bilateral access to public procurement markets.

A new document "Framework for Advancing Transatlantic Economic Integration between the EU and the USA" was adopted at the EU-USA summit in Washington on April 30, 2007. The document envisages promotion of co-operation in such spheres as intellectual property, security of trade, financial markets, innovation and technologies, and investment. A Transatlantic Economic Council supervising and promoting implementation of economic co-operation between the EU and the USA was established during the summit. The aim of the Council is to achieve harmonisation of EU and USA regulations and to promote development of mutual trade and dialogue between entrepreneurs.

Latvia will continue supporting implementation of the initiative while paying attention to the promotion of foreign trade, investment, and co-operation between entrepreneurs.

The economic dialogue between the EU and China is based on the EU-China Trade and Economic Co-operation Agreement concluded in 1985. A Joint Committee for Trade is set up within this framework.

¹ Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Autonomy, Syria, Tunisia

² Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates

³ Argentina, Brazil, Paraguay, Uruguay

⁴ Burma, Brunei, Philippines, Indonesia, Cambodia, Laos, Malaysia, Singapore, Thailand, and Vietnam

⁵ Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua, as well as Panama after its engagement in the Central American economic integration process

⁶ Bolivia, Ecuador, Columbia, and Peru

Box 6.4 continued

In order to support the economic and trade reforms of China and its integration into the world trading system, the EU-China co-operation programme was initiated in 2004, the most comprehensive WTO programme of the kind in China. The programme consists of six elements (customs and import/export regulatory systems, agriculture, technical barriers to trade, services, legislative aspects and protection of intellectual property rights, as well as policy development, co-operation and transparency).

In 2007, the EU started negotiations on conclusion of a new FTA with China, which *inter alia* envisages renovation of the Trade and Economic Co-operation Agreement. In order to balance the EU-China trade flow, the parties agreed on the establishment of a high-level mechanism of economic and trade dialogue at the EU-China summit in November 2007, which will supplement and promote the development of existing EU-China dialogues. The first meeting of both parties in the framework of this dialogue took place on April 25, 2008 in Beijing. During the meeting, the EU and China exchanged viewpoints in such fields as co-operation in the field of trade and investment, balanced economic development, transfer of innovation and technologies and international economic development. Detailed discussions were held about the issues of energy, trade and high technologies, protection of intellectual property rights, and trade promotion. It is planned that these issues will be also discussed in the future in the framework of the economic and trade dialogue mechanism, by additionally including such issues as market access, transport, regulatory issues and standards.

In 2007, the EU started negotiations on concluding FTAs with **South Korea**, the **ASEAN** countries and **India**. Currently, the FTA talks with **South Korea** have achieved the most progress. It is intended that the conclusion of an FTA with South Korea and India should take place in 2008.

The negotiations with **Mediterranean countries** on conclusion of Free Trade Agreements were started in 1995 with the goal of creating a Euro-Mediterranean free trade area by 2010. It is envisaged that these FTAs will be asymmetrical – the Mediterranean countries will have to assume a lower level of commitments.

Talks with **GCC countries** on conclusion of FTA were resumed in 2002, comprising also conditions of service trade and investment. The aim of this FTA is asymmetrical and development-orientated opening of goods and services trade in compliance with WTO norms, considering the development level of GCC countries.

Of the **Western Balkan countries**, Albania, Montenegro, Croatia, Macedonia, and Serbia have signed Stabilisation and Association Agreements with the EU. Talks on an agreement with Bosnia and Herzegovina have also been completed but the agreement has not been signed due to the political situation. These agreements are aimed at creating a free trade area between the EU and Western Balkan countries.

The strategic partnership between the EU, Latin American, and Caribbean countries continue to develop, in the framework of which negotiations are taking place on the conclusion of free trade agreements with the **Andean Community** countries, **Mercosur** countries, as well as the **Central American** states.

The third round of talks between the EU and the **Andean Community** countries on conclusion of an Association Agreement was completed on April 25, 2008, in Quito (Ecuador). During the talks, the parties reviewed the issues, goals, and basic principles of the future agreement, as well as political dialogue and co-operation in different fields (trade, transport and infrastructure, social issues, scientific and technical co-operation, regional integration, environment, culture, etc.).

The third round of talks between the EU and **Central American countries** on conclusion of an Association Agreement took place on April 14-18, 2008 in El Salvador, the main goal whereof was transformation of political support for negotiators into negotiations on the technical level.

The economic relations between the EU and the four *Mercosur* countries are based on the Interregional Framework Cooperation Agreement, which was signed in 1996 and envisages co-operation on the issues of trade, economics, customs, statistics, intellectual property, integration, inter-institutional co-operation, as well as education and science. In November 1999, negotiations were started and are still continuing between the EU and *Mercosur* countries on **conclusion of an EU-Mercosur Association Agreement**. The goal of the Agreement envisages promotion of co-operation between the EU and *Mercosur* countries on trade, economics, customs, statistics, intellectual property, integration, inter-institutional co-operation, as well as education and science, and also envisages establishment of a Free Trade Area of EU-Mercosur countries. Since 2004, only negotiations of a technical character have taken place and the further development thereof depends on the progress of the WTO Doha Round of negotiations.

On May 16-17, 2008, the EU and Latin America Summit took place in Lima, Peru, in the framework whereof a decision was made that negotiations with the Central American, Andean Community and Mercosur countries will be activated.

In the framework of talks on *EPA*, the final or temporary agreements had been concluded with **35 ACP countries** by the end of 2007. The other 32 ACP countries will have equally full access to the European market as the least developed developing countries. Up to now, a complete agreement on *EPA* has been concluded only with Caribbean countries¹. Therefore, all Caribbean Region countries have acquired unrestricted access (without taxes and quotas) to the EU market as of January 1, 2008, except for particular agricultural products, for which a transition period is established. Along with application of *EPA*, the Caribbean countries undertake to gradually open their markets to goods and services of Community origin.

The main goal of the *EPA* talks is to promote gradual integration of ACP countries into the global economy, which is planned to be implemented by agreeing on asymmetrical trade conditions, thus increasing the trade capacity of countries of these regions and fostering reciprocal integration of regions.

Economic co-operation agreements of Latvia with third countries and the regions of third countries

In order to activate bilateral economic co-operation after accession to the EU, Latvia has

concluded bilateral economic co-operation agreements with the Russian Federation, People's Republic of China, Republic of Belarus, Republic of Ukraine, Republic of Kazakhstan, Republic of Azerbaijan,

¹ Antigua and Barbuda, the Commonwealth of the Bahamas, Barbados, Belize, the Commonwealth of Dominica, Dominican Republic, Grenada, Guadeloupe, Haiti, Jamaica, Federation of Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Republic of Suriname and Republic of Trinidad and Tobago

Georgia, Republic of Moldova, Republic of Uzbekistan and Kyrgyz Republic.

An agreement on economic, industrial, scientific and technical co-operation was concluded between the governments of the Republic of Latvia and the Kyrgyz Republic on September 13, 2007.

These agreements are the most important umbrella agreements regulating bilateral economic co-operation and comprising co-operation in industry, tourism, transport, pharmaceuticals, agriculture, financial services, communications, professional training,

investment policy, Technologies and innovation and other fields, thereby promoting development of economic co-operation.

Economic co-operation agreements concluded between Latvia and third party countries require the establishment of an Intergovernmental Commission and/or Joint Committee, which ensures supervision of the validity of these agreements and opportunities to analyse, how to improve further co-operation (see Box 6.5).

Box 6.5

Activities of the Intergovernmental Commissions of Latvia and third countries

A meeting of the working group of the Latvia-Russia Intergovernmental Commission took place in Riga on April 8, 2008, where issues of economic co-operation, development of the contractual legal base, co-operation in the fields of energy, finance, information technologies, environmental and other fields, as well as regional and trans-border co-operation were reviewed.

In July, 2007, the Latvia-Russia Co-operation Council was established through co-operation between the Latvian Chamber of Commerce and Industry and the Employer's Confederation of Latvia, aimed at providing an additional impulse for activation of economic relations and further expansion thereof, as well as increasing the work efficiency of the Intergovernmental Commission.

The sixth meeting of the Latvia-China Joint Committee took place in Beijing on November 13-14, 2007, whereat the representatives of Latvian and Chinese institutions discussed issues of economic co-operation between both countries, including transport, transit, and logistics, industry, innovation and the economic dialogue between the EU and China. The latter is considered one of Latvia's most promising foreign economic co-operation partners outside the EU and other traditional markets, therefore increasing exports to China is a challenge for Latvian entrepreneurs. Broad opportunities are offered by the bilateral co-operation in the field of transport, transit and logistics. Latvia is interested in maintenance of containerised cargoes in transit between the EU and China.

The first meeting of the Latvia-Uzbekistan Intergovernmental Commission on issues of economic and industrial co-operation took place in Riga on April 28-29, 2008, during which economic co-operation between the countries in fields such as transport, standardisation and certification, small business, private entrepreneurship, IT, agriculture, education, tourism, and investment was discussed.

Latvia is interested in broadening the trade opportunities and developing economic relations with Uzbekistan. Although currently economic co-operation between countries may be evaluated as comparatively passive, wide opportunities for enhancing bilateral economic co-operation exist in the future. The most promising fields of co-operation are the food industry (including fishing), the chemical industry (especially pharmacy), as well as transport, transit and logistics, which should still be viewed in the context of transit opportunities through Russia.

The first meeting of the Intergovernmental Commission of the Republic of Latvia and Kyrgyzstan Republic on issues of economic, scientific and technical co-operation took place in Riga on May 22, 2008, during which the issues concerning co-operation in such fields as entrepreneurship, industry, agriculture, tourism, transport, finance were discussed, as well as other potential fields for activation and broadening of further trade and economic co-operation.

The first meeting of the Intergovernmental Commission took place simultaneously with the visit of the Prime Minister of Kyrgyzstan, I. Chudinov, and an accompanying delegation of entrepreneurs to Latvia. Under this umbrella, a business forum of Latvian-Kyrgyzstan entrepreneurs and bilateral meetings of entrepreneurs were organised on May 22, 2008. Industry, transport and tourism may be considered the most promising fields of co-operation for Latvian entrepreneurs.

Latvia is interested in a more active development of economic co-operation between both countries, including broadening of trade opportunities, as well as promotion of mutual investment flow. The foreign trade balance between Latvia and Kyrgyzstan is positive, and an increase in the trade of both countries has been observed in recent years.

The second meeting of the Intergovernmental Commission of the Republic of Latvia and Republic of Kazakhstan on issues concerning economic, scientific and technical co-operation took place on May 26-27, 2008 in Astan, Kazakhstan, which was managed by the Minister of Economics K. Gerhards from the part of Latvia. Simultaneously with the Intergovernmental Commission, the round table discussions between Latvian and Kazakhstan entrepreneurs took place on May 27 of this year in Astan and on May 28 in Almaty.

The main directions of the issues reviewed in the meeting were co-operation in broadening opportunities for entrepreneurs of both countries in all fields of mutual interest, promotion of transport flows through Latvian ports and railway, as well as co-operation in enhancing opportunities in fields such as tourism, financial services, IT and agriculture.

Kazakhstan is traditionally considered a strategically significant foreign economic co-operation partner of Latvia outside the EU, and the interest of Latvian entrepreneurs in the implementation of business projects in this Central Asian country has been increasing in recent years.

The meetings of the Intergovernmental Commissions with Azerbaijan, Ukraine and Belarus regarding several concluded economic co-operation agreements are planned to take place in the second half of the year 2008.

Although an agreement has been concluded between Latvia and Russia on economic co-operation, the promotion of economic co-operation with the regions of the Russian Federation is more promising.

On April 9, 2008, an agreement on economic co-operation was signed between the Ministry of Economics of the Republic of Latvia with the government of **Vologda Region (Russian Federation)**. Currently, work is conducted in order to conclude an agreement on economic co-operation with the government of **Yaroslavl Region of the Russian Federation** and the government of the **Republic of Bashkortostan**.

The promotion of economic relations between Latvia and Russia is also discussed in other ways.

The Council of the Baltic Sea States (hereinafter CBSS) is one of the co-operation forums of the Baltic Sea region countries, which implements regional co-operation in various spheres. One of the goals of CBSS is improvement of competitiveness and sustainable development of the region.

The member states of CBSS are Denmark, Estonia, Iceland, Russia, Latvia, Lithuania, Norway, Poland, Finland, Germany and Sweden.

Latvia is the presiding state of CBSS from July 1, 2007 to June 30, 2008.

Several working groups are established within the framework of CBSS: Working Group on Economic Co-operation, Baltic Sea Region Energy Co-operation (BASREC), Working Group on Customs Co-operation and Border-Crossing Aspects, Business Advisory Council, etc.

The work of the Working Group on Economic Co-operation (WGEC) of CBSS during the presidency of Latvia is organised by the Ministry of Economics.

The following priorities for the WGEC of CBSS are established during the presidency of Latvia:

- innovation,
- competitiveness and cluster formation in the Baltic Sea region,
- obstacles for trade and investments.

The second meeting of the CBSS WGEC took place in Riga on January 15-16, 2008, within framework whereof a WGEC seminar on innovation and cluster development policy in the Baltic Sea region was held, as well as the current meeting of the WGEC. Such issues as the role of the state sector in promotion of cluster development and opportunities of formation of new clusters in the Baltic Sea region were reviewed during the seminar. Further opportunities of co-operation were discussed at the CBSS WGEC meeting during the presidency of Latvia of CBSS.

The third meeting of CBSS WGEC took place in Sigulda on May 13-14, 2008, where the issues on the future perspectives of WGEC and economic co-operation (fields of co-operation, potential projects) were reviewed, and discussions were held on co-operation with the Barents Euroarctic Council (BEAC), the WGEC report for 2007-2008, and the work organisation of WGEC in the framework of the presidency of Denmark in 2008-2009.

From July 1, 2008, the presidency of CBSS will be taken over by Denmark.

EU sectoral agreements

Steel is a special strategic commodity, due to its diverse applications in various sectors and their productive capacity. In 2007, global steel production reached 1.3 billion tons and it had increased by 8% in comparison with 2006. This growth in production volumes was driven by Asian countries, especially China where steel production increased by 16.5% due to the high demand.

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 for 2007 and 2008, under which annual increases in quotas are envisaged. In regard to Kazakhstan, autonomous measures are currently being applied. On May 16, 2008, Ukraine became a WTO member state, therefore the previously established quantitative restrictions on imports of Ukrainian steel products to the EU were cancelled. After admission of Russia and Kazakhstan to the WTO, the EU steel agreements with these countries will lapse automatically.

The EU additionally applies the Prior Surveillance system for the import of particular steel products from all third countries for the purpose of steel flow monitoring.

The textile sector is a socially sensitive economic sector characterised by intensive use of labour, and it is of big importance both in regional development and in international trade. A trend is currently observable in the European textile sector, wherein production of goods with lower value added is moving to countries with cheaper costs, while production with higher added value, development, including design development, as well as use of new materials and technologies remain in Europe.

Since January 1, 2005, no quantitative restrictions have been applied between WTO member states regarding the trade of textiles. The EU is currently applying quantitative restrictions to the import of the textiles from Belarus and North Korea, while the double-checking system (licensing) without quantitative restrictions applies to the import of particular textiles of Uzbek, as well as Chinese origin.

Trade defence instruments

The system of trade defence instruments (hereinafter TDI - anti-dumping, antisubsidy measures and domestic market defence measures) operates in the European Union, as well as in most other countries importing goods and services.

The goal of anti-dumping and antisubsidy measures is to protect the local producers in the EU from losses caused by unfair competition from the enterprises of third countries or prohibited export subsidies granted by governments. The decisive base of application of domestic market protection measures is an increase of imports causing substantial losses to local producers, which are not indications of fair competition.

In Latvia, the producers and consumers of goods alike are affected by the TDI procedures, but the most essential interests of Latvia involve import and industrial usage of the goods subjected to TDI. The following trade defence cases were highly important for Latvia from the standpoint of import and user interests in the first half of 2008:

- anti-dumping proceedings concerning imports of ammonium nitrate originating in Russia and Ukraine. Latvia does not support

implementation of anti-dumping measures, because it is essential for agriculture as a raw material and these countries are the main sources of import;

- anti-dumping proceedings concerning imports of industrially-produced salmon from Norway. Latvia does not support implementation of anti-dumping measures, because it is not able to provide sufficient amounts of this product itself, and Norwegian salmon is the most competitive import alternative.

If the 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) or against exporters of the specific product of a particular EU member state (e.g. anti-dumping measures).

The most substantial loss incurred by a Latvian company in the market of a third party country originates from the anti-dumping measures against imports of steel bars from Latvia, which are effective in the US. Upon request of the EU, a panel of the WTO Dispute Settlement Body was formed on June 4, 2007, which reviews the compliance with WTO norms of the practice used by the US in the conduct of anti-dumping proceedings, which *inter alia* also affects a Latvian company. The US used the so-called “zeroing” method in its decisions adopted for determination of the dumping difference. If the US had not used this method against the Latvian company, then the established dumping difference would be minor or non-existent. The intermediate report of the WTO Panel in this process of settlement of disputes is expected in this year.

6.2.3. EU Internal Market

The EU internal market, a cornerstone of European integration, is acknowledged to be one of the most ambitious and successful EU projects. Currently the EU internal market comprises 30 countries (including the European Economic Area countries – Norway, Iceland and Liechtenstein) with approximately 500 million consumers. Many measures have been implemented to make the four freedoms included in the Treaty establishing the European Community – free movement of persons, free movement of goods, services and capital – a reality. A unified set of rules has been established for enterprises, border controls have been cancelled, a more competitive business environment has been developed, a wider choice of goods and services has been provided for consumers, new work places have been created, the possibility to live, work, study and retire in another country has been provided for residents, an opportunity has been found to introduce a single currency, and many other benefits have been provided. However, the potential of the internal market has not been fully exploited yet and its

improvement is continuing by promoting sustainable and stable development of the EU economy and prosperity for EU citizens.

In Latvia, the process of implementing the principles of the free movement of goods and services and the right of establishment, which arise from Articles 28-30 and Articles 43-55 of the Treaty establishing the European Community, 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.

Within the framework of the **procedure** established for notifying **draft technical regulations** (Directives 98/34/EC and 98/48/EC), which prescribes a legal obligation for the EU member states to submit draft technical regulations to the European Commission, other EU member states and European Economic Area countries for further assessment with a view to preventively assess and avert introduction of such requirements into national law, which have the potential to create barriers for free movement of goods, as well as for the freedom to provide information society services, Latvia submitted 8 draft technical regulations to the European Commission in 2007.

From May, 2004 until May 1, 2008, Latvia informed the European Commission about 50 draft technical regulations and received detailed opinions from the European Commission in 11 cases. In most cases, the detailed opinions of the EC 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 contracting party to the European Economic Area Treaty, should be granted free access to the Latvian market by the national authorities concerned.

The principle of mutual recognition is nearly the only legal instrument in the non-harmonised sphere of application of national technical regulations and standards to ensure free movement of goods in the EU internal market. The European Commission, by acknowledging the problems currently existing in practical application of the principle of mutual recognition, in February, 2007 launched a new initiative for a *Proposal for a Regulation of the European Parliament and of the Council*, aimed at establishing the procedures for application of national technical regulations to products legally sold in other member states. The aim of the regulation is to improve the way of how the principle of mutual recognition works in practice, as well as to provide the public institutions with the necessary instruments for correct introduction of the principle into daily practice and enable business representatives to use the advantages provided for by the principle of mutual recognition to

the full extent. The Regulation will not be applied to goods from Iceland, Norway, Liechtenstein and Turkey as the country of origin. A conceptual agreement between the EU member states concerning the draft Regulation has been already reached, and it is planned that it will be adopted during the Slovenian presidency, i.e. by July, 2008.

Implementation of **internal market directives** in Latvia is taking place successfully and high results have been achieved regarding efficiency of transposition of directives, with only Slovakia achieving better results. 99.4% of internal market directives were transposed into national legislation by December 10, 2007 (no directive implementation measures have been notified on 10 directives), ensuring that the Lisbon goal to transpose 99% of the requirements of directives or to allow the deficit of transposition of directives in the amount of 1% by 2009 is reached.

In order to encourage business activity and innovation, promotion of **free movement of services** is one of Latvia's priorities in the European Union. With regard to EU legal acts, European Parliament and Council Directive 2006/123/EC related to services in the internal market, the requirements whereof must be introduced into the national legislation by the member states by the end of 2009, is the most important for Latvia. The directive is aimed at creation of the legal regulations necessary to promote implementation of the right of establishment and free movement of services within the EU internal market. The directive will make a positive contribution in the context of provision of cross-border services, as well as in improvement of the business environment, especially in reducing the administrative burden.

In compliance with the requirements of the directive, the Ministry of Economics in collaboration with the involved public institutions shall create one-stop shops (single contact points) by the end of 2009, thus allowing the service provider to carry out administrative procedures remotely by means of electronic tools, as well as facilitating information availability in relation to national requirements and procedures not only for the service providers but also for the recipients. Development of the one-stop shop concept is currently actively taking place.

In order to facilitate starting and running a business, the existing administrative burden is in process of reviewing by eliminating or simplifying requirements for issuance of permits/licences through

reducing the payment for their receipt, issuing them for an indefinite period, as well as by creating the opportunity to complete the relevant procedures electronically. In certain fields licences are substituted by notification of the activity of an enterprise. In compliance with Directive 2006/123/EC on services in the internal market, amendments will be made to the existing laws and regulations by the end of 2009 for elimination of the administrative burden in the field of services. The results of legislative revision will also be submitted to the European Union, which will assess the validity of restrictions and indicate necessary improvements. In accordance with the requirements of Directive 2006/123/EC, from December 28, 2006 new requirements have not been drafted and implemented in Latvian law regulating provisions for access to starting a business in services under Directive 2006/123/EC, as well as conditions relating to the short-term provision of such services, unless these are justified by special public interests.

An informative campaign on the **SOLVIT network**, which operates as an alternative mechanism to solve internal market problems in the European Economic Area, was conducted in different cities of Latvia in the first half of 2008. The idea of SOLVIT is to find a fast and real solution to the internal market problems that have resulted from incorrect application of EU legal regulations by public entities. The SOLVIT centres solve problems of both residents and entrepreneurs, and SOLVIT services are free of charge.

Since the beginning of 2008, the Latvian SOLVIT centre has received 12 cases to be reviewed, of which six cases thereof are still being solved. Ten complaints have been submitted by residents, while two complaints were received from enterprises. Due to the fact that, unlike a court decision, a solution found by SOLVIT network is not binding for a public entity, which violates EU laws and regulations, the proportion of successfully solved cases is an essential indicator. In 2007 the figure was 80%, while in the first half of 2008 it reached 83.3%.

Up to now, the residents have complained most frequently about recognition of professional qualification and diplomas (e.g., a resident of Latvia wants to work as a dentist in Germany), as well as rights of family members of EU citizens to reside and work in the member states.

6.3. Sector-Specific Development Policies

6.3.1. Industrial Policy

One of the main goals of the economic development of Latvia is to create an efficient and competitive industry that would ensure high and stable

growth. Industry has a vitally important role in improvement of the foreign trade balance. Industrial policy in Latvia is developed in accordance with the policy development directions of the European Union, at the same time identifying and solving issues that are urgent for local industrial enterprises in co-operation

with organisations that represent industrial enterprises. Industrial policy is closely connected with innovations, business activity, education and other policies.

On June 28, 2007, the Cabinet of Ministers approved the Entrepreneurship Competitiveness and Innovation Promotion Programme for 2007.-2013. The Programme includes measures for promotion of development of innovations, business, small and medium-sized enterprises and industries. The Programme is developed in order to achieve bigger co-ordination of the Latvian economic policy in this strategically important policy direction, which up to now was implemented in the framework of the National Innovation Programme for 2003-2006, Programme of Development of Small and Medium-Sized Enterprises of Latvia in 2004-2006 and Industrial Development Guidelines of Latvia. The time period for implementation of the Programme allows to co-ordinate it with the measures included in the National Development Plan of Latvia successfully and with the structural funds utilisation opportunities offered by the EU Financial Perspective for 2007-2013.

Promotion of development of **industrial design** is one of the directions of action of Business Competitiveness and Innovation Promotion Programme for 2007-2013. Starting with 2007, the activities have been implemented with the intermediation of LIDA, the goal of which is to improve co-operation of industrial enterprises and professional design service providers. In 2007, a design audit was performed in 15 small and medium-sized enterprises in order to evaluate the situation in relation to its use in the activities of enterprises and development of new products, as well as provide recommendations to enterprises on the opportunities to improve their competitiveness by using the opportunities offered by industrial design. The involved enterprises represented the categories of both, micro and small, as well as medium enterprises in such sectors as production of clothing, textiles and furniture, metal processing, polygraphy, production of sweets, etc. Although the situation in the analysed enterprises is different, it is concluded that considerable opportunities exist to integrate in the common strategy of design enterprises and development cycle of products. The inspection of enterprises also testifies that enterprises do not involve professional designers within the entire development cycle of a product due to different circumstances.

In 2008, on the basis of the design audit results, the LIDA will implement knowledge transfer pilot projects for promotion of co-operation among designers and producers. As a result, at least one new prototype of a design product will be developed in each of the involved enterprise.

In 2008, a portal www.designlatvia.lv of the Latvian industrial design has started its work, the aim of which is to become a platform co-operation and information exchange for representatives of design and production

sector. The main tasks of the portal include establishment of contacts among designers and producers, provision of information regarding design projects in Latvia and in the world, co-operation opportunities and promotion of successful design projects.

In 2008, the Design Advisory Council will begin operation under supervision of the Ministry of Economics. The goal of activities of the Council is to promote development of design within promotion of economic competitiveness, in order to increase the value added of products and services. The Council consists of authorized representatives of ministries, higher educational institutions, institutions, unions, organizations and associations of different sectors. Some of the main tasks of the Council envisage making proposals for promotion of design development and identification of the problems hindering design development in Latvia, offering particular solutions for improvement of the situation, as well as following implementation of the proposals.

In June 2008, it is planned to begin a joint research of the Ministry of Economics and the Ministry of Defence on **development of the military sector and related sectors in Latvia**. The capacity of enterprises to handle deliveries for the needs of the armed forces will be assessed within its framework, and military industry delivery chains, as well as policy recommendations provided for promotion of competitiveness, *inter alia offset* (compensation deals) recommendations for arrangement of the policy in Latvia. The issues concerning military industry development are currently topical at the level of the EU, where development of competitive European defence technologies and industrial base is put forward as a priority. In the field of *offset* policy, the European code of ethics of offset transactions is in the development process. Its goal is to promote transparency of *offset* transactions and decrease their negative influence on competition.

Implementation of the international co-operation project BSR InnoNet (Baltic Sea Region Innovation Network) continues. The project is oriented towards co-operation in the sphere of creation of **cluster policy**, promotion of contacts, exchange of experience and co-operation among clusters, as well as analysis of clusters within a region. The Nordic Innovation Centre is proposed as the institution co-ordinating the project, the Latvian Investment and Development Agency and the Ministry of Economics represent Latvia in the project, involving also representatives of other public institutions and the private sector into various activities of the project.

One task of the project is to work out and launch one or more international innovation and cluster promotion programmes. In 2008, implementation of two such international pilot programmes was initiated.

One of the expected international programmes is oriented towards development of co-operation between regional clusters of countries. This co-

operation may be both, horizontal co-operation (which includes formation of co-operation and contacts between similar clusters) and inter-sectoral co-operation that involves clusters at different value added chain levels or clusters from different spheres, which may potentially supplement each other and promote formation of synergies. The pilot programme is oriented towards promotion of co-operation of four sectors – food, bio-energy, information technology and wood processing, as well as furniture clusters in the Baltic Sea Region. After assessment of results of the pilot programme, it is foreseen to start implementation of the programme in 2009, the goal of which is to form co-operation among the clusters of the Baltic Sea Region in order to be able to apply for clusters of different sectors in accordance with the tender procedure.

Other significant sphere, within which the international programme is developed, relates to the issues of capacity building. It is planned to create an international programme, in the framework of which a mutual exchange of experience and training of the persons and institutions involved in cluster development would be ensured. Co-ordinators and personnel of clusters as well as the state agencies and institutions that carry out the cluster promotion policy are the target audience of such programme. Implementation of the first training modules will begin in summer 2008.

Cluster development is set as a significant priority on the EU level. The European Cluster Presidency Conference took place in Stockholm in January 2008, in the framework of which the European Cluster Memorandum had been adopted. The document is foreseen to be a declaration stressing the importance of clusters in development of innovation in Europe, urging EU member states on the national and regional levels, as well as EU institutions on the EU level to promote cluster development and giving recommendations of cluster supporting initiatives.

6.3.2. Energy Policy

Main directions of the energy policy are aimed at improving security of energy supply of the country by encouraging diversification of supplies of primary energy resources and creating conditions for increasing self-provision of electricity generation, as well as 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.

The Cabinet of Ministers approved the *Guidelines for Development of Energy Sector for 2007-2016* on June 27, 2006. The guidelines include the governmental policy, development targets and priorities in the energy sector both in the medium-term and long-term.

