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OPENING STATEMENT

We would like to deliver the new Report on the Economic Development of Latvia prepared by the experts of the Ministry of Economics for your evaluation. The report assesses the economic situation, as well as forecasts the prospects of economic development.

Although economic growth in Latvia is more moderate in 2019, it is still one of the most rapid in the European Union (EU). In the first 9 months of 2019, GDP has grown by 2.5%. The deceleration of growth rates was underpinned by both internal factors (the investments from EU funds have reached their maximum, developments in the financial sector, etc.) and external factors (review of global trade relations, Brexit, slower growth in the EU). It may be expected that the above-mentioned global factors will affect Latvia's growth also in 2020, negatively impacting the export capacity. Positive trends in domestic demand-oriented industries are also expected to continue. The Ministry of Economics forecasts that in 2019 the economy will grow by 2.5%. Similar growth will also be observed in 2020.

Increased economic activity positively impacts the labour market. Economic activity of the population has reached the highest level so far and is currently close to its potential; therefore, further improvements are possible only by reducing structural disparities – regional differences in the labour market, skills mismatches.

To promote growth, the Ministry of Economics continues to strengthen the competitiveness of the economy by providing businesses with support to increase productivity and international competitiveness. This is particularly important considering that a substantial increase in labour costs is inevitable in conditions of an open labour market.

The target growth scenario developed by specialists of the Ministry of Economics provides that the benefits of Latvia's economic competitiveness are mainly based on technological factors, improvement of production efficiency, and innovation; however, to a lesser extent on cheap labour and low resource prices.

Human capital is particularly important in the promotion of competitiveness – reforms in the education system and restructuring of the labour market to prepare and adapt to structural changes. Therefore, ongoing reforms in the education system should be pursued with the emphasis on strengthening the quality of learning of exact and natural sciences in basic education and secondary education and on the development of adult education.

To coordinate inter-sectoral cooperation required for planning, development, implementation, and monitoring of labour market reforms or re-arrangement, thereby reducing the disproportion in the Latvian labour market, the Employment Board composed of three ministers (Minister of Economics, Minister of Education and Science, and Minister of Welfare) was established. In October 2019, the Board agreed to undertake the role of a strategic coordinator of

the system of anticipating changes in the labour market to ensure more harmonised cooperation between all the parties involved in anticipation of labour market changes and introduction of necessary restructuring, thus enabling society to adapt to the expected changes in a more timely manner. In 2020, the Ministry of Economics in cooperation with the State Employment Agency will continue work on the creation of a platform for online reflection of labour market forecasts to ensure the availability of labour market forecasts to a wider range of stakeholders.

To stimulate discussions and find the most effective solutions to boost productivity, at the initiative of the Ministry of Economics, the government has designated the Scientific Institute LV PEAK of the University of Latvia as Latvian representative in the network of Productivity Boards of European Union. The creation of Competitiveness and Sustainability Sub-Council of National Trilateral Cooperation Council (CSNTC) also fosters cooperation with the non-governmental sector in promoting productivity. There were five CSNTC meetings in 2019. Productivity and competitiveness of the Latvian economy, the Industrial Policy 2020+, the Smart Specialisation Strategy, and other important matters were discussed.

Latvia should be ready to embrace challenges related to the changes brought by *Brexit*, the withdrawal of the United Kingdom from the block of the EU countries. In this context, the Ministry of Economics continues to provide informative support to businesses and the population to help form a clear understanding of changes in practical life and business. Cooperation with other EU countries will continue, in particular, for the purposes of strengthening competitiveness of the Baltic – Scandinavian region to remove currently existing obstacles and barriers in the EU Single Market to foster opportunities of Latvian businesses; to develop provision of their services across borders, incl. the digital environment. The organisation of similar activities, such as the creative workshop "Digital tools of the Single Market – opportunities for cross-border growth of SMEs", on pressing issues in the EU Single Market and matters of importance to businesses jointly organised by the Ministry of Economics and the European Commission on 26 April 2019 will continue.

Support programmes of the EU funds are successfully implemented, providing the opportunity to invest 4.4 billion euro in the development of Latvia. The most important planned funding objectives of the EU funds include increasing the financial flow in research and development, facilitating the attraction of private investment, and activating the cooperation of research institutions and entrepreneurs. Significant investments are also planned for the improvements of the information and communication technology and transport infrastructure that directly affect economic productivity and are the basis for creating new, well-paid jobs and increasing the quality of life.

907.2 million euro for targeted investments into modernisation and industrialisation of Latvia's economy are available in activities of the Ministry of Economics in the 2014-2020 programming period, including for promotion of energy efficiency – 377 million euro; the promotion of competitiveness of small and medium-sized enterprises (SME) – 334.4 million euro; and the development of innovation – 195.5 million euro. The following EU funds activities will continue: *Introduction of New Products in Production* (support for acquisition of equipment), *Promotion of International Competitiveness* (national stands, including entering into external markets (participation in exhibitions)), *Training of the Employed*, *Competence Centres*, *Business Incubators* and *Heat Insulation of Apartment Buildings*, provision of aid to economic operators also in the form of financial instruments (guarantees, loans, venture capital instruments, incl. acceleration funds) will continue and will be extended.

The improvement of the national innovation system continues. Support programmes are being implemented, which foster the attraction of investments from the private sector in research and development (R&D) activities and motivate companies to invest in innovations. The most important support instruments ensure the promotion of cooperation between businesses and the research sector for the implementation of joint projects, commercialisation of research developments within the scope of fostering wider technology transfer processes, incl. by strengthening the capacity of the Investment and Development Agency of Latvia making it an agency of innovation and technology. At the same time, those activities continue, which are aimed at motivation of the wider community and its involvement in innovation and business development. We have activated work with state capital companies by creating cooperation mechanisms of these companies and identifying current and future R&D investments in these companies. These activities are closely related to the attempts to achieve targeted improvements and the increase of the rating of Latvia in the European Innovation Scoreboard. At the same time, foreign investment attraction activities aimed at the promotion of R&D, development of innovative products and their introduction in the most important sectors of the national economy will be strengthened.

It is important to emphasise the approach implemented by the Ministry of Economics, which results in identification on a national scale of value chains with high value added potential. By mobilising the leading representatives of national-level industries, the academic sector and related ministries and by ensuring their coordinated and strategic cooperation, integration of national-level value chains in global value chains is promoted. An integral part of the approach is its close link to the Smart Specialization Strategy, which allows to plan public investments, as well as develop knowledge-intensive products and services in the programming period 2021-2027.

One of the priorities of the Ministry of Economics is the improvement of the business environment. Targeted reforms and close cooperation with the business community has enabled Latvia to achieve high results – the World Bank's

Doing Business 2020 study places Latvia on the 19th place among 190 countries. Also, Latvia holds the 6th place among EU Member States.

On 22 May 2019, the Cabinet of Ministers approved the *Action Plan for Improvement of the Business Environment* drafted by the Ministry of Economics. The vision of the Plan is to create an excellent business environment and to move towards an innovative economic model. We have therefore defined five priority action lines for the further improvement of the business environment, such as strengthening the rule of law, developing customer-oriented public administration, digitisation of public services and industry (Industry 4.0), openness of the business environment, and increasing the competitiveness of the tax system.

In progress towards an excellent business environment Latvia has introduced the "Consult first" principle aiming to improve the mutual understanding between entrepreneurs and supervisory authorities, thus promoting the fulfilment of requirements rather than entailing punishment. A healthy and competitive business environment is based on fair businessmen, who want to observe the requirements of regulatory enactments and institutions based on understanding and cooperation, which are able to balance interests of society and business in their supervisory activities. The Ministry of Economics has intended to carry out an annual evaluation of the implementation of the "Consult first" principle in the work of institutions supervising the market and customer service, which will help to follow up the development of the principle. The Food and Veterinary Service was recognised as the leader of the "Consult first" initiative in 2018. At the same time, the State Revenue Service, the Consumer Rights Protection Centre, the Central Statistical Bureau and the State Plant Protection Service received the highest evaluation in five nominations. The State Agency of Medicines has been recognised as the leader of the initiative in 2019. The State Revenue Service, the Food and Veterinary Service, the Register of Enterprises, and the Central Statistical Bureau also obtained the highest assessment in different nominations.

Provision of a fair competitive environment is also considered to be an essential element in promoting competitiveness. A pressing topic in the competition policy is how to ensure equal and non-discriminating competition between public persons (for example, state or local government capital companies) and the private sector. To tackle with these challenges, "Amendments to the Competition Law" will enter into force on 1 January 2020, which enable the Competition Council to address distortions of competition by public persons more effectively.

Extensive work is ongoing in the construction sector to improve and simplify the construction process, aiming to ensure that the Construction Information System (CIS) supports a full electronic construction process. Since 1 October 2019, CIS provides not only submission and approval of the construction plan up to obtaining the building permit, but also the functionality for control of construction works and commissioning of buildings. An electronic construction process allows to track the stage of the concept, thus making the process transparent.

Companies in the construction sector make considerable investments to increase their productivity, strengthening of social guarantees of employees and promotion of social protection, as well as implementation of innovative technologies. A *General Agreement on minimum wage levels in construction related professions* entered into force on 3 November 2019, which provides for a considerable increase in minimum wages in the sector, envisaging the minimum gross wage of 780 euro in construction. In 2019, the Ministry of Economics together with the persons involved in the construction process developed a *Construction Information Modelling (CIM) Roadmap*, which is an important step towards raising productivity and competitiveness of companies in the construction sector, shortening the period of implementation of construction, and reducing lifecycle costs of buildings.

To simplify the acquisition of a home for young families, the total funding of the housing support programme has reached 23 million euro providing for issuing a guarantee of the first instalment for 92.5 million euro. Since the beginning of the programme in 2014, it has helped more than 12.5 thousand families with 18,350 children to get housing of appropriate size and quality.

In order to develop and introduce efficient support for housing availability in Latvia, a project "Availability of housing in Latvia" is worked out in cooperation with the Organisation for Economic Co-operation and Development (OECD), during which OECD will develop a project, within the scope of which it will define persons and households, which need support in ensuring availability of housing, as well as will develop proposals for an effective set of support tools to ensure housing availability in Latvia by taking over and adapting good foreign practices. At the same time, it is necessary to ensure a fair balance between interests of landlords and tenants, therefore a draft law "Law on Rental of Living Spaces" has been drafted, which will introduce an improved legal regulation for rent and will provide a quick and convenient dispute resolution procedure.

Considerable activities are implemented in the energy sector, which will allow to increase competitiveness of companies. It was decided to change the model of financing of mandatory procurement (MP), which will allow to reduce mandatory procurement component payments of producing companies.

On 14 November 2019, the Saeima adopted in the second reading the amendments drafted by the Ministry of Economics to several laws regulating the energy field, which provide that starting from 1 January 2020 energy policy implementation functions, including supervision of the MP mechanism, will be transferred to the State Construction Control Bureau (SCCB). Amendments to several regulations of the Cabinet of Ministers were drafted. *Amendments to the Electricity Market Law* intend to transfer to SCCB administration of supervision and control of stations of electricity mandatory procurement recipients, as well as introduce a fee for regulation of functioning of the energy sector state support system to cover administration of control of these stations. The work on improvement of the laws regulating the MP system will continue in 2020.

In addition to improvement of the legislative conditions of the energy market of Latvia, active work is carried out on the development of electricity infrastructure, to strengthen national energy security and diversification of routes and sources of energy. The project for synchronization of power grids of Baltic countries with the synchronous zone of Central Europe is particularly important to stop the dependence from Russian and Belorussian power supply systems and integrate the Baltic countries in the European Union electricity market. It is planned to implement this project by 2025.

The establishment of a single natural gas market on 1 January 2020 is considered to be an event unique for Europe and historical for the Latvian natural gas sector. This is the result of long-term cooperation that was rich in challenges among regulatory authorities, natural gas transmission system operators and ministries responsible for the sector of the Baltic countries and Finland. The initial participants of the single market area are Finland, Estonia and Latvia, but there are plans to develop the market providing benefits to all players, and also users, of this market, and other European Union Member State will be urged to join it.

At present, Latvia is drafting the National Energy and Climate Plan 2021-2030, which will set the main target for transition to low-carbon economy competitive in the region and globally, as well as will set main action policies and measures in all dimensions of the energy union, including to ensure the share of renewable energy sources and to improve energy efficiency, to reduce greenhouse gas (GHG) emissions and for energy security, as well as energy market.

To achieve the objectives set, the Ministry of Economics is actively creating a dialogue with entrepreneurs, non-governmental organisations, and other members of the community.

In this Report you will find information on the most important economic and social indicators of Latvia, development of industries and the external economic environment, the government's economic policy, and the main instruments of its implementation.

Not all the issues discussed in the Report were assessed by the Cabinet of Ministers, therefore, part of judgments on economic development of Latvia and suggestions for further action reflect only the opinion of the experts of the Ministry of Economics.