Box 6.6

Harmonisation of normative acts with EU directives

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

- **security of supply and creation of oil product reserves.** The Concept of the State Oil Product Reserve was approved on June 27, 2006. On June 27, 2006, the Cabinet of Ministers accepted its Regulations No. 541 “Procedure for the Establishment and Storage of Petroleum Product Reserve” that regulates the procedure for oil product reserves to be established by enterprises;
- **electricity sector.** The Electricity Market Law and regulations of the Cabinet of Ministers issued in accordance with this law constitute the legal regulation for efficiently functioning electricity market, where electricity is supplied safely, qualitatively, and at justified rates and rights to choose electricity supplier freely are ensured for all users of electricity, as well as electricity generation by use of renewable resources is promoted and preconditions are provided for increasing safety of electricity supply. On May 15, 2008, the Law came into force “Amendments to the Electricity Market Law”. The amendments envisage that in case if it follows the report of electricity transmission system operator that safety of electricity supply of the country is threatened by insufficiency of production capacities, the government shall announce a competition on establishment of new production capacities or reconstruction of the existing equipment. A winner of the competition will obtain the right to receive payments for the new electricity capacities. At the same time, the respective producer of electricity will be entitled to take part in electricity market and sell the produced electricity for the agreed price to any participant of electricity market.
- **gas sector.** On May 26, 2005, the Saeima passed the Law “Amendments to the Energy Law” establishing the principles for operation of 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 regulatory normative acts with requirements of EU legislation. Transitional provisions of the law prescribe that time and procedure for coming into force of the legal norms regulating principles for operation of the natural gas market are set forth by a special law. The law on procedure for enforcement of particular paragraphs of the Energy Law prescribes that these norms of the Energy Law will be enforced on January 1, 2010. Delivery and utilisation of the natural gas are regulated by the Regulations No.99 of February 12, 2008 of the Cabinet of Ministers “Regulations of Delivery and Utilisation of Natural Gas”.

In **electricity supply**, 86% of all electricity generated in Latvia is generated by the JSC “Latvenergo” in 2007, which also ensures import of electricity and its supply to customers. Starting with September 1, 2005, functions of electricity

transmission system operator are performed by the JSC “Augstsprieguma tīkls”. Starting with July 1, 2007, functions of electricity distribution system operator are performed by the JSC “Latvenergo Sadales tīkls”. JSC “Latvenergo” is the sole owner of both companies. In

addition, more than 100 small power plants and 15 licensed electricity distribution and sale companies operate in Latvia.

Latvia, as an EU member state, has to ensure compliance with the unified requirements set forth in EU legal acts concerning the energy sector (see Box 6.6). In electricity supply, it means that the electricity market in Latvia operates in accordance with provisions of Directive 2003/54/EC of the European Parliament and of the Council of June 26, 2003 concerning common rules for the internal market in electricity and provisions of Directive 2005/77/EC of the European Parliament and of the Council of January 18, 2006 concerning the measures in order to ensure safety of electricity supply and investment into infrastructure.

On July 23, 2004, the Cabinet of Ministers accepted “Guidelines for Creation of Preconditions for Electricity Market in Latvia”, which define the basic principles for the model of opening the electricity market in Latvia, necessary preconditions for the market opening, market participants, and basic functions, duties and rights thereof, and principles of the perspective structure and regulation of the sector. It also formulates the problems that currently hinder opening of the Latvian electricity market and implementation of the rights of choice granted to the users of electricity. The draft guidelines were prepared, taking into account Directive 2003/54/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity. In order to create a legal environment for efficiently functioning and competitive market in electricity based on the guidelines, the Saeima passed the “*Electricity Market Law*” on May 5, 2005.

JSC “Latvijas Gāze” is the only enterprise operating in the **natural gas market** in Latvia at present. In compliance with licences issued by the Public Utilities Commission, JSC “Latvijas Gāze” performs transmission, distribution, storage and sale of natural gas. Approximately 70 companies compete in supply of liquefied petroleum gas.

Amendments to the “*Energy Law*” made on May 26, 2005 prescribe the main conditions for opening the natural gas market and were developed, taking into account Directive 2003/55/EC of the European Parliament and of the Council concerning common rules for the internal market in natural gas. The law includes issues related to operation of systems, duties and rights of market participants, as well as competition opportunities in the natural gas market. The Saeima has passed a special law prescribing that these amendments will become effective on January 1, 2010.

By choosing a regulated procedure of access, member states carry out the necessary measures to confer rights of accessing the system to natural gas companies and qualified users inside or outside the area containing an interconnected system on the basis of published rates and other conditions and

obligations that are to be complied with, when the system is used.

In order to update regulation in **heat supply**, on November 30, 2006 the Cabinet of Ministers adopted Regulations No. 971 “Regulations for Supply and Use of Thermal Energy”, establishing the procedure, according to which an energy supply enterprise supplies thermal energy and a thermal energy user uses it, and the procedure, according to which a supplier is authorised to stop supply of thermal energy to a user, who has not paid for received thermal energy or has not met other commitments to the supplier.

Investments in the energy sector

State assistance in the energy sector is only granted to those projects, which are linked to adjustment of heat supply systems. In the budget for 2007, in the framework of the energy policy appropriation planned for the Ministry of Economics, subsidies to local government budgets in the amount of LVL 5 million were included with the aim to support improving efficiency of thermal energy production, transmission and distribution, as well as to foster energy efficiency of public buildings. The abovementioned financing was granted to 42 local government projects through a tender of projects of the Energy Efficiency Programme of Local Governments.

In order to increase efficiency of thermal energy production, decrease the loss of thermal energy in transmission and distribution systems and foster replacement of the imported types of fossil fuels with renewable fuels or domestic fuels of other types, the Ministry of Economics has developed a draft regulation “Regulations on 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 framework of the use of the Cohesion Fund establishing the procedure, by which a funding is allocated in the framework of Activity 3.5.2.1 “Measures Regarding the Increase of Efficiency of Centralised Heat Supply Systems” of the Measure 3.5.2 “Energy” of Priority 3.5 “Promotion of Environmental Infrastructure And Environmentally Friendly Energy” of Supplement to the Operational Programme “Infrastructure and Services”.

In order to increase electricity and thermal energy production volumes of renewable resources substantially, diversify supply of primary energy resources and increase self-provision of electricity, thereby decreasing dependence of Latvia on the imports of primary energy resources, the Ministry of Economics has developed a draft regulation of the Cabinet of Ministers “Regulations on Activity 3.5.2.2 “Development of Cogeneration Power Plants Utilising Renewable Energy Sources” of Supplement to the Operational Programme “Infrastructure and Services” prescribing the procedure, by which a funding is allocated in the framework of Activity 3.5.2.2 “Development of Cogeneration Power Plants Utilising

Renewable Energy Sources” of the Measure 3.5.2 “Energy” of Priority 3.5 “Promotion of Environmental Infrastructure and Environmentally Friendly Energy” of Supplement to the Operational Programme “Infrastructure and Services”.

Co-financing is envisaged from the EU Cohesion Fund resources in the amount of EUR 127 400 000 in the framework of the Measure 3.5.2 “Energy” of Priority 3.5 “Promotion of Environmental Infrastructure And Environmentally Friendly Energy” of Supplement to the Operational Programme “Infrastructure and Services”.

87 project applications were submitted and evaluated in the framework of the open tender of project applications “Modernisation of Heat Supply Systems in Accordance with Environmental Requirements and Rise of Energy Efficiency both on the Production and Distribution Side, as well as the End Consumer Side of the Heat Supply System” of SPD Sub-activity 1.1.4.2. Co-financing from the European Regional Development Fund (ERDF) was granted to 29 project applications. The projects envisage modernisation of heat supply systems according to environmental requirements and rise of energy efficiency both on the production and distribution side, as well as the end consumer side of the heat supply system. 6 project applications were approved and are being implemented in the framework of the national programme “Improvement of Heat Supply Systems by Reducing the Content of Sulphur in Fuel” of SPD Sub-activity 1.1.4.1.

Supporting reconstruction of centralised heating systems, construction of heat distribution units and other heat regulation equipment and reduction of heat losses in buildings, the Decree No. 192 of April 23, 2007 of the Minister of Economics “On Energy Efficiency Programme of Local Governments” was issued in 2007, wherewith utilisation of appropriation in the amount of LVL 5 million, granted in the form of earmarked subsidy to local governments by the Law “On the State Budget for 2007” in the Ministry of Economics’ Programme 29.00.00 “Energy Policy”, was ensured in the framework of an open tender of local government projects.

6.3.3. Construction Policy

The goal of the state policy in construction is creation of conditions to build environmentally friendly, healthy and modern buildings for the needs of the national economy, while saving energy and resources. The main objectives of the construction policy include development of a competitive construction sector, promoting qualitative and energy-efficient construction, developing the efficient information circulation system, and ensuring efficient elaboration of construction laws and regulations in accordance with EU requirements and market interests.

The following tasks are set up for developing the construction sector:

- improvement of the business environment by reducing administrative obstacles in construction;
- optimising the institutional system of construction;
- increasing transparency of the construction process and public awareness;
- promotion of construction sector competitiveness.

Although inflation has increased and other factors threatening macroeconomic stability exist, in general, development trends of construction sector increased in the previous years (see Box 6.7).

In order to strengthen the state supervision and prevent overlapping of the functions of supervisory institutions in the construction and power industry, as well as to promote efficiency in public institutions, on December 4, 2007 the Cabinet of Ministers adopted the Decision to merge the *National Energy Inspection* and the *State Construction Inspection* as of January 1, 2008.

In compliance with the regulations No. 831 of the Cabinet of Ministers of December 4, 2007 “Statute of the State Construction Inspectorate”, as of January 1, 2008 the *State Construction Inspection* has been performing the functions prescribed in the *Construction Law*, the Law on Safety of Hydrotechnical Constructions of Hydroelectric Power Stations, the *Energy Law* and the Law on Technical Supervision of Dangerous Equipment.

In order to optimise the institutional structure, the *Construction, Energy and Housing Agency* was established and started its activities on January 1, 2008. Its main tasks include:

- gathering information in the field of construction, energy, and housing in order to ensure preparation and analysis of energy resource balance sheets, maintaining an updated construction information system, the Register of Construction Entrepreneurs and the Register of builder’s practice or architects practice certificates, as well as energy and housing monitoring systems;
- development of construction and energy draft technical regulations and draft standards in the regulated area;
- development of methodological materials for public procurements in construction in collaboration with the Procurement Supervision Bureau;
- preparation of reports on the performed research and analyses in the field of housing, construction, energy, etc.

On March 13, 2008 the Parliament adopted the Building Energy Efficiency Law, which came into force on April 16, 2008. The purpose of the law is promotion of rational use of energy resources and

improvement of energy efficiency of buildings. The requirements of EU Directives on energy efficiency of

buildings¹ are adopted as well as energy certification of buildings is introduced in this law.

Box 6.7

Construction development trends

In 2007, construction volumes reached 1609.7 million lats, which exceeded the level of 2006 by 12.8%. During the last five years, construction volumes increased by nearly 3.5 times (from 524.7 million lats in 2002 to 1609.7 million lats in 2007). In 2007, new construction volumes in constant prices increased by 21.3% or by 157.6 million lats, and the volume of renovation and reconstruction work grew by 3.6% or by 24.5 million lats. Construction of residential buildings has particularly increased, by more than six times (accommodation unit increased from 187.6 thousand m² in 2002 to 1188.4 thousand m² in 2007). According to the data of the Central Statistical Bureau, in the first quarter of 2008 the total accommodation unit of constructed dwelling houses was 258.9 thousand m².

According to the changing market situation, at the end of 2007, the increase of construction costs slowed. Due to the high proportion of wages, the biggest increase of costs could be observed in renovation of office buildings (by 31.8% in comparison with the first quarter of 2007 and by 5.3% in comparison with the preceding quarter). On the other hand, the least increase of costs could be observed in hotel construction – by 14% and 2.4% respectively.

In 2008, construction costs will continue to grow, though not as rapidly as in the previous years. The rise in prices is facilitated by the price increase of energy resources, but reduced by the increase in competition among both builders and construction material merchants.

Taking into account the number of building permits issued in the fourth quarter of 2007, it may be forecasted that in 2008:

- construction of dwellings will decrease, especially construction of family housing and multi-apartment buildings;
- office building, trade and communication construction, and in particular industrial production and storehouse construction will increase.

Remarkable building activities are foreseen in construction of engineering structures, such as ports and hydro-structures, main pipelines, communication and electric transmission systems, as well as industrial complexes.

The consequences of labour emigration affected construction sector until the end of 2007 and caused continuous growth of wages. Though with the decreasing growth rates of construction volumes, a part of the low qualified labour force employed in construction will be laid off, because due to increasing competition contractors will be motivated to reduce costs and increase productivity.

According to the information provided by CSB, in the first quarter of 2008, in comparison with the fourth quarter of 2007, construction costs in Latvia grew on average by 5.1%, wages increased by 6.4%, maintenance and operational costs of machinery and equipment – by 2.9% and prices of construction materials – by 1.6 per cent.

In 2007, 226 public procurement procedures in construction were cancelled. Comparing competition in the field of public procurements, it may be concluded that in 2007 competition increased. In 2006, the average number of applicants was 2.4, but in 2007 this number increased to 3.2.

In 2007, 293 negotiation procedures were registered on the “works which have become necessary for the fulfilment of contracts concluded previously due to unforeseeable circumstances” – for additional construction work. In 2006, only 161 negotiation procedures were registered.

Energy certification of buildings is a process within which energy efficiency² of building is determined and building energy certificate issued. Heating consumption in dwelling houses built in the last century is about 180 kWh/m² per year. In relation to new buildings, the minimum energy efficiency requirements will be set in compliance with delegation of the law, which will refer also to reconstructed buildings with a total area bigger than 1000 square metres and the total reconstruction costs whereof exceed 25% of cadastral value of the respective buildings or for which reconstruction work affects 25% of the area of such buildings.

In 2008, the Ministry of Economics will develop the draft for Regulations on Latvian Construction Norm LBN 204 “Design of Steel Structures” and in 2009 the draft for Regulations on Latvian Construction Norm LBN 215 “Design of Aluminium

Structures”. These draft regulations will be developed on the basis of LVS EN 1993:2005 – *Design of Steel Structures* and LVS EN 1999:1998 – *Design of Aluminium Structures*.

Taking into account the harmonisation trends of EU legal acts in the EU member states, Latvia is interested in development of the single EU legislation base and regulations similarly like in the field of standardisation. In the construction sector, such harmonised system pursuant to Directive 89/106/EEC of December 21, 1988 on approximation of laws, regulations, and administrative provisions of the Member States relating to construction products is developing very successfully. This harmonised system of technical standards ensures implementation of the basic principle of free movement of goods in construction.

In the 1980s, construction design was viewed as a field of construction services wherein harmonised regulations could be adopted without various obstacles and which is quite closely related to construction products. Eurocode was a unified system of rules for design of building structures proposed as a solution. It consists of ten series of documents, whereof three (EN 1990:2006, EN 1991:2006 and EN 1998:2005) are

¹ Directive 2002/91/EC of the European Parliament and of the Council of March 31, 2004 on energy efficiency of buildings.

² Energy efficiency of a building is a relative amount of energy, which characterizes the energy consumption necessary for heating, ventilation, cooling, lighting and hot water supply of the particular building. Energy efficiency of a building is stated in kilowatt-hours per square meter per year (kWh/m² per year).

the so-called horizontal series comprising basic design principles of structures, influence on the structures and design of seismically resistant structures. Seven series contain design provisions of different structures (LVS EN 1992:2004 – *Design of Concrete Structures*, LVS EN 1993:2005 – *Design of Steel Structures*, LVS EN 1994:2004 – *Design of Composite Steel and Concrete*

Structures, LVS EN 1995:2004 – *Design of Timber Structures*, LVS EN 1996:2006 – *Design of Stone Structures*, LVS EN 1997:2004 – *Geotechnical design*, LVS EN 1999:1998 – *Design of Aluminium Structures*). The Eurocode system contains 58 standardisation documents.

Box 6.8

Legal acts on construction adopted or prepared in 2007 and in the first quarter of 2008

The following legal acts were issued in 2007:

- Regulations of the Cabinet of Ministers No. 331 of May 22, 2007 “Procedure for Public Discussion of the Intended Building”;
- Regulations of the Cabinet of Ministers No. 420 of June 26, 2007 “Amendments to the Regulations of the Cabinet of Ministers No. 112 of April 1, 1997 “General Construction Regulations”;
- Regulations of the Cabinet of Ministers No. 457 of July 3, 2007 “Regulations on European Technical Approval”;
- Regulations of the Cabinet of Ministers No. 694 of October 16, 2007 “Statute of the Construction, Energy and Housing Agency”;
- Regulations of the Cabinet of Ministers No. 709 of October 16, 2007 “Regulations on Latvian Construction Norm LBN 261-07 “Construction of Internal Electrical Installations of Buildings”;
- Regulations of the Cabinet of Ministers No. 866 of December 11, 2007 “Regulations on LBN 201-07 “Fire Safety of Construction Works”;
- Regulations of the Cabinet of Ministers No. 831 of December 4, 2007 “Statute of the State Construction Inspection”.

Amendments to several regulations of the Cabinet of Ministers were prepared in the first quarter of 2008 in relation to a number of construction standards:

- Regulations of the Cabinet of Ministers No. 451 of December 23, 1997 “Regulations on Latvian Construction Norm LBN 203-07 “Design Standards for Concrete and Ferroconcrete Structures”;
- Regulations of the Cabinet of Ministers No. 139 of April 21, 1998 “Regulations on Latvian Construction Norm LBN 205-97 “Design Standards for Stone and Tarred Thread Stone Structures”;
- Regulations of the Cabinet of Ministers No. 140 of April 13, 1999 “Regulations on Latvian Construction Norm LBN 206-99 “Design Standards for Timber Structures”;
- Regulations of the Cabinet of Ministers No. 409 of October 20, 1998 “Regulations on Latvian Construction Norm LBN 211-98 “Multi-Storey Apartment Residential Buildings”.

In order to ensure complete adaptation of the Eurocode standards, the national Eurocode introduction plan for 2008-2011 is developed. In accordance with this plan, the translation of Eurocode standards and the development of national supplements were envisaged in order to implement updating of the construction standard system, as well as to improve the construction standardisation system.

In 2008, a number of notified institutions for conformity assessment of construction products in Latvia had been extended. On April 7, 2008 the European Commission acknowledged the Testing Laboratory of the Forest and Wood Research and Development Institute of the Latvian University of Agriculture to be the EU notified institution under the Construction Products Directive 89/106/EEC. Thus, the competence of the MeKA Testing Laboratory to perform conformity assessment of construction products and the right to issue testing reports recognized internationally, also within the EU, on the mechanical properties of timber products and structures and their reaction to fire is testified in the regulatory sector.

In order to ensure transparency of performance of the construction process and to improve construction process management, development of Building Information System (BIS) is continuing. Its implementation is one of the main priorities of the Ministry of Economics in the construction sector. The fact that the documentation and decisions relating to the construction process will be unified in one

centralised system will ensure both uniform application of construction procedures in local governments and the opportunity to operatively perform supervision and control of the decisions issued by local governments and the building authority.

In 2007, 15 seminars and information days were organised for employees of municipal building authorities, architects, building engineers, and other experts, as well as nine extensive reports, provided by participating in seminars and conferences of other organisations on the situation in the construction sector, solutions regarding the lack of qualified labour force, decrease of the influence of inflation, topicalities of production of domestic construction materials, illegal employment and the measures for reduction thereof, employment remuneration and development of a social dialogue, results of 2007 and plans for 2008.

Other measures organised in collaboration with the representatives from the Russian Association of Architects in the Baltic States including the exposition of the best works of Latvian architecture of the year in the Daile Theatre, the conference “Water and Architecture” within International Architecture Days in Jūrmala, as well as the exhibition of Latvian architecture in St.Petersburg within the framework of the Riga Days acknowledged architects with the work accomplished by others, including the work and ideas of the grand architecture masters of the Netherlands, Great Britain and Rome.

Environment accessibility monitoring has been prepared and implemented by participation of the NGO “Apeirons”, a tender on the most humane building “ZELTA KRUKĪS 2007” and granting of the annual award “Zelta krukis” for the most human building in several categories. A supplement to the newspaper “DIENA” of December 7, 2007 (Nr. 286 (5026)) “ENVIRONMENT ACCESSIBILITY AFFAIRS” had been published.

In accordance with the amendments to the *Construction Law* and regulations of the Cabinet of Ministers No. 453 of June 28, 2005 “Regulations for the Registration of Construction Entrepreneurs”, 5806 construction entrepreneurs were registered in the *Construction Entrepreneur Register* from July 1, 2005 to December 31, 2007, 1250 of which in 2005, 2759 – in 2006, and 1797 – in 2007. In 2007, 562 construction entrepreneurs were deleted from the Register, but 129 entrepreneurs renewed in the Register. As of May 15, 2008, 511 construction entrepreneurs have been entered into the Construction Entrepreneur Register, while information about 7158 certified persons is included in the joint register of certified specialists maintained by the Ministry of Economics, 193 certified specialists whereof were registered in the first quarter of 2008.

The Ministry of Economics implements general supervision and co-ordination of construction in the country, while supervision of particular spheres is within the scope of the authority of other ministries. The authority of the Ministry of Transport includes road construction (JSC “Latvijas Autoceļu direkcija”), railways, ports and telecommunications, while territorial planning is within the scope of the Ministry of Regional Development and Local Government. The Ministry of Welfare, the Ministry of Justice, the Ministry of Interior, the Ministry of Environment, the Ministry of Health and the Ministry of Agriculture determine particular requirements for buildings or their construction, while the State Inspection for Heritage Protection, which is subordinated to the Ministry of Culture, sets forth the requirements for reconstruction and restoration of cultural monuments.

Direct supervision of construction in their administrative areas is carried out by 553 local governments (seven cities, 53 towns, 35 amalgamated local municipalities and 432 rural municipalities) that have established building authorities for this purpose or have delegated their supervision powers to other building authorities. In 2007, 147 building authorities and 99 building inspectors operated in the Latvian local governments.

In order to reduce illegal employment, “envelope wages” and tax payment violations, the State Revenue Service performed 432 inspections in 2007 on construction objects of private houses belonging to natural persons, where construction was carried out by 105 legal persons and 555 natural persons. During the inspection, 460 persons were found with whom employment contracts had not been concluded or who

performed unregistered economic activity. 326 thematic inspections were carried out by employers in construction objects belonging to legal persons, including 110 inspections in buildings where renovations were taking place, and 66 inspections in construction objects of private houses, while after the inspections in the construction objects an additional 109 inspections of employers were performed in offices, SRS institutions or accounting service providers. Out of 435 thematic inspections performed by employers, violations were discovered in 190 inspections.

The website of the Ministry of Economics provides current information about the news in construction and informative measures, as well as access to policy and legal documents of the construction sector, procedures for the performance of the construction process, responsibilities of producers and the set procedure of conformity assessment, information on public procurement in construction, procedures for conferring and renewing rights of construction and control of environmental accessibility, procedure for registration of construction entrepreneurs, as well as the required application forms.

Since the Building Energy Efficiency Law came into force on April 16, 2008 the website of the Ministry of Economics is updated with information on energy efficiency of buildings and its calculation methods.

6.3.4. Tourism Policy

The main goals of Latvian tourism policy are to improve competitiveness of the tourism sector and, through promotion of sustainable growth of tourism, create new workplaces, encourage balanced development of regions, preserve cultural and natural heritage and foster social integration of the society.

In order to determine and implement the tourism development policy, a system of policy planning documents (see Box 6.9) and normative acts regarding tourism (see Box 6.10) has been created and is being improved on a regular basis in Latvia.

Guidelines of Tourism Development Policy of Latvia (hereinafter – Guidelines) approved by the Order No. 559 of August 11, 2004 of the Cabinet of Ministers define basic principles of tourism development policy, set goals of tourism development and identify main lines of action to achieve these goals.

In order to ensure achievement of goals set forth in the Guidelines, the *Tourism Development Programme of Latvia for 2006-2008* (hereinafter – Programme) was developed, which was approved by the Order No. 505 of July 5, 2006 of the Cabinet of Ministers.

Specific activities promoting tourism development in the framework of the allocated state budget are determined in the annual action plan.

From the point of view of Latvian tourism development perspective, the most important task in 2008 is to develop a new medium-term policy planning document of the tourism sector – *Guidelines of Tourism Development Policy of Latvia for 2009-2015*. It is planned to determine in the framework of this document the

strategic directions for sustainable and competitive development of the tourism sector, therefore increasing the flow of tourists, income from tourism, as well as promoting development of Latvian economy, social and economic welfare of the population and international integration in general.

Box 6.9

Guidelines of Tourism Development Policy of Latvia

The Guidelines are a medium-term policy planning document, defining the basic principles of tourism development policy and the goal of tourism development policy of Latvia for 2004-2008: to increase the share of tourism in GDP of Latvia.

The following lines of action are identified for achievement of this goal:

- Positioning of Latvia as a distinctive, safe and recognised tourist destination;
- Development of incoming and domestic tourism;
- Promotion of co-operation.

Tourism Development Programme of Latvia for 2006-2008

The Programme is a medium-term policy-planning document with the goal to ensure annual increase of the value added of the tourism sector by 10-15% and growth of the share of the tourism sector in GDP by 20% annually (at current prices).

An Action Plan of Latvian Tourism Development for 2008 (approved by the Order No.403 of July 9, 2008 of the Cabinet of Ministers) has been elaborated in accordance with the directions set in the Guidelines and Programme, and it includes specific activities for promotion of tourism development and determines responsible institutions, expected financing, terms of execution, and indicators of assessment. A comparative report is also included in the Action plan regarding achievement of the set goals in 2004-2007.

The Programme and the Plan include horizontal activities for tourism development, which are being implemented by the Ministry of Economics, Latvian Tourism Development Agency (hereinafter – Agency),

other ministries and public institutions in co-operation with the local governments, the private sector and non-governmental organisations.

Box 6.10

Changes in normative acts regulating tourism

On the basis of delegation stipulated by the Law “Amendments to the Tourism Law” adopted by the Saeima On February 16, 2006, a draft regulation of the Cabinet of Ministers is developed concerning the procedures for certification and provision of services of tourist guide, the goal of which is to ensure procedures for certification of a tourist guide – physical person and provision of services of tourist guide in order to ensure qualitative provision of tourist guide services to the local and foreign tourists in Latvia, as well as a draft regulation of the Cabinet of Ministers – “Amendments to the Regulation No. 460 of June 6, 2006 of the Cabinet of Ministers “Regulations Regarding the Lists of Specialities, Sub-specialities and Additional Specialities for the Regulated Professions””, which are submitted for approval to the Cabinet of Ministers.

In order to ensure implementation of the Section 29 of Consumer Rights Protection Law stipulating the consumer rights, if a service inadequate to provisions of the Contract is provided, a draft regulation “Amendments to the Regulation No. 67 of January 23, 2007 of the Cabinet of Ministers “Regulations Regarding the Procedures for the Preparation and Implementation of a Package Tourism Service, Information to be Provided to a Client, and the Rights and Duties of a Package Tourism Service Provider and a Client”” is submitted to the Cabinet of Ministers for approval.

On February 2, 2008, regulation No. 66 of the Cabinet of Ministers was adopted “Amendments to the Regulations No. 666 of November 29, 2003 of the Cabinet of Ministers “Bylaws of Latvian Tourism Consultative Council””.

In 2007, the Ministry of Economics continued work on harmonisation of the draft agreement between the government of the Republic of Latvia and the government of the Russian Federation regarding co-operation in the sphere of tourism. The agreement was adopted by the regulation No. 477 of June 30, 2008 of the Cabinet of Ministers “On the Agreement of the Government of the Republic of Latvia and the Government of the Russian Federation Regarding Co-operation in the Sphere of Tourism”. It envisages co-operation in such directions as promotion of development of group and individual tourism, promotion of co-operation of public and private tourism sector, exchange of information, co-operation in the framework of international organisations, including the United Nations World Tourism Organization (hereinafter – UNWTO), exchange of journalist and expert delegations, as well as carrying out training and research. A Joint Tourism Committee will be established for implementation of the agreement.

In June 2008, a draft Decree “On Channeling Privatisation Income to Promotion of Identification of Tourism Products of Latvian Conferences and Corporate Activities” elaborated by the Ministry of Economics was approved by the Cabinet of Ministers. The Decree envisages to channel LVL 294 thousand from deductions of the income obtained in the privatisation of state property objects for implementation of the specified goal in addition to the approved tourism policy implementation budget of 2008.

According to the informative report “Report on Tourism Development in Latvia in 2007” worked out by the Ministry of Economics, which is reviewed and adopted for information in the meeting of July 8, 2008 of the Cabinet of Ministers, in 2007 rapid growth of the tourism sector continued in Latvia (see Box 6.11).

In 2008, LVL 1.28 million are allocated for implementation of the state budget programme

“Implementation of Tourism Policy”, which will be utilized in accordance with the priorities specified in the Guidelines – strengthening the positions of Latvia as a tourist destination, improvement of tourism infrastructure, promotion of development of new tourism products and expansion of co-operation.

In the first half of 2008, several meetings of the management of the Ministry of Economics and other

ministries took place with social partners of the tourism sector in order to discuss various topical issues of tourism development, including development of spa

resorts, drawbacks in the declaration system of foreign travellers, Latvian representation (including tourism) abroad.

Box 6.11

Indicators of Latvian Tourism Development in 2007

In 2007, the share of the tourism sector in Latvian GDP was 1.6% (1.7% in 2006).

In 2007, the number of foreign travellers reached 5.2 million, which is by 12.7% more than in 2006. Expenses of foreign travellers in Latvia have also increased in 2007, reaching LVL 338 million, which is by 27% more as compared to 2006. The number of persons employed in the tourism sector has risen by 11%, reaching 35.6 thousand in 2007.

Growth of the tourism sector in 2007 was mostly promoted by the following factors:

- strengthening of Latvia as a new tourist destination after accession to the European Union;
- accessibility to EU financial resources;
- measures of Latvian tourism marketing implemented in high-priority, priority and perspective countries;
- increased number of direct flights;
- increased number of expanded volume of low-cost airline services;
- increased number of tourist class hotels.

In spite of these positive trends, the indicators of tourism balance of payments are still negative – expenses of Latvian residents abroad in 2007 exceeded the expenses of foreign travellers in Latvia by LVL 146.8 million. The average stay of foreign travellers in Latvia has decreased from 1.5 days in 2006 to 1.4 days in 2007, without reaching the planned annual growth to 2.5 days.

Despite activities of the public and private sectors for promotion of development of the sector, the supply of tourism services lags behind the evergrowing demand, hence a decrease of the quality of provided services has been observed. The high inflation in the

country has affected rise of prices for tourism services, thereby deteriorating correspondence of the value of provided services with the price, which up to now was one of the biggest factors of Latvian attractiveness from the viewpoint of other tourists.

Box 6.12

Utilisation of resources from the European Regional Development Fund

Measure 3.4.2 “Tourism”

Activity 3.4.2.1 “Development of Tourism Product of National Importance”:

Sub-activity 3.4.2.1.1 “Conservation and Renovation of Urban Monuments of State Importance and Adjustment of Infrastructure to Development of Tourism Product” (submission of projects from May 19 to July 18, 2008 (additional information: http://www.liaa.gov.lv/?object_id=3163)):

- objective – to promote development of cultural tourism products of national importance, ensuring improvement of tourism infrastructure for internationally recognised Latvian cultural and historical values;
- volume of ERDF financing – LVL 10 542 060;
- type of implementation – open selection of project applications;
- potential places of investment – urban planning monuments of state importance in accordance with a list of the State Inspection for Heritage Protection as of January 1, 2007;
- beneficiaries of financing – local governments.

Sub-activity 3.4.2.1.2 “Development of Bicycle Tourism Product of National Importance”:

- objective – to promote development of bicycle tourism product establishing a bikeway infrastructure, as well as observing requirements of ensuring sustainability of tourist safety and tourism resources;
- volume of ERDF financing – LVL 4 919 628;
- type of implementation – open selection of project applications;
- beneficiaries of financing – local governments.

Sub-activity 3.4.2.1.3 “Development of Cultural, Active, Health and Recreation Tourism Product of National Importance”:

- objective – to promote development of internationally competitive and recognizable tourism products in Latvia by investing in creation of new tourism products or substantial improvement of the existing ones;
- volume of ERDF financing – LVL 13 528 098;
- type of implementation – open selection of project applications;
- beneficiaries of financing – enterprises and local governments;

Activity 3.4.2.2 “Development of Tourism Information System”:

- objective – to establish a complex tourism information carrier system, which would ensure convenient way of finding of tourism objects and obtaining information for travellers;
- volume of ERDF financing – LVL 790 499.88;
- type of implementation – limited selection of project applications;
- beneficiary of financing – Latvian Tourism Development Agency.

From the view of Latvian tourism development perspective, important work of the Ministry of Economics and Agency in 2008 is related to development of the draft of the necessary normative

acts (including criteria) for receipt and absorption of **resources of the European Regional Development Fund** (EUR 42.3 million) in 2007-2013 for the Measure 3.4.2 “Tourism” of Priorities 3.4 “Quality

Environment for Life and Economic Activity” of Supplement to the Operational Programme *“Infrastructure and Services”*. The goal of the Measure is to promote strengthening of Latvia as a tourist destination and increase of competitiveness creating favourable conditions for complex development of tourism products of national importance. Two

activities are planned in the framework of the measure: Activity 3.4.2.1. *“Development of Tourism Product of National Importance”* and Activity 3.4.2.2 *“Development of Tourism Information System”* (see Box 6.12).

The state policy for tourism development is implemented by the **Latvian Tourism Development Agency** (see Box 6.13).

Box 6.13

Activities of the Latvian Tourism Development Agency in 2008

Activities of the Agency for tourism policy implementation are determined by its Action Plan for 2008, which is prepared on the basis of Activity Strategy, Programme, Guidelines of the Agency for 2007-2009.

In order to promote implementation of the line of activity prescribed in the Strategy – promotion of recognisability of Latvian tourism image and popularisation of Latvia as a tourist destination in the international tourism market, the Agency has:

- started implementation of direct marketing activities in 13 tourism target markets. Tourist agencies and mass media are being aggregated in the respective markets, updated data bases are established and maintained, as well as meetings with potential co-operation partners organised;
- performed negotiation regarding placing information stands in the airports of highly priority target markets of Sweden and Finland, port terminals and tourism information centres in order to ensure continuous accessibility of information for tourists regarding tourism possibilities in Latvia;
- continued to popularise Latvia as an attractive tourist destination and participated in 15 international tourism fairs, organised visits of journalists and several working seminars for tourism professionals, as well as published informative materials. Representatives of mass media and tourism industry were informed of the new travelling opportunities provided by accession to the Schengen Agreement area in the press conferences organised by the Agency in eight CIS countries in co-operation with the Ministry of Foreign Affairs and airline company “airBaltic”;
- similarly as in 2007, an international working seminar *“Buy Latvia, Buy the Baltics”* had been organised for tourism professionals in February 2008. The objective of the activity was to acquaint the existing and potential sellers of Latvian and Baltic tourism products with tourism opportunities in Latvia and the Baltic states, show tourism products, their variety, provide an opportunity to tourism professionals to meet tourism product and service providers of the Baltic states, as well as acquaint themselves with a supply of tourism products not only in presentations, but also by personal visits, going on 35 different tours for several days throughout Latvia. Considering the big interest (more than 200 foreign and 100 Latvian representatives of the tourism sector of more than 100 foreign tourist agencies and 78 tourist agencies of the Baltic states), such an Activity will be organised also in 2009;
- organised the “Baltic Travel Marathon” already for the second year in co-operation with national tourism organisations of Lithuania and Estonia with a goal to popularise new tourism products, to acquaint with the supply of tourism, as well as encourage development of domestic tourism of the Baltic states region. 36 tourism sites are included in the marathon (12 of each state);
- started work of organisation of a foreign tourist inquiry and performing research on 10 target markets (of United Kingdom, Germany, Lithuania, Estonia, Poland, Russia, Sweden, Finland, France, Spain). The data collected in the research will be useful for planning and implementation of further Agency marketing activities in the set target markets, as well as for representatives of the tourism sector;
- in order to raise the quality level of Latvian tourism services, the development of a quality system of Latvian tourism services is continued also in 2008. The quality system of tourism services developed in Switzerland will be used as a basis for establishment of the quality system in Latvia, which is already established and successfully operates in several other European countries;
- caring of safe tourism in Latvia, the free of charge “Tourist hot phone – 22033000” established in the previous year is also maintained in 2008, providing an opportunity to inform foreign tourists of different conflict situations related to tourism service providers in Latvia, as well as provide informative assistance 24 hours a day. In addition, popularisation measures of a telephone line are carried out;
- continues to take part in the project of the European Commission *“European Destinations of Excellence”*, and a wide publicity for the best Latvian tourist destination. The goal of the project is to draw attention to variety of destinations for European tourists, different and common values, as well as support the destinations, within which the economic growth is provided by sustainable development of tourism. In 2008, the theme of EDEN project is “Tourism and Non-Material Heritage”. A project application was prepared and approved by the European Commission, therefore in 2008 also a competition of the best Latvian tourist destination was organised and 13 applications assessed. The application “Latgale Potters – Masters of Clay” submitted by Rēzekne District Council was approved to be the most excellent. Awarding a winner at European level will take place in autumn 2008 in the framework of the European Tourism Forum.

The following directions of action must be considered as a priority in 2008 in the field of tourism, which also reflect in the Action plan of the Agency, as well as the activities to be performed:

- strengthening of the positions of Latvia as the Baltic tourism centre;
- improvement of the information system and increasing the role of the Internet;
- adjustment of marketing activities to target markets;
- quality promotion of tourism services;
- development promotion of new tourism products.

The data of European Travel Commission on tourism development trends in European countries

confirm that the importance of Internet has substantially increased over the last years in making

decisions on the choice of travel destinations (from 5% in 2005 to 32% in 2007). Results of the foreign tourist inquiry carried out by the Agency in 2007 show that 23.6% foreign tourists have used Internet for obtaining information before going to Latvia. On the basis of importance of the Internet in making decisions on the choice of travel destinations, the Agency has started to improve the state tourism portal www.latviatourism.lv in 2008, in order to make it a modern and efficient marketing instrument.

In order to ensure further international integration of Latvian tourism sector, representation of state interests, and adoption of better practice, international co-operation is being developed, e.g., taking part in the UNWTO and the European Travel Commission, and in the work of the Tourism Advisory Committee and the Tourism Sustainability Group of the European Commission.

6.4. Business Environment

Business environment in Latvia is being consistently improved through development of the legal framework, harmonising it with the EU requirements and monitoring the effects of administrative procedures on business activities. Considerable reforms and improvements have been achieved in registration of enterprises, taxation policy, customs legislation, procedures, border crossing, construction, real estate and other areas.

Reforms for improvement of business environment are evaluated positively in various surveys.

Regular and systematic improvement of business environment is important also for increasing competitiveness of Latvia's business environment among other countries. Latvia takes the high – 22nd place in the world among 178 countries as it is described in the World Bank Report "Doing Business 2008: How to reform" published in 2007. Business environment is evaluated in 10 aspects, and assessment of Latvia is as follows:

- 3rd place – in enforcing contracts;
- 13th place – in loan availability;
- 19th place – in trading across borders;
- 20th place – in paying taxes;
- 30th place – in starting a business;
- 51st place – in protecting investors;
- 64th place – in closing a business;
- 82nd place – in dealing with licenses;
- 85th place – in registering a property;
- 96th place – in employing workers.

One of the efficient mechanisms for the improvement of the business environment in Latvia is the *Action Plan for Improvement of Business Environment* annually developed since 1999. The *Action Plan* is an inter-ministerial policy-planning document, which prescribes actions in the framework of the business environment policy, as well as tasks, measures to be implemented, responsible institutions, indicators for

assessment of how the tasks have been achieved and their achievement terms. Problems included in the *Action Plan* and their solutions are identified through close co-operation with organisations representing entrepreneurs (Council of Small and Medium-Sized Enterprises and Crafts, National Economy Council, Foreign Investors Council in Latvia), as well as through assessment of problems identified in business environment surveys. The *Action Plan* covers amendments to legal acts, revision and simplification of procedures, improvement of co-ordination between various bodies, preparation and publication of information, as well as training employees of public institutions.

Directions and tasks of the *Action Plan* cover such spheres as taxation policy and tax administration, improvement of legal environment for business activity, reduction of the number of procedures and required time, as well as improvement of information accessibility.

The *Action Plan* for 2008 was approved by the Cabinet of Ministers on April 29, 2008.

It includes 32 measures for improvement of taxation system, promotion of employment, simplification and improvement of construction process, simplification of real estate registration process, ensuring efficient public administration, etc. The *Action Plan* may be downloaded from the Internet homepage of the Ministry of Economics of the Republic of Latvia (<http://www.em.gov.lv/em/2nd/?cat=17804>).

The most essential measures included in the *Action Plan* are:

- non-taxation of the reinvested profit;
- promotion of investments in development of enterprises and innovations;
- improvement of the repayment system of VAT overpayment;
- establishment of "the principle of one stop shop" for receiving working permits and residence permits;
- consumer incentives for employment of the persons sentenced to imprisonment in penal institutions;
- ensuring participation of enterprises in reduction of administrative obstacles;
- reform implementation of the payment procedure of sick-leave certificates;
- simplification of construction coordination procedures;
- reviewing construction claims for public buildings of small dimensions;
- simplification of real estate registration procedures;
- establishment of a joint information access point in relation to licenses and permits.

Informative report on progress of implementation of the *Action Plan* will be prepared in August 2008.

In April 7, 2008 a **Co-operation Memorandum** was concluded between the Employers' Confederation of Latvia (hereinafter – ECL), Latvian Chamber of

Commerce and Industry (hereinafter – LCCI) and the Ministry of Economics.

In the framework of Co-operation Memorandum, the parties agreed to establish a working group for making proposals for the necessary amendments to the normative acts regulating corporate income tax (hereinafter - CIT) and real estate tax (hereinafter – RET). In order to assess the influence of these proposals on the results of economic activity of enterprises, ECL and LCCI form a *Group of Calculations and Modelling* of their members.

A working group has been established by the Order No. 176 of the Minister of Economics of April 14, 2008 in order to implement the goals set in the Co-operation Memorandum concluded on April 7, 2008, containing representatives of the Ministry of Economics, Ministry of Finance, ECL, LCCI and the National Economy Council. The task of the working group envisages preparation of proposals for the necessary amendments to the normative acts of CIT and RET by June 13, 2008 in order to promote competitiveness of enterprises, whereas the proposals prepared by the Ministry of Economics have to be submitted to the Ministry of Finance and the Cabinet of Ministers by June 30, 2008.

The draft law “Amendments to the Law “On Maternity and Sickness Insurance”” had been adopted in the meeting of the Cabinet of Ministers of May 13, 2008, by which it is planned to reduce the number of days of work incapacity paid by the employer from 14 to 10.

Meetings of the **Foreign Investors Council in Latvia (FICIL)** with higher government officials are held annually. The government is represented by the Prime Minister, who chairs the high-level meeting and ministers, as well as high-level officials subordinate institutions responsible for administrative and regulating areas actual for entrepreneurs, whereas FICIL is represented by the foreign investors and their representatives in Latvia.

Since the 2nd High-Level Meeting, recommendations of FICIL have been included in the *Action Plan*.

The 12th high-level meeting of Latvian government and FICIL took place on June 5-6, 2008, in which the following was discussed:

- labour force planning;
- energy policy;
- future perspective of Latvian macroeconomic situation and taxation policy;
- sustainable planning in local governments.

In March 2007, the European Council approved the European Commission’s *Action Programme for Reducing Administrative Burdens in the European Union*. The Programme sets a goal to reduce the **administrative burden** in the EU by 25% until 2012. The basic component of the measures of this programme is administrative burden, which is faced by entrepreneurs upon providing administrative costs resulting from EU legislative acts.

Project implementers – consortium companies *Capgemini*, *Ramboll management* and *Deloitte* work in all EU member states. The measures were started in August 2007 and cover more than 40 legislative acts in 13 priority fields (regulation of business activity, health protection, food products marking, regulation of work environment and labour relations, tax regulation (VAT), statistics, environment, agriculture and agricultural payments, fishing, transport, financial services, cohesion policy and public procurement). 340 information provision claims resulting from EU legislative acts were initially identified in the priority fields.

According to the information provided by the European Commission it is calculated that the biggest number of information provision claims ~ 80% are in the areas of business activity legislation, financial services, environment, food safety, pharmacy, taxation (VAT).

Since August 2007, the project in Latvia has been implemented by the audit company *Deloitte Latvia*. In order to ensure co-operation with the European Commission, the Ministry of Economics acts as the *Joint Contact Point* since April 2007. An inter-ministerial working group under the management of the Ministry of Economics was established in June 2007 for ensuring co-operation with other ministries, within the competence of which the information provision claims resulting from EU legislative acts are studied and the administrative burden measurements of EU level are made.

In 2007 and at the beginning of 2008 those national legislative acts had been surveyed and assessed, which were adopted by transposing the EU legal acts in 13 priority fields and the information provision claims had been summarized. In general, more than 6000 information provision claims are provisionally summarized in the national legislation of the member states, of which 558 are such information provision claims, which are envisaged in the national legislative acts in addition to those prescribed in EU directives. Summarization of the national legislative acts and enumeration of information provision obligations in relation to Latvia is carried out by *Deloitte Latvia* in co-operation with the ministries and the Ministry of Economics. The results are submitted to the European Commission, thereby the approved results of enumeration of information provision obligations might be available in summer.

Currently, the first stage of the project – summarization of information provision claims – is nearly completed. The next stage of the project – quantitative measurements of information claims (or turning information provision obligations in monetary terms) will take place in 2 fields in Latvia – in the field of environment and taxation (VAT). It is planned that in general, EU quantitative measurements will be completed and proposals for improvement of legislative acts will be prepared by the end of 2008.

The Guidelines for Public Administration Policy Development for 2008-2013 were approved by the Order No. 305 of the Cabinet of Ministers of June 3, 2008, containing the following sections:

- policy planning and activity results;
- quality of administration: services and institutional system;
- the rule of law of the administration;
- development of human resources in the public administration;
- participation and co-operation of society within public administration.

The activity directions included in the Guidelines envisage introduction of *better regulation* in the public administration by improving the service quality of

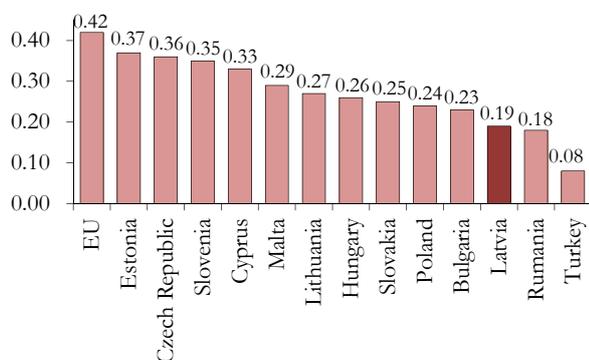
institutions, development of e-government and e-services, development of quality management systems, simplification of administrative procedures and reduction of administrative burden, as well as co-operation improvement of public and private sector. The Guidelines also set the Latvian national goal for reduction of administrative burden in the amount of 25%. On the basis of the Order of the Cabinet of Ministers for approval of the Guidelines, several documents will be drawn up ensuring achievement of the set goals, inter alia, the concept of implementation of better regulation policy, as well as the concept of introduction of the principle of one stop shop for administrative procedures of performers of economic activity, etc.

6.5. Innovations and New Technologies

Upon assessing the progress of EU member states in implementation of innovation policy, the European Commission has published the new European Innovation Scoreboard in spring 2008¹. In the framework of the EU, the best indicators belong to Sweden and Finland, whereas Estonia and the Czech Republic have the best results in implementation of innovation policy among the new EU member states.

Figure 6.3

Innovation Index of the New EU Member States and Candidate Countries in 2007



Source: European Commission, European Innovation Scoreboard 2007

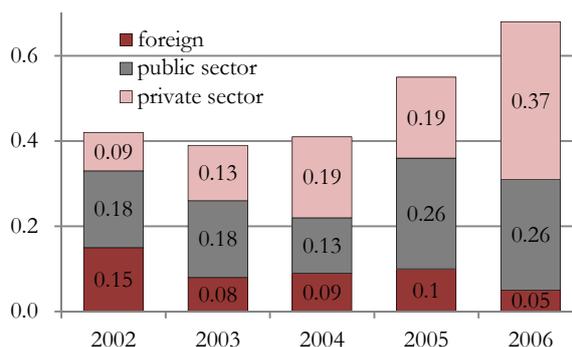
Latvian innovation index has not substantially changed over the last years and Latvia takes the 35th place among 37 surveyed EU member states and candidate countries. Upon assessing the innovation index indicators, it may be concluded that Latvia has comparatively better indicators in the spheres characterising the possible innovation potential, for example, the number of graduates of natural sciences,

the number of people involved in further education, expenditure in the sphere of information technologies, access to venture capital. At the same time, such indicators as exports of the products of high technology sectors, the number of employees in medium and high technology sectors, the number of European and international patents is one of the lowest among the EU member states and that indicates shortcomings in the national innovation system and directly the insufficient capacity in competitive product of knowledge management.

The total funding for research and development in Latvia in 2006 was 0.7% of GDP or LVL 78.2 million (public sector investments – 0.26% of GDP; private sector investments – 0.37% of GDP or LVL 41.2 million), whereas in EU member states on average 1.84%. The target set by the Lisbon Strategy is to increase R&D expenditures 3% of GDP by 2010, inter alia private sector investments – 2% of GDP. The total funding of Latvia for research and development is one of the lowest indicators within the EU and substantially lags behind the set target.

Figure 6.4

Funding for Research and Development in Latvia for the Period of 2002 -2006 by Sectors
(% of GDP)



Source: CSB

¹ 25 indicators are included in the Report characterising development of human resources, creation and introduction processes of new knowledge, as well as provision with the necessary funding. Total indicators form innovation index, which enables to compare achievements of the member states in the sphere of innovation policy implementation.

Programme for Promotion of Entrepreneurship Competitiveness and Innovation for 2007-2013 sets the objective to promote the increase in capacity and efficiency of the national innovation system. The following main tasks are defined for development of innovation in the programme:

- promote knowledge and technology transfer in production;
- increase innovation capacity by developing favourable institutional environment for innovative activity, facilitating co-operation of science, education and private sector;
- support development of new products and technologies, inter alia promoting understanding of entrepreneurs about intellectual property and its protection.

Both, the initiated activities are continued for promotion of industrial research implementation, development of new products and introduction in the market and several new activities are started for implementation of the tasks set in the Programme for Promotion of Entrepreneurship Competitiveness and Innovation.

Commercial companies have an opportunity to submit projects to the Ministry of Education and Science for receipt of support for project implementation in the framework of EUREKA Programme. EUREKA Programme is EU Programme for promotion of international co-operation of business activity and scientific institutions for facilitating development of high technologies, development of new, competitive products and services. Commercial companies may receive up to LVL 91 000 for implementation of a co-operation research project and support intensity may be 75% of the industrial research implementation costs and 50% of the costs of planning work. In 2007, 11 projects were supported in the amount of LVL 342 523.

The Ministry of Education and Science continues to implement the Market Oriented Research Programme, in the framework of which such research projects are supported, the goal of which is to promote integration of science and production. The funding may be received by the institutions registered in the Register of Scientific Institutions in the amount of 70% of the referable costs, and the remaining 30% must be attracted from commercial companies. In the framework of the programme, 17 projects have been supported in 2007; in 2008, funding in the amount of LVL 1 million is available for the market-oriented research projects.

In 2008, the Ministry of Economics continues implementation of the Programme for Development of Innovation Centres and Business Incubators. Its objective is to promote improvement of innovation infrastructure and ensure provision of services of innovation centres and business incubators to new enterprises. In the framework of competition, 11 projects of innovation centres and business incubators

were supported as a result of an open project competition. During 2007, 69 enterprises were established in the incubators as a result of programme implementation, of which 61 enterprises are registered in 2007. 136 new workplaces were established in these enterprises, as well as the incubator enterprises paid taxes in the amount of LVL 241.3 thousand.

On February 26, 2008, the Cabinet of Ministers issued Regulations No. 129 “Regulations on the Sub-activity 2.1.2.1.2 “Technology Transfer Contact Points” of Supplement to the Operational Programme “Entrepreneurship and Innovation”” for facilitation of technology transfer, envisaging continuation of providing support to the operation of the technology transfer contact points in higher education institutions in order to promote co-operation of scientists and entrepreneurs ensuring efficient introduction of the research results of the public research institutions into production. In 2007, 34 patent applications and 134 commercialization proposals were prepared, as well as 23 co-operation agreements were concluded with entrepreneurs in the framework of contact points.

In 2008, Latvian Investment and Development Agency (LIDA) started implementing the national support programme “Attraction of Highly Skilled Employees”, in the framework of which support is available for enterprises for involvement of engineers, scientists or other skilled specialists of such level in order to solve particular technological issues or develop new products in enterprises. The programme is co-financed by the resources of the European Social Fund. The total funding available in the framework of the Activity is LVL 9.8 million, of which LVL 4.9 million is planned as a public funding and LVL 4.9 million – as a private co-funding. During the first round of project competitions from April 21 to May 30, 2008, entrepreneurs have submitted 7 project applications.

Development of the normative acts necessary for implementation of the national support programmes, which would facilitate investments of the private sector in research and development of new projects and introduction into production, is continued. In 2008, implementation of the national support programmes is planned to initiate for:

- development of new products and technologies;
- protection of industrial property;
- introduction of new products and technologies into production;
- establishment and operation of competence centres;
- establishment and operation of a science and technology park.

Particular attention is paid to the measures, the goal of which is to facilitate as wide as possible public understanding of innovation and its role in promotion of competitiveness. Regional innovation days are one of the instruments for formation of public understanding. Like in the preceding years, it is

planned to organise informative seminars also in 2008 for popularization of innovation in Latvian regions. The goal of seminars organised by the LIDA is to interpret the concept and meaning of innovation in development of entrepreneurship, encourage entrepreneurs and local governments to search for the ways of co-operation for promotion and development of entrepreneurship, as well as explain the necessity and opportunities of establishment of innovative entrepreneurship.

An important measure for establishment of new innovative companies is the competition of business

ideas “Cup of Ideas” organised by the LIDA in cooperation with other partners. In the framework of this competition, participants have an opportunity to obtain advice and contacts from experts to start their business, as well as to attract equity capital to start their business activities. In 2008, the competition takes place for the second time, and the number of submitted business ideas indicates its popularity, namely, in 2007 – 269 ideas, whereas in 2008 – 376 ideas.

6.6. Information Society

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

Building the information society is set as a priority in the National Lisbon Programme of Latvia for 2005-

2008 (see Chapter 6.1). The main planned activities for promotion of ICT and building the information society are the following:

- to encourage widespread use of ICT in public services, SMEs and households (see Box 6.14);
- to ensure the security of networks and information as well as convergence and interoperability in order to establish an information area without frontiers;
- to encourage development of broadband networks, including the poorly served regions, in order to develop the knowledge economy.

Box 6.14

Computer and Internet usage in Latvia

According to the data of the CSB survey “Computer and Internet Usage in Households”, 49% of all households (households where at least one person in the age of 16-74 years lives) had computers and 51% of households had Internet connection in 2007. 58% of inhabitants (inhabitants in the age of 16-74 years) used computer on a regular basis (in the last 3 months) and 56% of inhabitants used Internet on a regular basis. 32% of all households had broadband Internet connection. In order to access Internet, desktops and mobile phones with Internet service were most used in households (38% and 30% respectively).

93% of companies with at least 10 employees had computers, 84% of such companies had Internet connection and 38% of such companies had their own Internet website in January 2007. 44% of companies with at least 10 employees used Internet for communication with public institutions. 28% of all employees of companies used computer on a regular basis, while Internet was used regularly by 24% of employees.

At the beginning of 2006/2007 academic year, the number of computers per 100 full-time students at higher education institutions and colleges was 11.6 (8.8 at professional education institutions and 7.3 at comprehensive schools). 100% of higher education establishments and colleges, 86% of professional education institutions and 97% of comprehensive schools had Internet connection.

According to estimation by the Ministry of Economics, the share of the ICT¹ sector in GDP

reached 6.5% in 2006. According to CSB data, 2910 companies operated in the ICT sector in Latvia in 2006, 23 750 persons were employed in them, the total turnover of the companies amounted to LVL 2.2 billion, the personnel costs were LVL 129 million. Value added of ICT production was

¹ The ICT sector was determined according to the definition of OECD that provides the inclusion of the following economical activities (NACE) in the ICT sector: ICT manufacturing (manufacture of office machinery; manufacture of computers and other information processing equipment; manufacture of insulated wire and cable; manufacture of electronic valves and tubes and other electronic components; manufacture of television and radio transmitters and apparatus for line telephony and line telegraphy; manufacture of television and radio receivers, sound or video recording or reproducing apparatus and associated goods; manufacture of instruments and appliances for measuring, checking, testing, navigating and other purposes, except industrial process control equipment; manufacture of industrial process control equipment) and ICT services, including wholesale (wholesale of electrical household appliances and radio and television goods;

wholesale of computers, computer peripheral equipment and software, wholesale of other office machinery and equipment; wholesale of other electronic parts and equipment, wholesale of other machinery for the use in industry, trade and navigation), telecommunications (telecommunications) and services (renting of office machinery and equipment, including computers; hardware consultancy; publishing of software, other software consultancy and supply; data processing; database activities; maintenance and repair of office, accounting and computing machinery; other computer-related activities).

LVL 29 million, while provision of ICT services amounted to LVL 603 million. Foreign trade balance of ICT was negative and amounted to LVL -246.9 million, because imports remarkably exceeded exports, which were LVL 337.6 million and LVL 90.6 million respectively.

According to data of the “European Information Technology Observatory 2007”, Latvian expenditures for ICT amounted to 9.89% of GDP in 2006, of which expenditures for information and telecommu-

nication technologies were 2.34% of GDP and expenditures for telecommunications were 7.55% of GDP. To compare, expenditures for ICT amounted to 9.66% of GDP in Estonia and 6.72% of GDP in Lithuania.

With Latvia’s accession to the EU, the European Union initiatives with regard to building the information society (see Box 6.15) became binding for Latvia.