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



Ralfs Nemiro,
Minister of Economics

December 2019

CONTENTS

ABBREVIATIONS, MEASUREMENT UNITS, AND SYMBOLS	8
PART I. ECONOMIC DEVELOPMENT TRENDS	10
1. ECONOMIC DEVELOPMENT TRENDS: OVERVIEW	10
2. GLOBAL ECONOMIC DEVELOPMENT	13
3. GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND	16
3.1. DYNAMICS AND STRUCTURE	16
3.2. CONSUMPTION	17
3.3. INVESTMENT	20
3.4. EXPORTS AND IMPORTS	23
4. CONTRIBUTION OF SECTORS	30
4.1. DYNAMICS AND STRUCTURE	30
4.2. MANUFACTURING	32
4.3. OTHER INDUSTRIES	45
4.4. AGRICULTURE, FORESTRY AND FISHING	45
4.5. CONSTRUCTION	47
4.6. TRADE, ACCOMMODATION AND FOOD SERVICE ACTIVITIES	49
4.7. TRANSPORTATION AND STORAGE	50
4.8. BUSINESS SERVICES	52
4.9. PUBLIC SERVICES	53
5. ECONOMIC DEVELOPMENT FORECASTS	55
6. ECONOMIC STABILITY AND COMPETITIVENESS	58
6.1. PRICES	58
6.2. BALANCE OF PAYMENTS	65
6.3. FOREIGN DIRECT INVESTMENT	68
6.4. MONETARY INDICATORS	71
6.5. FISCAL POLICY AND PUBLIC DEBT	74
6.6. BUDGET REVENUE AND EXPENDITURE	76
6.7. PRODUCTIVITY AND COMPETITIVENESS	80
6.8. ALERT MECHANISM	85
6.9. LATVIA IN INTERNATIONAL RATINGS	88

7. LABOUR MARKET	93
7.1. EMPLOYMENT AND UNEMPLOYMENT	93
7.2. WAGES	96
7.3. LABOUR MARKET FORECASTS	98
7.4. EMPLOYMENT POLICY	100
 PART II. ECONOMIC POLICY PRIORITIES	 105
8. LATVIA'S INTEGRATION IN THE EU ECONOMIC AND STRUCTURAL POLICIES	105
8.1. EUROPEAN SEMESTER	105
8.2. USE OF EUROPEAN UNION STRUCTURAL FUNDS AND THE COHESION FUND	109
8.3. EU SINGLE MARKET	112
 9. IMPROVEMENT OF THE BUSINESS ENVIRONMENT	 115
 10. INNOVATION AND NEW TECHNOLOGIES	 120
 11. PROMOTING PRODUCTIVE INVESTMENTS AND EXPORTS	 124
11.1. PROMOTION OF ACCESS TO FINANCE	124
11.2. SUPPORTING ACCESS TO FOREIGN MARKETS	126
11.3. FOREIGN INVESTMENT ATTRACTION POLICY	127
 12. ENERGY POLICY	 129
12.1. ENERGY MARKET AND INFRASTRUCTURE	129
12.2. PROMOTING ENERGY EFFICIENCY	134
12.3. ENERGY FROM RENEWABLE SOURCES	136
12.4. REDUCING GREENHOUSE GAS EMISSIONS	137
 13. CONSTRUCTION POLICY	 140
 14. HOUSING POLICY	 144
 15. TOURISM POLICY	 147
 16. COMPETITION POLICY	 149
 17. CONSUMER RIGHTS PROTECTION AND MARKET SURVEILLANCE	 153

ABBREVIATIONS, MEASUREMENT UNITS AND SYMBOLS

Abbreviations

ALTUM	Joint Stock Company “Development Finance Institution Altum”	LGA	Latvian Guarantee Agency
BIF	Baltic Innovation Fund	LLC	Limited Liability Company
BIS	Building Information System	LNAB	Latvian National Accreditation Bureau
CC	Competition Council	LTDA	Latvian Tourism Development Agency
CF	Cohesion Fund	LV	Latvia’s Productivity, Effectiveness, Development and Competitiveness Forum
CIS	Commonwealth of Independent States	PEDCF	
CIT	Corporate income tax	LVS	Latvian Standard
CM	Cabinet of Ministers	MET	Microenterprise tax
CPCB	Corruption Prevention and Combating Bureau	MoA	Ministry of Agriculture
CPI	Consumer Price Index	MoE	Ministry of Economics
CRPC	Consumer Rights Protection Centre	MoEPRD	Ministry of Environmental Protection and Regional Development
CSB	Central Statistical Bureau	MoF	Ministry of Finance
EAGGF	European Agricultural Guidance and Guarantee Fund	MoH	Ministry of Health
EAPP	Expanded Asset Purchase Programme	MoJ	Ministry of Justice
EC	European Commission	MoT	Ministry of Transport
ECC	The European Consumer Centre of Latvia	MoW	Ministry of Welfare
EDEN	European Destinations of Excellence	MPC	Mandatory procurement component
EEA	European Economic Area	MSS	Meeting of the State Secretaries
EFSI	European Fund for Strategic Investments	MWh	Megawatt hour
ERDF	European Regional Development Fund	NDP2020	National Development Plan 2014–2020
ESF	European Social Fund	NPP	Nuclear Power Plant
EU	European Union	NRP	National Reform Programme
EU ETS	European Union Emissions Trading System	OECD	Organisation for Economic Co-operation and Development
EU-15	European Union Member States before the enlargement on May 1, 2004	OP	Operational Programme
EU-27	European Union Member States after the enlargement on January 1, 2007	PJ	Petajoule
EU-28	European Union Member States after the enlargement on July 1, 2013	PMB	Procurement Monitoring Bureau
Eurostat	Statistical Office of the European Union	PPS	Purchasing Power Standard
FCMC	Financial and Capital Market Commission	R&D	Research and Development
FDI	Foreign Direct Investment	RES	Renewable energy source
FIFG	Financial Instrument for Fisheries Guidance	RIS3	National/regional research and innovation strategies for smart specialisation
FTA	Free Trade Agreement	RTSD	Road Traffic Safety Directorate
GBSC	Global Business Services Centre	SCCB	State Construction Control Bureau
GDP	Gross Domestic Product	SEC	Sectoral Expert Council
GHG	Greenhouse gas emissions	SMM	Small and Medium-Sized Merchants
HGP	Heat-electric generating plant	SOLVIT	EU Internal Market Problem Solving System
HPP	Hydroelectric Power Plant	SRS	State Revenue Service
ICT	Information and Communication Technologies	STEM	Science, Technology, Engineering and Mathematics
LIAA	Investment and Development Agency of Latvia	TDI	Trade defence instruments
IMF	International Monetary Fund	TWh	Terawatt hour
JSC	Joint Stock Company	UGSF	Underground Gas Storage Facility
LCCI	Latvian Chamber of Commerce and Industry	ULC	Unit Labour Cost
		USA	The United States of America
		WTO	World Trade Organization

Country Abbreviations

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

PART I. ECONOMIC DEVELOPMENT TRENDS

1. ECONOMIC DEVELOPMENT TRENDS: OVERVIEW

Stable economic growth in Latvia continues with its rates exceeding the EU average. From 2011 to 2018, GDP grew by 3.5% per year on average.

In 2017-2018, growth rates accelerated. GDP grew by 3.8% and 4.6%, respectively. The acceleration of growth was fostered by the improvement of the situation in the external environment, more intensive absorption of EU Structural Funds and increase in employment and wages.

In 2019, growth of the economy has become more moderate. GDP has grown by 2.5% in the 3 quarters of the year. The deceleration of growth rates was underpinned by both internal factors (the investments from EU funds have

reached their maximum, developments in the financial sector, etc.) and external factors (revision of global trade relations, Brexit, slower growth in EU countries). It may be expected that the above-mentioned global factors will affect Latvian growth also at the end of 2019 and in 2020 having negative impact on the Latvian export capacity. Positive trends in domestic demand oriented industries are also expected to continue.

The Ministry of Economics forecasts that, **in total, GDP growth rate might reach 2.5 per cent in 2019.**

Table 1.1

Latvia: Key Figures of Economic Development								
	2013	2014	2015	2016	2017	2018	2019f	2020f
Gross domestic product (at current prices, billion euro)	22.8	23.7	24.4	25.1	26.8	29.2	30.7	32.3
<i>changes, %</i>								
Gross domestic product	2.3	1.9	3.3	1.8	3.8	4.6	2.5	2.5
Private consumption	5.7	1.1	2.5	1.5	3.1	4.2	3.8	3.1
Public consumption	1.2	2.1	3.0	2.9	3.2	4.0	2.8	2.7
Gross fixed capital formation	-5.9	-0.3	-1.2	-8.2	11.3	15.8	4.7	2.5
Export	1.1	6.5	2.9	4.0	6.4	4.0	2.4	1.8
Import	0.4	3.0	1.7	3.8	8.4	6.4	2.5	3.0
Consumption prices	0.0	0.6	0.2	0.1	2.9	2.5	2.8	2.0
<i>as a percentage in relation to the GDP, unless indicated otherwise</i>								
General government sector balance	-1.2	-1.4	-1.4	0.1	-0.5	-0.7	-0.5	-0.3
General government debt	39.4	40.9	36.7	40.3	38.6	36.4	36.6	37.0
Export-import balance	-3.5	-2.0	-0.9	1.0	0.2	-0.2	-0.2	-1.5
Changes in the number of the employed (15-74 years of age, % compared to the previous year)	2.1	-1.0*	1.3	-0.3	0.2	1.6	0.0	-0.2
Employment rate	58.2	59.1	60.8	61.6	62.9	64.5	65.0	65.3
Unemployment rate (unemployed, % of the economically active population, 15-74 years of age)	11.9	10.8	9.9	9.6	8.7	7.4	6.3	6.0
Changes in the average gross monthly wage, %	4.6	6.8	6.8	5.0	7.9	8.4	7.5	6.5
f – forecast								
* As of 2014, changes have been made to the labour force survey methodology. The quarterly average number of people living in private households (previously – population at the beginning of the year) is used to generalize the quarterly data								

The increase in investments has made a considerable contribution to growth, which increased by 11.3% in 2017 and by 15.8% in 2018. The rate of investments reduced in 2019 having reached its maximum within the scope of the

existing programming period of investments from EU funds. In three quarters of 2019, they increased by 4.8 per cent.

Foreign direct investment flows to Latvia also increased. According to the balance of international investment, the

amount of FDI accrued in the economy of Latvia at the end of September 2019 reached 15.7 billion euro (51.8% of GDP). They increased by 5.6% during the year mainly due to extensive investment of Estonian and German businesses in the Latvian national economy.

Consumption is one of drivers of growth. As employment and wages were growing, private consumption grew by 4.2% in 2018. This has been the fastest increase since 2014. Private consumption growth rates (3.5%) remained comparatively rapid also in the three quarters of 2019. In 2018, public consumption increased by 4%, while in the three quarters of 2019 – by 2.6 per cent.

Export of goods and services also continues to grow. However, growth rates slowed down. Exports grew by 4% in 2018 and by 2.3% in the 3 quarters of 2019. In January-October 2019, the increase in export of goods was considerably affected by the increase in exports of agriculture and food, as well as chemical industry products. Volumes of the largest group of export of goods, wood and wood products, were similar to those of the previous year. At the same time, the development of exports in this period was negatively affected by the drop in exports of machinery and appliances.

Exports of services increased by 3.3% in the 3 quarters of 2019, which was mainly secured by income from export of road transport, information and communication and other business services.

The deficit of the current account of the balance of payments has been low since 2011, which gives proof of the external balance of the Latvian economy. The current account has a small deficit of 0.7% of GDP in 2018, but the deficit was 0.6% of GDP in the 3 quarters of 2019. Current account is expected to be with a small deficit also in the coming years without jeopardising the external balance of the Latvian economy.

In terms of sectors, the construction industry, information and communication services, the transportation and storage industry, as well as trade and other business services industries made the most significant contribution to economic growth in 2018. In the 3 quarters of 2019 the most rapid increase was in agriculture, forestry and fishery, accommodation and food service activities, as well as several domestic demand oriented services.

The increase in competitiveness of businesses and the demand dynamics in the largest export markets has promoted growth in manufacturing. Manufacturing volumes were growing particularly rapidly in 2017 (by 6.9%). More moderate growth in 2018 and in the 3 quarters of 2019 was observed in manufacturing. In the first ten months of 2019, its production volumes increased by 3% compared to the corresponding period of the previous year. Increase in volumes of metalworking and manufacture of electrical and optical equipment made a considerable contribution to total growth of manufacturing. Production volumes in paper industry and publishing, chemical industry, manufacture of machinery and appliances, as well as woodworking have also grown in this period. The second largest manufacturing

sector, manufacture of food products, had a reduction in production volumes.

Distinct macroeconomic imbalances of the “fat” years have been eliminated and risks of economic vulnerability due to internal and external shocks have been reduced in the Latvian economy. Public debt is small, budget is close to balance, balance of payments is balanced. Although inflation is growing, it is affected by supply-side factors.

The average annual inflation was 2.5% in 2018, and 2.8% – in November 2019. The increase in prices of services had a considerable effect on the level of consumer prices. In total, the annual inflation may reach 2.8% in 2019. In 2020, average annual inflation might be slightly lower than that observed in 2019, which will mainly be underpinned by moderate development of global economy, fluctuations in global oil and food prices. At the same time, inflation in Latvia will still be affected by different supply-side factors, as well as the demand side promoted by increase in wages.

Since 2011, Latvia has returned to growth, and significant improvements have been achieved in its fiscal position. Budget has been with a small deficit in recent years. In 2018, budget had a deficit of 0.7% of GDP. The Saeima adopted the state budget with a deficit of 0.5% of GDP for 2019. In 2019, the fiscal security reserve of 0.1 % of GDP is anticipated.

The general government budget deficit of 2020 is planned in the amount of 0.3% of GDP. The medium-term budget framework provides that the permissible general government budget deficit is 0.2% of GDP in 2021, but a surplus of 0.1% of GDP is expected in 2022.

After the financial market turmoil at the end of 2008 and the beginning of 2009 monetary indicators of Latvia are gradually stabilising – quality of the credit portfolio is improving and the banking sector is generally working with profit. Considerable measures to strengthen the capital of credit institutions have been taken. However, crediting is weak although residents' deposits are growing. Banks are still cautious in the implementation of more active crediting, and, on the other hand, businesses are also cautious in the implementation of new credit liabilities. Considerable changes are ongoing in the banking system in relation to service of deposits of risky non-resident customers.

Increasing economic activity has a positive impact on the labour market situation – high unemployment rate caused by the crisis is falling, and the employment rate is rising.

The employed population increased by 1.6% or 15 thousand in 2018 mainly due to the increase in labour demand in construction and trade. In the 3 quarters of 2019, the number of the employed remained at the level of the corresponding period of the previous year, which can be explained by deceleration of economy rates. The increase in the number of the employed is also affected by demographic trends, because the population capable of working is shrinking.

The employment rate continues to increase. It reached 64.5% of the population aged 15-74 in 2018, which was by 1.6 percentage points more than in 2017. Similar trends in

economic activity of the population were observed also in the 3 quarters of 2019. Taking into account negative demographic trends, the involvement of different economically inactive population groups into the labour market will become increasingly more important in retaining labour supply at the current level.

The unemployment rate fell to 7.4% in 2018 thus rapidly reaching historically lowest unemployment rates of 2006/2007. In 2019, they continue to decline as well. The unemployment rate was 6% in October (to compare: 6.8% in October 2018). A more rapid decline in unemployment is delayed by large share of long-term job seekers accounting for more than 1/4 of the total number of unemployed. A more rapid decline in unemployment is also delayed by regional differences – the unemployment rate in the Riga Region twice lower than in the Latgale Region, which, in the context of low geographic mobility of labour force, increases the risks of structural unemployment.