Box 6.15

European Union initiatives in building the information society

To boost development of digital economy, the European Commission launched a new initiative “*i2010: European Information Society 2010*” on June 1, 2005, which is a strategy for the next 5 years. Its goal is to foster growth and jobs in the information society and media industries. 3 policy priorities are outlined in the initiative:

- to create an open and competitive single market for information society and media services within the EU;
- to increase EU investment in research on information and communication technologies by 80%;
- to promote an inclusive European information society.

On April 25, 2006 the European Commission communicated the action plan “*i2010. eGovernment Action Plan: Accelerating eGovernment in Europe for the Benefit of All*” that corresponds to the initiative “*i2010*” and is focussed on such important e-government goals for the period by 2010 as inclusion of all EU population in the use of information, provision of access to a wide range of informative services, creation of an electronic public procurement system, achieving conclusion of 50% of transactions electronically and ensuring availability of all information about all public procurement, etc.

On June 6, 2007 the European Commission adopted the Communication “Towards a general policy on the fight against cyber crime”, envisaging specific actions to improve co-ordination between law enforcement authorities and between law enforcement and private sector operators, which plays an important role in the fight against cyber crime in Internet. The Communication also envisages several measures at the national, European and international levels.

On November 8, 2007 the European Commission adopted the Communication on the *European i2010 initiative* “*To be part of the Information Society*” to the European Parliament and to the Council, European Economic and Social Committee and Committee of the Regions.

Declaration of the Intended Activities of the Cabinet of Ministers headed by the Prime Minister Ivars Godmanis emphasises the following tasks:

- in public administration policy: implementation of better regulation policy by providing electronic services and electronic processing of documents and taking measures aimed at mutual compatibility and exchange of information of all national information systems;
- in regional policy: development of a spatial planning information system, providing availability of all spatial plans and construction regulations on the Internet;
- in public involvement: ensuring involvement of the civic society in the early stages of drafting of policy planning documents and legal acts by providing information on the Internet;
- in education: enhancement of the education information system; provision of natural science cabinets in secondary education establishments with modern equipment; promotion of linkage of higher education and research, etc.
- in communications: adoption of rules for privatisation of LLC “Lattelecom”; covering the losses of the state-owned JSC “Latvijas pasts” and introduction of the universal postal service; creation of the Post Bank;

implementation of the project “Development of broadband communication infrastructure in rural regions”, providing electronic communications throughout the territory of the country; ensuring repeated use of information accumulated in public administration; support to the national information systems and their integrating services; protection of data and computer networks by presenting uniform principles and approaches for computer network protection; alignment and improvement of the Resident Register;

- in general availability of information services: implementation of the State Library Information System project; ensuring structural development of the Latvian National Library by implementing also the project of the National Digital Library; development of a digital stock of the heritage of the Latvian culture and memory institutions; development of an interconnected electronic information portal of archives, museums and libraries by 2010; development of a cultural education information system; development of the Latvian Culture Map; enhancement of the system of national orders to public broadcasting organisations;
- in improvement of the business environment: ensuring actual operation of e-government;

- in innovations and science: provision of support to medical sciences, and ensuring and introducing of innovative technologies (e-health) and solutions in health care; elaboration of the Latvian National Digital Encyclopaedia project;
- in security: development of electronic security and protection systems for safeguarding information systems against cyber crimes;
- in culture: establishment of the Latvian Register of Intangible Cultural Heritage; creation of a Single State Archive Information System; implementation of a linked electronic catalogue of archives, cinema, museums and libraries by 2010;
- in environment: development of single environmental monitoring and information system which would be compatible with similar EU and international systems.

On July 18, 2006 the Cabinet of Ministers approved the *Guidelines for the Development of the Information Society for 2006-2013*, setting lines of action for building the information society in Latvia.

Short-term priority tasks are:

- to develop territorial coverage of ICT access infrastructure;
- to make ICT more accessible financially for households and SME;
- to provide basic skills of ICT usage to individuals and motivate them to use ICT;
- to create electronic services of public administration and use ICT in order to optimise administrative functions; ensure access to public information for local governments and entrepreneurs for provision of services and develop centres for provision of public administration services;
- to introduce e-signature and develop infrastructure for its usage;
- to support creation of online services and innovative, knowledge-intensive and environmentally friendly products.

Lines of long-term actions for development of the information society are as follows:

- to expand the access infrastructure and promote ICT accessibility;
- to develop knowledge and skills of users;
- to develop services and content;
- to develop ICT usage in commercial companies and innovations;
- to develop ICT science and research;
- to promote creation of export-capable ICT products and services.

Financing from the EU structural funds and resources from the state and local government budgets will be used for implementation of the development programme.

On December 11, 2007, “Concept on Establishment of Electronic Election System” was approved by the Cabinet of Ministers. The goal of the Concept is development of an electronic election system by ensuring establishment of electronic registration and electronic voting of a voter’s participation in municipal elections and elections of the European Parliament. The solution option ensuring previous and secret ballot with an opportunity of recurrent voting was supported in the Concept ensuring high and complete secretness of voting.

On July 21, 2008, the Cabinet of Ministers approved the “Regulations on Sub-Activity 3.2.2.1.1 “Development of Information Systems and Electronic Services” of Supplement to the Operational Programme “Infrastructure and Services””. The regulations envisage that the total financing available for establishment, integration and development of information systems, e-services, as well as digitalisation of information resources amounts to LVL 116.4 million, of which ERDF co-financing accounts for LVL 98.9 million and the state budget financing – LVL 17.5 million.

Electronic Services

On May 26, 2006, the Electronic Procurement State Agency started its operation. The Agency took over the system maintenance functions, as well as the functions of ensuring procurements, computer hardware, software, accumulated data and started centralized procurements from the Procurement Supervision Bureau.

According to the data of the Electronic Procurement State Agency, the total amount of general agreements on procurements was LVL 498 thousand in 2006, LVL 3.460 million in 2007, LVL 2.752 million in the first half of 2008. The major part consisted of procurements of computer hardware, printing equipment and photocopiers. In 2008, the procurement “Antimicrobial medicaments” was implemented by involving 70 medical treatment institutions, the amount of which reached LVL 1.052 million.

In September 2006, the state JSC “Latvijas Pasts” introduced the e-signature service and started the issue of e-signature smart cards. In order to promote introduction of e-signature, a competition was organised for procurement of 50 000 e-signature smart cards for employees of public institutions. However, only 15 099 e-signature smart cards were issued to employees of public institutions until April 30, 2008.

Considering the small number of available electronic services and financial losses caused by introduction and maintenance of e-signature, on May 28, 2008 the Ministry of Transport informed the Cabinet of Ministers of the proposal of the state JSC “Latvijas Pasts” not to continue provision of certification services. The Cabinet of Ministers assigned the Ministry of Transport to work on transfer

of the functions of provision of certification services to another institution in co-operation with the Secretariat of Special Assignments Minister for Electronic Government Affairs.

According to *Eurostat* data, in 2007 Latvia established 6 basic services or 30% (EU-27 average – 58%) of 20 electronic basic services. It is planned to establish at least 20 more new e-services in 2008, some of which are basic services. The list of currently available e-services may be found in the Internet portal www.latvija.lv.

Taking into account the positive experience of other EU Member States in introduction of e-signature, at present, several public institutions are working out such a person identification card, which at the same time could be used also as an e-signature smart card.

Broadband Internet

According to *Eurostat* data, in the beginning of 2008, the share of broadband Internet connections in Latvia reached 15% (on average EU-27 – 20%) of all Internet connections. Due to the project implemented by support of EU Structural Funds in 2006-2007 “Development of broadband communication infrastructure in rural areas”, accessibility of rural population to Internet was improved ensuring data transfer rate 256 Kbit/s. However, in accordance with the initiative “i2010 – European Information Society for Growth and Employment” for 2010, a goal is set by the European Union to provide at least 75% households with a broadband Internet connection and with at least 8 Mbit/s download rate, as well as provide broadband networks of appropriate quality in distant territories for a subscribers’ fee which is maximally adjusted to the subscriber’s fee in densely populated areas.

In accordance with calculations made by the Ministry of Transport, if the opportunities provided by the infrastructure established in the framework of broadband development project of 2006-2007 are taken, so that to achieve EU target at least in 2013, the total support to electronic communication enterprises should exceed LVL 250 million. At present, LVL 15.9 million are allocated for introduction of a broadband development activity into the Operational Programme “Infrastructure and Services”, including ERDF resources.

Fight Against Computer Piracy

The level of computer piracy in Latvia was 56% (EU – 35%) in 2007 according to the data of the

International Antipiracy Software Copyright Protection Organisation “Business Software Alliance”, but the loss to Latvian economy caused by piracy has reached USD 29 million. Although the level of computer piracy has not decreased in Latvia as compared to 2006, the World Intellectual Property Organisation has taken Latvia out of the so called “black list” in 2007, which includes countries to be supervised concerning the field of piracy.

eCommerce¹

14% of all companies with at least 10 employees had made purchases over the Internet, while mere 4% of companies had sold goods or services over the Internet in 2007. The turnover of goods and services purchased over the Internet made up 2.2% of the total purchases in Latvia, while the turnover of goods sold over the Internet constituted 1.4% of the total net turnover in 2006. As indicated by *Eurostat*, the total turnover of e-commerce of EU companies made up 11% in 2006.

In the 1st quarter of 2007, 15% of all inhabitants or 25% of Internet users had at least once made purchases and ordered goods or services for their needs over the Internet. Purchases over the Internet are mostly made by its users in the age group of 25-34 years (32%).

On June 28, 2007 the Cabinet of Ministers approved the *Entrepreneurship Competitiveness and Innovation Promotion Programme for 2007-2013* worked out by the Ministry of Economics. Main goals of the programme are:

- to provide favourable conditions for development of business;
- to promote increase of capacity and efficiency of the National Innovation System;
- to achieve substantial growth of competitiveness and productivity in industry, fostering increased volumes of manufacturing products with a high value added.

In the framework of the programme, measures for promotion of e-commerce relations will also be worked out: e-commerce information days and seminars will be held and the competition “Best Entrepreneur of eCommerce” and other activities will be organised, which will foster improvement of healthy competition and trade quality among entrepreneurs of e-commerce with every year.

6.7. Small and Medium-Sized Enterprises

Small and medium-sized enterprises (SMEs) comprise a major part of the national economy and play a significant role in the GDP growth and

employment in Latvia like elsewhere in Europe (see Box 6.16).

¹ Source for Latvian data: CSB; source for EU data: *Eurostat*

Box 6.16

The number of small and medium-sized enterprises in Latvia

There were 68 646 economically active enterprises and commercial companies in Latvia in 2007 (excluding agricultural and fishing farms and self-employed persons, who perform economic activities), of which more than 99.5% belong to the category of SMEs. The distribution of economically active SMEs in Latvia according to their size is similar to the EU member states: micro enterprises – 79.7%, small enterprises – 16.7%, medium-sized enterprises – 3.1%, large enterprises – 0.5%. 69.9% of the private sector employees in the country are employed in SMEs that contribute 63.2% to GDP.

An important indicator characterising economic activity is the number of economically active enterprises and commercial companies per 1000 inhabitants – this indicator in Latvia has been continuously growing over the last 7 years from 17 in 2001 to 30 in 2007.

It is of equal importance to accentuate the number of self-employed persons, which amounted to 46 748 in 2007 (21 per 1000 inhabitants), and the number of agricultural and fishing farms, which equalled to 14 505 in 2007 (6 per 1000 inhabitants). Considering the fact that there is no single methodological practice among EU member states for calculating the indicator characterising 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. Applying analogous practice accordingly, Latvia had 57 performers of economic activity per 1000 inhabitants in 2007, which is close to the EU average.

Statistical data of the recent years indicate positive trends in growth of the number of newly established enterprises. According to statistical data calculated by the Lursoft in cooperation with the Register of Enterprises, 14 185 enterprises and commercial companies were registered in 2007, which is the highest number of newly registered entities conducting commercial activity in the last 13 years and it is by 21.24% more than in 2006 (11 700). Growth of the number of newly established enterprises continued in the first 4 months of 2008 as well. This may indicate efficiency of the measures conducted to ensure improvement of the business environment and promotion of business development.

However, it is important to take into account that constant natural growth is inevitable in any free market conditions under certain objective positive circumstances. This is the case of Latvia, where favourable conditions for gradual growth of the number of newly established enterprises are ensured with the accession to the European Union and with substantially increased opportunities of local enterprises. Nevertheless, promotion of establishment of new enterprises is not sufficient to ensure sustainable development. In order to ensure increase of competitiveness, these newly established enterprises must be sustainable. Statistical data show, that the total number of enterprises increases by approximately half of the growth of the number of newly established enterprises, hence indirectly indicating problems concerning their sustainability.

Assistance 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 6.17

Definition of SMEs

Law on Control of Aid to Commercial Activity establishes the definition of SMEs (according to the EC Regulation No. 70/2001 and amendments to the EC Regulation No. 364/2004, as well as pursuant to the EC Recommendation No. 361 of May 6, 2003):

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.

Despite the implementation of an active and successful policy for improvement of the business environment and activities to support the SMEs in the previous years, the study “Impact of Administrative Procedures on Business Environment in Latvia” conducted by the Ministry of Economics in 2007 shows, that development of the SMEs in Latvia is still hindered by several essential problems:

- inflation – the most prevalent hindrance to business, mentioned as an obstacle to performance of business activities by 81.3% of entrepreneurs. Spread of inflation as a factor

hindering business activities still tends to grow: inflation created problems for 39.4% of entrepreneurs in 2001, for 48.1% in 2003 and for 72.3% in 2005;

- tax rates hinder business activities for 71.1% of entrepreneurs;
- frequent changes of laws and regulations cause problems for business activities for 58.9% of entrepreneurs;
- tax laws and regulations/tax administration is the fourth prevalent hindrance to business activities for 50.3% of entrepreneurs.

The Cabinet of Ministers approved the “**Basic Guidelines for Development Policy of the Small and Medium-Sized Enterprises in Latvia**” on January 27, 2004. These guidelines lay down the basic principles for actions of the government, long-term objectives and tasks, as well as the main directions of the SME development policy. The goal of these guidelines is to ensure promotion of favourable business environment, spur initiative of entrepreneurs and lessen the total risk, prevent obstacles to entrepreneurship, and foster stability and efficiency of the financial system and of the capital market in order to improve competitiveness of enterprises in the market.

Basic Guidelines prescribe implementation of a policy, based on the best practices of companies of the developed countries in accordance with the activities outlined in the European Charter for Small Enterprises, at the same time also considering the specifics of SME development problems in Latvia.

Taking into account that 2006 was the last year for implementation of the *Programme on Development of Small and Medium-Sized Enterprises of Latvia for 2004-2006* and of the *National Innovation Programme for 2003-2006*, and in accordance with the practice of the European Commission to review the development policy planning of entrepreneurship, innovation and industrial manufacturing together, on June 28, 2007 the Cabinet of Ministers approved the **Programme for Promotion of Business Competitiveness and Innovation for 2007-2013**.

The programme includes policy actions for promotion of business competitiveness, innovative activities and industrial development, describing the vision of competitiveness promotion and of the development of innovation and industry for the next 7 years. The main goals of the programme are to provide favourable conditions for business development, to promote increase of capacity and efficiency of the National Innovation System, to achieve substantial growth of industrial competitiveness and productivity, fostering increased volumes of high value added manufacturing products.

The programme defines measures to be implemented for the improvement of the business environment, promotion of the availability of finances, development of new entrepreneurship initiatives and fostering their competitiveness, promoting awareness of society on the role of innovation in the promotion of competitiveness, for contribution to co-operation of industrial, educational and scientific sectors, transfer and commercialisation of knowledge, as well as for promotion of industrial development and improving their productivity.

The measures reflected in the action plan for implementation of the programme are financed within the framework of the budget of the Ministry of Economics and other involved ministries in 2007. For the period of 2008-2013, the action plan includes programmes co-financed from the EU Structural

Funds, activities planned in the framework of the budget of the Ministry of Economics and other involved ministries, as well as the necessary additional budget. The action plan does not include those measures that are included in the action plans for implementation of other programmes. The Ministry of Economics will implement management, co-ordination, supervision and assessment of implementation of the programme.

The SME support policy is determined in Chapter 2.2.4 of the **National Lisbon Programme for 2005-2008**, prescribing the main directions of governmental policy to promote SME development, which are as follows:

- promotion of availability of finances, including funds for development of an idea (seed capital);
- ensuring informative and consultative support;
- raising competitiveness through support to introduce new technologies and modernisation of production.

Mortgage and Land Bank of Latvia (hereinafter – Mortgage Bank) plays an important role in the **SME support system**. With the help of the Mortgage Bank, the “Programme of Crediting Latvian SME Development” is in process of implementation since 2000. Implementation of the programme insofar has substantially promoted accessibility of capital to SMEs, as well as encouraged engagement of commercial banks in SME crediting more actively. In the framework of the first phase of the programme, the Mortgage Bank has granted approximately 1000 loans for the total amount of LVL 33.9 million, while 1000 loans for the total amount of LVL 53.9 million were granted in the framework of the second phase of the programme.

The Cabinet of Ministers accepted the concept “On Development of the State Joint Stock Company “Mortgage and Land Bank of Latvia” for 2007-2013” in October 2006, envisaging a gradual transformation of the Mortgage Bank to a full-spectrum development bank. The concept determines that establishment and development of SMEs remains one of the Mortgage Bank priorities.

The key role in implementation of the support instruments is played by a structural unit of the Mortgage Bank – Administration of Support Programmes ALTUM. It implements support programmes financed by the state and the EU, granting high-risk loans to sustainable and perspective projects of SMEs and business beginners, which are not financed by commercial banks due to insufficient collaterals and other risks of the project.

Within the framework of the *Crediting Programme for Business Beginners*, loans for implementation of investment projects are granted to the companies that have been established less than 5 years before getting the loan. The total budget of the programme is LVL

20.56 million¹, and it is financed by the ERDF, the state and the Mortgage Bank. In accordance with conditions of the programme, SMEs may apply for a loan up to LVL 700 thousand with a term of 3 to 10 years. Requirements regarding the loan security are preferential – the loan may exceed the security up to two times. LVL 22.8 million to finance 261 investment projects of beginners have already been granted within the framework of the programme. The amount of the issued loans makes LVL 17.8 million². Issuance of loans will continue until the end of operation of the programme – August 2008.

In the framework of the *Crediting Programme of Rapidly Developing SMEs*, it is possible to get a loan of

up to LVL 2 million. The programme is financed from a state-guaranteed loan, and so far, 182 loans with the total amount of approximately LVL 17.5 million have been granted within its framework. The amount of the granted loans is LVL 10.4 million.

Programme of Training and Consultations and Financial Support for Business Beginners is provided for persons willing to start their business, but lacking the necessary knowledge and initial financing. The total budget of the programme amounts to 8.38 million³ and consists of financing from the ESF, the state and the Mortgage Bank (see Box 6.18).

Box 6.18

Programme of Training and Consultations and Financial Support for Business Beginners

The programme had been launched at the end of 2006, when the Mortgage Bank selected one training provider in each of the five planning regions of Latvia through a tender procedure. The training process took place within one year – from January 2007 until January 2008, involving almost 1000 people in total. Training was organised in groups of up to 20 people, five groups in every planning region. The participants of the programme took the training course in about 2 months, and, upon its completion, they had to prepare a business plan for starting a business activity. The business plan had been examined by the experts of the Mortgage Bank and if they took a positive decision, the participant of the programme got funding for implementation of the project (micro-loan, grants for starting operation of enterprise and ensuring subsistence in the initial period of operation, payment for mentor services).

Although the training opportunities of the programme had been used very actively, a relatively lower activity so far was observed in utilisation of financial instruments of the programme until the end of 2007. In order to ensure absorption of resources of the programme in the planned amount, the range of applicants to get support of the programme had been expanded from January 2008 until the deadline of submission of the financial support applications – March 31, 2008. Along with the current graduates of training of the programme, also other emerging businesses with adequate higher or professional education or adequate skills (completed other similar training courses), or with adequate job experience in the chosen business sphere could apply for financial support. In addition, the amount of financial support was increased both, for the current and the new clients of the programme: the amount of loans increased to LVL 50 thousand, and the amount of grant for ensuring subsistence raised to LVL 3.7 thousand.

By the end of the submission deadline of financial support applications, ALTUM received about 600 applications from the potential business beginners. Up to now, financial support has been granted to 340 projects of business beginners in the total amount of loans of LVL 6.1 million. In addition, LVL 403.6 thousand are paid in grants to the programme clients for the grants of establishment of enterprises; LVL 758.5 thousand – for the grants of subsistence and LVL 433.4 thousand – for the grants of consultants.

Along with the programmes implemented by ALTUM, through performance of functions of a development bank, the Mortgage Bank additionally continues work on development and introduction of new support instruments in the framework of its resources. The Cabinet of Ministers approved “*Support Programme of Improvement of Business Competitiveness*” on May 13, 2008. At least 300 SMEs will receive loans for investments and receipt of current assets in the framework of the programme, reaching LVL 200 million of the total investments.

The necessity of the introduction of such programme is determined by the situation of Latvian national economy, when it is necessary to support sectors, in which it is possible to successfully compete with producers and service providers of other countries. The programme will facilitate SMEs to find financing for investments in technologies or current assets. In the framework of the new programme, the enterprises oriented towards international markets,

manufacturing products or providing services with high value added will be particularly supported, as well as technologically capacious production enterprises and establishment of new enterprises.

It is planned that introduction of the programme will be implemented by the Mortgage Bank in close co-operation with the Latvian commercial banks and risk investment funds. The investment and current asset loans granted to one client may not exceed LVL 3 million, bearing the total costs of less than 80% of the business project. In case of investment loans, the maximum term of the loan is up to 10 years, for current assets loans – to 3 years. Evaluating applicants for granting support, the following criteria of SMEs conformity will be taken into account: the enterprise does not have tax liabilities; the project is economically sustainable and implementable; the project introducer has good reputation and credit history.

The state support to SMEs is also provided by the LLC “Latvian Guarantee Agency” (LGA).

¹ In May 2008, draft amendments to the programme are worked out, envisaging increase of the programme budget by LVL 4 million, that is, to LVL 24.56 million.

² In the case of ALTUM programmes mentioned here and hereinafter – pursuant to the situation as of April 30, 2008.

³ In May 2008, draft amendments to the programme had been worked out, envisaging increase of the programme budget by almost LVL 4 million, that is, to LVL 11.38 million.

The LGA is a state-supported institution with a goal to support accessibility of financing for small and medium-sized enterprises of Latvia, by issuing:

- loan guarantees as the necessary additional security for receiving the loan in a commercial bank;
- financial leasing guarantees as an additional security for receipt of industrial leasing;
- co-financing investments in Latvian small and medium-sized enterprises by specially established risk capital funds.

In 2005, the European Commission (EC) approved the State Support Programme (SSP) for development of the guarantee system, which had been developed by the Ministry of Economics. Since launching of the programme, the LGA has developed and introduced guarantee products of investment loan, current assets loan and financial leasing. The LGA has also carried out wide-scale information measures, in order to inform entrepreneurs and credit institutions about the guarantee products and procedure of their receipt. Results of the programme are summarized in the Table 6.6.

Table 6.6

Results of the LGA Guarantee Programme

| | 2005 | 2006 | 2007 | 4 months of 2008 |
|--|-------|-------|--------|------------------|
| Number of the issued guarantees | 20 | 31 | 130 | 54 |
| Amount of the issued guarantees (million LVL) | 0.890 | 2.306 | 11.501 | 4.581 |
| Amount of the guaranteed credits (million LVL) | 1.810 | 6.048 | 23.098 | 8.138 |

The European Commission (EC) approved the State Support Programme (SSP) for development of risk capital in 2005, which had been developed by the Ministry of Economics. In 2005, the LGA announced a tender for selection of risk capital fund management companies in the framework of the SSP “Support to Risk Capital of Small and Medium-Sized Commercial Companies”. Eight applications for establishment of risk capital fund management companies were received, of which the companies LLC “Zaļās gaismas investīcijas”, JSC “Eko Investors” and LLC “TechVentures Fondu Vadības Kompānija” were chosen as the winners of the tender, and contracts were concluded with them, establishing 3 risk capital funds accordingly – limited partnerships: CC “ZGI fonds”, CC “Otrais Eko fonds” and CC “INVENTO”. By the end of 2006, the risk capital funds attracted private investors, among them such institutional investors of Latvia as JSC “Atklātais pensiju fonds SEB Unipensija” and JSC “Pirmais Slēgtais Pensiju Fonds”. As a result, the total volume of subscribed capital of the risk capital funds available for investment projects in Latvian enterprises reached LVL 21.8 million. The risk capital funds started their activities in the beginning of 2007, having made investments in 15 enterprises for the total amount of LVL 3 558 645.64 at the end of the year. The number of investments has increased to 18 enterprises for the total amount of LVL 5 250 760.63 after 4 months of 2008.

In 2007, the Ministry of Economics has concluded **three co-operation contracts** on performance of particular public administration tasks:

- the co-operation contract “On Performance of Particular Public Administration Tasks in the Field of Quality Development – Organisation of International Conference on Quality Management in 2007, 2008 and 2009” with the “Latvian Association for Quality” in order to promote competitiveness of business activities

for facilitating understanding of responsible business activities and ensuring its sustainable development, promote competitiveness of Latvian enterprises – particularly the SMEs, as well as facilitating competitiveness and sustainable development, using new and modern management methods and instruments;

- the co-operation contract “On Performance of Particular Public Administration Tasks in the Field of Business Activity Development – Organisation of Business Forum “Uzņēmēju zinību dienas” in 2007, 2008 and 2009” with LLC “Komerccizglītības centrs”, popularization of business activity for support and development of entrepreneurs and business beginners, as well as social and knowledge capital of business environment, promoting development of competitive business environment in Latvia based on knowledge and business management innovations;
- the co-operation contract “On Performance of Particular Public Administration Tasks in the Field of Mentoring Development” with the association “Lidere” on implementation of the Mentoring programme in Latvia in 2007 and 2008. Within the framework of the programme, a mentoring programme has been organised for entrepreneurs and business beginners, dividing it in stages. Stage I of the Mentoring programme was initiated in March 2007 (duration of the programme – 1 year, until February 2008), 10 pairs are involved in the programme. Stage II of the Mentoring programme was launched in August 2007 (duration of the programme – 1 year, until July 2008), 10 pairs are involved in the programme.

EU member states approved the **European Charter for Small Enterprises** at the European

Council meeting in Feira on June 19-20, 2000. It is one of the most important political documents of the EU for achievement of the Lisbon goals and recognises the great role of small enterprises in development of competitiveness, innovation and employment, and they constitute the driving forces for social and local

integration in Europe and the base for the growth of the national economy. Latvia joined the Charter on April 23, 2002 by signing the Maribor Declaration in Slovenia together with other EU candidate countries, thereby pledging to work in accordance with 10 lines of action of the Charter (see Box 6.19).

Box 6.19

European Charter for Small Enterprises

Ten activity directions of the Charter:

1. Education and training for entrepreneurship;
2. Cheaper and faster establishment of enterprises;
3. More efficient legislation and regulation;
4. Availability of training;
5. Improving Internet access;
6. Gaining more from the Single Market;
7. Taxation and financial matters;
8. Strengthening the technological capacity of small enterprises;
9. Employing successful e-business models and developing top-class small business support;
10. Developing stronger, more effective representation of the interests of small enterprises at the EU and national level.

In April 2005, the European Commission came forward with a legislative initiative, by which the **Competitiveness and Innovation Framework Programme (2007-2013) (CIP)** would be established. The Transport, Telecommunications and Energy Council of Ministers officially adopted the programme on October 12, 2006. It is intended as a continuation

of the **Multiannual Programme for Enterprise and Entrepreneurship in Particular for Small and Medium-Sized Enterprises (SMEs) (2001-2006)** and would be organised in the framework of the next EU financial perspective (2007-2013). The total budget of the CIP amounts to EUR 3 620 million.

Box 6.20

Competitiveness and Innovation Framework Programme (2007-2013)

The programme has three separate sub-programmes or pillars:

- Entrepreneurship and Innovation Programme;
- Information and Communications Technology Policy Support Programme;
- Intelligent Energy – European programme.

In the framework of the **first pillar** the following financial instruments will be developed:

- High Growth and Innovative Facility (GIF) – actually, the development of risk capital, dividing it into GIF 1 (seed and start-up stage of SMEs) and GIF 2 (SMEs expansion stage investments);
- SMEs Guarantee Facility;
- Capacity Building Scheme for improvement the capacity of institutions investing in innovative SMEs.

The second pillar is established in order to support information and communication policy and attract more investments in this sector. It is planned to ensure the support in the following way:

- by developing a single European information space and strengthening information products and services of the Internal Market;
- by stimulating innovations, its implementation and investment in information and communication technologies;
- by developing an inclusive information society and effective services in the interest of the society, as well as by improving the quality of life.

In the framework of the **third pillar**, the Intelligent Energy – European programme for 2003-2006 will be continued and expanded, which was established by merging the following four programmes:

- SAVE programme, in its framework, norms and standards for increase of efficiency of heat insulation of buildings were developed;
- in the framework of ALTENER programme, projects for more efficient use of renewable energy resources in heat supply and electricity generation were implemented;
- in STEER programme, projects related to improvement of energy efficiency in transport and to promotion of use of renewable energy resources (among them biofuel) in transport were implemented;
- COOPENER programme envisaged development of energy policy and market conditions.

6.8. Competition Policy

The Competition Council (hereinafter – CC) is responsible for development and implementation of the competition policy in Latvia. Its goal is to promote

the opportunity for market participants to perform economic activities under conditions of free and fair competition, as well as facilitate development of

competition within the public interests in all economic sectors.

The CC acts in accordance with the Competition Law and three directions of activity defined in the Operational Strategy of the CC for 2007-2009 are as follows:

- Protection of competition;
- Promotion of competition;
- Strengthening the role of the Competition Council in development and implementation of EU legal acts and in international organisations and networks.

Protection of Competition

Protection of competition comprises activities directed against the following violations of the Competition Law: prohibited agreements, abuse of dominant position and unfair competition. The CC also supervises the merger of enterprises.

In the 1st half of 2008, the CC has adopted 61 decision, eight of which relate to prohibited agreements, nine – to abuse of dominant position, thirty-three – to merger of enterprises, five – concerning unfair competition and six – regarding potential violation of the Advertising Law. The priority of the CC is disclosure and prevention of the most grievous violations of the Competition Law – prohibited agreement and abuse of dominant position.

At the beginning of 2008, the CC established violations of prohibited agreements within the framework of two investigated cases. For example, the CC established a violation and made a decision to impose a penalty on LLC “Apgāds Zvaigzne ABC” for the fact that it included provisions concerning the minimum resale price restriction in contracts with retail companies of books, and imposed a penalty on LLC “AV&D” for setting resale prices in the sales market of alcoholic beverages within the territory of Latvia (see Box 6.21).

Box 6.21

CC imposes a penalty on LLC “AV&D” for setting resale prices

Within the course of investigation of the case, the CC stated that LLC “AV&D” had included provisions in the contract regarding the minimum resale price restriction in about 99% of purchase contracts with retail and wholesale commercial companies of alcoholic and soft beverages. This provision of the contract entitled LLC “AV&D” not to deliver goods within a particular amount and term if the client did not agree with the seller within a particular term in advance to reduce the sale price of the goods by the percentage amount determined by the seller.

The CC specified that price is a relevant competition element, as well as the basis of independent economic activity of each market participant. Competition was eliminated by inclusion of the restrictive provision of a wholesale and retail minimum resale price in the purchase contract. Thus, other distributors of alcoholic beverages were restricted and less interested in offering alcoholic products to LLC “AV&D” for lower wholesale and retail prices than those set by LLC “AV&D”. Obvious hindrance of competition is observable in the activities of LLC “AV&D” upon concluding about 3000 purchase contracts containing provisions for restriction on distributors to set the sale price. It is to be considered that such activities were performed with a purpose to deform competition.

Taking into account that LLC “AV&D” has been the initiator of the violation, the CC considers that the issue of an administrative act in relation to the clients of LLC “AV&D”, who have concluded the contracts, is not necessary.

In determining the amount of the penalty, the CC took into account as extenuating circumstances the fact that LLC “AV&D” has specified that from 2008 provisions of the contracts regarding the resale price will be changed.

At the beginning of 2008, the CC adopted a decision on abuse of dominant position in the activities of SJS “Latvijas dzelzceļš” and imposed a penalty in the amount of LVL 25 000, because the

enterprise had included such provisions in the contracts with providers of freight transportation and passenger traffic, thereby deforming competition (see Box 6.22).

Box 6.22

CC imposes a penalty on SJS “Latvijas dzelzceļš” for abuse of dominant position

Within the course of investigation of the case, the CC established that SJS “Latvijas dzelzceļš” as a public-use railway infrastructure carrier, holding dominant position unreasonably proposed to conclude agreements with commercial companies, the private-use railway infrastructure, which is connected with the public-use railway infrastructure. One of the agreement clauses stipulated that materials for the railway track repair are to be delivered to the co-contractors of Daugavpils railway track division within certain terms, i.e., JSC “DITTON driving chain factory”, JSC “Daugavpils siltumtikli” and LLC “Veiksme VR”, but, if it is not carried out within the stipulated terms, it is prescribed to discharge the contract and shut off the branch-lines for supply of cars.

The CC concluded that JSC “Latvijas dzelzceļš”, upon concluding contracts with commercial companies on rendering railway services to these companies, made fulfilment of these contracts dependent on the abovementioned commercial companies undertaking additional obligations, which may not be referred to the particular transaction according to substance and commercial usage.

Taking into account that SJS “Latvijas dzelzceļš” holds the dominant position in the service market in usage of public-use railway infrastructure SJS “Latvijas dzelzceļš” must observe the restrictions prescribed in the Competition Law, so that activities of the concern do not restrict and deform competition by harming a consumer or other market participant.

Taking into account that the committed violation may be evaluated as a grievous violation of competition law, SJS “Latvijas dzelzceļš” is the initiator of the violation and conclusion of such contracts was practised for more than 10 years, the CC adopted a decision to impose a penalty in the amount of LVL 25 000.

Promotion of competition

This direction of activity comprises supervision and investigation of market sectors, as well as formation of a competition culture in society.

At the beginning of 2008, the CC has completed several market surveillances:

- 1) textbook market surveillance (see Box 6.23). The opinion on the situation in textbook market and proposals for improvement of the competition situation were sent to the Ministry of Education and Science and to the Latvian Education Publishing Association. Market surveillance was the basis for bringing administrative actions regarding the violation prescribed in Paragraph 1 of the first part of the Article 11 of the Competition Law in the activity of LLC "Lielvārds", as well as the violation prescribed in Paragraph 1 of part one

- of the Article 11 of the Competition Law in the activities of LLC "Apgāds Zvaigzne ABC" and LLC "Grāmatu nams "Valters un Rapa"", as well as the violation specified in Item 4 of the Article 13 of the Competition Law in the activities of LLC "Apgāds Zvaigzne ABC";
- 2) surveillance of the intercity bus traffic services market in the Latgale region, as a result of which an action was brought concerning the potential violation of Paragraph 1 of part one of the Article 11 of the Competition Law in the activities of JSC "Nordeka", LLC "Daugavpils autobusu parks" and LLC "Dautrans";
- 3) surveillance of the dentistry practice services market. Information on the competition situation in the dentistry practice services market was sent to the Ministry of Health.

Box 6.23

The competition situation in the textbook market

Within the framework of market surveillance, the CC has concluded that the circle of textbook publishers in Latvia is relatively unchangeable, with seven textbook publishers operating – LLC "Apgāds Zvaigzne ABC", LLC "Izdevniecība RaKa", LLC "Lielvārds", LLC "Izdevniecība Pētergailis", LLC "Mācību Grāmata", LLC "Retorika A" and State Agency "National Agency for Latvian Language Training". The latter three publishers have mainly specialized in publishing tutorial literature for training of minority programmes.

In separate cases, the textbook of the respective subject for particular form is published by one publisher in the field of general secondary education, and as a result a monopoly position has formed in separate relevant markets. For instance, a monopoly position has formed in such relevant textbook publishing and sales markets – Russian for training of minority programmes for Form 5-9, Cultural History for Form 10-12, Music for Form 10-12, Geography for Form 10-12. A better situation in the choice and replaceability of textbooks exists at primary and elementary school levels, while the least possibilities for choice are at the secondary school level. Insufficient competition is established in the provision of secondary school subjects with teaching literature, because for most of the subjects it is offered by only one publisher.

The CC has established substantial entrance barriers in the textbook publishing market:

- 1) the lack of authors of teaching literature;
- 2) the approved bylaws and instructions in relation to the process of textbook publishing;
- 3) the market power of LLC "Apgāds Zvaigzne ABC" – in several relevant textbook markets, where market share exceeds 40% and is substantially larger than that of other competitors. The market power is substantially strengthened by the fact that the abovementioned commercial company works in both retail and wholesale with regard to the teaching literature;
- 4) objective competition barriers exist in this field, because business activity requires long-term investments and does not guarantee the profit obtainable within a short period of time. Compiling a textbook appropriate for national education standards is a complicated and time-consuming process and requires considerable attraction of finance and intellectual resources. Practice shows that compilation of a qualitative textbook may be ensured by such publishing houses cooperating with the editorial board of the respective education sector (specialized editors, project managers). Specialized editorial boards are generally not at the disposal of the small publishing houses.

Since efficient competitors, who would be able to compete with the largest publishing houses, have not entered the market within the last five years, from the point of view of the CC, stagnation has appeared in the market, which does not promote competition and reduction of prices.

Research has been completed on investigation of the competition situation by involving independent researchers regarding:

- 1) the market of gypsum products for construction. The barriers established within for the entry of new market participants in the market of gypsum products are related to the great amount of investments, high level of minimum efficient activity, and the lack of specialists, experience and knowledge concerning manufacturing technology. It is concluded in the research that artificially created obstacles (standards regulating the sector, administrative obstacles, etc.), restricting

competition within the sector, do not exist in Latvia;

- 2) competition in the field of bailiffs. After evaluating competition among sworn bailiffs, it is concluded that competition restrictions are applied to bailiffs in Latvia, which are substantiated concerning the necessity of quality assurance and availability of a service from the point of view of costs and regional availability: qualifying restrictions, fixed prices (compensation rates), geographical (territorial), advertising restrictions. Irrespective of the restrictions applied in Latvia to the work of sworn bailiffs, the bailiffs may compete with

other representatives of this profession by providing qualitative and quick services to clients as much as possible. The conclusions of the research regarding the opportunities to improve competition in the free legal professions, including those in relation to bailiffs have been submitted to the Ministry of Justice.

In March 2008, amendments to the Competition Law were adopted, envisaging greater opportunities for the CC to turn against abuse of dominant position, including abuse of market power in the retail sector. The CC actively participated in providing explanations of the essence and necessity of these amendments to both members of the Parliament as well as law offices and nongovernmental organizations.

Within the framework of public awareness, upon meeting market participants, consultations have been provided concerning the issues of application of Competition Law, and press releases have been distributed on the decisions adopted by the CC and other topics. In order to increase understanding by entrepreneurs of the issues of competition policy, employees of the CC have met with representatives of the Latvian Dairy Producers Association and representatives of food processing companies.

The CC has performed assessment of draft laws and regulations and policy documents within the aspect of competition protection and development. Upon evaluating draft regulations of the Cabinet of Ministers "Amendments to the Regulations No. 97 of the Cabinet of Ministers of March 6, 2001 "Procedures by which the State Organizes and Finances Publishing and Acquisition of Training Aids"", the CC specified the necessity of both changing the organizational process of textbook publishing and textbook funding procedures, and also proposed to supplement the draft regulations with norms prescribing that public procurement procedures are to be introduced in the markets for compiling textbook content and publishing.

6.9. Regulation of Public Utilities

According to the Law on Regulators of Public Utilities, a two-level regulation system of public utilities is established in Latvia and the sectors regulated on the state level are separated from the sectors regulated on the local government level.

The Public Utilities Commission (hereinafter – Commission) regulates public utilities on the state level, while the local government regulators regulate providers of services in the respective municipal territories and supervise sectors of municipal waste management (with the exception of municipal waste recovery), water supply, sewage and heat supply (except combined heat and power). It must be noted

Strengthening the role of the Competition Council in development and implementation of EU legal acts and in international organisations and networks

The CC participates in the work of the European Competition Network (ECN), the goal of which is to ensure the opportunity for the competition authorities of the EU member states to discuss the application of the Article 81 (prohibited agreements) and Article 82 (abuse of dominant position) of the EC Treaty, as well as facilitate cooperation among them. The CC representatives have participated in the plenary session of ECN and several meetings of its subgroups, in which competition in pharmacies, the power industry, insurance, liberal professions and other sectors has been discussed.

CC representatives participate in several working groups of ECN experts, where issues concerning vertical agreement restrictions are discussed, as well as the draft Guidelines on evaluation of the affairs of non-horizontal mergers in relation to the issues of merger pursuant to the conditions of European Community Merger Regulation are reviewed.

In February and March 2008, CC representatives took part in several important international events: the OECD Global Forum on Competition, a seminar organised by the International Competition Network (ICN) on merger of enterprises and the annual meeting of the Competition Department of the American Bar Association.

In May 2008, the CC was represented at the annual conference of the European Competition Authorities (ECA) in Budapest, where strategically relevant matters for competition development were discussed, including the concentration of institutional resources for the timely discovery and investigation of the most serious competition violations, attraction additional resources for combating cartels, and setting and applying tougher penalties for the gravest competition violations.

that the Commission does not supervise the local government regulators and is not authorised to influence their operations.

The Public Utilities Commission is a multi-sector regulator performing regulatory functions in the sectors of energy, electronic communications, postal services and railway transport. 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 to develop to businesses providing public services with profitability according to the economic situation. An important part of the Commissions work

is promotion of competition in the regulated sectors. The Commission adopts its decisions independently and is not subject to decisions of the government or other state institutions. 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 repeal them. Activities of the Commission are financed by the duty paid by businesses based on the annual net turnover of regulated public utilities.

Functions of the Commission include control of the regulated sectors and businesses that operate therein, protecting interests of users and promoting development of public service providers, setting the rate calculation methodologies and approving rates in accordance with laws of every sector, issuing licenses and registering general authorisations, promoting competition in the regulated sectors, carrying out extra-judicial settlement of disputes, and supervising compliance of the provided services with license or general authorisation conditions and specified requirements of quality.

In accordance with the delegation agreement on regulation of public utilities in the Riga City administrative territory concluded on November 20, 2007, since January 1, 2008 the Commission has been regulating provision of public services as business in the municipal regulated sectors (heat supply, water supply and sewage, waste management) in the Riga City administrative territory.

Situation and policies of the regulated sectors

Energy sectors

In the energy sector, electricity supply and gas supply are regulated by the state. The dominant role in electricity supply is held by JSC "Latvenergo", which generates more than 90% of the electricity produced in Latvia and ensures import of electricity, as well as delivery to those users, who have not chosen another supplier. As from September 1, 2005, all functions of electricity transmission system operators are carried out by JSC "Augstsprieguma tīkls" fully owned by JSC "Latvenergo". On July 1, 2007, the distribution system operator JSC "Sadales tīkls" started its operations completely taking over functions of a distribution system operator from JSC "Latvenergo".

Electricity is also generated in about 150 small hydropower stations with the total capacity of 25 MW, 14 wind power stations with the total capacity of 25.2 MW and 39 cogeneration plants with the total capacity of 137 MW, 12 other licensed businesses implement distribution or sale of electricity.

Latvian electricity market is completely open to competition starting from July 1, 2007, and several electricity users have already used the opportunity to change their power supplier.

From April 1, 2008, new electricity final tariffs for related users are effective. The tariff has increased on average by 37.6%, including 39.2% for households. The reason for the rise of tariff is increase of prices of

the imported electricity for about 50%, increase of prices of natural gas, as well as costs of mandatory procurement resulting from manufacture of supported electricity.

On November 14, 2007, the Commission approved a calculation methodology of mandatory procurement components, which envisages that the Commission approves the mandatory procurement components once per half a year based on actual information of the previous year on the purchased electricity volumes and costs of mandatory procurement. On February 6, 2008, the Commission approved the mandatory procurement components, which came into force on April 1, 2008. On January 16, 2008, the Commission approved the repeatedly updated Network code, which regulates the activities of electricity system participants.

The amendments to Electricity Market Law adopted by the Saeima are valid from May 15, 2008, stipulating to involve large electricity users in the open electricity market, i.e., businesses employing 50 and more employees or the businesses with annual turnover of 7 million lats or more.

Supply of natural gas in Latvia is ensured by the vertically integrated business JSC "Latvijas Gāze". The Commission has received a draft of the final sales rates of natural gas, which envisages the rise of rates in the second half of 2008. The amount of the rise of rates will depend on the prices of oil in the world market at the moment, when the rates will be enforced.

According to the regulations No. 718 of the Cabinet of Ministers of October 23, 2007 "Amendments to the Regulations of the Cabinet of Ministers No. 297 of July 3, 2001 "Regulations on Types of Regulated Public Utilities"", only distribution of liquefied oil gas from aboveground and underground by pipelines to the input into apartment houses is regulated in the liquefied gas supply as of November 1, 2007. Thereby, refill and sale of liquefied gas in cylinders is not regulated anymore as a public service. 11 businesses are licensed for distribution of liquefied gas in Latvia.

Electronic communication and postal service

The biggest market participants in the sector of electronic communications are the landline network operator LLC "Lattelekom" and mobile communication operators LLC "LMT" and LLC "Tele2". 527 companies were registered in the sector of electronic communications as of May 15, 2008.

In the postal sector, the state JSC "Latvijas Pasts" provides general postal services, while approximately 40 service providers operate actively in the sector of express mail.

Railway

In the railway sector, the state JSC "Latvijas Dzelceļš" ensures maintenance of public railway infrastructure, as well as carries out international passenger transportation. Domestic passenger transportation is carried out by 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”.

In February 2008, the Commission made amendments to the methodology for calculating the payment for the use of public railway infrastructure for

transportation, which prescribe that further on the payment for the use of public railway infrastructure for transportation will be set for a calendar year. In 2008, the railway infrastructure payment will remain the same, and a new railway infrastructure payment will be set for 2009.

6.10. Export Promotion Policy

The Ministry of Economics develops and implements Latvian foreign economic policy, with the aim of stimulating a favourable trade balance and promoting competitiveness of Latvian companies in the markets of foreign countries. This goal is achieved by implementing three policy directions: promotion of exports and investment attraction, state support instruments, and contractual provision.

These directions are implemented within the framework of the **Latvian Export Promotion Programme for 2005-2009** (EPP), setting the goals and main tasks of export promotion policy and the results to be achieved. The EPP has been implemented within the framework of annual action plans, comprising work co-ordinated by several public institutions. Implementation of the EPP is supervised by the Export Promotion Council, consisting of representatives of public institutions, industry associations and social partners.

The direction of promotion of export and investment is implemented by carrying out direct measures of export promotion in accordance with the EPP action plan for 2008, approved at the meeting of the Export Promotion Council on February 27 of this year. A wide choice of support services is available for the Latvian exporters: advice on issues related to export, informative seminars, seminars on export skills, market reports on groups of countries and different sectors, trade missions in foreign countries and participation at international exhibitions, programmes to find co-operation partners (including measures ensuring commercial enterprises' alignment with international supply chains), visits to foreign countries within the framework of the visits of the chief officials of the country etc.

In order to increase the export capabilities of Latvian commercial enterprises and to promote exports of Latvian goods and services, over 745 consultations were provided in the first half of 2008 to businesses on issues related to export, including information about foreign markets, sectoral market reports on the food and wood-processing sectors in countries, such as Norway and the United Kingdom, and marketing materials for export sectors (for example, an engineering industry catalogue). In order to introduce the Latvian businesses with the basic development and implementation measures of the export strategy of goods or services, four export

seminars on export skills were organised in Jelgava, Rezekne, Liepāja, and Daugavpils within the framework of the seminar cycle “Seven steps to successful export”. In total, over 100 representatives of Latvian small and middle-sized companies have taken part in these seminars.

Foreign economic representative offices of Latvia (hereinafter – Offices) constitute one of the most efficient instruments for export promotion. The Offices foster the flow of export and investment projects to Latvia, provide support to Latvian companies in the development and maintenance of business contacts, provide information on market demands of the respective foreign countries, implement marketing measures for export promotion and attraction of investment abroad, participate in finding co-operation partners, and identify potential investors and business partners. Twelve Offices are open and operating actively in Germany, the United Kingdom, Sweden, France, Russia, Kazakhstan, the Netherlands, Denmark, Norway, the USA, Japan and Poland. In accordance with EPP, development of the Office network will be continued by opening two new Offices in the priority export markets every year.

At the beginning of 2008, the Ministry of Economics carried out an efficiency assessment of the Foreign Economic Representative Offices of Latvia and the Offices of the Latvian Tourism Development Agency (LTDA) and submitted the informative report on “Activity Efficiency of the Offices of the Investment and Development Agency of Latvia and Latvian Tourism Development Agency” to the Cabinet of Ministers together with proposals for further development of the network of offices and improvement of their efficiency. It is concluded in the assessment that in general the previous activities of the Offices have achieved the set goals. However, the geographical coverage of the Offices is not sufficient under conditions of globalization for Latvia's export structure or for the export structure of services related to tourism and its development. Therefore, it is necessary to improve the coverage of Latvian Economic Representative Offices.

Regarding provision of state support instruments, implementation of the programme “Business and Innovations” of the EU Structural Funds for 2007-2013 is planned. Within this framework, it is envisaged to provide support to small and medium-sized

commercial enterprises in certain export promotion activities.

On the basis of previous experience of the absorption of state support programmes (SSP) and recommendations of social partners, the Activity 2.3.1.1 “Entry in Foreign Markets” of the measure “Business Support Activities” of the programme “Entrepreneurship and Innovations” of the EU Structural Funds operation was elaborated to introduce the foreign customers with the advantages of Latvian goods and services, promote participation by Latvian commercial enterprises at international exhibitions and national stands in trade missions, as well as alignment of Latvian commercial enterprises with international supply chains. It is mainly envisaged to promote the outlets of higher value-added products and services.

Within this framework, it is planned to provide much wider support to Latvian businesses through export-oriented measures such as:

- external marketing (support for participation at exhibitions, contact exchanges, trade missions, organisation of seminars and conferences).
- strengthening international competitiveness of sectors (support for development and acquisition of market research, development of product export strategies, finding strategic partners and organising their visits to Latvia).

The financing available within the framework of the Activity “Entry in Foreign Markets” for the entire planning period is LVL 7.03 million.

An **export credit guarantee system** will be introduced within the framework of the Investment Fund envisaged by the Activity 2.2.1.1 “Holding Fund for the Investment in Guarantee, High-Risk Loans, and Venture Capital Funds and Other Financial Instruments” of the Measure “Access to Finances” of the Programme “Entrepreneurship and Innovation” of the EU Structural Funds operation. Initial financing for the introduction of this system in the planning period is envisaged to the amount of LVL 20 million. Short-term export credit insurance services will be available for businesses, provided by the state-supported private insurance joint-stock company chosen by the tender procedure.

The export credit guarantee system is provided for increasing access by Latvian exporters to markets with higher degrees of risk and promoting export diversification for the goods and services of Latvian origin. Its introduction will provide an opportunity for businesses to receive export credit insurance services, which will reduce the commercial, political and disaster risks related to exporting.

The goal of the **direction of contractual provision of foreign economic policy** is to ensure maximum and predictable market accessibility for goods and services exported by Latvia. The goal of this direction is achieved with assistance of World Trade Organisation (WTO) multilateral agreements, EU enhanced bilateral and regional integration agreements, and bilateral economic co-operation agreements between Latvia and third countries. The EU implements the common trade policy. The EC negotiates with third countries on behalf of the EU member states.

Box 6.24

EU Market Access Strategy

In 1996 a special mechanism was established – the *EU Market Access Strategy* – as the basis for elimination of trade barriers and informing European exporters of market access conditions in third countries. Under this framework, the *Market Access Database* has been established as the main operation instrument of the strategy. The database is accessible to exporters of EU member states, including also Latvian businesses.

Since the character of trade barriers in the global economy has substantially changed over the recent years and trade barriers are more complicated and take longer to disclose, analyse and prevent, in considering the EU Market Access Strategy and its further development, the EC has developed the renewed EU Market Access Strategy “*Global Europe: a stronger partnership to deliver market access for European exporters*”. The goal of the renewed strategy is identification and prioritisation of particular sectors and markets, where abolition of trade barriers would provide the greatest benefits to European exporters.

Market Access Database (<http://mkacddb.eu.int/mkacddb2/indexPubli.htm>)

The Market Access Database is a free interactive database for easy online use providing the following information to the European exporters:

- rates of import duty of third party countries, internal taxes, customs procedures, and other requirements/procedures to be observed upon importing goods in the respective country;
- a complaints register (for registration of complaints on the problems of commercial companies and sectoral associations in the field of trade and investment in third countries);
- import licensing requirements and descriptions of customs procedures;
- particular trade barriers influencing the sphere of activity of European exporter in third countries;
- sanitary and phytosanitary requirements applied by third countries;
- market research on the markets of third countries;
- export and investment conditions in third countries;
- statistical information on EU trade with third countries, etc.

Considering that contractual provisions in foreign trade are of increasing importance in the rapidly

changing contemporary environment, the Ministry of Economics devotes particular attention to

improvement thereof. For this purpose, the new sub-direction *Contractual Provision* in the EPP action plan for 2008 includes measures directed at ensuring maximum and predictable market accessibility for goods and services exported by Latvia.

A significant contribution to ensuring effective market accessibility is provided by implementation of the renewed EU Market Access Strategy, envisaging a specific body of measures for determining and reducing the trade barriers in third countries (see Box 6.24).

6.11. Protection of Consumer Rights and Market Surveillance

The measures are implemented in the field of protection of consumer rights and market surveillance, in order to improve activities of consumer rights protection institutions and ensure efficient market surveillance and protection of consumer rights.

On January 15, 2008, the **Programme of Consumer Rights Protection and Market Surveillance for 2008-2010** was approved by the Cabinet of Ministers. The Programme envisages continuing the started work, developing the current system for protection of consumer rights, as well as setting priorities in this sphere taking into consideration the Consumer Rights Protection Programme for 2005-2007. Particular attention in this Programme is devoted to strengthening the market surveillance system. The Programme of Consumer Rights Protection and Market Surveillance for 2008-2010 prescribes the following main directions of action:

- improvement of the normative base of consumer rights protection;
- creation of favourable business environment, implementing adequate and efficient market surveillance and supervision of normative acts of consumer rights protection;
- informing consumers and entrepreneurs on issues of consumer rights protection and promoting education of consumers;
- improving the procedures for settlement of domestic and cross-border extrajudicial disputes;
- promotion of operations of consumer rights protection institutions.

The procedures for examination of consumer complaints in Latvia regarding the goods or services inadequate to contract provisions are regulated by the **Consumer Rights Protection Law** (hereinafter – CRPL) stipulating consumer rights in the cases, when goods or services do not comply with contract provisions, as well as with the Regulations of the Cabinet of Ministers No. 631 of August 1, 2006 *“Procedures for the Submission and Examination of Consumer Claims Regarding the Non-conformity of Goods and Services with Contract Provisions”*.

Ensuring of high-level consumer rights protection is set as the most important goal of the consumer policy in the *Basic Guidelines of Consumer Rights Protection Policy* approved by the Order No. 754 of October 14, 2004 of the Cabinet of Ministers, inter alia one of the

sub-goals is to ensure efficient settlement of consumer conflict situations.

However, problems are established in the current procedures for examination of consumer complaints, which do not promote efficient settlement of consumer disputes, and the main problems include a rapidly increasing amount of complaints, long court proceedings, problems due to the fact that according to substance civil disputes are settled within the framework of administrative procedure, as well as problems in relation to expertise conclusions.

In order to improve the procedures for examination of consumer complaints and promote voluntary complaint examination systems in Latvia in accordance with EU recommendations, the Ministry of Economics has prepared a draft concept **For Improvement of the Procedures for Examination of Consumer Complaints Regarding the Non-conformity of Goods and Services with Contract Provisions** (announced in the meeting of State Secretaries on May 15, 2008).

Three variants of solutions for improvement of the procedures for examination of consumer complaints are proposed in the draft concept.

One of them envisages maintaining the current regulation, where *Consumer Rights Protection Centre* (CRPC) examines consumer complaints within the framework of administrative procedure, however decisions of CRPC are not appealed to a higher authority, but immediately to the Regional Administrative Court thereby providing a slightly faster process of adjudication of matters.

The second variant proposes a system within the implementation process of which CRPC would examine consumer complaints as an extrajudicial authority by making recommendatory decisions, and, if any of the matter participants was not satisfied with the decision of CRPC, he/she could turn to court with such subject matter of the dispute in accordance with the procedure stipulated in the Civil Procedure Law.

The third variant envisages establishment of *Consumer Complaints Examination Committee*, wherein there would be representatives of the *Consumer Rights Protection Centre*, entrepreneur associations, professional associations (experts), and consumer non-governmental organizations, thus providing a faster and more efficient procedure, as well as increasing trust of the Parties to a decision of the Committee, as well as amount of those matters in which settlement is

obtained. Decisions of the Committee would be of a recommendatory nature.

For ensuring efficient examination of consumer complaints regarding non-conformity of goods and services with the contract provisions, the Ministry of Economics supports introduction of the second variant by introducing simultaneously the third variant of solution in the spheres where it is possible to complete *the Consumer Complaints Examination Committee* for proceedings.

After discussions of almost six years, on April 7, 2008 the new **Directive for Consumer credit agreements** was approved in the sphere of consumer crediting in EU Council of Europe Transport, Telecommunications and Energy Council, which will allow consumer credit borrowers in the EU to choose the most profitable loan easier and receive it in other EU state. The Consumer credit agreements directive will come into force on the twentieth day after its publication in the EU Official Journal. The member states will have to introduce the directive requirements in their legislation within two years from the moment of publication, i.e., until 2010.

The Consumer credit agreements directive was planned as one of the measures for establishment of EU internal market in the field of consumer credit, therefore the aim of the Directive is to harmonise particular aspects of normative and administrative acts of the member states in regard to consumer credit, setting clearer and stronger demands, more adequate to the current situation in the financial services market in respect to information to be provided to the consumer in order to ensure better consumer protection in case of cross-border crediting.