With the economic situation becoming more stable, wage growth has resumed since the end of 2010. The increase in wages has been remained above 5% per year in the last four years. The average gross wage grew by 8.4% in 2018. The average gross wage grew by 8.3 % in Q3 2019 compared to Q3 2018, reaching 1,091 euro for full-time work.

Strong pressure from the demand side on the labour market is expected to continue further. At the same time, the labour

market will continue to be affected by negative demographic trends and regional labour market differences.

Further economic development depends on the situation in the external environment and progress in reforms. Further development of Latvia's economy will be still closely linked to export possibilities. Therefore the highest risk to the growth of Latvia is linked to global economic development. Further development of the EU's common economic space is particularly important. In the medium term, economic advantages of Latvia are mainly based on the achieved macroeconomic stability, as a result of which Latvia's credit ratings have improved, as well as on the efficiency of planned aid programmes of the EU structural funds and on the improvements in the business environment.

The scenario of a more rapid growth provides for continuation of growth in the main export markets of Latvia, and the benefits of the Latvian economic competitiveness are mainly based on technological factors, improvement of production efficiency, and innovation, to a lesser extent on cheap labour and low resource prices. In the medium term, growth rates of Latvia could reach an increase of 4% a year. By contrast, in the scenario of a weaker growth, with weak growth resuming in Europe and the geopolitical situation not improving, the economic growth rate of Latvia could be much slower.

2. GLOBAL ECONOMIC DEVELOPMENT

Global economic growth has considerably slowed down in 2019. International trade of goods has been weak, the previously identified risks (incl. growing trade tensions, geopolitical conflicts, lack of certainty about *Brexit*) have not reduced. The majority of indicators evidence that inert global growth will persist also in 2020.

In 2018, the real GDP in the **United States** (US) reached 2.9%. However, in 2019¹, the economic growth slowed down and GDP increase slid down to 2.3%. The US economy is projected to continue slowing down, because constant economic tensions with China and increase political uncertainty will affect prospects of private investments. At the same time, less strict monetary policy will reduce economic downturn, while the effects of previously implemented fiscal stimuli will reduce.

Economic development of **Asian** countries is mainly determined by the largest economies of the region – China, Japan and India. Asia is still the fastest growing region in the world, however, its economic growth is expected to slow down in the coming years.

Chinese economy grew very rapidly in 2018 with real GDP increasing by 6.6%. However, growth rates reduced to 6.1% in 2019. Growth is expected to continue to slow down in 2020, but will still remain at rather high level with real GDP

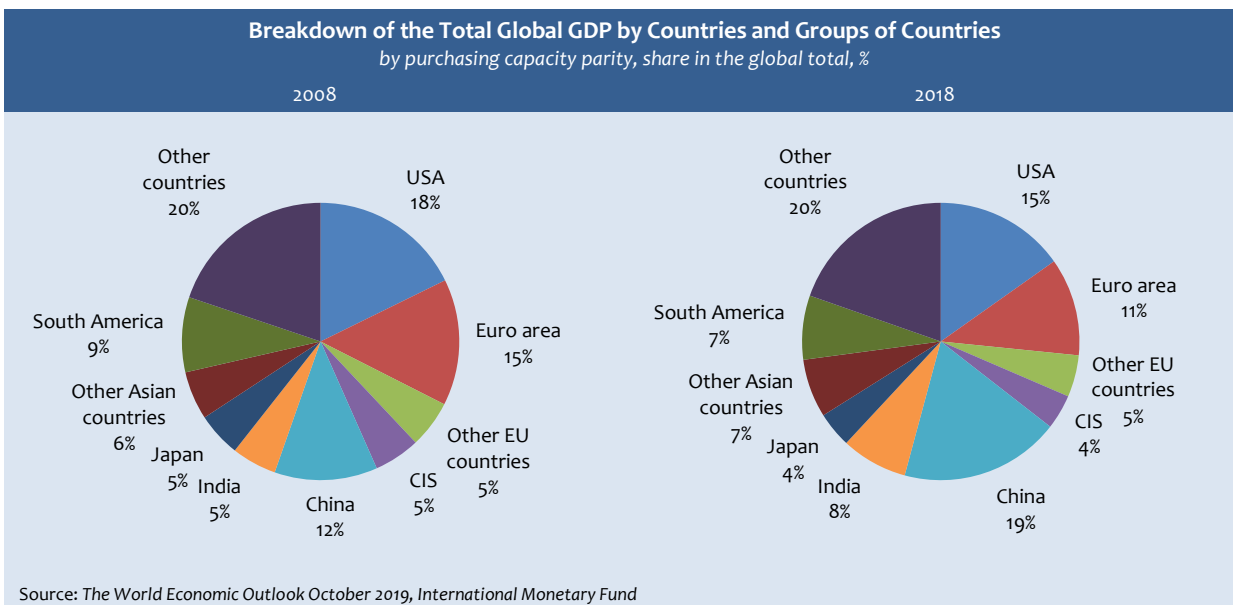
increasing by 5.8%. The decline in growth rates will be largely underpinned by the economic tensions with the United States, increased uncertainty in the external environment and different structural factors. The monetary policy is expected to reduce economic downturn, but will be unable to compensate it fully.

Table 2.1

GDP Growth Rate changes compared to the previous year, %					
	2016	2017	2018	2019f	2020f
World including:	3.2	3.7	3.6	2.9	3.0
USA	1.6	2.4	2.9	2.3	1.8
Japan	0.6	1.9	0.8	0.9	0.4
EU including:	2.0	2.6	2.0	1.4	1.4
Euro area	1.9	2.5	1.9	1.1	1.2
Russia	0.3	1.6	2.3	1.0	1.4
China	6.3	6.8	6.6	6.1	5.8

Source: European Commission – European Economic Forecast, Autumn 2019
f – forecast

Figure 2.1



In 2018 and 2019, **Japanese** economy grew by 0.8% and 0.9%, respectively. Economic growth in 2020 is expected to slow down and real GDP will grow by 0.4%. Slower growth

in 2020 will be affected by the increase in consumer taxes and weaker external demand. A stimulating fiscal and monetary policy will reduce growth downturn, while more

¹ Here and below this chapter provides information about 2019 in general – an estimate.

rapid economic recovery is expected only after 2021, because Japan is still very poorly protected from global and regional trade tensions.

Despite the economic slowdown and the long-term effects of the demonetisation observed in 2017, economic growth of **India** is still largely positive. GDP is mainly fostered by strong private consumption and public investments, as well as ongoing structural reforms.

Table 2.2

Main Macroeconomic Indicators of the EU Member States									
percentage									
	Real GDP			Inflation			Unemployment rate		
	2018	2019f	2020f	2018	2019f	2020f	2018	2019f	2020f
European Union	2.0	1.4	1.4	1.9	1.5	1.5	6.8	6.3	6.2
United Kingdom	1.4	1.3	1.4	2.5	1.8	2.0	4.0	3.8	4.0
Austria	2.4	1.5	1.4	2.1	1.5	1.6	4.9	4.6	4.6
Belgium	1.5	1.1	1.0	2.3	1.3	1.4	6.0	5.5	5.4
Bulgaria	3.1	3.6	3.0	2.6	2.4	1.6	5.2	4.4	4.1
Czech Republic	3.0	2.5	2.2	2.0	2.6	2.3	2.2	2.1	2.2
Denmark	1.5	2.0	1.5	0.7	0.8	1.3	5.1	4.9	4.8
France	1.7	1.3	1.3	2.1	1.3	1.3	9.1	8.5	8.2
Greece	1.9	1.8	2.3	0.8	0.5	0.6	19.3	17.3	15.4
Croatia	2.6	2.9	2.6	1.6	0.9	1.4	8.4	6.9	5.8
Estonia	4.8	3.2	2.1	3.4	2.4	2.1	5.4	5.1	5.4
Italy	0.8	0.1	0.4	1.2	0.6	0.8	10.6	10.0	10.0
Ireland	8.2	5.6	3.5	0.7	0.8	1.1	5.8	5.2	5.0
Cyprus	4.1	2.9	2.6	0.8	0.6	0.7	8.4	7.2	6.3
Latvia	4.6	2.5	2.6	2.6	3.1	2.5	7.4	6.6	6.4
Lithuania	3.6	3.8	2.4	2.5	2.4	2.2	6.2	6.2	6.2
Luxembourg	3.1	2.6	2.6	2.0	1.7	1.6	5.5	5.3	5.3
Malta	6.8	5.0	4.2	1.7	1.6	1.7	3.7	3.6	3.5
Netherlands	2.6	1.7	1.3	1.6	2.6	1.4	3.8	3.5	3.7
Poland	5.1	4.1	3.3	1.2	2.2	2.6	3.9	3.5	3.6
Portugal	2.4	2.0	1.7	1.2	0.3	1.1	7.0	6.3	5.9
Romania	4.0	4.1	3.6	4.1	3.9	3.5	4.2	3.9	4.2
Slovakia	4.0	2.7	2.6	2.5	2.7	2.5	6.5	5.8	5.7
Slovenia	4.1	2.6	2.7	1.9	1.8	1.9	5.1	4.4	4.2
Finland	1.7	1.4	1.1	1.2	1.2	1.4	7.4	6.7	6.5
Spain	2.4	1.9	1.5	1.7	0.9	1.1	15.3	13.9	13.3
Hungary	5.1	4.6	2.8	2.9	3.4	3.1	3.7	3.4	3.4
Germany	1.5	0.4	1.0	1.9	1.3	1.2	3.4	3.2	3.4
Sweden	2.3	1.1	1.0	2.0	1.7	1.5	6.3	6.8	7.1

Source: European Commission – European Economic Forecast, Autumn 2019
f – forecast

Economic growth in the **European Union** (EU) reached 1.4% in 2019. Real GDP growth is expected to remain unchanged at the level of 1.4% in 2020.

Domestic demand was the main growth driver in the EU in 2019. Taking into account growing trade tensions, stagnation in international trade and increase in global growth, the external environment has become less favourable than in the previous years. Moreover, tariff threats, growing geopolitical tension, lack of clarity about

Brexit and several structural factors will create a long period of high uncertainty, which will delay economic growth.

Moderate growth is expected in the **German** economy after it sunk into technical recession in the first half of 2019. In 2019, the real GDP increase in Germany reached 0.4%. Real GDP is expected to increase by 1% in 2020. External demand is expected to be weaker. Domestic demand will also be reduced by low level of investments. Moreover, the favourable situation in the labour market will continue to

promote private consumption, although to a smaller extent than in the previous years. The current account surplus and domestic investments will remain high. Fiscal policy is expected to be moderately expansive in the coming years.

Swedish economy is clearly slowing down. In 2019, the real GDP reached 1.1%. Economic growth rates are expected to reduce to 1% in 2020. Domestic demand and investments are weak, however, stable growth of exports is observed. Net exports are expected to become the main driver of growth in the coming years. The unemployment rate is expected to exceed 7% and inflation will remain below 2%. The moderately expansive fiscal policy in 2020 and slower growth will reduce budget surplus. The state debt to GDP will also keep reducing.

Real GDP of the **United Kingdom** is expected to increase stably, yet at a more moderate rate. Private consumption will continue to be stimulated by the increase in real wage, but lack of certainty about further trade relations of the United Kingdom with the EU means that investments in business will most probably remain at weak level. Net trade is expected to continue to hinder economic growth as external demand reduces. Employment growth rates will drop, however unemployment rate will remain low. It is also forecast that inflation will gradually grow in the coming years.

Economic growth rates in **CIS** countries have accelerated in recent years, which was largely underpinned by the economic recovery after recession in the previous years. Improved trade terms, favourable external environment, less volatile macroeconomic conditions, lower inflation, stable currency exchange rates and growing oil prices have created a favourable environment for regional development.

However, most CIS countries showed a comparatively small increase in 2019. Both cyclic and structural factors restrict short-term and long-term economic prospects. Economic

activity in **Russia** slowed down in 2019. Growth is delayed by the increase in VAT rates, growing uncertainty in the external environment and reduction of global demand.

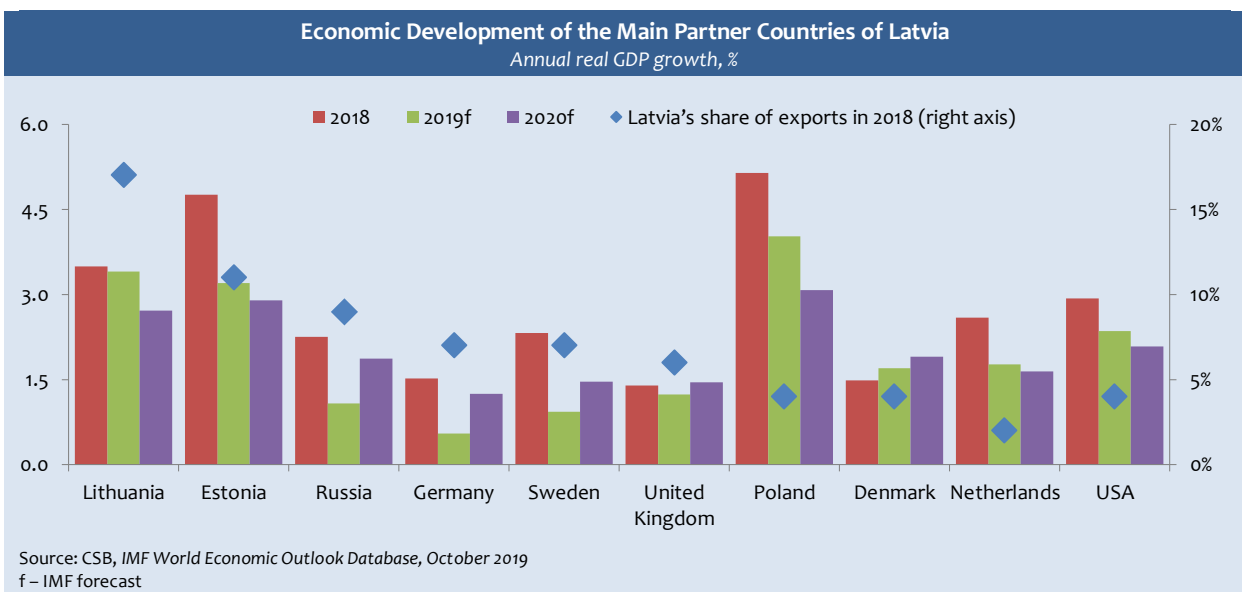
The unresolved conflict in the east of **Ukraine** has a negative effect on economy of this country, because lost control over resources has considerably reduced exports and competitiveness of Ukraine. To be noted, **Belarus** and **Azerbaijan** have overcome their economic downturn. However, their economic recovery has become more moderate reflecting worsening of the situation in the external environment.