The scope of the Directive will concern all consumer credit agreements, except a mortgage credit or a credit for acquisition of buildings and land, credit agreements below EUR 200 and above EUR 75 000, rental and lease agreements, pursuant to which ownership of goods does not devolve to a consumer (for example, operative leasing), pawn credit, credit for payment of current debts, credit granted by employers, etc. Member states will be enabled to stipulate the regulation in relation to these types of consumer credit agreements further in the national normative acts. The sphere of consumer credit in Latvia is regulated by the valid *Consumer Rights Protection Law*, as well as Regulations of the Cabinet of Ministers No. 257 of July 13, 1999 “Regulations on a Consumer Crediting Agreement”. Upon adopting the *Directive for Consumer Credit Agreements*, appropriate amendments will be made to the national legislation of Latvia by introducing the new requirements and updating the current ones.

In the sphere of safety of goods, on February 28, 2008, the Commission's Committee on General Product Safety Directive approved and on April 18, 2008 the European Commission adopted the decision 2006/501/EC, by which the member states are required to ensure that commercialized or available

toys with magnets had a warning notice concerning danger to health and safety caused by the items. The Commission decision refers to all toys for children of up to 14 years of age containing or consisting of magnets, the size and shape of which allow for children to swallow them.

The risk related to magnets in toys becomes increasingly higher due to their strong gravitation. Not only the information of a case of death in the USA in 2006 is received, but also about tens of cases all over the world, when children have swallowed at least two magnets or a magnet and some metal object and when a serious surgery has been necessary.

In 2006 and 2007, several toy manufacturers began wide withdrawal of the magnet toys from the market by withdrawing a total of more than 18 million magnet toys all over the world. Hundreds of consumer complaints and accident reports have been submitted. Taking into consideration the serious risk caused by magnet toys, the European Commission has decided to adopt the mentioned temporary decision in order to ensure consumer health and safety protection on an equally high level within the entire EU, as well as to prevent obstacles to trade created by the national measures introduced by particular member states. A permanent solution for the magnet problem is also simultaneously prepared, reviewing the European Standard EN 71-1:2005 “Safety of toys – Part I: Mechanical and physical properties”, which is planned to be completed in summer of 2009.

After enforcement of the decision, the member states will have to ensure attachment of a notice to the magnetic toys available in EU market within 3 months (until July 2008).

Supervision of consumer rights

The Consumer Rights Protection Centre (hereinafter – CRPC) under control of the Ministry of Economics is the main co-ordinating institution, which supervises compliance with the normative acts of consumer rights protection. CRPC reviews applications and complaints of consumers about non-compliance of purchased goods or services with agreement terms, gives practical help to consumers in cases of solving conflict situations, protects consumer rights in legal proceedings, represents interests of consumers in the process of drafting normative acts, gives consultations on consumer rights protection legislation and compliance of goods, and co-operates with international consumer rights protection bodies and national institutions of consumer rights protection of other countries. Information about consumer rights is available on the CRPC website www.ptac.gov.lv, as well as on the website of non-governmental organisations for protection of consumer interests www.pateretaja-celvedis.lv. These websites contain information on the valid legislation of consumer rights protection, different goods and services, as well as possibilities to protect consumer lawful rights. In accordance with Regulations No. 631 of August 1, 2006 of the Cabinet of Ministers on “Procedure for

Submission and Review of Consumer Claims Concerning Goods or Services Non-compliant with Agreement Terms”, the CRPC created and posted a database of examiners on its website, where 14 examiners are registered. However, a bigger diversity for examination of various goods and services would be desirable.

The activity results of the *Consumer Rights Protection Centre* in 2007 and in the 1st quarter of 2008:

- in 2007 26 454 consultations are provided, in the 1st quarter of 2008 – 7993;
- in 2007 3124 consultations are provided to entrepreneurs;
- in 2007 2124 complaints are reviewed, which is by 71% more than in 2006, but in the 1st quarter of 2008 671 complaints are reviewed, which is by almost 40% more than in the same time period in 2007.

The number of complaints still tends to grow considerably in the last years, which could be explained by both the economic activity of residents and the greater consumer awareness about their rights. In 2007, the number of complaints on services exceeded the number of complaints on goods for the first time. Out of 2124 complaints reviewed in 2007, 903 were reviewed in favour of a consumer. A positive solution is also made for a complaint of a consumer regarding 671 complaints reviewed in 2008 for more than a half of the cases.

Out of the received complaints (in 2007 – 759, in 2008 – 222) concerning goods non-compliant with agreement terms the most complaints are received regarding electric appliances, mobile phones and footwear.

The majority of all complaints are the complaints regarding services non-compliant with the agreement terms (in 2007 – 890), the most – on construction, travel services, air traffic services, individual orders of furniture, rent and public utilities, as well as electronic communications services. In 2008, the complaints concerning air traffic services (within 3 months in 2008 – 23). Within most of them passengers have requested for help from the CRPC in the receipt of a compensation and support from airlines, which is stipulated by the European Parliament and Council Regulation No. 261/2004 of February 11, 2004, *establishing common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights, and repealing Regulation No. 295/91*. CRPC, which is responsible for supervision of air transport passengers' rights observance in Latvia, has assisted air passengers by explaining their rights and in case of necessity has made decisions, delegating the responsibility to airlines to fulfil lawful requirements of passengers.

Supervision of advertising

In 2007, the CRPC has assessed 7699 advertisements, of them 84 – upon individual applications. Examination of cases was started on 373 occasions. In 2007, administrative penalty was

applied in 119 cases. The number of reviewed cases has increased by 58% in 2007, as the number of employees involved in supervision of advertising has grown and skills of employees have increased as well, because certified lawyers are engaged in the work. The biggest number of violations was established in advertisements of special promotions. The number of misleading advertisements has also increased.

The categories of cases reviewed most often are misleading and discriminatory advertisements (see Box 6.25).

Within three months of 2008, the CRPC has assessed 1169 advertisements, of them 30 – upon individual applications. Examination of cases was started on 55 occasions. Within three months in 5 cases of 2008 administrative fine is applied, in 7 cases advertisement distribution is prohibited. The biggest number of violations was established in advertisements of special promotions as it was in the previous year.

Supervision of Law on Prohibition of Unfair Commercial Practices

The supervision sphere of the CRPC has considerably widened from January 1, 2008, because the *Law on Prohibition of Unfair Commercial Practices* has come into force, which means that the CRPC supervises not only advertisement, but also commercial practices of any kind – activities (behaviour, statement, commercial communication, marketing) or inaction (default), which directly relate to trade promotion, sale of goods (tangible or intangible property) or provision of service to a consumer.

Within three months of 2008, investigations of 6 cases on unfair commercial practices have been initiated.

It should also be specified that due to the amendments to *Advertising Law* and enforcement of the *Law on Prohibition of Unfair Commercial Practices*, the CRPC has introduced a new practice in its work – appealed to performers of commercial practices and advertisers to undertake in writing to prevent a violation within a particular term. Within three months of 2008, violations have been already prevented in this way in three cases.

The most often reviewed categories of the cases are misleading advertisements and misleading commercial practices.

Supervision of agreements

In 2007, the CRPC has issued 64 administrative acts on unfair and unequal terms of agreement, demanding to cease fulfilment of the unfair agreement terms concluded with the specific consumer and of agreements concluded with other consumers, as well as demanding to alter draft agreements offered to consumer. The number of established violations of unfair terms of agreement has increased in comparison with the previous year, which is attributable to the activity of the CRPC in this area and to the increased level of consumer knowledge in assuming contractual obligations.

Within three months of 2008, the CRPC has issued 14 administrative acts on unfair and unequal terms of agreement, demanding to cease fulfilment of the unfair agreement terms concluded with the specific consumer

and of agreements concluded with other consumers, as well as demanding to alter draft agreements offered to consumer.

Box 6.25

Misleading and discriminatory advertisements

In 2007, CRPC has carried out investigations in 32 cases on misleading advertising, administrative fine was applied in 11 cases and the CRPC imposed an obligation to withdraw advertisement in three cases.

Withdrawal of advertisement was applied to those advertisements, where non-existent qualities (incredible effect) were ascribed to the respective goods. For example, information with the slogan “I will take care that 5 of your earnest wishes pertaining to money would fulfil by the end of the year” was distributed in press. CRPC established that the advertisement gives wrong declarations (statements) and misleading idea both, for the society on the whole and for individual persons about opportunities to acquire financial resources or other material values, by paying LVL 0.44 as a price for two postage stamps. Due to the fact that during the review of the case the advertiser did not submit evidence that would confirm the special abilities of person indicated in the advertisement, the advertisement was acknowledged as misleading.

Advertisements of food supplements are a characteristic type. Upon reviewing cases on food supplement advertisements, CRPC has taken decision on prohibition of distribution of two advertisements and has imposed administrative penalty on advertiser. The main problem in this sphere is that medical properties have been ascribed to food supplements (which is prohibited) and a surprising and incredible effect (e.g. increase of breasts by several sizes, losing weight in sleep) has also been attributed to them.

CRPC also acknowledged as misleading the advertisement of air tickets distributed by airline, which did not indicate the payment for transaction to be paid in addition to the ticket price if reservation of tickets is done on the Internet. Hence, the CRPC applied administrative penalty for this violation.

Violations of prohibition of discriminatory advertising have been established as well. CRPC applied administrative penalty for an advertisement, where a photo shows a dark-skinned man wearing a worker's helmet, above a scarf tied in a form of turban. The photo displays a notice in broken Latvian “*I want to repair your house!*” in black letters on yellow background; information “Pērnavas Street 27/29. Everything for repairs and construction. Except imported labour force.” is given under the photo. In assessment of individual components of the advertisement's content in connection with the object of the advertisement (construction goods and services offered in the advertisement), the CRPC established that the advertisement expresses discrimination against a person because of race, skin-colour, national or social origin.

The most frequent unfair terms in agreements with consumers are as follows:

- prescribing settlement of disputes only by the court of arbitration or by the court of arbitration at claimant's choice;
- prescribing disproportionately large penalty to be paid by a consumer in case of non-fulfilment or inadequate fulfilment of contractual obligations;
- infringement of legitimate rights of a consumer;
- prescribing rights to alter terms of agreement unilaterally;
- prescribing rights to the service provider or vendor to unilaterally keep the advance payment paid by a consumer, while not providing such opportunity for the consumer.

Since 2007, decisions regarding collective consumer interests are published on the CRPC website (www.ptac.gov.lv) in the section “Decisions of the CRPC”.

Also within three months of 2008, as it was in 2006 and 2007 the CRPC dedicated a lot of work, to information of entrepreneurs on different issues of consumer rights protection, providing to entrepreneurs a broadened assessment of the terms of agreement offered by them or of other provided information before adoption of decisions in order to enable entrepreneurs to prevent the made violations of consumer rights voluntarily. Due to this work, one entrepreneur has completely amended the draft agreement voluntarily, whereas in several cases partial amendments are voluntarily made.

Cross-border trade

As the number of residents going abroad and the number of tourists visiting Latvia is increasing, a positive solution of consumer problems in relation to the acquired low-grade goods and services, as well as cross-border consumer protection is becoming increasingly more topical.

The *European Consumer Centre* (ECC Latvia) was established as a separate department of the CRPC, co-financed by the European Commission.

In 2007, consumers addressed the ECC Latvia 627 times, out of which 528 were consultations and 99 – complaints. 49% of the received complaints concerned air traffic services, 16% – to tourism, 9% – to clothing and footwear, 8% – to low-grade household appliances, 3% – to e-commerce, 1% – to accessories, as well as other issues.

18% of the provided consultations related to air traffic services, 15% – to low-grade household appliances, 9% – to clothing and footwear, 13% – to e-commerce, 8% – to tourism services, 2% – to accessories, and 35% of consultations were given on EU normative acts and other services.

Within 3 months of 2008, 35 complaints are reviewed 174 consultations given concerning solution of consumer cross-border complaints. In case of a cross-border complaints, assistance is provided to a consumer in finding an institution for solution of a complaint, but decisions are not adopted in regard to a foreign entrepreneur.

Box 6.26**The projects implemented by the CRPC in supervision of agreements at the end of 2007 and the 1st quarter of 2008**Supervision of agreements of complex tourism services

In 2007, the CRPC conducted inspections of altered draft agreements and service programmes of complex tourism services, as well as assessed, whether they comply with requirements of the Regulation No. 67 of January 23, 2007 of the Cabinet of Ministers “Regulations on the Procedure of Preparation and Implementation of a Complex Tourism Service, Information to be Provided to Customer, and Rights and Services of a Complex Tourism Service Provider and of a Customer”. Considering the above-mentioned measures, amendments have been made to the draft agreements and service programmes offered to consumers, as well as security guarantee payments have been made.

Inspections of Internet Websites

During the second half of 2007, the CRPC implemented a project of inspections of Internet homepages. Within the framework of the project, the CRPC inspected, whether all the information prescribed in the normative acts is included in the homepages of Internet shops, whether terms of agreements and guarantees appropriate to the normative acts are included, as well as that if complete and true information is provided about electric appliances offered on the Internet homepages. The goal of the project was to clarify the situation in the market: if all the information stipulated in the normative acts regulating distance agreements and information society services is included in the Internet homepages, if complete and true information is included in the homepages on particular categories of goods (electric appliances), as well as, if unfair terms of agreement in the websites are not included and the concept “guarantee” is not used without reason. 18 homepages of the Internet shops were inspected in total. 10 entrepreneurs made amendments voluntarily, non-compliances are prevented partially in three cases, decisions were issued in eight cases.

Supervision of consumer crediting provisions

Within the period from July 1 to December 30, 2007, the CRPC implemented supervision of consumer crediting provisions. The goal of the project was to investigate, if the lenders without the status of a credit institution observe all conditions of the normative acts, as well as inform entrepreneurs of correct preparation of agreements, and eliminate the violations of the normative acts.

The main established problems:

- the information prescribed in the Regulations No. 257 of the Cabinet of Ministers of July 13, 1999 “On Consumer Crediting Agreement” is not specified;
- unfair terms of agreement are included in agreements (disproportional penalties, advance payment compensations, as well as clauses of a court of arbitration).

Amendments were voluntarily made to a part of agreements in draft crediting agreements within the framework of the project, as well as several entrepreneurs have already submitted the information on fulfilment of the adopted decisions to the CRPC.

Violation of consumer's freedom of choice

In 2007, the CRPC has performed protection of collective interests of consumers not only in regards to terms of agreements, but also has issued several decisions pertaining to the established violations of consumer rights with regard to violations of consumer's freedom of choice. E.g., a decision No. 33-pt on changes of the air ticket reservation system on Internet homepage was taken on June 18, 2007. CRPC acknowledged that the ticket reservation system offered to consumers in the section that makes consumers to deactivate the automatically activated option on flight date/time change guarantee denies them full and free exercising of their choice and will, violating the consumer rights protected by CRPL (Item 1 of Section 3, Part 3 of Section 4) and obligated to make the respective changes in the air ticket reservation system on the Internet homepage, henceforward offering to consumers the opportunity to choose acquisition of flight date/time change guarantee by activating the respective option themselves.

Investigation of goods and services offered to consumers, the target audience of which is children and youth

The CRPC specialists made a research “Investigation of goods and services offered to consumers, the target audience of which is children and youth” with the aim to summarise, assess and analyse the measures of different types related to sale of goods and services, for example, mobile phone melodies, animations, horoscopes, calculators, different tests (concerning success, love, etc.), games (the games to be ordered both, on the Internet and over the mobile phone), the accessories attached to the goods, as well as make their analysis, and prepare the information for the CRPC homepage containing summary of the research results.

The research results will be used in review of complaints, assessment of agreements and performance of other protection measures of consumer collective interests.

Supervision of KASKO agreements

Beginning with January 2008, the CRPC implemented a supervision project of KASKO insurance agreements by assessing 10 insurance agreements of insurance companies in Latvia. Letters with an invitation to prevent the established non-compliances were sent to all insurers, as well as the CRPC organised a meeting with insurers on March 5, 2008, in which the problem issues established in insurance agreements were emphasized. Similarly, within the period to March 5, 2008 individual meetings were organised with insurers, within which the insurers undertook to voluntarily prevent the greatest part of non-compliances established by CRPC. Insurers undertook to submit the amended draft agreements to the CRPC until the middle of May 2008, when the CRPC will assess them and proceed with the further activities, unless the violations are prevented. Similarly, in collaboration with insurers, guidelines are prepared for consumers for concluding KASKO insurance agreement.

Supervision of security guarantees of complex tourism service providers

Taking into consideration that the obligation of complex tourism service providers in accordance with the new regulations is to submit reports on the sold tourism services on the second half-year of 2007 to the CRPC until January 20, 2008, specifying also the issuer of the paid security guarantee, the CRPC performed measures, so that the service providers were informed on the necessary reports, as well as carried out inspections and brought the actions of administrative violations, if the reports were still not submitted. In total, 34 actions of administrative violations were initiated. Upon completion of the activities performed by the CRPC, nearly all enterprises have submitted the reports, which enable the CRPC to make sure of the security deposit paid by the customer.

54% of the received complaints related to air traffic services, 3% – to tourism, 3% – to clothing and footwear, 3% – to low-grade household appliances, 6% – to e-commerce, 31% – to other goods and services.

23% of the provided consultations concerned air traffic services, 7% – low-grade household appliances, 7% – clothing and footwear, 13% – e-commerce, 6% – tourism services, 1% – accessories, and 43% of

consultations were given on EU normative acts and other services.

In 2008, in 37 different places of Latvia visited by foreign tourists (in Riga International Airport, tourism information centres, hotels, etc.) MINICARDS with contact information of the ECC Latvia are available, as well as the information on the cases when a consumer may address ECC Latvia for assistance.

Box 6.27

Activities of European consumer interest protection in the 1st quarter of 2008

In collaboration with the Association of Tourism Agency (ALTA) the ECC Latvia participated in the 15th international fair “Balttour 2008”, which took place from February 8 to February 10 in the International Exhibition Centre in Kipsala, where the informative materials prepared by the ECC Latvia were distributed “A complex tourism service and Consumer Rights in the European Union!”, “Your Air Passenger’s Rights” and advertising materials on the ECC Latvia.

In 2008, the co-operation of the ECC Latvia and Consumer Interests Protection Association continued. Representatives of the ECC Latvia participated in the educational seminar “Consumer Rights and Housing Policy” performed by the Consumer Interests Protection Association in Ogre on February 25 this year and informed the seminar participants on activities of the ECC Latvia within the framework of ECC-Net and Latvia, as well as procedures for review of cross-border complaints.

By celebrating the International Consumer’s Day, on March 13 the ECC Latvia participated in the press conference jointly organised by the CRPC and EC representatives ECC Latvia and informed on activities of the ECC Latvia.

Within the framework of the International Consumer’s Day, the consumers were informed on activities of the ECC Latvia and consumers rights in the EU in Ventspils and Valmiera regional televisions, as well as in the morning programme of LTV 1 “Good morning, Latvia!”, as well as representatives of the ECC Latvia participated in seminars of the International Consumer’s Day organised by Europa Direct in Ventspils and Jelgava.

Press releases were prepared and published on the activities of the ECC Latvia and consumer rights protection in EU newspapers “Latvijas Avīze” and “Čas”.

A booklet in English concerning the right of cancellation in Latvia is prepared.

In order to provide wider information to consumers on consumer rights in the EU, the ECC Latvia continues to regularly supplement the information in the homepage www.ecclatvia.lv, so that the consumers receive more qualitative information of cross-border purchases and information on how to act in the cases if low-grade goods or services are acquired. Since the opening of the ECC Latvia, the homepage has been visited for 6255 times from 44 different countries of the world, including also the countries, which are not in the EU.

Market surveillance

CRPC has set the following priority directions of market surveillance in 2007 and 2008: toys and children’s goods (cots, baby walkers, diaper changing tables), baby-proof lighters, individual means of protection, electric appliances and vehicles.

In 2007, the CRPC:

- carried out 3235 inspection visits to trade and service companies;
- adopted 27 decisions on safety of goods and services;
- adopted 8 decisions on compliance of goods and services with requirements of normative acts.

Within the framework of all projects inspections were conducted in the trade sites of goods, as well as at importers by inspecting, whether the goods have all the necessary labelling, the necessary documentation stipulated in the normative acts, as well as samples of the goods were taken for testing. The market surveillance projects implemented by the CRPC may be viewed on the CRPC website www.ptac.gov.lv, as well as in the public report on 2007.

In January 2008, the activities within the framework of *Twinning* project LV/2006/IB/EC/01 “Strengthening of market surveillance” are begun. The general goal of EU Bilateral co-operation project is to

strengthen capacity of the CRPC by adopting knowledge and experience of consumer rights protection and market surveillance institutions of the United Kingdom.

The specific goals of the project are implementation of new market surveillance methods and procedures in the CRPC work and improvement of competence of the CRPC employees.

The following results are planned in the framework of the project:

- development and implementation of procedures of information society services;
- developed procedures and planning for supervision of particular goods;
- developed guidelines to summarise statistics of accidents related to goods and services;
- professional training of personnel;
- developed guidelines for introduction of certain legislation;
- expanded framework of quality management, including the sphere of market surveillance.

State metrological supervision

In 2007, the following measures of metrological supervision have been carried out in the CRPC:

- in order to establish compliance of measuring instruments with normative requirements, 24.8

thousand measuring instruments were subjected to state metrological supervision in 637 enterprises, incl.:

- 7250 measuring instruments in 490 trading companies;
- 15 869 measuring instruments in 109 production companies;
- 1524 measuring instruments in 27 health care companies;
- 186 measuring enterprises in 11 state administrative institutions.

Of the inspected measuring instruments 2.9 thousand or 11.7% of the total number were acknowledged as non-compliant with normative requirements, among them measuring instruments without the necessary certifications of conformity assessment, inadequately labelled, as well as used by violating the repeated verification terms set by legislative requirements. As a result of metrological supervision, binding instructions for prevention of violations were given and administrative violation reports for non-observance of metrological requirements were drawn up for 26 natural and legal persons, administrative reports were prepared and decisions adopted in accordance with Article 99 of the Administrative Violations Code of Latvia;

- the projects for study of non-automatic weighing instruments and water meters market were implemented in order to clarify compliance of non-automatic weighing instruments to be sold on wholesale trade sites with the normative acts on metrological requirements, as well as to eliminate the established violations in order to reduce the risk of placing in the market and handing over for use in the regulated sphere the measuring instruments non-compliant with normative requirements. In the framework of the projects, employees of the CRPC inspected 10 wholesale trade companies of weighing instruments (of which 1 company is also a manufacturer of weighing instruments) and 31 trading companies of water meters. It was assessed in the trading companies of weighing instruments, whether the wholesalers offer weighing instruments and the attached devices (among

them cash systems – POS systems of trade points) to consumers in accordance with requirements of the Regulations No.180 of March 7, 2006 of the Cabinet of Ministers “Conformity Assessment Regulations for Non-automatic Weighing Instruments”, and whether the non-automatic weighing instruments are provided with the necessary certificates of conformity and have the CE conformity marking. In 20% of cases, it is established that the conformity assessment procedures have not been implemented in the sphere regulated for the sale of weighing instruments, nor a manufacturer’s conformity declaration is attached, and the conformity certifications of weighing instruments issued by the declared institutions are not available. The most violations are established in relation to application of inadequate conformity assessment procedures to handing over of water consumption meters for use, due to this reason 11.5% of the inspected 3.5 thousand meters were acknowledged as inadequate;

- control of pre-packed goods was performed in 62 production companies, where 312 consignments of goods were inspected (a test of statistical control was performed). Non-compliances were detected – 34 consignments of goods or 10.9% of the total number of inspected consignments did not comply with the normative requirements regarding the actual volume of content. During the report period, in total, administrative violation reports for non-compliance of the volume of content of pre-packed goods with the normative requirements were issued for 11 legal and natural persons and decisions were adopted in accordance with Article 99 of the Administrative Violations Code of Latvia.

CRPC continuously co-operates with metrological supervision institutions of other countries and takes part in the working groups WG2 “Implementation of Non-Automatic Weighing Instruments Directive 90/384/EEC”, WG5 “Metrological Supervision” and WG6 “Pre-packages” of the European Co-operation in Legal Metrology (WELMEC).

6.12. Quality Assurance

6.12.1. Quality Structural Policy

The main task in the area of quality assurance is to promote observance of requirements of normative acts in the regulated and non-regulated sphere, as well as to improve the base of normative acts in accordance

with EU requirements, taking into account the needs of the national market and national economy, thereby ensuring compliance of the products placed in the market and of the provided services by facilitating also the increase of competitiveness of entrepreneurs 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 Regulations of the Cabinet of Ministers deriving from the above-mentioned laws.

The main directions of the policy are:

- improvement of the conformity assessment infrastructure (including testing and calibration of laboratories, inspection and certification institutions, environmental verifiers) in accordance with the needs of Latvian national economy in order to protect consumers and environment from low-quality products and services, promote growth of competitiveness of entrepreneurs and reliability of products of Latvian producers and services provided by Latvian entrepreneurs;
- improvement of the informative and consultative base;
- participation of national institutions of accreditation, standardisation and metrology in international organisations, ensuring their international recognition and compliance of the national 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 population from inaccurately conducted measurements;
- encouraging introduction of quality management system, environmental 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;
- improvement of the market surveillance system in order to provide equal conditions for all market participants and protect consumers from the potential unfair competition of companies.

Upon improving the legislative base, as well as the infrastructure of the conformity assessment system, the following activities are implemented in 2007, including:

- the annual National Accreditation Conference is organised in co-operation with the Latvian National Accreditation Bureau, thereby promoting public confidence in accredited institutions of conformity assessment;
- the necessary amendments are made to the respective normative acts by improving the Conformity Assessment System;
- in order to promote public understanding concerning quality assurance issues and to popularize quality assurance as one of the ways for increasing competitiveness of commercial

companies, society is informed about topicalities in the field of quality assurance on a regular basis.

In order to improve the infrastructure of Conformity Assessment System also in the future, it is planned to develop amendments to the Law “On Conformity Assessment” in the second half of 2008, taking as the basis the results, conclusions and proposals included in the voluminous research “Analysis of Normative Acts of the Republic of Latvia in the Field of Conformity Assessment” carried out by non-governmental organisations during 2007.

6.12.2. Accreditation, Standardisation, Metrology

Accreditation. The state agency “Latvian National Accreditation Bureau” (hereinafter – LATAK) is a public administration institution under supervision of the Ministry of Economics, which ensures operations of the national accreditation system.

According to the Law “On Conformity Assessment” the main functions of LATAK are:

- to evaluate, accredit and supervise the testing and calibration laboratories and certification and inspection institutions in conformity with the prescribed requirements of normative acts, Latvian national standards, EU or international standards;
- to organise and co-ordinate inter-laboratory comparative testing in compliance with Latvian, EU and international requirements;
- to represent Latvia in international accreditation organisations;
- to maintain and update the informative base of accredited institutions.

The number of accredited institutions (see Figure 6.5) over the last years proves the importance and stability of accreditation process in the field of assessment of competence. 180 institutions are maintained in the system at present. LATAK continues to provide accreditation services in Ukraine where 1 institution is accredited.

LATAK participates in the European Co-operation for Accreditation (EA) in the framework of the Multilateral Recognition Agreement (MLA) in 6 accreditation spheres.

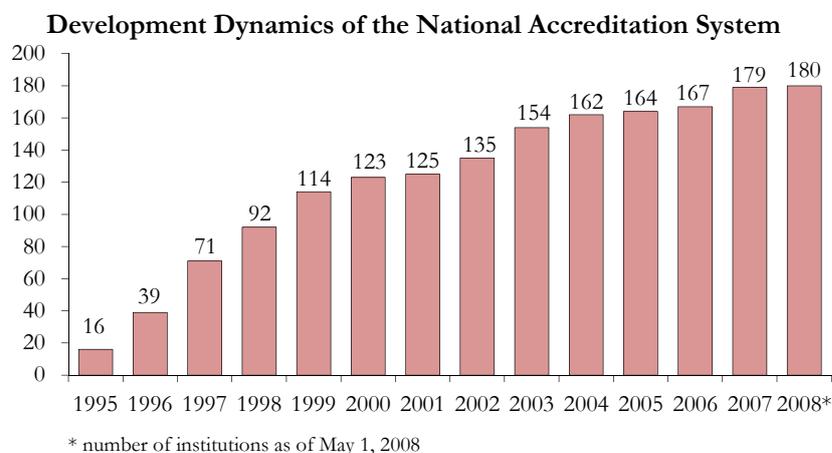
LATAK participated in several committees – EA Inspection-Certification Committee (EA IC / CC), EA Laboratory Committee (EA LC), a meeting of the Committee of the Multilateral Recognition Agreement (EA MAC).

In the framework of international co-operation, LATAK provided an informative seminar to representatives of an accreditation institution of Moldova – training on accreditation issues in accordance with guidelines of the European Co-operation for Accreditation and requirements of

international standards. LATAK also co-operates with accreditation institutions of Uzbekistan and Georgia, providing support in establishment of national accreditation systems.

Upon implementing the tasks on co-ordination of inter-laboratory comparative testing, the LATAK has co-ordinated 2 programmes, as well as organised 5 skill tests.

Figure 6.5



Standardisation. The LLC “Latvijas standarts” (hereinafter – LVS) was founded as the national standardisation organisation with a goal to manage and co-ordinate activities of businesses, institutions and organisations in standardisation, and it operates according to the provisions of the Standardisation Law.