Growth rates in the **Baltic countries** have been comparatively strong in 2019 mainly due to strong domestic demand and stable external environment.

The **Lithuanian** economy grew by 3.8% in 2019. Although strong domestic demand and stable exports will persist, real GDP is expected to reach only 2.4% in 2020. In 2019, inflation growth rates reached 2.4%. Inflation is expected to slightly reduce in the coming years. After a considerable increase in 2019, employment is expected to grow also in 2020. The increase has mainly been fostered by historically high immigration.

Strong private investments and flexible labour supply in **Estonia** have promoted growth in 2019. Real GDP of Estonia grew by 3.2% in 2019. The increase in growth rates in the first half of 2019 was secured by private investments. Domestic demand is expected to remain the main growth driver due to the increase in income of the population. However, growth is expected to slow down in 2020 due to cyclic factors and restructuring of the energy generation sector.

Figure 2.2



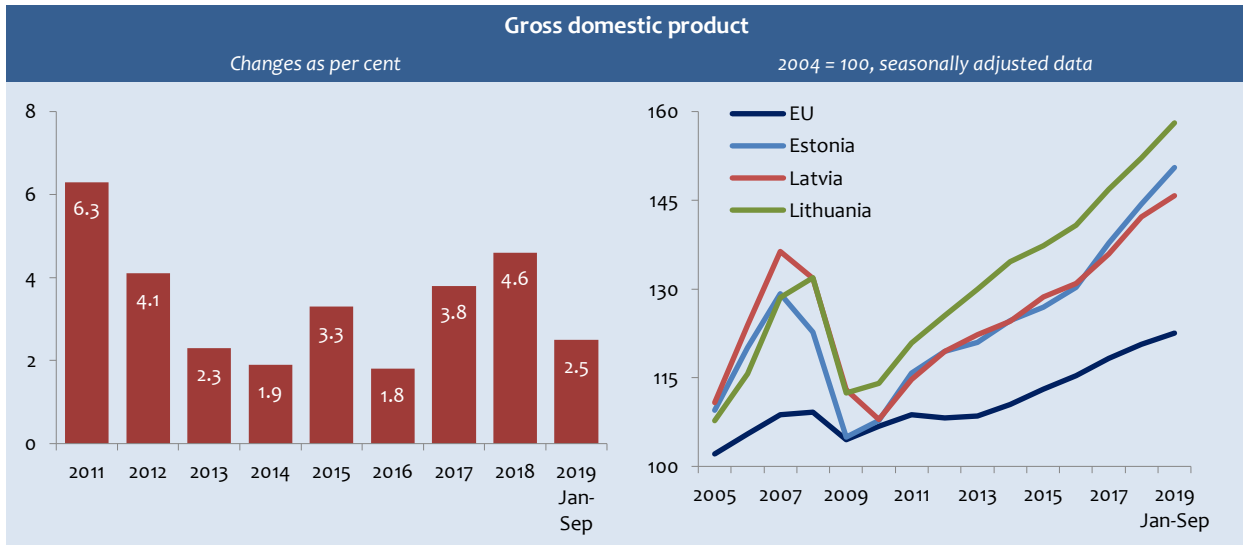
3. GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND

3.1. DYNAMICS AND STRUCTURE

Since 2011, economic growth has been one of the most rapid in the EU. In 2011-2012 it reached 5.2% per year on average. During the first years after the crisis, Latvia's economic growth was largely based on an increase in export volumes. In 2010-2012, the share of exports increased by

7 percentage points of GDP – from 54% to 61%. From 2013 to 2016, economic growth was slower due to different factors. Overall, GDP was growing by 2.3% per year on average during this period.

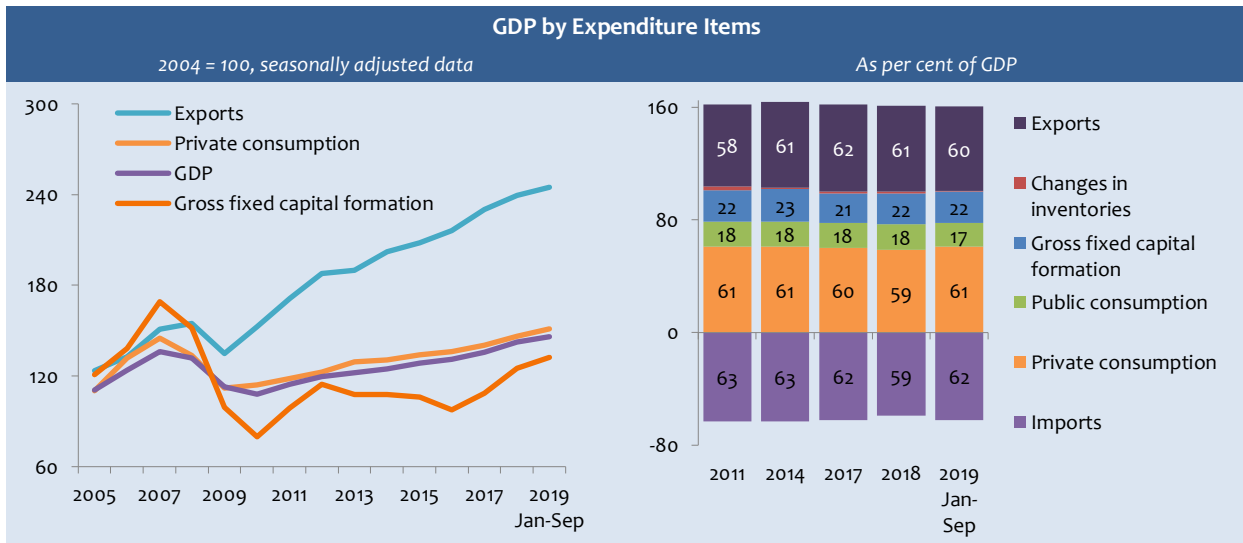
Figure 3.1



In 2013-2014, the slower economic growth rates were influenced by trends in the external environment – growth in the EU that was slower than previously expected, as well as weakening of the economic situation in Russia. Even though the geopolitical situation in the region was tense, the

Latvian economy continued to grow in 2015. Growth was comparatively weak in 2016 due to the drop in investments and delayed implementation of the new programme of the structural funds.

Figure 3.2



In 2017-2018, was experienced the fastest growth over the last five years. It reached 4.2% per year on average. The acceleration of growth was fostered by the improvement of the situation in the EU, the commencement of a new programme of the structural funds, increase in wages and employment. In this period, export, investments, private and public consumption were growing stably.

In 2019, growth of the economy has become more moderate. GDP has grown by 2.5% in the three quarters of the year. The deceleration of growth rates was underpinned by both internal factors (the investments from EU funds have reached their maximum, developments in the financial sector, etc.) and external factors (review of global trade relations, *Brexit*, slower growth in EU countries).

In three quarters of 2019, a moderate increase in exports was observed. Exports of services have increased more rapidly. Private consumption is still growing stably promoted by the situation in the labour market and the stable increase in wages. Public consumption was also growing slower than in the previous years.

In 2011-2018, growth in all the three Baltic countries was similar. It grew slightly faster in Estonia and Lithuania – by 3.7% per year on average and by 3.5 per cent in Latvia.

Figure 3.3

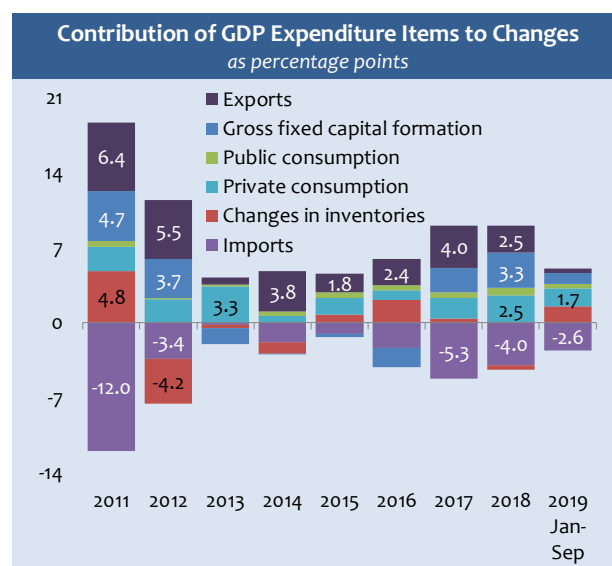


Table 3.1

GDP by Expenditure Items compared to the previous year, changes as per cent									
	2011	2012	2013	2014	2015	2016	2017	2018	2019 Jan-Sep
Gross domestic product	6.3	4.1	2.3	1.9	3.3	1.8	3.8	4.6	2.5
Private consumption	3.7	3.7	5.6	1.1	2.5	1.5	3.1	4.2	3.5
Public consumption	2.7	0.4	1.2	2.1	3.0	2.9	3.2	4.0	2.6
Gross fixed capital formation	23.8	16.1	-5.9	-0.3	-1.2	-8.2	11.3	15.8	4.8
Exports	12.0	9.8	1.1	6.5	2.9	4.0	6.4	4.0	2.3
Imports	22.0	5.4	0.4	3.0	1.7	3.8	8.4	6.4	2.9

3.2. CONSUMPTION

From 2011 to 2013, private consumption increased by 4.3% per year on average. Despite the improvement of the situation in the labour market and low inflation, volumes of private consumption similarly to economic growth were more moderate in 2014-2016. The increase in private consumption was only 1.7% per year during this period. The increase was fostered by growth in wages, while the rise in employment was slow.

In 2017-2018, private consumption similarly to total economic growth grew faster – by 3.7% per year on average secured by an increase in employment and a considerable increase in wages.

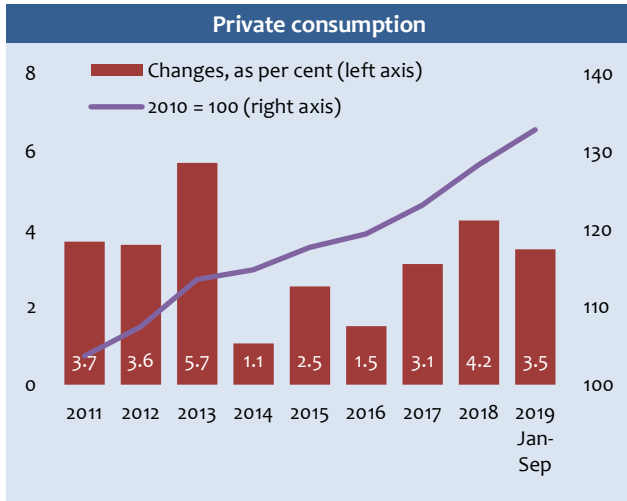
In the 3 quarters of 2019, private consumption has continued to grow, however, despite the increase in wages

and the favourable situation in the labour market, the rate of increase was more moderate.

Since 2011, Latvia has been having the slowest increase in private consumption in comparison with other Baltic countries.

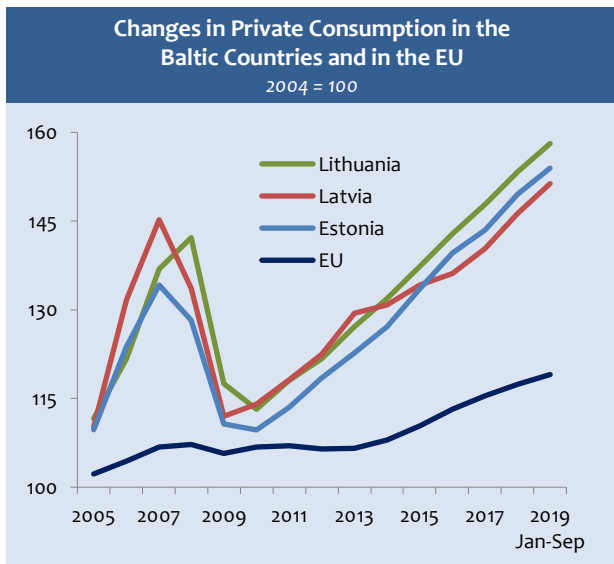
In the structure of household consumption, most of expenditure are for food, expenditure for housing are the second largest group, while transport is the third priority in household expenditures. The share of expenditure for food, housing, communications and education in the structure of household consumption expenditures has been dropping since 2010, while the share of expenditure for transport, recreation and culture, restaurants, cafes and hotels, as well as health and home improvement has been growing.

Figure 3.4



To be noted, in 2018, household expenditure were the highest in monetary terms in the last 10 years. In 2018, in comparison with the previous year, expenditure for the purchase of food increased by 6%. The amount of expenditure for housing and utility services slightly increased – by 2%. Expenditure for transport have increased as well – by 4%. This was mainly due to the increase in expenditure for operation of personal vehicles and purchasing of cars. The fastest increase was in expenditure for recreation and culture – by 12%, which form the fourth largest group of expenditure.

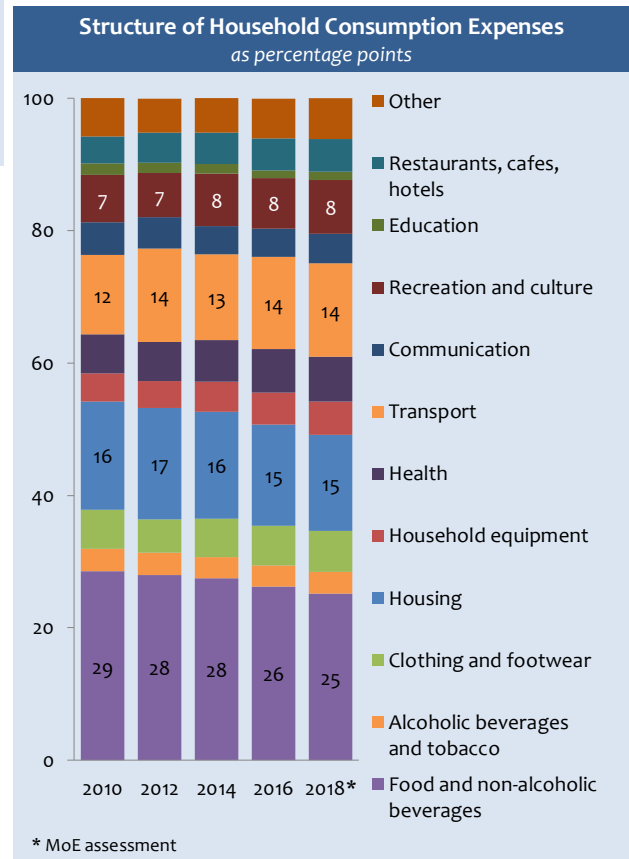
Figure 3.5



In 2018, compared to 2010, household consumption expenses increases in all groups of household expenses with the exception of education. Expenses on transport and food made the largest contribution into the increase of consumption expenses.