Since 2004, the LVS is a full-fledged member of the European Committee for Standardisation (CEN) and of the European Committee for Electrotechnical Standardisation (CENELEC), as well as a corresponding member of the International Organisation for Standardisation (ISO) and an associate member of the International Electrotechnical Commission (IEC).

The main functions of LVS are to establish the Latvian fund of standards, co-operate with international and European standardisation organisations and issue Latvian standards.

In order to carry out development of the national standards, as well as adaptation of the international and regional standards within the status of Latvia, LVS co-ordinates the activity of 43 technical standardisation committees (LVS/STK) in different national economy sectors.

As of June 1, 2008, 27 842 standardisation documents are registered in the LVS, including 26 505 EU standards adapted within the status of Latvian standard. 736 EU standards and 11 international standards have been adapted within 5 months of 2008, 8 compulsorily applicable standards translated in Latvian, standardisation information services provided to 2950 legal and natural persons.

The automatic system of electronic notification of information introduced by the LVS provides a free-of-charge service “Monthly Report on the Standards Registered at the Status of Latvian Standard and on Abolished Latvian Standards” to customers in the areas of customers’ interest. In 5 months of 2008,

498 permanent customers used the service and 2507 regular reports had been sent to them.

As of January 2008, it is possible to buy Latvian standards on the Internet – in the e-shop of standards. Legal persons, paying for the purchase on the Internet by credit cards, may use the service.

In April 2008, the LVS participated in the 1st meeting of Intergovernmental Commission of Latvia–Uzbekistan regarding economic and industrial co-operation issues, during which the further co-operation opportunities and initialised draft co-operation agreement were discussed with the representative of Standardisation, Metrology and Certification of Uzbekistan agency of Uzbekistan “Uzstandart”.

On May 28, 2008 the LVS in co-operation with the Netherlands company “Virage BV” – administrator of the project “STEPPIN” (*S*tandards in *E*uropean *P*ublic *P*rocurement lead to *I*nnovation), supported and financed by the EU organised a seminar for experts in the field of public procurement “Standards in Procurement Process”. “STEPPIN” is a part of the series of projects, dealing with mutual connections between standards and innovations and the seminar taken place in Rīga is one of 15 seminars concerning the use of standards in the procurement process organised by “STEPPIN” in all EU member states.

Standardisation work is popularised in press on a regular basis. Since the beginning of the year, 4 articles on topical problems of standardisation in Latvia and Europe are placed in the regular column “Standardisation” of the “Quality” magazine.

Informative material is prepared for the updated and improved edition “Construction Catalogue” published by the LLC “OPENINFO” jointly with the Construction Department of the Ministry of Economics and several co-operation partners.

Metrology. The state agency “Latvian National Metrology Centre” (hereinafter – LNMC) is a national

metrology institution under supervision of the Ministry of Economics and implements the national policy in the field of metrology. The LNMC started its operation on August 1, 2006 in compliance with the Order No. 573 of August 1, 2006 of the Cabinet of Ministers “On Establishment of the State Agency “Latvian National Metrology Centre”” and the Law “On Uniformity of Measurements”.

The mission of the LNMC is promotion of competitiveness of Latvian national economy, facilitating uniformity of measurements in the Republic of Latvia, at the same time ensuring international credibility of measurements, fostering international trade and reliability on assessment of conformity of commodities carried out in Latvia and excluding a repeated necessity for performing conformity assessment procedures. The main tasks of the LNMC are as follows:

- to ensure maintenance of the base of measurement standards of physical quantities and reproduction of measurement units;
- to approve the types of measuring instruments and register them in the State Register of Measuring Instruments;
- to carry out conformity assessment procedures of measuring instruments subjected to the state metrological control;
- to provide calibration services;
- to participate in development of the laws and normative acts related to regulated metrology;
- to co-operate with metrology organisations of other countries;
- to take part in the work of international metrology organisations;
- to organise inter-laboratory comparison and take part therein;
- to organise training in the metrology sphere.

Box 6.28

Activities of the LNMC in the first half of 2008

In the field of mass measurements, 152 calibration services were provided, including 143 standard weights, 8 non-automatic scales, and 1 metal measuring vessel for the total amount of LVL 3614. The own measuring instruments have been calibrated – 81 standard weights and 7 mass comparators. The seminar “Metrological Provision of Mass Unit of Measure, Weights, Non-automatic Scales” was held for seven employees of the Consumer Rights Protection Centre. Calibration of the National mass standards LNE 08 and reference standard weights was carried out in the National Metrology Institutions of the Czech Republic and Denmark. The representatives participated in the meeting of the technical committee EURAMET TC-M “Mass and the Values Related to it” in Rumania. The works in establishment of Suspectometer and mass comparator CCS 300K continue.

In the field of electrical measurements, 27 measuring instruments are calibrated for the total amount of LVL 2664, as well as three own calibration and direct voltage sources. In accordance with the schedule, calibration of a standard multimeter 4950 was performed in England in the company “Fluke”. Uncertainty was calculated and the new multimeter 8508A put into operation. Two employees of JSC “Latvenergo” were trained.

Within the part of temperature measurements, calibration of 8 temperature sensors and 13 glass thermometers was performed, as well as drift measurements of the National temperature standard No.LNE 13 were made at the ice melting temperature.

Research of zero point drifts was made by the multimeter Fluke 1529 and relative temperature deviations determined for the calibrator H9009 to the National standard No. LNE 13 “Platinum Resistance Thermo-Transformer”. The obtained results are recalculated in absolute temperature and correction tables made within the range 0 °C ÷ 100 °C.

Processing of the calibration results of the National temperature standard No. LNE 13 “Platinum Resistance Thermo-Transformer” and the deviation function calculated for the range of temperature 0 °C ÷ 420 °C.

Regarding the field of time measurement, two EURAMET projects were completed and the work on “BALTIC TIME” project is being continued. Calibration services were provided to seven organisations, as well as a training seminar “Frequency measurements” held for the employees of JSC “Latvenergo”.

200 measuring instruments are calibrated **in the field of geometric measurements** for customers and 219 own measuring instruments in the amount of LVL 4055 lats. A part of them participated in the international project of calibration of six and twelve side prisms. In accordance with the schedule “SP” in Sweden and “MIKES” in Finland, the sets of linear measures of standards were calibrated.

Salaspils branch “Radiation Metrology and Testing Centre”(RMTC) gave a presentation on final introduction of the RMTC quality system in the meeting of EURAMET in Sofia (Bulgaria), thereby RMTC and its quality system have received full support of “EURAMET TC-Q” as Designated Institute of Latvia in the field of radiation measurements. A stand is made for calibration of brachtherapy equipment – treatment and storage of the used radioactive isotope samples. Measurements are made and the results are sent to the EC IRMM for organised comparative measurements on the quality of drinking water “REM-06 Radium and Uranium in water”. EURAMET expert audit is carried out in the laboratory of the LLC “OSMUNDS”, performing testing of medical diagnostic x-ray equipment, as well as bilateral comparative measurements of dosimetry of spaces with the laboratory of the LLC “NMS GRUPA” are made. According to the equipment calibration plan, 10 measuring instruments of RMTC laboratories are recalibrated, as well as 14 sources of radioactive isotopes. 83 calibration certificates and 30 testing reports and certificates are issued to customers, and the opinion on technical inadequacy of the equipment to calibration requirements is issued. In total, bills are written out in the amount of LVL 10172.

6.13. Privatisation

The goal of privatisation is, by changing ownership of a state or local government property, to create a favourable environment for operation of the private capital in interests of development of Latvian economy and scale down the activities carried out by the state and local governments as businesses.

As the objective of the mass privatisation process implemented in Latvia is basically achieved, the Saeima

adopted the *Law on Completion of the State and Local Government Property Privatisation and Use of Privatisation Certificates* (hereinafter *Privatisation Completion Law*), which was enforced on September 1, 2005 and prescribes how to complete the privatisation process and land reforms and ensure completion of the use of privatisation certificates (see Box 6.29).

Box 6.29

Law on Completion of the State and Local Government Property Privatisation and Use of Privatisation Certificates

The *Privatisation Completion Law* prescribes:

- the term of August 31, 2006, by which every legal or natural entity could propose to bring any state or municipal property to privatisation;
- the procedure, by which a privatisation proposal submitted by a person is reviewed and decision is adopted to bring the state or local government property to privatisation;
- that privatisation may be denied and the property is maintained in possession of the state or local government if the property is necessary to carry out public administration functions or commercial activities of the state or local government;
- that the Cabinet of Ministers or a local government could take decisions on bringing the state or local government property to privatisation by December 30, 2008;
- that the state joint stock companies “Latvenergo”, “Latvijas pasts”, “Starptautiskā lidosta “Rīga””, “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 by which the land boundary plan or confirmation of the land redemption payment executed with privatisation certificates before conclusion of the land redemption contract has to be submitted to the State Land Service (September 1, 2008);
- that privatisation certificates do not have an expiry term, but they may only be used within the framework of the privatisation process;
- the procedure of ending the issuance of privatisation certificates. The final term of April 28, 2006 is established, by which applications for privatisation certificates can be submitted, whereas privatisation certificates were allocated if the application was submitted until December 28, 2007.

In order to ensure successful and open progress of privatisation completion processes, the Cabinet of Ministers has established a procedure of how the institutions conducting privatisation and land reform have to create publicly available registers of privatisation proposals and land redemption.

In the framework of application of norms of the *Privatisation Completion Law*, problems of interpretation and implementation of several norms arose. In order to avoid jeopardising completion of privatisation and land reform, amendments to the *Privatisation Completion Law* were enforced on February 15, 2008. The most essential issues that are settled by the amendments are as follows:

- to extend the term for review of privatisation proposals that are submitted for the period from July 1 to August 31, 2006, the term set forth is 28 months from the moment of registration of privatisation proposals, i.e., by December 30, 2007;
- It is determined, that if within the period until legal proceedings are initiated and not completed due to the dispute on ownership and a property belonging to the state or local government or their corroboration in Land Register or if legal proceedings are initiated and not completed in the case on acknowledgement of a property as ownerless property or escheat, the Cabinet of Ministers or municipality council shall adopt the decision on bringing the property to privatisation or a justified denial to bring the property to privatisation within four months from the day when a court order or notarial act has been legally enforced.
- considering the large number of submitted privatisation proposals, a special term of December 30, 2009 for review of privatisation proposals on vacant land lots was set for the municipality of Riga;
- it is determined that from January 1, 2010 the rent amount for the land lots belonging to the state or municipality will be calculated from cadastral value of the land and it will not be attached to the value for privatisation needs;
- the cases are specified, when the rights to use the land allocated for permanent use in rural areas expire;
- an opportunity is established for a person, the ownership whereof is not restorable in compliance with Paragraph 3 of the first part of Section 12 of “Law on Land Reform in the Cities of the Republic of Latvia” and the former value of the land property of whom was so low on July 21, 1940 that it does not compensate the cadastral value of the land lot included in the land compensation fund of equal value, that this person is entitled to acquire a land lot, the area whereof is not less than the minimum area of the land lot set in the spatial plan of the local government.
- it is determined that the value of built-up land lots for privatisation needs is further established by the State Land Service as of August 31, 2007.

Privatisation of state-owned property units and land

Privatisation of state-owned property units or land is carried out and privatisation proposals are summed up

by the Privatisation Agency under the Law on Privatisation of Property Units Owned by the State and Local Governments.

A decision to bring a state-owned property unit (including capital shares) or vacant land lot to privatisation is made by the Cabinet of Ministers, while a decision to bring a built-up land lot (whereon there are buildings or structures owned by other person) to privatisation is made by the Privatisation Agency. The decision is taken based on a privatisation proposal submitted by any natural or legal person.

618 proposals for privatisation of real estate, 57 proposals for privatisation of state capital shares and 4235 proposals for privatisation of land lots have been registered by the *Register of Privatisation Proposals* of the Privatisation Agency from September 1, 2005 (when the *Privatisation Completion Law* became effective) until April 1, 2008. After August 31, 2006, the *Register of Privatisation Proposals* registered those privatisation proposals, which were submitted by mistake to other state or local government institutions by this date and transferred by cognisance to the Privatisation Agency later.

A natural or legal entity eligible to acquire a movable or real property in Latvia can be the subject in privatisation or state-owned property (real estate, capital shares, land). Payments for the property units have to be executed in lats (LVL) and/or privatisation certificates.

In accordance with the *Privatisation Completion Law*, the Cabinet of Ministers has taken decisions on forwarding 209 properties to privatisation and denying initiation of privatisation for 97 properties by April 1, 2008.

From April 17, 1994 to April 1, 2008, privatisation rules were approved in the statutory procedure for 2324 state property units (except land). 94 companies were transformed to public joint stock companies, issuing 439.14 million shares into public circulation. From April 17, 1994 to April 1, 2008, income from privatisation of state property units (with the exception of land, sale of shares resulting from capitalisation of debts, and alienation of capital shares) amounted to LVL 1.653 billion, of which LVL 387.920 million in cash and LVL 1.265 billion in privatisation certificates. The new owners took over liabilities of the privatised state companies (enterprises) valued at more than LVL 185.8 million. The specified investments amounted to LVL 143.8 million, while the amount of investments actually invested reached LVL 265.2 million.

The Privatisation Agency carries out privatisation of state-owned land since 1997. 4542 state-owned land lots with the total area of 6964.48 hectares were privatised (purchase agreements signed) by April 1, 2008. Total sales price for the privatised state-owned lands reached LVL 165.80 million, of which LVL 72.10 million in cash and LVL 93.70 million in property compensation certificates. As of April 1, 2008, income from privatisation of these land lots amounted to LVL 153.87 million, of which LVL 63.87 million in cash and LVL 90 million in property compensation certificates.

Privatisation of property units and land lots owned by local governments

Decision concerning real estate owned by a local government is taken by the council of the local municipality (city, region, rural municipality). The decision is made based on a privatisation proposal submitted by any natural or legal entity.

A natural or legal entity eligible to acquire a movable or real property in Latvia can be the subject in privatisation of local government property (real estate, capital shares, land). Payments for the property units have to be executed in lats and/or privatisation certificates.

Privatisation of local government property in the local government area is ensured by property privatisation commission of the respective local government (rural municipality, city, district, region).

Compliance of privatisation projects, rules and announcements approved by a local government with provisions of the Law on Privatisation of Property Units Owned by the State and Local Governments and of the Law on Completion of Privatisation is ensured by the Ministry of Economics.

From February 17, 1994 to April 1, 2008, the Ministry of Economics has reviewed and accepted for consideration 3171 privatisation projects for the total relative price of LVL 123.1 million (including payments in certificates for the nominal value of LVL 56.3 million).

From January 1, 1997 to April 1, 2008, the Ministry of Economics has reviewed and accepted privatisation rules in respect to 1647 built-up and vacant land lots of local governments (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 22.3 million (of which LVL 12.8 million to be paid in property compensation certificates).

Pursuant to Item 7 of Section 5 of the Law on Completion of Privatisation, after August 31, 2006, local governments shall submit data to the Ministry of Economics once quarterly, regarding the received privatisation proposals for municipal property units and built-up and vacant land lots, decisions on forwarding these property units and land lots to privatisation, the sale price and the amount of privatisation certificates to be used for payment.

Privatisation of apartment buildings

Privatisation of apartment buildings in Latvia was initiated in 1995. The Central Apartment Building Privatisation Commission (renamed as the state agency "*Mājokļu aģentūra*" (*Housing Agency*) as of January 1, 2004) and apartment privatisation commissions of the respective local governments have prepared and put up for privatisation in the procedure laid down in the Law on Privatisation of State and Local Government Apartment Houses 29 222 state and local government apartment houses with 501127 apartments or 99.58% of the total number of apartments (501 645) by April 1, 2008. 194 441 apartments have been handed over to

private owners by a resolution preceding privatisation of the apartment building.

There are 432500 state and local government apartments privatised (purchase agreements signed, or handed over to private owners preceding privatisation of the apartment building) in Latvia by April 1, 2008, constituting 85.68% of the total number of apartments. So far, apartment owners have taken over management of 9162 apartment buildings, among them 5621 local government apartment buildings and 3541 state-owned apartment buildings, where more than 50% of apartment units have been privatised.

Owners of privatised apartments can decide on the most acceptable form for management and maintenance of their apartment building: either organise a co-operative society of apartment owners (CSAO) or sign an authorisation agreement for management of the house. Because of this process, 397 CSAOs have been founded in Latvia, among them 290 in seven biggest cities and 107 in districts of Latvia. The most of the established CSAOs are in the cities of Riga (192), Liepāja (69), Ventspils (21) and in the district of Valmiera (34). Authorisation agreements for property management have been signed for 2778 apartment buildings.

Land reform

The principal objective of the land reform is to change the legal, social and economic relations of land use and ownership from the command 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 and redemption of the land allocated for permanent use (purchase), and privatisation (alienation) of land owned by the state or local government. Redemption (purchase) of land allocated for permanent use is implemented in relation to the rural and urban land reform, which is currently in progress in the country. According to data of the information system of the Real Estate State Cadastre, 723 359 land units are registered in the country as of April 1, 2008, of which 704 352 land units or 97% are recorded in the Land Register.

Allocation of urban land for the use to apartment owners or orchard users, who received the land for establishing an orchard with building rights, has been completed, and urban land commissions have reviewed conclusions concerning rights to acquire ownership of land for payment but, in accordance with the conclusions, signing of purchase agreements is continued in compliance with Regulations No. 171 of May 6, 1997 of the Cabinet of Ministers "Regulations on Calculation of Compensation for Former Landowners or their Heirs and on Setting Fee for Urban Land Given into Ownership". The state JSC "Mortgage and Land Bank of Latvia" (hereinafter – Mortgage Bank) has signed a total of 71 727 agreements by April 1, 2008, of which 293 agreements were signed during the 1st quarter of 2008. Pursuant to Item 7 of Section 32 of the Privatisation Completion

Law, the Mortgage Bank has received 75 prepayments for urban land purchasable for use by April 1, 2008.

Claiming the free (unclaimed) rural land pertaining to the state for permanent use, i.e., until June 1, 2006, and submission of redemption (purchase) claims to the State Land Service for redemption of rural land allocated for permanent use, i.e., until November 30, 2007, have been finished. After submission of a redemption (purchase) claim, the State Land Service verified the claimant's rights to acquire ownership of land. If the claimant was entitled to redeem (purchase) land, the State Land Service included the land unit of permanent use into the Rural Land Redemption Register. The person permanently using the land unit included in this Register, which has not been subjected to cadastral survey, as well as the included claimants have to submit a land boundary plan registered in the information system of the Real Estate State Cadastre, settle a prepayment in privatisation certificates for the land to be redeemed (purchased) or, according to the procedure set by the Cabinet of Ministers, submit a confirmation of land redemption payment in privatisation certificates before conclusion of land redemption agreement to the respective regional bureau of the State Land Service by September 1, 2008.

The State Land Service has received 60 858 redemption (purchase) claims in total for 95 380 land units with the total area of more than 378 000 hectares.

In the period from August 1, 2007 till November 30, 2007, when, in accordance with amendments made to the Law on Completion of Privatisation, which became effective on August 1, 2007, several categories of persons were granted with an additional opportunity to claim for redemption of rural land allocated for permanent use, the State Land Service received 7120 claims for redemption of 8700 land units within a particular period of time.

Permanent land users and former landowners did not show notable activity in claiming land for redemption during this additional claim period because the absolute majority of those permanent land users, who were interested in redemption of the land allocated for permanent use, took the opportunity to claim during the previous period of submission of land redemption (purchase) claims, i.e., by August 31, 2006.

Claiming for redemption (purchase) of rural land applied to its permanent users – individuals and legal entities, to which the local government or land commission has granted land for permanent use during the land reform by relevant decision. Since 1993, it was possible to redeem the land granted for permanent use, and the majority of permanent land users have already done it. Since the beginning of the land reform, about 250 000 land units with the total area of 1 288 500 hectares have already been redeemed in rural areas.

As a result of assessment of archival documents at disposal of the State Land Service and alignment of

data of the information system of the Real Estate State Cadastre, 15 845 land units with the total area of more than 77 500 hectares are currently included in the Rural Land Redemption Register on grounds of land border plans registered in the information system of the Real Estate State Cadastre. In accordance with provisions of the Law on Completion of Privatisation, these land units allocated for permanent use included in the Rural Land Redemption Register automatically, because the permanent land user, by commissioning a cadastral survey of the land, has shown the interest in further management of the land. Hence the number of land units included in the Rural Land Redemption Register might still increase, because inclusion of the land unit areas allocated for permanent use to the former landowners or their heirs, which is bigger than that land unit area to which the ownership rights are to be restored, is continuing and as a result of cadastral survey of the land exceeds the permissible off-line limits.

111 219 land units with the total area of 455 600 hectares accounting for 6.8% of the total area of Latvia are claimed for redemption and data on them are recorded in the Rural Land Redemption Register on grounds of land boundary plans.

Transfer of ownership of rural land for a payment and conclusion of land redemption (purchase) agreement with the Mortgage Bank are continued. The mortgage Bank has signed a total of 224 622 agreements, among them 2678 agreements in the 1st quarter of 2008, for sale of 1.6 million hectares of land, of which 14 463 hectares in the 1st quarter of 2008, whereas in compliance with Item 7 of Section 32 of the Privatisation Completion Law the Mortgage Bank has received 155 prepayments for the rural land to be redeemed (purchased) by April 1, 2008.

Pursuant to Section 16 of the Law on Completion of Land Reform in Rural Areas, former landowners or their heirs may submit a claim for restoration of ownership rights for whom property compensation

certificates have not been allocated to the land envisaged for completion of land reform to the Central Land Commission by December 28, 2008. 2 266 land units with the total area of 3208 hectares are registered as envisaged for completion of land reform in the information system of the Real Estate State Cadastre. In accordance with the Law on the State and Local Government Land Ownership Rights and their Corroboration in Land Registers by September 30, 2008 councils of local governments and Cabinet of Ministers have to assess the necessity of pertaining rural area vacant lands for state administration functions or for the use of completion of land reform, but regarding urban land – until December 30, 2009.

Privatisation certificates

Privatisation certificate is a state-issued dematerialised security, which can be used only once as means of payment for the state or local government property to be privatised.

Privatisation certificates are issued and used according to the Law on Privatisation Certificates. By April 1, 2008, 2.45 million residents have been granted 103.9 million privatisation certificates for the time they had lived in Latvia, including 794.7 thousand privatisation certificates granted to 41.4 thousand politically repressed persons. 8 million property compensation certificates were issued to 117.2 thousand former owners or their heirs, including 691.7 thousand certificates for property appropriated for state needs at the privatised specialised state agricultural enterprises, 4895 thousand for land in rural areas, 966 thousand for residential property ownership, 813.8 thousand for urban land, 461 thousand for companies and other property units, 89.8 thousand for property taken away from politically repressed persons and 83.8 thousand for property alienated in illegal manner.

3.2 thousand property compensation certificates have been granted to 35 former owners or their heirs in the 1st quarter of 2008.

Table 6.7

Use of privatisation certificates
(by April 1, 2008)

| Type of property | Number | Number of privatisation certificates (million) | incl. property compensation certificates (thousand) |
|--------------------------------|---------------------------------------|--|---|
| Residential properties | 430 thousand privatised housing units | 37.72 | 589.8 |
| Companies and other properties | accurate data not available | 7.20 | 109.6 |
| Capital shares (stocks) | accurate data not available | 44.44 | 954.0 |
| including: | | | |
| in public offering | 128.7 million shares | 37.14 | 820.0 |
| Land | 296 thousand land lots | 16.04 | 5396.9 |
| Total: | | 105.40 | 7050.3 |
| % of total certificates issued | | 93.9% | 94.2% |

Pursuant to the stipulated in Section 27 of the Law on Completion of the State and Local Government Property Privatisation and Use of Privatisation Certificates, from December 1, 2007 55 thousand persons have lost the rights to transfer 1.17 million privatisation certificates to the account.

According to the Law on Privatisation of Land in Rural Areas, 11 076 decisions have been taken by April 1, 2008 about payment of cash compensations for former land ownership in rural areas. Compensations in the total amount of LVL 17.46 million were paid to 8413 persons, cancelling 0.62 million property compensation certificates.

Cash compensations in the total amount of LVL 4.64 million were paid to 26.2 thousand politically repressed persons as payment for privatisation certificates by April 1, 2008. Pursuant to the prescribed by Section 27 of the Law on Completion of Privatisation 3.1 thousand persons have lost their rights to cancel 14.9 thousand certificates.

105.40 million privatisation certificates or 94.2% of the total number of issued certificates were used for

privatisation of state and local government property units by April 1, 2008 (see Table 6.5).

2.41 million privatisation certificates or 2.1% of the total number of issued certificates, including 0.159 million property compensation certificates, were on accounts of 394 thousand physical persons as of April 1, 2008.

2.09 million privatisation certificates or 1.9% of the total number of issued certificates, including 0.022 million property privatisation certificates, were on accounts of physical persons as of April 1, 2008.

In April 2008, holders of privatisation certificates could use services of 15 licensed intermediary capital companies for transactions in the market of privatisation certificates. Total monthly transactions with privatisation certificates (buying from natural persons and selling), carried out by intermediary capital companies in the 1st quarter of 2008, decreased from 0.11 million privatisation certificates in January to 0.08 million privatisation certificates in February.

6.14. Public-Private Partnerships

Public-private partnership (hereinafter – PPP) has already been implemented worldwide as a solution for the successful provision of public services and for development and maintenance of infrastructure to

promote economic growth and provide public welfare. The PPP and the opportunities it may provide for the development of the national economy have been increasingly discussed in Latvia within recent years.

Box 6.30

Definition and preconditions for successful PPP

European Community law still provides no special definition of PPP and only gives a general explanation of PPP. The European Commission classifies PPP (EC Green Paper on PPPs and Community Law on Public Contracts and Concessions, 30.04.2004) as:

- **purely contractual PPP** (DBFO type contracts and concessions), if co-operation between the public institution and the private partner is based on a long-term contract.
- **institutionalised PPP** (joint ventures), if co-operation between the public institution and the private partner is carried out within a joint entity.

In accordance with the abovementioned, the PPP is most often perceived as long-term contractual relations between a public and a private person, in order to ensure performance of the public person's function in constructing, reconstructing and maintaining a socially important object of infrastructure or providing a public service, where the private partner undertakes the risks related to fulfilment of obligations prescribed in the PPP contract or a part of these risks, when attracting private sector resources.

Similarly, different PPP models are also categorised at present in Latvia, depending on specification of project implementation, for example, provisions of the contract, schemes for financing flow, specific character of the object or service:

- **concession contract** or **concession** (regulated by the Concessions Law);
- **partnership procurement contracts** or **DBFO type contracts** (implemented on the basis of the third part of the Article 67 of the Public Procurement Law);
- **participant contract** or **institutionalised PPP type**.

The successful operation of PPP requires that before the start of each PPP project, the public partner must carry out financial and economic calculations of the project with assessment of the value for money (VFM) by comparing several project implementation scenarios, as well as review and analyse all phases of the life cycle of the PPP project to obtain full understanding of the benefits and risks of the PPP project, and also the long-term scope of obligations for the state budget in relation to the PPP project in particular cases and regarding observance of fiscal discipline.

The private sector should also have an interest in the respective PPP project, because in addition to the public partner benefiting from implementation of PPP project, the private partner, who must be ready to undertake project implementation. From the point of view of the entrepreneur, participation in such projects is driven mainly by financial considerations or as an opportunity to obtain predictable regular income over the long-term, and identify as well as open up wider business opportunities, thereby ensuring a stable position in the market.

The promotion of PPP began at the beginning of 2000 in Latvia, when the *Concessions Law* had been adopted by the Parliament, as well as came into force and an institutional system was established for implementation of PPP policy and PPP projects. Since 2004, the Ministry of Economics and the Investment and Development Agency of Latvia (LIDA) have promoted the implementation of potential PPP projects, as well as organising meetings and providing consultations for representatives of the public, private and non-governmental sectors regarding issues related to implementation of PPP projects, thereby facilitating the development of PPP in Latvia.

In addition to the Ministry of Economics and LIDA, several other institutions including the Ministry of Finance, the Treasury, ministries and local governments are involved in the PPP process and have substantial influence on the opportunities to use PPP.

The main PPP policy planning and implementation documents are as follows:

- *Concept on Promotion of Concessions (Attraction of Private Capital to Perform State Functions)*, approved by the Cabinet of Ministers on April 16, 2002, which envisaged establishing the Concessions Division at the Ministry of Economics and to expand the competence of the LIDA by including PPP issues;
- *Latvian Public Private Partnership Development Guidelines*, approved by the Cabinet of Ministers on March 22, 2005, which determine the basic principles and targets of PPP policy and achievement indicators;
- *Action Plan for Implementation of the Latvian Public Private Partnership Development Guidelines in 2006-2009*, approved by the Cabinet of Ministers on November 15, 2005, which sets forth the following directions of action for promotion of PPP until 2009.

Several measures promoting PPP are included in the *Declaration of the Intended Activities of the Cabinet of Ministers chaired by the Prime Minister Mr. Ivars Godmanis and Government Action Plan* adopted in the beginning of 2008. Several measures related to PPP development are also included in the *Latvian National Development Plan for 2007-2013*, which is a medium-term strategic planning document determining the main development directions of Latvia and stipulating the main tasks of the state and society on the way to achievement of the set long-term goals.