Since 2010, consumer confidence has generally improved although it has been volatile, but it is still negative. The most optimistic level was reached in January 2018, when the indicator reached -1 points, the highest level in the last 10 years. Such an improvement in consumer confidence has been largely fostered by rapid economic growth in recent years. However, although the confidence has been generally improving, it lagged behind the average level in the European Union. It has finally exceeded the EU average only since December 2018 as consumer confidence have improved.

Figure 3.6



The consumers' assessment of the financial situation of their families has largely stabilised since 2012, and tends to improve, with the exception of small drops in the middle of 2013 and at the beginning of 2017. Optimism has been generally growing since the middle of 2017.

A growing trend in consumers' assessment of the overall situation in the country has been similar to the assessment of the financial situation of their families since 2010. A rapid increase has been observed until 2012, and in 2012 consumer confidence stabilised at the same time sticking to the ascending trend. Since the rapid drop at the beginning of 2017 the assessment has improved, however, its increase is no longer rapid and is still negative.

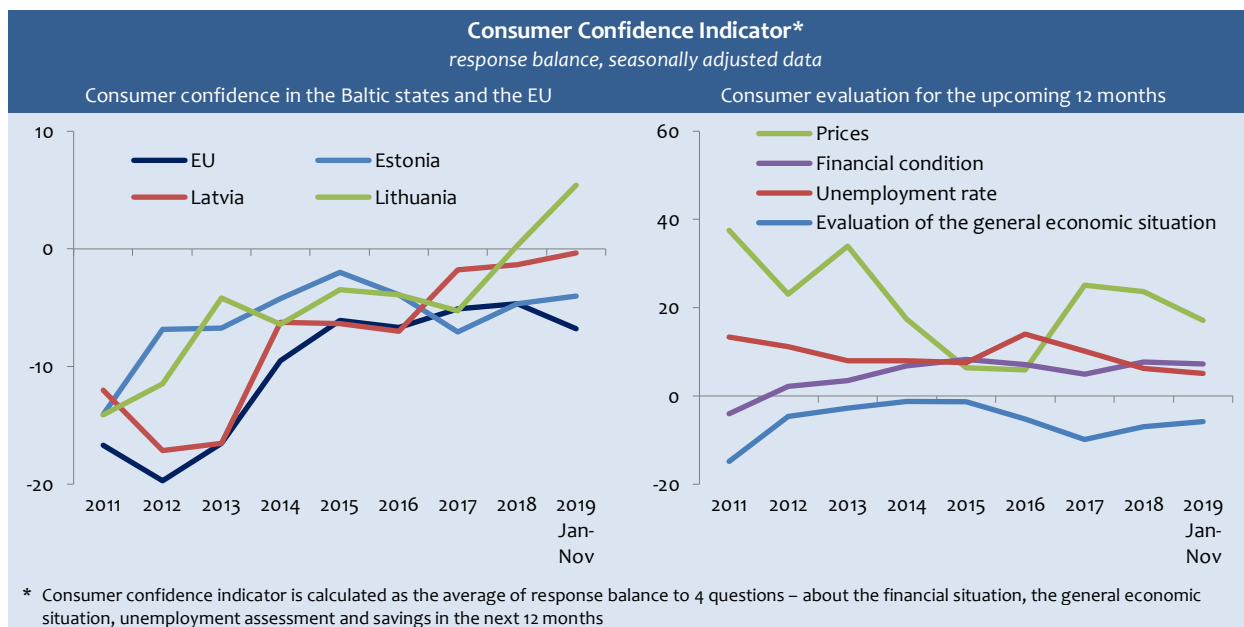
The consumers' assessment of the financial situation of their families largely depends on growth of the state, therefore, it is natural that as the economic situation in the country

improves, the consumers' assessment of the overall situation in the country and also of the financial situation of their families improve.

Unemployment expectations of consumers have been generally falling since 2010 generally sticking to a

descending trend regardless of fluctuations. However, since 2016 the expectations resumed growth reaching the highest rise (24.3 points) at the end of 2016. Since the middle of 2017, unemployment expectations have been generally declining, which is largely related also to the overall decline in the unemployment rate and an increase in employment.

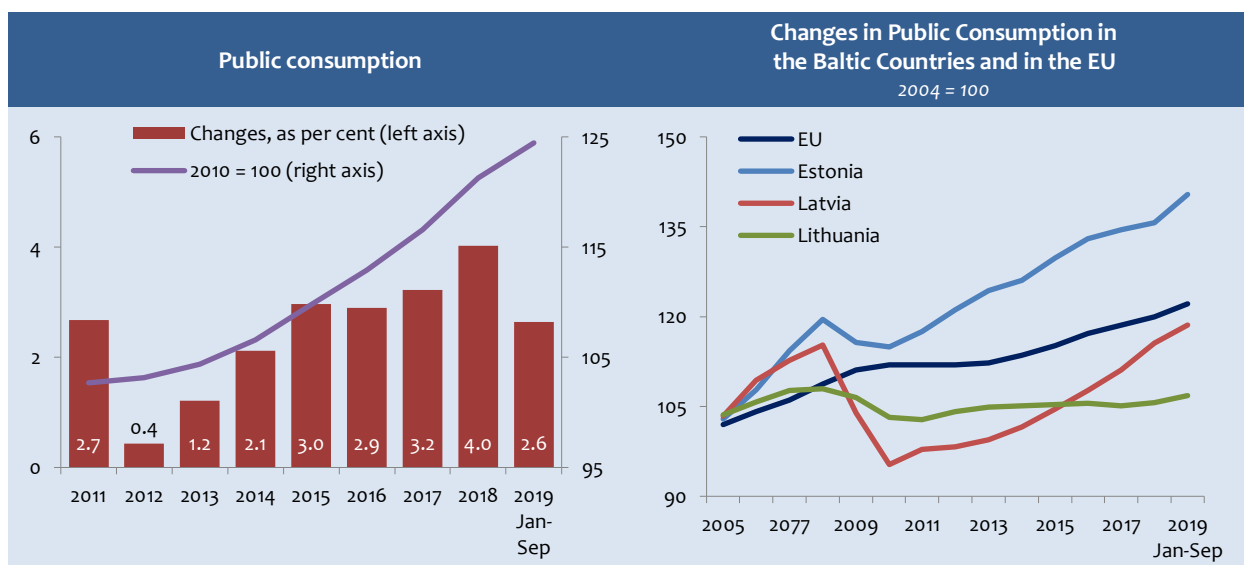
Figure 3.7



Consumers' inflation expectations had been growing rapidly until April 2011. Since the middle of 2011, inflation expectations have been very cyclical – in this way consumers responded to different changes, however, they have been generally declining. Since the middle of 2013 the drop has been very rapid reaching the level of -2 points in September

2016, the lowest since 2011. At the end of 2016, inflation expectations resumed growth until the middle of 2017. Since the end of 2017, inflation expectations have reduced largely under the influence of a slower rise in prices and high inflation in the previous years.

Figure 3.8



The increase in **public consumption** or the volumes of public services after the crisis was slow. The government’s commitment to continue reducing the national budget deficit in 2012 and 2013 held back a rapid increase in expenditure. As budget income was growing, public consumption has been growing more rapidly since 2014. Overall, from 2011 to 2018, public consumption was growing by 2.4 per cent per year on average.

In 2018, the fastest increase since 2006 was observed. It continues to increase also in 2019, although its growth rates are more moderate. Budget expenditure has been growing

rapidly in recent years to increase public defence capacity and ensure public defence funding to 2% of GDP. To promote sustainable and balanced country’s economic development, deferred corporate income tax for enterprise profits was introduced, the tax burden of the labour force was reduced and an increase of funding for defence, health, demography and road maintenance was primarily ensured within the scope of the State budget possibilities.

Since 2011, Latvia has been having the most rapid increase in public consumption in comparison with other Baltic countries.

3.3. INVESTMENT

Investments in the Latvian economy continue to grow, but their rates are becoming more moderate. The weak investment period has been overcome since 2017. Expenditure for gross fixed capital formation in 2017 and 2018 increased by 11.3% and 15.8%, respectively, which was much faster than in most of the EU Member States. The increase in investments in recent years was mainly driven by large investment volumes in construction assets. In the nine months of this year, investments in the Latvian national economy were by 4.8% higher than a year ago.

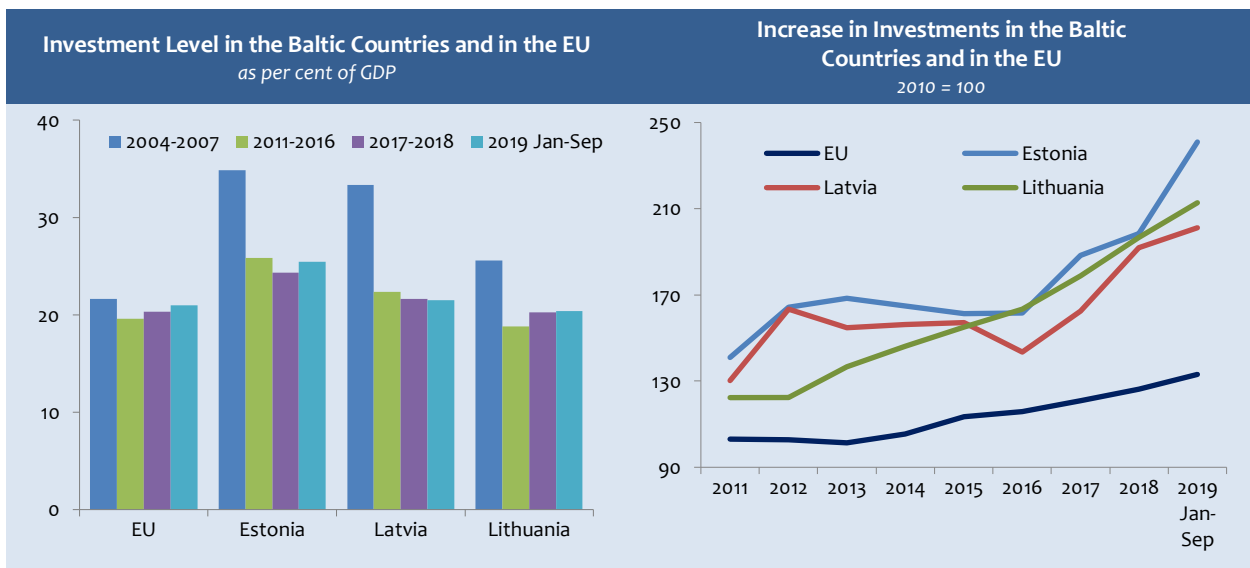
The recovery of investments after the crisis is comparatively slow. Its annual growth rates have been generally more moderate than before the crisis since 2010, when expenditure for gross fixed capital formation reached historically the lowest level – 19.7% of GDP. From 2011 to 2018 investments increased by 6.4% per year on average and amounted to 22% of GDP. Moreover, the investment

dynamics were unstable: showing a rapid increase in 2011-2012 and a long weak investment period in 2013-2016. Overall, from 2011 to 2016, investments were growing by 3.4% per year considerably lagging the historical (1995-2004)¹ average growth rates (18.3%). Volatility of investments was largely affected by the cyclic nature of acquisition of the EU structural funds.

Since 2017, investments in fixed capital formation have been increasing more rapidly – by 13.6% per year on average. Along with more rapid investment dynamics the investment level has increased as well reaching 22.5% of GDP in 2018. Investments continue to grow also in 2019, although their dynamics are more moderate.

Despite the increase of the last years, the level of investments is still considerably lower than in the years of rapid growth (2005-2007).

Figure 3.9



¹ The period from 1995 to 2004 may be considered a long-term trend indicator, which excludes any rapid increase in the amount of investments in the years of economic boom and its later drop in the years of recession.

The funding for investments was mainly provided from own funds of businesses and EU structural funds, while crediting has remained low for a long time. Despite comparatively low costs and growing demand, the credit-to-GDP ratio continues to shrink. In accordance with the data of the Bank of Latvia, the balance of credits issued to non-financial companies and households reduced to 40.2% of GDP at the end of 2018, which is a considerably lower level than before the crisis.

In weak crediting conditions the changes in the scope of investments will largely be determined by the availability of funding from EU structural funds also in the coming years.

More rapid dynamics of investments are also considerably limited by relatively low demand, comparatively high level of debt both in the private and public sector, as well as an uncertain external economic and political situation.

Most of investments have been made in construction assets. These mainly are investments in buildings and structures, which account for almost half of the expenditure on gross fixed capital formation. The drop in investments into these assets due to the crisis was comparatively low, while the recovery after the crisis has been rather rapid. Since 2011, investments in buildings and structures have increased by 5.3% per year on average, including by 18.1% in 2017 and by 23% in 2018, which was largely affected by public investments in infrastructure projects.