The usage opportunities of PPP are emphasized in the planning documents of several sectors, for example:

- Action Strategy of the Ministry of Transport for 2007-2009;
- Transport Development Guidelines for 2007-2013;
- Action Strategy of the Secretariat of Special Assignments Minister for Electronic

Government Affairs for 2007-2009 (updated for 2008-2010);

- National Sports Development Programme for 2006-2012, etc.

Development of the concept of establishment of a joint and coordinated state investment planning process and introduction in the public administration has started in 2007, which envisages PPP as a state development instrument.

Although the legislation, which is currently in-force in Latvia, allows implementation of the PPP projects, in 2007 drafting of the *Public-Private Partnership Law* has begun, which will prescribe and regulate the main issues of PPP in the partnership models between the public and private sector based on contractual relations (purely contractual PPP) and models, in which partnership takes place within a joint entity (institutionalised PPP).

A working group was established by the Order No. 90 of the Prime Minister of February 22, 2008, which must develop and submit both the abovementioned law and draft legislative acts related to the law to the Prime Minister by July 1, 2008. Thus, a law will be created involving the most important representatives of the public and private partners, as well as sponsors (representatives of the Procurement Monitoring Bureau, Ministry of Justice, State Chancellery, Latvian Association of Certified Auditors, Large Cities Association of Latvia, Ministry of Economics, Ministry of Transport, the Treasury, Latvian Association of Local and Regional Governments, Ministry of Finance, Public and Private Partnership Association and Association of Latvian Commercial Banks are in the working group), which would comprise all spheres of activity of the parties involved in implementation of the PPP projects.

One of the goals of the *Public-Private Partnership Law* also envisages specification of the responsibility and role of public administration institutions in the implementation of PPP projects and dealing with the issues of statistical registration of PPP projects, sustainable financial planning and project quality (joint assumptions, assessment criteria, transfer of knowledge), as well as formulation of division of potential risks in PPP projects.

PPP project implementation support

Until 2008, only 15 comparatively small concession contracts had been registered in the Concession Register, as well as particular cases identified when PPP structure is indirectly used in the public projects. This is a very small number, taking into account the great need for investment projects in Latvia. Therefore, to promote wider implementation of PPP projects in the national economy, in 2008 the Ministry of Economics has continued the initiated activities in relation to development of financial support mechanism for preparation of qualitative PPP projects.

The main goal of the programme “*Promotion of Development of Public Private Partnership in Latvia*”

managed by the LIDA and co-financed by the Norwegian Financial Mechanism is to support state and local government institutions in their efforts to implement a consistent and well-founded PPP approach in the development of infrastructure and public services. Additionally, the following activities will be supported within the framework of the programme:

- development of the financial and economic calculations for PPP projects, including training of applicant of a sub-project application and employees involved in the sub-project by a co-operation partner;
- preparation of tender documentation of PPP projects, including training of applicant of a sub-project application and employees involved in the sub-project by a co-operation partner.

Ministries, Secretariats of Special Assignments Minister, as well as local and district governments will be able to apply for co-financing under the Programme, which is supported by the Norwegian Financial Mechanism and Latvian state budget financing. The total planned Norwegian Financial Mechanism and state budget co-financing of the Programme amounts to EUR 1 940 135.

On May 27, 2008, the Cabinet of Ministers approved the tender rules for sub-projects of the Programme and an open tender is planned to be announced in August 2008.

In compliance with the Paragraph 3 of the Minutes No. 29 42.§ of the Meeting of the Cabinet of Ministers of May 15, 2007 on “Construction of New Nursery Schools”, on December 11, 2007 a co-operation contract was concluded between the Riga City Council and LLC “Rīgas Pilsēt būvnieks” on repeated use of the documentation of the technical design project of the pre-school “Kindergarten for 136 children”

implemented in Riga dwelling area “Dreilīņi-2” in order to promote *development of the pre-school network* pursuant to the interests of residents of the country.

Therefore, all the concerned local governments of Latvia have the opportunity to use a building design free of charge for construction of a pre-school in their administrative territory, while only having to fund the adjustment of the plan for their particular territory from the local government budget.

Eight local governments had taken this opportunity by May 2008, two of which plan to use this option for construction of new pre-schools in accordance with the PPP models.

In 2008, the Ministry of Economics and the LIDA have continued providing *advisory support* to implementers of potential PPP projects by informing them of the applicable type of PPP business, the applicable procurement procedures, financial and economic calculations, possible legal solutions for projects and other issues related to PPP, as well as by organising informative seminars for public institutions on the methodology of PPP project management and standard documents. Until the end of March 2008, over 15 consultations were provided to both the public and private sector on topical issues of implementation of PPP projects.

In order to provide broad information to the society on current and topical events, draft laws and regulations, and progress in relation to PPP, the Ministry of Economics has created a PPP homepage (www.ppp.gov.lv), where topical information is published and all the resources on PPP available up to now (methodological materials, standardised PPP draft contracts, etc.) from the Ministry of Economics and the LIDA are summarised. Since June 2, 2008, the abovementioned homepage has been made publicly accessible to all interested persons.

6.15. Advisory Councils of the Ministry of Economics

6.15.1. National Economy Council

National Economy Council (hereinafter – NEC) of the Ministry of Economics is an advisory body established by the 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. The NEC operates in accordance with Sub-paragraph 6.11 and Sub-paragraph 7.2 of the Regulation No. 238 of April 29, 2003 of the Cabinet of Ministers “Statutes of the Ministry of Economics”, “Agreement of Co-operation in the National Economy Council” concluded on February 17, 1999 and Bylaws of the NEC of the Ministry of Economics of May 14, 2007.

The NEC is an advisory institution, which participates in solving the issues related to business activity policy. The objective of its operation is to promote establishment and implementation of a favourable business environment policy in Latvia, foster introduction of the principles of sustainable economy and encourage the process of sustainable development of Latvia, as well as participation of society, fulfilment of the tasks prescribed by the Lisbon Strategy in Latvia and involve public institutions, local governments and social partners in implementation of these tasks.

The NEC reviews issues and follows elaboration of draft legislation, the concept of national economy development, state budget and other documents, which are significant for development of Latvian economy. The NEC prepares proposals and adopts

recommending decisions on these issues. The NEC implements a dialogue between entrepreneurs and the Ministry of Economics, as well as with other public

institutions and public organisations. The decisions adopted by the NEC are of a recommendatory character.

Box 6.31

The structure of the NEC is approved by the Minister of Economics on grounds of a decision of the NEC Steering Committee.

NEC Steering Committee is a consulting and co-ordinating body, which takes part in the settlement of issues related to business policy and is responsible for assessment and approval of issues in the agenda of the NEC action plan and NEC meetings, as well as for ensuring and improvement of efficiency of the NEC work.

The staff of the Steering Committee is approved by the Minister of Economics. The Steering Committee consists of five representatives of NEC founders, who are simultaneously members of the NEC:

- a representative of the Ministry of Economics;
- a representative of Latvian Chamber of Commerce and Industry;
- a representative of Employers' Confederation of Latvia;
- a representative of Free Trade Union Confederation of Latvia;
- a representative of Latvian Association of Local and Regional Governments.

NEC consists of 21 expert designated by the NEC Steering Committee, among them the Minister of Economics, NEC chairman and representatives of Latvian business organisations, public institutions and other organisations.

The representatives of Advisory Council of the Small and Medium-Sized Enterprises and Crafts of the Ministry of Economics and Foreign Investors Council in Latvia take part in the meetings of NEC in the status of observers.

The change or addition of the NEC staff is decided by the NEC founders in the meetings of the NEC Steering Committee.

NEC is administered by the Chairman of the Council, elected by the members of the NEC Steering Committee from among the members in a manner of rotation order for a term of office for one year.

NEC meetings are held on average once per month.

Operations of the NEC are organised by the Secretariat of the National Economy Council, the activity of which is ensured by the Ministry of Economics.

In between the NEC meetings, recommending decisions of the NEC are taken by the NEC Steering Committee.

NEC co-operates with the Saeima (the Parliament), ministries and other public institutions in order to incorporate NEC's proposals necessary for improvement of the business environment into normative acts prepared by the responsible institutions.

In order to ensure professional representation of the interests of national economy sectors in 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 for co-operation with national economy sectors.

Ministry of Economics and the NEC have concluded a protocol of agreement on co-operation with the following councils of experts (CE) of sectors: CE of Machine Building and Metal Processing Industry, CE of Chemical and Pharmaceutical Industry, CE of Light Industry, CE of Construction Materials Producers, CE of Timber Industry, CE of

Food Industry, CE of Construction Industry, CE of Passenger Carrier Industry, CE of Business Education and Management Advisers, CE of Tourism Industry, and CE of Printing and Publishing Industry.

Upon signing the protocol of agreement, the parties agreed to unite their resources for development of programming documents, take measures for implementation of the economic development and business environment improvement programmes adopted as a part of the governmental declaration, and that the councils of experts will assess draft legal acts worked out by the ministries and will issue their opinions thereof.

Box 6.32

The NEC members and experts work in the following councils, committees and working groups:

- Consultative Board for Development Co-operation Policy Issues at the Ministry of Foreign Affairs;
- Supervisory Board of the Lisbon Strategy at the Ministry of Economics;
- Construction Council at the Ministry of Economics;
- Latvian Tourism Advisory Council at the Ministry of Economics;
- Export Promotion Council at the Ministry of Economics;
- National Standardisation Council at the Ministry of Economics;
- European Union Structural Funds Supervision Committee at the Ministry of Finance;
- Working Group of Development of Corporate Income Tax and Real Estate Tax of Proposals Promoting Economic Development of the Ministry of Economics;
- Information Society National Council of Special Assignments Minister for Electronic Government Affairs;
- Advisory Council of the Latvian Investment and Development Agency.

In the first half of 2008, 4 meetings of the NEC have taken place, during which the following most important issues were reviewed:

- Macroeconomic Stabilization Plan;
- Plan for Improvement of the Business Environment for 2008;

- Options for establishment of new base capacities for electricity production;
- Proposals for the criteria of labour force migration;
- Amendments to the Civil Law (draft law Lp/528);
- Law on Holding Companies.

Box 6.33

Entrepreneurs are among the most important “users” of legal acts and most directly face the controlling impact of legislation in their daily work, so it is necessary to popularise work of business associations as partners in development of legal acts and help raise the capacity of business associations.

NEC holds an opinion that the work should continue in order to provide a stable macroeconomic environment in Latvia. Therefore, in order to maintain a stable macroeconomic environment and promote competition, a balanced budget must be formed in Latvia, supervision of competition must be strengthened and development of competition promoted within all national economy sectors by identifying the risk sectors on time, in which violations of the Competition Law are possible, restricting administrative and other obstacles for competition.

NEC still considers tax policy and administration, labour force education, macroeconomic stability and non-predictability of changes in legal acts as problematic areas.

Normative acts have to be assessed already during their development in order to identify and prevent possible violations of the Competition Law, technical barriers to trade and discriminatory conditions in the field of free movement of goods and services and Entrepreneurship Law. Supervision of state support and procurements has to be improved, by achieving high transparency for state support projects.

It is necessary to promote establishment of efficient and competitive sectoral structure, as well as research, development and innovations, especially in the private sector, as well as develop and introduce the measures promoting co-operation of educational, research and national economy sectors, by ensuring knowledge and technology transfer.

Entry in new export markets and consolidation in the current ones must be promoted, institutional base of export promotion and rise of its capacity, development of foreign economic representative offices, access to financial instruments and support to companies in export marketing must be ensured.

Undeclared unemployment must be reduced, which can be attained by the following measures:

- raising the minimum wage and proportionally increasing the non-taxable minimum in order to lessen the tax burden for persons with low income;
- increasing the administrative capacity of the State Labour Inspectorate through recruitment of additional staff, improvement of control over observance of Labour Law norms and raising awareness of society about issues of the Labour Law;
- strengthening the role of trade unions and employer associations in entrepreneurship through promotion of consolidation of entrepreneurs in business organisations;
- creating a favourable environment to increase reputation of socially responsible business activity.

NEC holds an opinion that it is necessary to improve administrative procedures in Latvia, because after Latvia’s accession to the EU, a lot of time is necessary for entrepreneurs in solving the issues related to the requirements and administrative procedures regulating the state and local governments and absorbing new administrative procedures related to application of EU legal acts, as well as for acquainting with often extensive and directly applicable EU legal acts.

6.15.2. Council of the Small and Medium-Sized Enterprises and Crafts

Council of the Small and Medium-Sized Enterprises and Crafts (hereinafter – CSMEC) is an advisory institution of the Ministry of Economics.

Composition and statutes of the CSMEC were approved by the Regulation No. 560 of December 1, 2007 of the Ministry of Economics.

The goal of the activities of the Council envisages promotion of development of small and medium-sized enterprises and craftsmen and establishment of favourable business environment for SMEs in Latvia.

The key functions of the CSMEC are to review and follow settlement of such issues (draft legislation, national economy development policy documents, etc.), which are important for the development of SMEs, as well as to prepare proposals and make recommending decisions on these issues; to carry out dialogue between entrepreneurs, the Ministry of Economics, other public institutions and social organisations, which affect operations and development of SME.

On the basis of the Order No. 560 of December 11, 2007 of the Minister of Economics “On Advisory Council of the Small and Medium-Sized Enterprises and Crafts of the Ministry of Economics”, the Ministry of Economics has updated composition of

the CSMEC, expanding the institutions represented within it and recruiting by representatives of producer associations and regional development agencies.

CSMEC consists of 21 authorised representatives of the organisations representing small and medium-sized enterprises, among which there are SME institutions, societies, organisations and associations representing different national economy sectors, consolidating SME and representing their interests. The Ministry of Economics, Latvian Investment and Development Agency and Entrepreneurship Co-ordination Centre of the Riga City Council take part in the status of observers.

Meetings of the CSMEC are held on average once per month.

The work of the Council of the Small and Medium-Sized Enterprises and Crafts is led by the Chairman elected by the Council.

The work of the Council and functions of the Secretariat are performed by the Ministry of Economics.

In the first half of 2008, 5 meetings of the Advisory Council of the Small and Medium-Sized Enterprises and Crafts have taken place, where the following most important issues were considered:

- Macroeconomic Stabilization Plan;
- Proposals for the criteria of identifying priority sectors;

- Plan for Improvement of the Business Environment for 2008;
- Options for establishing new base capacities for electricity production;
- Proposals for export promotion measures;
- Proposals for the criteria of labour force migration;
- Support programme for improvement of competitiveness of enterprises;
- Concept for improvement of the reviewing procedure of consumer complaints regarding the goods and services non-compliant with contractual provisions.

In collaboration with the Ministry of Economics, entrepreneurs are invited on a regular basis to assess SME development issues, as well as draft programme documents shaping SME development policy before adoption by the Cabinet of Ministers. Proposals for various legal acts, the Plan for Improvement of the Business Environment for 2008, as well as the Macroeconomic Stabilization Plan for 2008-2009 have been developed during the meetings.

The Council has continued the initiated positive dialogue relating to business with the institutions representing entrepreneurs, the Ministry of Economics and public institutions, which are responsible for business environment improvement of Latvia.

Box 6.34

In order to strengthen the role of Advisory Council of the Small and Medium-Sized Enterprises and Crafts in improvement of the business environment and to ensure that the non-governmental sector is properly represented in absorption of the EU Structural Funds and support programmes, CSMEC members are delegated to take part in the following councils, committees and working groups:

- EU Structural Funds Supervision Committee at the Ministry of Finance;
- Subcommittee of the European Regional Development Fund and the Cohesion Fund at the Ministry of Finance;
- Subcommittee of the European Social Fund at the Ministry of Finance;
- Working group of Elaboration Guidelines for Development of the State Tax and Duty System at the Ministry of Finance;
- Export Promotion Council at the Ministry of Economics;
- Advisory Council at the Ministry of Economics and the Latvian Investment and Development Agency;
- Commercial Activity Development Council of the Riga City Council.

Through participation in entrepreneur delegations outside Latvia, co-operation agreements between the Council and similar organisations of the Republic of Azerbaijan and the State of Israel were concluded.

The Council of the Small and Medium-Sized Enterprises and Crafts plans to solve the following issues at the meetings in the nearest future:

- personal income tax;
- application of corporate income tax allowances in case of re-invested profit;
- implementation of Business Activity Competitiveness and Innovation Promotion Programme for 2007-2013 in the first half-year;
- adoption measures of the Directive 2006/123/EC on services in the internal market, including the concept of one-stop shop;
- optimisation of the representation system of external economic interests of Latvia;
- the National Lisbon Programme of Latvia.

6.15.3. Advisory Council of Public Private Partnership

The Advisory Council of Public Private Partnership (hereinafter – Advisory Council of PPP) is a consulting and co-ordinating institution established by the Ministry of Economics.

The aim of its operation is to participate in addressing the issues related to PPP policy and thereby foster creation of favourable environment for implementation of PPP projects and encourage the use of PPP instrument, attracting private capital to construction of public infrastructure and to public

services. The decisions of the Council are of a recommending character for public institutions and local governments.

The structure of the Advisory Council of PPP was approved by the Order No. 23 of January 19, 2007 of the Ministry of Economics “On Establishment of the Advisory Council of Public Private Partnership” consisting of representatives of the Economic Affairs Committee of the Saeima, Ministry of Economics, Ministry of Finance, the Treasury, Ministry of Education and Science, Ministry of Culture, Ministry of Welfare, Ministry of Regional Development and Local Government, Ministry of Transport and Communications, Ministry of Justice, Ministry of Health, Ministry of Environment, Latvian Association of Local and Regional Governments, Riga City Council, Latvian Investment and Development Agency (LIDA), State Regional Development Agency, Association of Latvian Commercial Banks, Public Private Partnership Association, Latvian Builders Association, Association of Latvian Cities, National Economy Council, Latvian Chamber of Commerce and Industry and Employers’ Confederation of Latvia. The Council is chaired by the Minister of Economics.

The functions, tasks and rights of the Advisory Council of PPP, as well as organisation of its operations were approved by the Order No. 59 of February 8, 2007 of the Ministry of Economics “On the Statute of the Advisory Council of Public Private Partnership”, as well as statutes of the Advisory Council of PPP, determining that the Economic Policy Department of the Ministry

of Economics performs functions of the Secretariat of the Advisory Council of PPP and organises its work.

The first meeting of the Advisory Council of PPP took place on January 25, 2007, during which the information on the current situation in the field of PPP was provided, as well as on opportunities to implement PPP projects and the work performed by the Ministry of Economics, the LIDA and other public institutions for PPP development. Assessment of the draft Concessions Law developed by the Ministry of Economics was established as the main issue of the

meeting, as this draft law does not fully solve the issues related to this field. Based on decisions taken at the first meeting of the Advisory Council of PPP, additional discussions about the legislative framework regulating PPP took place on February 8, 2007 and on February 20, 2007, when proposals submitted by ministries and other institutions for amendments to the draft Concessions Law developed by the Ministry of Economics were considered.

The next meeting of the Advisory Council of PPP is planned to convene after submission of a single draft Public Private Partnership Law and the related draft legal acts to Prime Minister.

7. RECOMMENDATIONS

Taking into consideration the current economic development tendencies, the main task at present is to provide the necessary conditions for sustainable growth and not to allow rapid fall of the growth.

The main directions for ensuring macroeconomic stability are as follows:

- to continue the initiated fiscal consolidation (budget with a surplus) and promotion of budget efficiency, as well as to improve the tax policy;
- to promote productive capacity, particularly in the trade sectors;
- to implement a structural policy directed towards knowledge-intensive economy.

Considering the abovementioned, in our opinion, the most important and urgent tasks of the economic policy are as follows:

- **in efficiency promotion of budget income and expenditure:**
 - to improve efficiency of state administration by establishing a result-bearing indicator system of the state strategic planning, eliminating permanent vacancies in state institutions by forming a unified state financial and human resource information and management system;
 - to improve efficiency of funding distribution and project implementation of EU funds (EU Structural Funds and the Cohesion Fund), accelerate preparation of programmes;
 - to promote introduction of the public and private partnership mechanism by connecting it with the public investment plans and programmes (local government, state and the EU);
- **in reduction of administrative burden:**
 - to improve the process of registration, granting authorisations and tax administration of entrepreneurship in order to simplify and accelerate initiation and performance of business activity. Simplification of procedures and requirements must be ensured for receipt of authorisations, where it is justified by issuing authorisations for an indefinite period or creating a possibility of performing the necessary procedures electronically. An option must be provided to make the registration of a value added taxpayer simultaneously with registration in the Commercial Register;
 - to promote development of e-government and e-services in order to increase availability and efficiency of public services. Establishment of the state mega-system (“register of registers”) must be completed; all the harmonisations, as

well as necessity of registration that require references from other public institutions are to be identified, it has to be ensured that this can be done automatically and in e-environment, e-signature has to be introduced in all public bodies, and functionality of e-signature must be expanded;

- to establish a uniform information availability point in relation to permits and licences, so that to make obtaining of information on the permits and licences necessary for starting a particular type of business activity easier for entrepreneurs;
- to improve the flow of state-level official statistical information and mutual harmonisation of the statistical indicators to be included in public registers and other information systems, in order to exclude repeated enquiry of information from respondents. The proportion of reports to be submitted electronically must be increased, creating the opportunities for respondents to submit reports in an electronic form;
- to implement optimisation of the regulating and control institutions of the construction sector and establishment of e-government in order to ensure transparency of the construction process and improve control thereof. The number of procedures and time necessary for harmonisation of documentation of construction projects must be diminished;
- to reduce costs related to employment and regulated by various legal acts and create incentives for entrepreneurs for more active involvement of various social groups in the labour market, by reviewing regulations of the labour market. Reduction in the number of days in sick-leave certificates paid by employers must be continued, and more active involvement of various social groups (disabled persons, persons after childcare leave, ex-prisoners) in the labour market must be promoted by various incentives for employers; to ensure that the expenses of enterprises related to attraction of labour force were considered as the expenses related to economic activity and not imposed a personal income tax;
- to improve the process of real estate registration by uniting the procedures – introducing the one stop-shop principle in real estate registration, reducing the number of days and procedures necessary for the registration;

- **in implementation of tax policy and tax administration promoting entrepreneurship:**
 - to increase efficiency of operation of the State Revenue Service, continuing transformation of SRS to institution that helps entrepreneurs;
 - to keep improving the normative acts regulating tax administration, so that also the degree of responsibility would be taken into account in imposition of punitive sanctions;
 - by introducing changes in the tax system, to ensure comprehensive assessment of the influence of the expected changes on entrepreneurship and national economy, as well as create preconditions to improvement of competitiveness of Latvian entrepreneurs in the domestic market;
 - to improve the system of tax allowances in order to foster contribution of entrepreneurs to development;
 - to establish a taxation system, which would create preconditions to financial involvement of employees in development of companies;
- **in ensuring competition and setting administratively regulated prices, as well as consumer rights protection:**
 - to fight the most important competition violations as effectively as possible, ensuring efficient implementation of amendments to the Competition Law;
 - to conduct analysis of entry barriers and competition level in the sectors that ensure goods and services domestically (with the exception of exports) and that have a comparatively high level of concentration;
 - to carry out preventive and inspection measures for identification of prohibited agreements in the sectors important in national economy, by paying particular attention to public procurements and Structural Fund competitions, as well as auctions in the spheres of priority, for example construction;
 - to perform research of competition situation in important sectors of the national economy sectors – retail trade (non-specialised stores), pharmacy, motor road and engineering construction work, in order to assess, if fair competition conditions exist in these sectors, and if indications of prohibited agreements may be established;
 - to create a single body for regulation of public services in order to introduce a public services regulation model most suitable to the situation of Latvia;
 - to improve supervision methods of consumer rights protection, particularly establishing an efficient market surveillance system, ensuring successful review of consumer complaints and protection of collective consumer interests.
- Particular attention must be concentrated on the safety of goods and services to protect the consumers from use of goods and services incompliant with requirements, as well as on supervision of observance of economic consumer interests;
- **in promotion of investments, business start-ups and access to finances:**
 - to encourage formation and development of new enterprises in Latvian regions, providing them with the necessary infrastructure and consultative services in order to facilitate start-up of business. Business incubators must be created in various Latvian regions and support to the new enterprises formed therein must be provided;
 - to pay more attention to allocation of funding for development of business activity in early stage (measures for access to pre-seed and seed capital, opportunities to get loans on preferential terms) and access to finances in the form of risk capital. Informative and consultative support to SMEs and business beginners must be ensured in order to promote awareness of entrepreneurs on access to funding in different stages of company development;
 - to create an investment fund in order to carry out introduction of financial support instruments in a co-ordinated way;
 - to support investment in development of micro and small businesses in areas requiring special assistance in order to promote business start-ups and investment in these regions;
 - to review territorial plans of regional centres by planning new industrial territories;
 - to envisage the accelerated procedure for the change and transformation of land zoning for industrial projects;
 - to establish an earmarked subsidies fund/ or a state support programme for construction of industrial area infrastructure (road, water, sewerage);
- **in export promotion:**
 - to introduce an export credit guarantee system in order to increase access to markets with a higher degree of risk and promote exports of Latvian origin goods and services outside the European Union;
 - to increase work efficiency of foreign economic representative offices of the state and improve integration of the system, expanding the network of these offices and ensuring co-ordinated representation of economic interests of Latvian entrepreneurs abroad;
 - to expand export support services for small and medium enterprises in order to foster diversification of exports and consolidation in the existing markets;

- to ensure observance of interests of Latvian entrepreneurs in multilateral and bilateral/regional talks in order to promote improvement of contractual conditions in third party countries;
- **in establishing flexible labour market:**
 - to encourage economic activity of population, increasing the labour supply and using the local resources more efficiently. It is necessary to facilitate involvement of young people in the labour market in order to give an opportunity to employ young people more flexibly, promote employment of young people with special needs, retaining the allowance in case the young person works, and more flexible return to work for new mothers. It is advisable to give the employer the right of choice to determine a shorter trial period, setting the maximum of 6 months as a trial period stipulated by the Labour Law. It is advisable to form labour courts that would allow settling labour disputes more efficiently and faster. It is advisable not to obligate the employer to cover the costs related to payment for study leave, covering the expenses from the state budget instead;
 - to solve structural problems of employment, supporting aspirations to acquire adequate and higher qualification in accordance with labour market requirements and facilitating labour mobility, especially improving the transport infrastructure;
 - to reduce undeclared employment, diminishing the tax burden on employment and raising administrative capacities of the State Labour Inspectorate, recruiting additional personnel, improving the control over observance of labour law requirements, raising society's awareness about labour law issues, strengthening the role of trade unions and employer associations in entrepreneurship, and encouraging entrepreneurs to unite in entrepreneur organisations in order to create favourable environment for increasing reputation of socially responsible business activity;
 - to improve the regulation system of the labour market demand and supply, inter alia, ensuring preparation of medium-term and long-term forecasts of the labour market;
- **in ensuring efficient, safe and sustainable energy supply:**
 - to promote the use of renewable energy resources in electricity generation and heat supply considering the available resources and potential in the country hence reducing dependence on imported energy resources, as well as including the installation costs of self-provision power in justified expenses of private persons and companies by also including them in the fixed assets, for acquisition whereof tax allowances are applied;
 - to provide sufficient funding in the budget of JSC “Sadales Tīkls” for construction of the new connections and increasing the existing power;
 - to develop projects of base power stations, choosing those types of power stations that will ensure guarantee and sustainability of resource supply, as well as increase self-provision of the state with energy;
- **in improvement of energy efficiency:**
 - to implement the state support programme for promotion of renovation of apartment houses, carrying out energy audits and renovation projects of dwelling houses and, meanwhile, raising interest and responsibility of co-owners in renovation of residential buildings;
 - to implement the Measure “Energy Efficiency of Home” of Priority “Providing High-Quality Environment for Life and Economic Activity” of Operational Programme “Infrastructure and Services” of the EU Structural Funds for 2007–2013, implementing the measures for improvement of heat steadiness of apartment houses and social residential buildings;
 - to integrate the energy efficiency policy into other sectoral policies (tax, transport, regional policies);
- **in establishing knowledge-intensive economy:**
 - to foster co-operation between scientists and entrepreneurs, creating Competence Centres in order to promote co-operation between the research and industrial sectors in implementation of industrial research, new products and technologies, as well as creating Technology Transfer Contact Points and Technology Transfer Centres, science and technology parks in order to develop the necessary scientific competence in higher educational establishments and scientific institutes;
 - to support business activities with high value added, promoting investments in fixed assets and current assets;
 - to support development of new products and technologies, encouraging entrepreneurs to conduct industrial research, introduce new products, services and technologies into production, and strengthen the industrial property rights;
 - to support recruitment of highly skilled employees;
 - to plan wider activities of education and confidence-building for young people – potential businessmen – and to promote reciprocity of hard science students and business students through common measures.

In order to ensure efficient implementation of structural policy, it is necessary to envisage institutional provision within each measure of the policy, which guarantees and controls, that the norms included in the respective laws are fairly observed by the subjects of economic activities, and support conditions are clear, as well as availability thereof is based on the principles of equality.

Consistently implemented structural policy will promote change of the economic model from exploiting advantages of cheap labour to knowledge-intensive economy, which will be a base for raising the standard of living of the population. Successful development and economic growth of Latvia will depend not only on the work of public institutions, but also on everyone's personal initiative everywhere in Latvia under the conditions of mutual understanding and dialogue within the society.