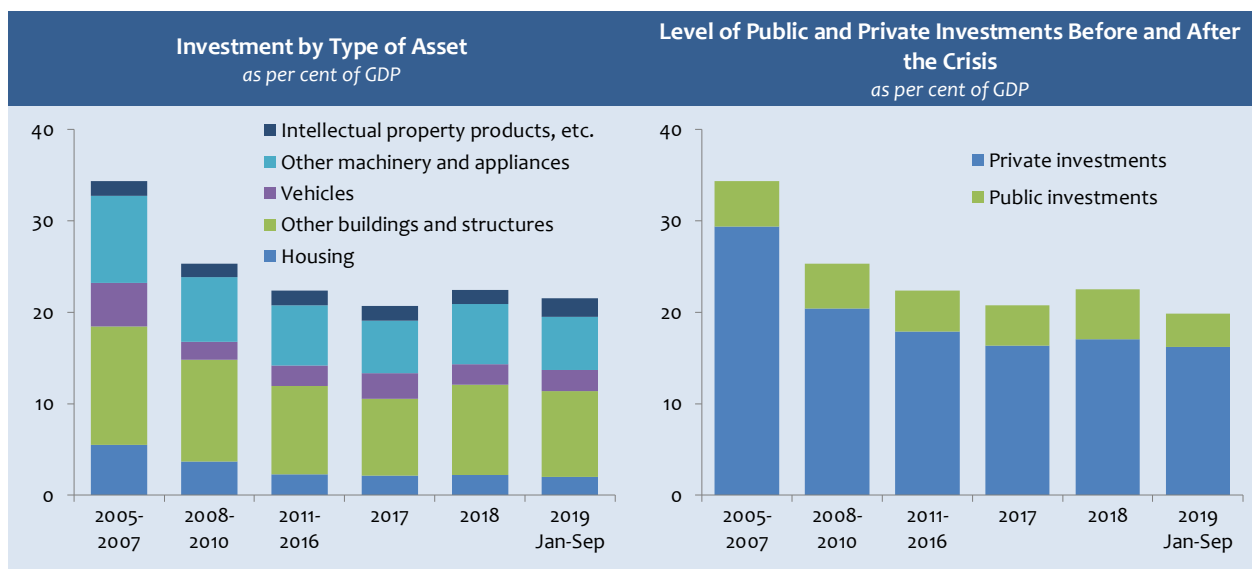
In the structure of total investments, investments in housing in recent years have constituted a comparatively small part – about 9-10%, i.e. 2-3% of GDP. They are mainly financed

from bank loans, the reduction in which under the influence of the global financial crisis along with the increase in debt liabilities of the private sector largely determined the drop in investments in these assets – by almost 70% (in 2008-2010). In the period from 2011 to 2018, investments in housing were growing by 2.2% per year on average, which is close to the historical indicators. In 2018, investments in housing were almost by 7.2% higher than in a year ago and accounted for 9.8% of total investments in the national economy of Latvia.

The recovery of investments into machinery and equipment after the crisis has been slower than into other assets, which is mainly explained by weak crediting, comparatively high private sector debt and unfavourable market environment. From 2011 to 2018 investments in machinery and appliances increased by 8.8% per year on average. Such investment dynamics were insufficient to compensate the drop in investments in the years of the crisis. In 2018, the volume of investments in machinery and appliances accounted for 9% of GDP and is almost by half smaller than the average volume in the pre-crisis years (1995-2007).

Investments in intellectual property assets have almost not changed remaining at the level of 1.6% of GDP on average (including investments in R&D of 0.6% of GDP) for several years. In the years of economic recession, investments in these assets reduced insignificantly – by 6.7% per year on average, and in the following years (2011-2018) their dynamics were moderate – by 2% per year in average. In 2018, compared to 2017, investments in intellectual property assets increased by 4.6% and amounted to 1.5% of GDP.

Figure 3.10



The structure of investment of the previous years persisted in 2019. However, investments in machinery and appliances are growing more rapidly, while the dynamics of investment in construction assets is slowing down. In the first half of 2019, by 0.2% more was invested in construction assets than a year before, including investments in engineering

structures and buildings increased by 4%, while investments in housing were by 13.6% lower than a year before. By 10.5% more in total was invested in machinery and appliances than a year ago, while investments in vehicles reduced – by 5.2%. The increase in investments in

intellectual property products was also more rapid than in the previous year (increased by 9.5%).

Private investments are growing moderately, and their level is still lower than before the crisis. From 2011 to 2018, private investments amounted to 17.6% of GDP on average, that is by almost 11 percentage points lower level than in

the years of rapid growth. The dynamics of private investments have become increasingly more rapid in recent years. In 2018 and in the first half of 2019, they increased by 11.6% and 3.7%, respectively. In low crediting conditions private investments are mainly funded from own funds of businesses. The state provides significant support to private investments by co-funding from EU structural funds.

Table 3.2

Gross Capital Formation							
	1995-2007	2008-2010	2011-2016	2016	2017	2018	2019 Jan-Sep
annual changes, as per cent							
GDP	7.4	-7.4	3.3	1.8	3.8	4.6	2.5
Gross capital formation	18.1	-24.4	6.0	1.3	11.8	13.1	1.3
- gross fixed capital formation	18.4	-21.5	4.1	-8.2	11.3	15.8	4.8
as per cent of GDP							
Gross capital formation	27.9	25.8	23.7	20.8	21.9	23.5	22.0
- gross fixed capital formation	25.2	24.5	22.4	19.5	20.7	22.5	21.5
- changes in inventories	2.6	1.2	1.3	1.3	1.2	1.0	0.5

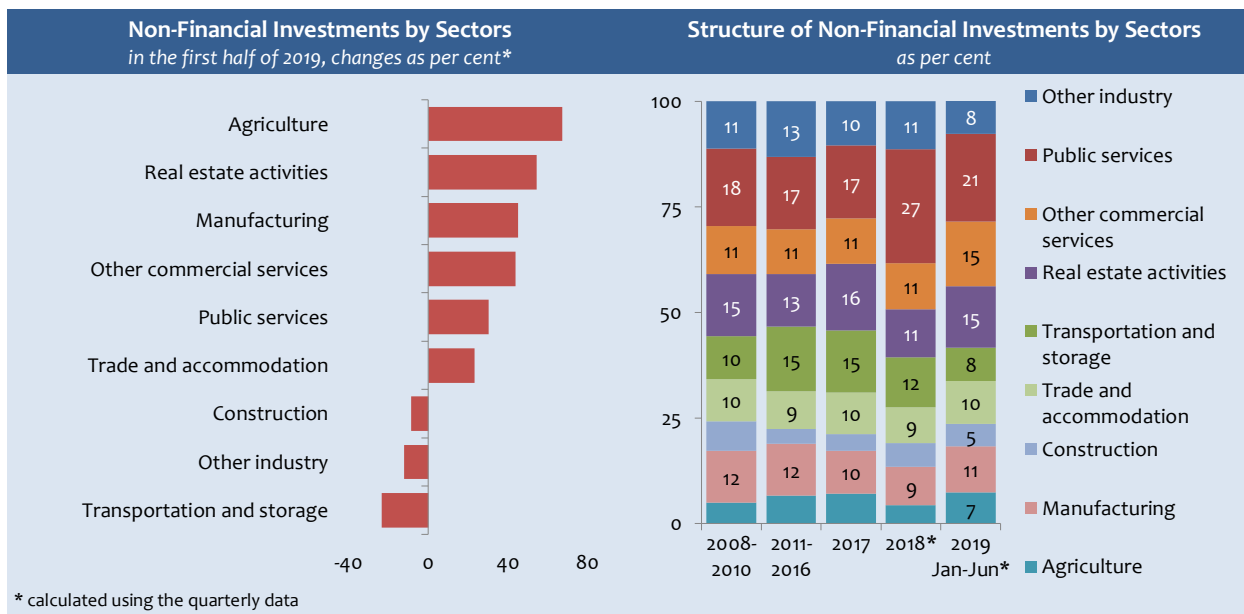
Public investments in Latvia remain at a high level and play an important role in the accumulation of the fixed capital. In recent years, public investments have been amounting to 1/5 of total investments in the Latvian national economy, and their dynamics is largely related to the cyclicity of acquisition of EU structural funds. When funding from EU structural funds resumed, public investments have been increasing by 33.5% per year on average since 2017. By contrast, in the first half of 2019, the volume of public investments was by 10,7% lower than a year before.

The share of public investments in total investments in Latvia is one of the highest among EU Member States – in accordance with Eurostat data public investments in EU-28

countries in 2018 amounted to 2.9% of GDP on average (in Latvia – 5.4%).

Investments in sectors of the Latvian national economy are rather volatile. Due to the financial crisis, investment fell in all sectors. A particularly large drop in the investment volumes was observed in the construction. In 2010, investments in the construction were by 83.2% lower than in 2007. A similarly large decrease was observed in the trade, accommodation and catering services sectors. Investments fell rather moderately in such sectors as information and communication services, health and social care, mining and energy industries.

Figure 3.11



Since 2011 the investment intensity¹ has increased in several sectors, and the most rapid dynamics has been in the services sectors. In 2011-2018, investments in services sectors increased by 4.6% per year on average, which was significantly affected by extensive investments in transportation and storage services, as well as in trade and accommodation sectors. In sectors manufacturing goods investments increased more moderately – by 2.6% per year on average. Overall, the investment intensity in the services sectors has been close to historical indicators since 2011, while in manufacturing sectors it was at a lower level.

Similar trends preserved also in 2019. By almost 26% more was invested in services sectors than a year ago. Volumes of investments in goods manufacturing sectors increased by 18 per cent.

Increase in the investments in the public administration sector (an increase of 33%) and real estate activities (an increase of 54%) contributed the most. Investments in manufacturing were by 45% higher than a year ago.

Investments in energy and construction were lower than a year ago.

Results of the survey of managers of industrial companies show that the most significant factor encouraging investments is the increase in demand. In recent years, the role of the factors of access to finance in stimulation of investment has increased. Financial conditions are estimated as an important supportive factor for investment also in 2019, equivalent to the factors of technical nature, such as technological development, availability of skilled labour, etc.

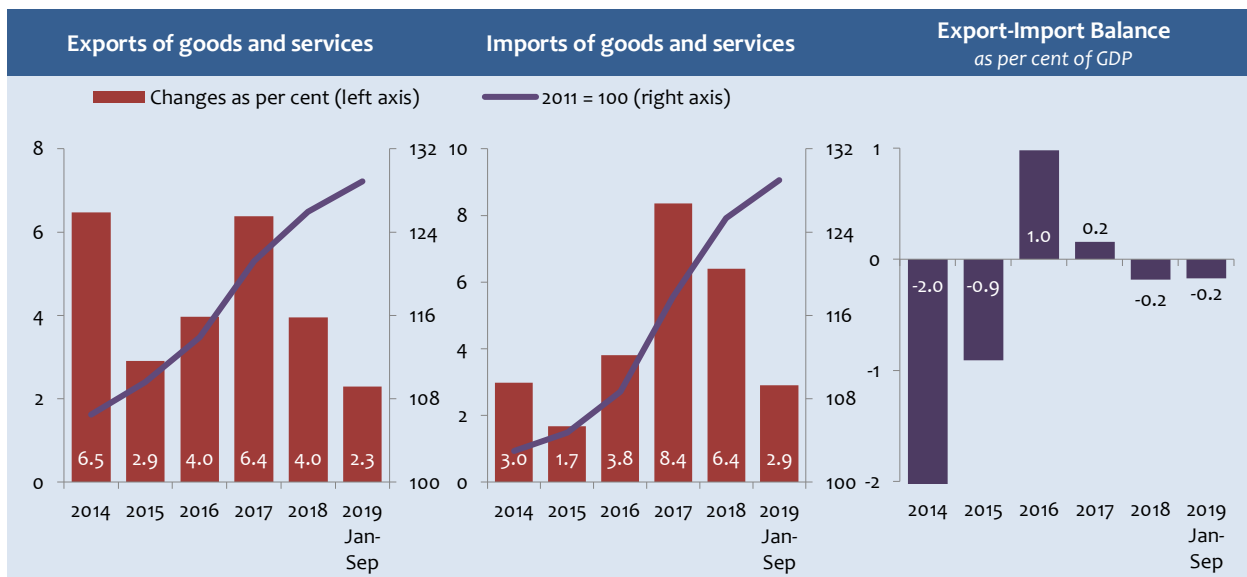
In the coming years Investment dynamics may weaken as uncertainty in the external environment and low levels of lending remain. More moderate dynamics of the investment process will be affected by closure of programmes of EU structural funds, as well as weaker external demand. At the same time, limited labour supply and high capacity utilization may become a stimulus for investment in the favourable business climate.

3.4. EXPORTS AND IMPORTS

Exports have been developing dynamically in Latvia in recent years. Export is one of the main factors of economic growth,

and its dynamics is closely related to external demand and rates of development of economies of partner countries.

Figure 3.12



The most important export markets for Latvia are EU countries, including Lithuania and Estonia. In 2017-2018, the development of exports was fostered by economic growth in both Baltic countries, as well as stable demand in other EU countries. In 2019, as economic growth rates of

partner countries are declining, the development of exports has been more moderate.

Exports to CIS countries, including Russia, also account for a large share. The stabilisation of the economic situation in the region has a positive effect also on external demand,

¹ investment (investments in fixed capital formation) to value added ratio.

respectively improving Latvian export opportunities in CIS countries.

The main factors of development of imports of Latvian goods and services are increases in production volumes in manufacturing and in income available to households. Import volumes have been growing considerably in recent years, as internal demand is growing.

The export-import balance has balanced from the clearly negative balance of 2012-2015 and has been positive since 2017.

EXPORTS

More than two thirds of Latvian export are composed of export of goods, while the rest is export of services. This proportion has not significantly changed in recent years.

Figure 3.13



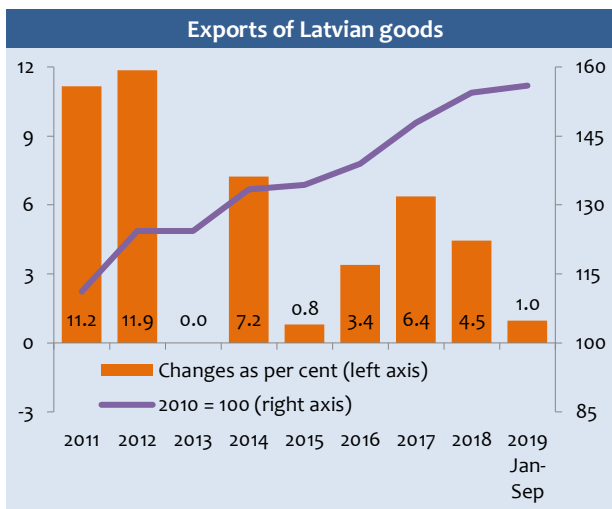
Latvian exports of goods were developing dynamically in 2014-2018, except in 2015, when its volumes actually remained at the level of the previous year. In the three quarters of 2019, as external demand reduced, exports of goods have been slightly below the level of the previous year.

Changes in export prices have a positive effect on the development of exports. At current prices, exports increased by about 10% per year on average in 2017-2018, but when external demand reduced, in the nine months of 2019 – by 0.6 per cent.

Improvement of the competitiveness of the Latvian producers in the post-crisis years was mainly driven by a decrease in labour costs. In 2012-2013, with growth in the EU weakening, external demand reduced significantly, and the development of exports was mainly determined by the increase in competitiveness. In 2015-2017 the increase in exports of goods was mainly fostered by external demand, and the role of competitiveness in export growth reduced respectively. Starting from 2018, development of Latvian

exports to the EU countries has been equally determined by a rapid increase in the competitiveness of the Latvian companies and foreign demand.

Figure 3.14



More rapid growth of larger groups of goods such as wood and wood products and agricultural and food products results in a worse indicator of diversification of export goods, but more rapid development of comparatively smaller export groups improves this indicator. An improvement in the diversification indicator for goods was observed in 2015-2017. An opposite process was observed in 2018, when exports of wood and wood products grew considerably having a negative effect on the diversification indicator for goods. However, this indicator has slightly improved in 2019.

Table 3.3

	2016	2017	2018	2019 Jan-Oct
Total	-0.1	11.0	9.4	0.6
Agricultural and food products	3.8	19.2	-0.5	12.8
Mineral products	-23.6	3.7	11.0	-11.2
Chemical industry products	8.9	8.1	6.8	10.7
Light industry products	-15.0	9.6	-0.4	17.1
Wood and wood products	4.1	7.1	19.4	-1.5
Metal and metal articles	-6.3	21.0	14.1	-5.1
Machinery, appliances and electrical equipment	-6.3	10.8	14.1	-11.4
Vehicles	21.4	8.7	12.4	-3.0
Other goods	7.0	5.3	4.9	3.1

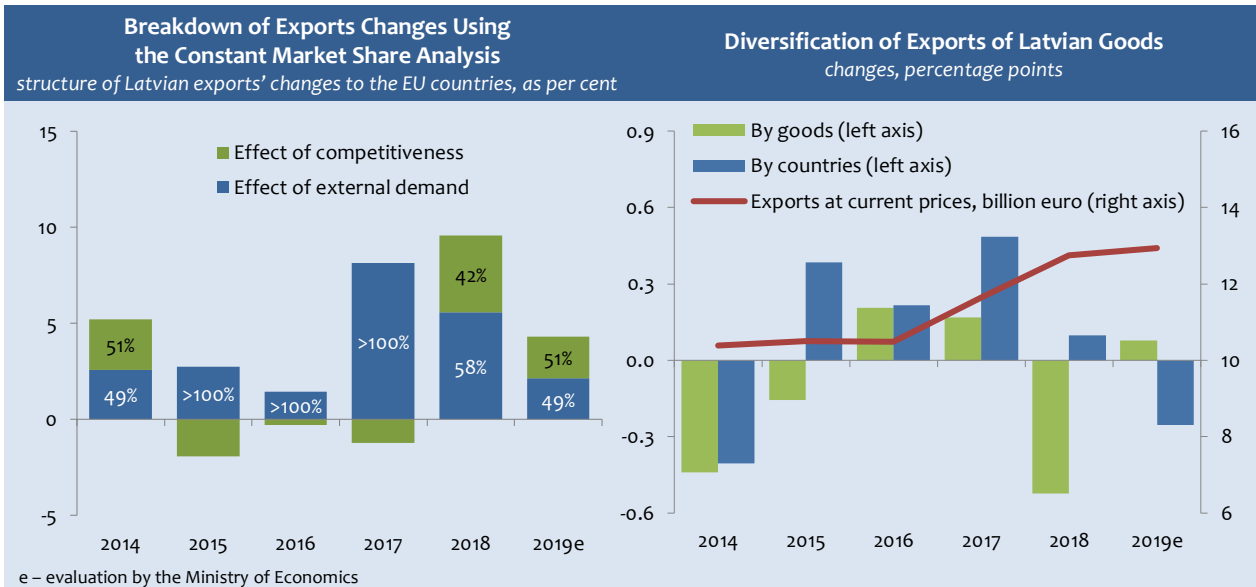
Diversification of exports of goods by countries improved in 2015-2018 evidencing of entering into new markets. In 2019, exports to larger partner countries (Estonia, Lithuania

and Germany) have been growing more rapidly, which has respectively worsened the export diversification indicator.

In 2018, export volumes of almost all groups of goods increased, except agriculture and food, as well as light

industry products, which essentially remained at the level of the previous year. More rapid growth was observed in export groups of wood and wood products, as well as machinery and appliances.

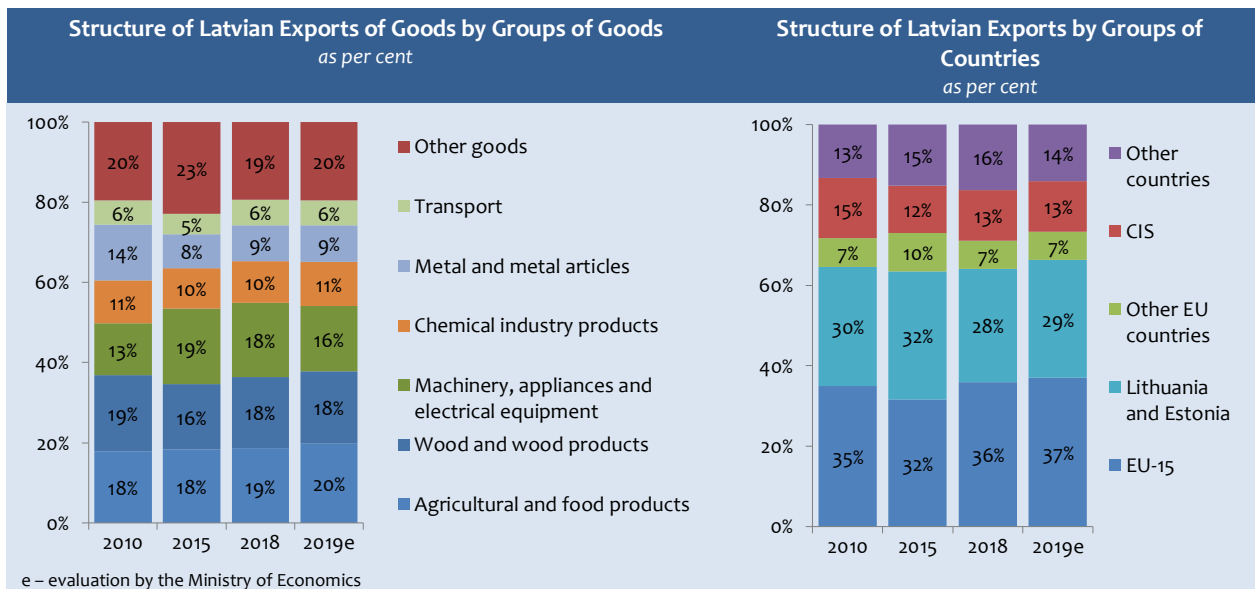
Figure 3.15



In January-October 2019, the increase in export was considerably affected by the increase in exports of agriculture and food, as well as chemical industry products. The export value of light industry products increased as well. Volumes of the largest group of export of goods, wood and

wood products, were slightly smaller than those of the previous year. The development of exports in this period was also negatively affected by the drop in value of exports of machinery and appliances. The exports of mineral products and metals and metal products also fell.

Figure 3.16



The amount of exports of goods to the EU countries in 2018 grew similarly to total exports – by 9.5%. A large part of the increase was due to the growth of export of wood and wood products.

Furthermore, exports to the EU countries also grew more moderately in January-October 2019 – by 3.1%, however much more rapidly than total exports. This was considerably influenced by increases in the export values of iron and steel

articles, cereals, pharmaceutical products and oil seeds to EU countries. The largest decline was observed in the value of exports of mineral products.

After the drop in export volumes of goods in 2014-2016, in 2017 exports to CIS countries increased considerably – by 27% (including to Russia by 32.2%). This increase was mainly underpinned by a particularly rapid increase in the export value of alcoholic and non-alcoholic beverages, as well as machinery, appliances and electrical equipment.

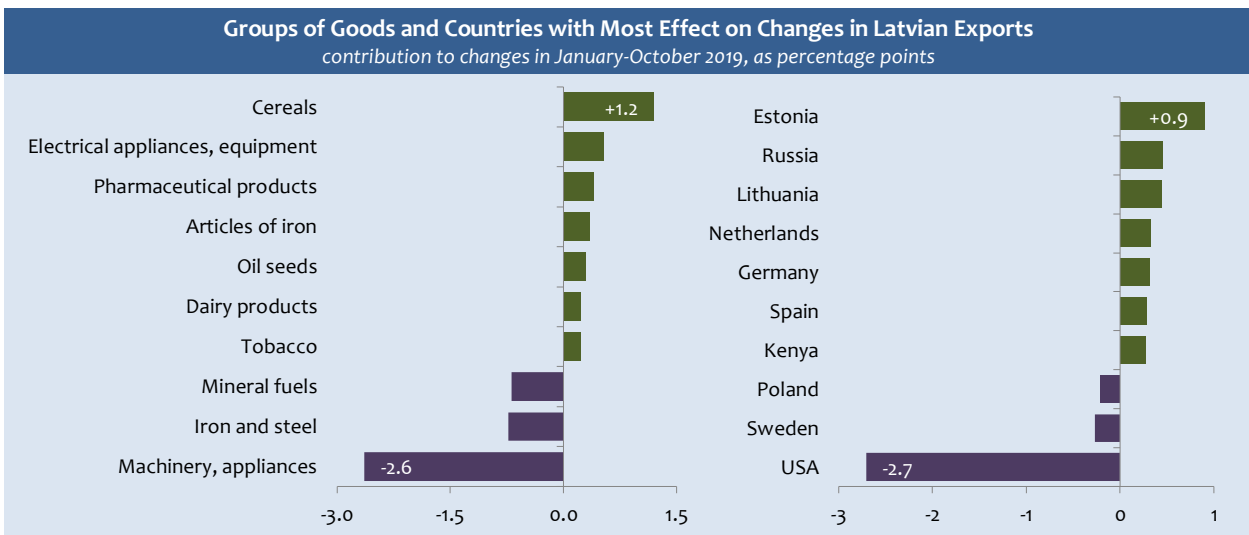
The amount of exports to CIS countries increased comparatively rapidly also in 2018 – by 7.4%. This was considerably influenced by the increase in the export value of optical devices, electrical appliances and equipment, as well as beverages.

Similar trends in exports to CIS countries persisted also in the ten months of 2019 – an increase by 5.4%. The most rapid increases were observed in exports of electrical appliances and equipment, pharmaceutical products and textile and knitted and crocheted apparel. In contrast, exports of optical devices and ornamental plants and flowers to CIS countries decreased.

The rapid increase in exports of goods (by 10.7%) to other countries, with the exception of EU and CIS countries, in 2018 was largely affected by exports of machinery and appliances to the United States.

Furthermore, in January-October 2019, as exports of machinery and appliances to the United States reduced considerably, total exports to other countries reduced by 13.8%. The reduction was partially compensated by the increase in exports of cereals to Kenya, Turkey and Nigeria.

Figure 3.17



Exports of services grew more rapidly than exports of goods in 2015-2016 with the share of services making a bigger contribution to the total increase in exports than the share of services. Therefore, the positive balance of exports of services in this period fully compensated the negative balance of exports of goods.

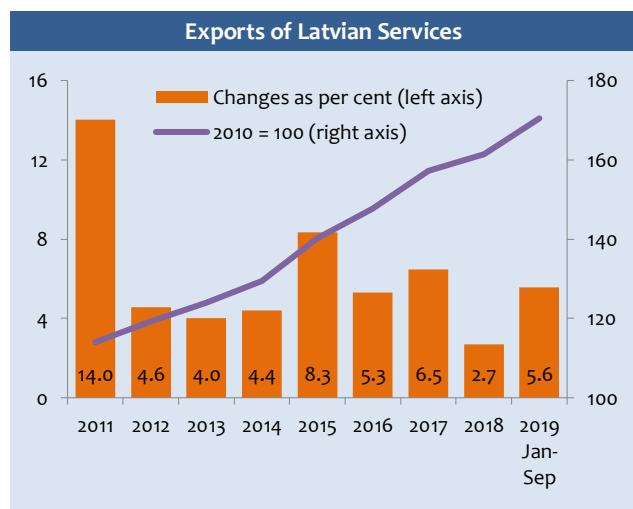
In 2017, as growth resumed, export rates of goods and services were similar. The positive export balance also persisted in 2017.

In 2018, exports of services continued to grow, however, its growth has been the weakest over the last five years. By contrast, in three quarters of 2019, growth of exports of services was considerably more rapid than a year before.

In recent years, about 40% of the exports of services have consisted of income from transport services. 2018 and also 3 quarters of 2019 were comparatively successful in export of transport services. In 2018, exports of transportation by air and railway increased more rapidly, while exports of transportation by sea and road shrank. In the 3 quarters of 2019, volumes of export of road transport services increased

considerably, while exports of sea transport services reduced.

Figure 3.18



Income from foreign tourists grew more rapidly in 2018 and more moderately in January-September 2019.

Two thirds of the total exports of the Latvian services are related to the EU countries and their share in total exports of services is growing year on year.

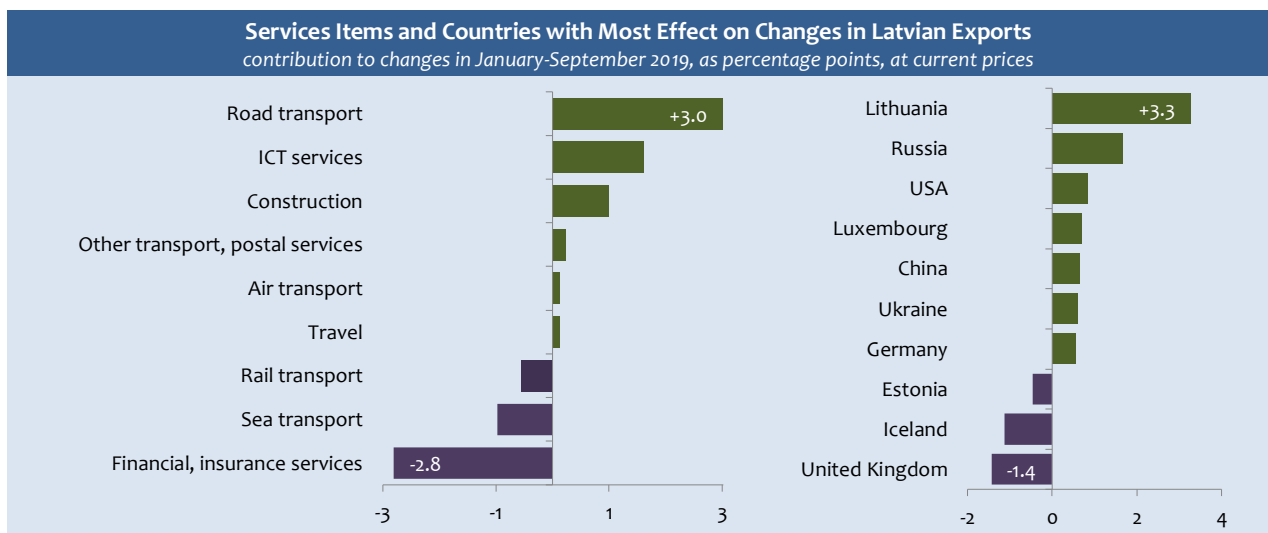
Table 3.4

Export of Services as per cent, at current prices						
	2018			January-September 2019		
	structure	changes	contribution to the changes	structure	changes	contribution to the changes
Total	100	6.1	6.1	100	6.5	6.5
Transport services, including:	40.2	2.2	0.9	40.2	4.6	1.9
– sea transport	7.5	-5.7	-0.5	6.2	-12.8	-1.0
– air transport	10.1	16.2	1.5	10.4	1.2	0.1
– rail transport	6.4	15.5	0.9	5.4	-8.9	-0.6
– road transport	15.0	-8.0	-1.4	17.0	20.1	3.0
– other transport services	1.2	35.4	0.3	1.3	20.0	0.2
Travel	17.0	7.0	1.2	16.5	0.7	0.1
Other services, including:	42.8	9.8	4.1	43.3	10.8	4.5
– construction services	5.0	0.4	0.0	5.5	20.7	1.0
– financial and insurance services	5.9	-16.9	-1.3	3.3	-44.4	-2.8
– ICT services	14.8	24.8	3.1	14.8	11.4	1.6
– other business services	15.7	14.5	2.1	18.3	31.4	4.7
– other services	1.4	5.6	0.1	1.4	3.6	0.1

The amount of exports to the EU countries increased stably both in 2018, and in three quarters of 2019. Transport services (road transport and air transport), as well as travel

constitute the largest share of exports of services to the EU countries.

Figure 3.19



IMPORTS

Volumes of imports have been growing comparatively rapidly since 2017. However, growth rates slightly decline every year – from 8.4% in 2017 to 3.9% in the nine months of 2019.

The **increase in imports** at current prices in 2017 was 14.2%, which has been the sharpest increase since 2011. Import volumes of essentially all groups of goods increased. Imports of aircraft and parts thereof, machinery and appliances and mineral products have grown most rapidly.

Imports of goods at current prices continued to grow rapidly also in 2018. The increase was positively affected by the increase in volumes of imports of machinery and appliances, iron and steel, refined petroleum products and other.

By contrast, in the ten months of 2019, imports of good have been slightly lower than a year before. The largest positive contribution to the increase in imports of goods was made by groups of goods of pharmaceutical products, aircraft and parts thereof, fertilisers and knitted and crocheted clothing. The value of imports of machinery and appliances and refined petroleum products reduced in this period.

Imports from the EU countries grew slightly slower than total exports (by 6%) at current prices in 2018. The growth of imports of goods from EU countries continued also in the ten months of 2019 – by 3.3%. It was positively affected by increases in imports of machinery and appliances and pharmaceutical products.

Imports from CIS countries at current prices increased by 20.8% in 2018. Thus, the increase in imports was promoted by volumes of imports of iron and steel, cereals, as well as wood and wood products. In the nine months of 2019, as imports of mineral products and iron and steel considerably

reduced, total imports of goods from CIS countries have reduced by 9.8 per cent.

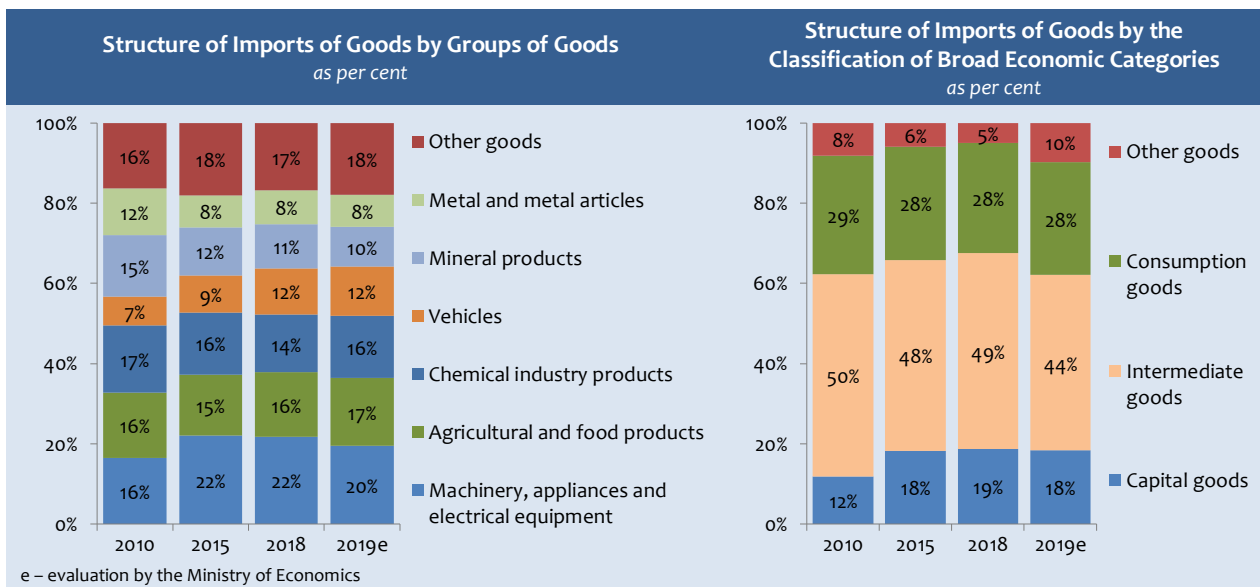
In the group of countries other than EU and CIS countries imports in 2018 increased very rapidly – by 37.8%, which was mainly determined by imports of machinery and appliances and aircraft, parts thereof from Canada. In the nine months of 2019, as imports of machinery and appliances considerably reduced, total imports of goods from other countries have reduced by 15.9%. The reduction was partially compensated by imports of aircraft, parts thereof from Canada.

Table 3.5

Import Dynamics of Latvian Goods <i>changes as per cent, at current prices</i>				
	2016	2017	2018	2019 Jan-Oct
Total	-2.3	14.2	11.3	-1.1
Agricultural and food products	7.2	16.0	7.0	5.3
Mineral products	-26.3	15.1	17.6	-13.9
Chemical industry products	2.0	11.1	3.2	7.4
Light industry products	-5.4	5.8	2.8	12.6
Wood and wood products	13.3	10.5	30.1	-0.7
Metal and metal articles	-5.5	20.3	18.8	-5.7
Machinery, appliances and electrical equipment	-4.3	13.9	14.6	-9.9
Vehicles	10.8	27.4	13.6	1.2
Other goods	1.7	3.2	7.0	6.3

The structure of imports has not significantly changed in terms of end use of goods in recent years.

Figure 3.20

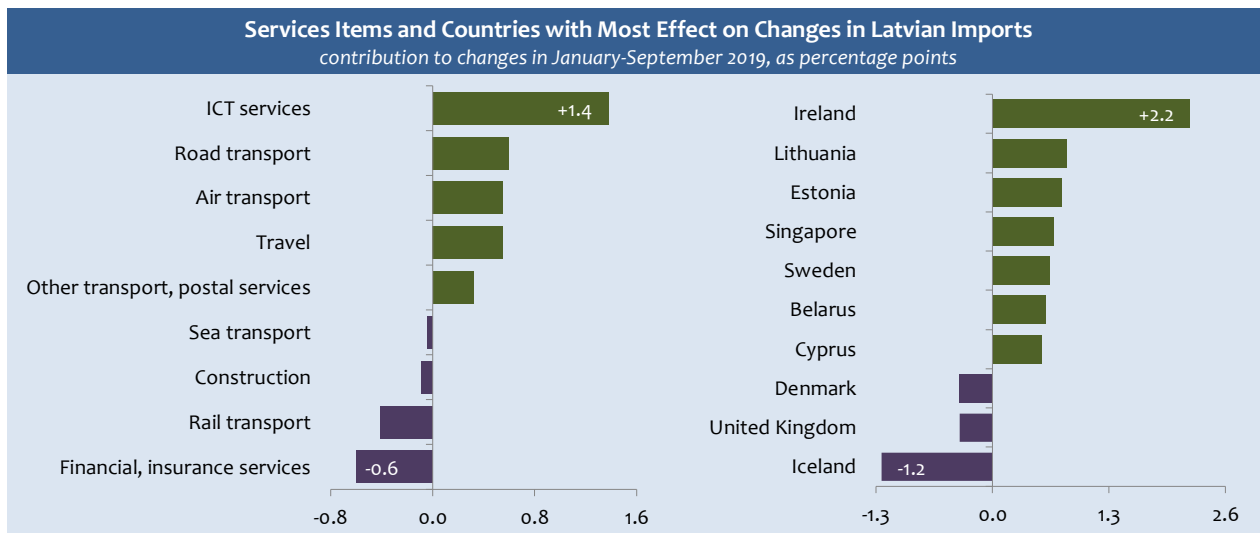


The development of **import of services** in 2018 and in January-September 2019 was slightly more rapid than the development of export. Imports of ICT services, as well as transport and trade mediation related import services developed more rapidly in 2018. Meanwhile, volumes of imports of financial and insurance import services reduced. Volumes of import of services related to trade mediation also grew more rapidly in the 3 quarters of 2019. Imports of ICT

and transport services increased considerably, while imports of financial services reduced.

Two thirds of all services are provided to Latvia by EU countries. The share of imports from EU countries in the total imports of services has also been growing in recent years. The largest import groups are transport and travel related services.

Figure 3.21



4. CONTRIBUTION OF SECTORS

4.1. DYNAMICS AND STRUCTURE

In 2009-2010, as labour costs declined, competitiveness of Latvia's producers improved, thus stimulating the growth of exports and the development of tradable sectors.

The structure of the economy has changed. In 2008, tradable sectors (i.e., agriculture, forestry, industry, and transport services) accounted for only 26.5% of total value added. However, in 2010 the share of these sectors reached 33.2%.

In 2018, the share of sectors slightly shrank to 28.8%. In 2018, compared to 2010, the share declined in all sectors except construction and business services. Meanwhile, the share of public services sectors has remained practically unchanged.

In 2018, goods accounted for 27%, but services – for 73% of total value added.

Table 4.1

Structure of the Economy by value added, as per cent							
	2000	2005	2008	2010	2016	2018	2019 Jan-Sep
Agriculture, forestry	4.9	4.1	3.1	4.5	3.5	4.1	4.6
Manufacturing	15.3	12.9	10.7	13.4	11.8	11.9	11.8
Other industries	4.2	3.1	3.4	4.8	4.3	3.8	3.8
Construction	7.0	6.8	10.2	4.9	5.4	6.7	6.4
Trade, accommodation	15.6	18.2	15.9	17.6	16.5	15.9	16.1
Transportation and storage	11.9	12.3	9.3	10.5	9.1	8.9	8.3
Other commercial services	23.8	27.3	30.3	28.3	33.2	32.6	32.9
Public services	17.4	15.2	17.0	16.0	16.2	16.1	16.1
Total	100	100	100	100	100	100	100

Figure 4.1

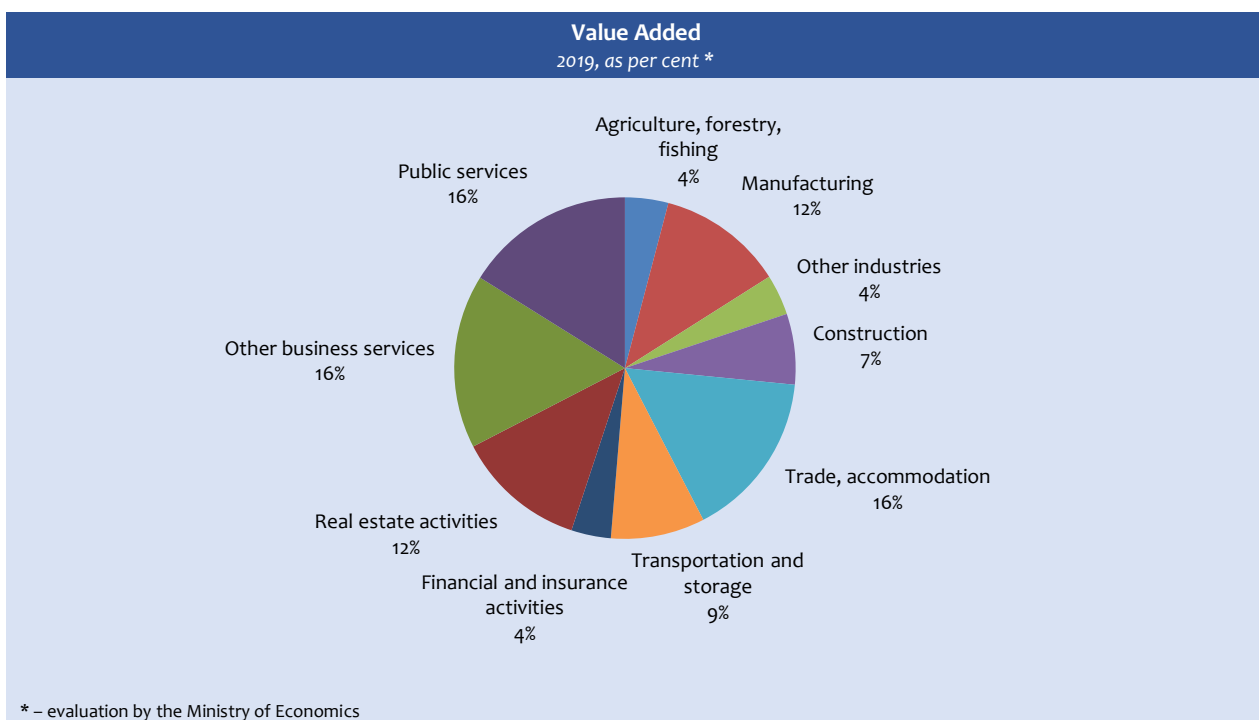


Table 4.2

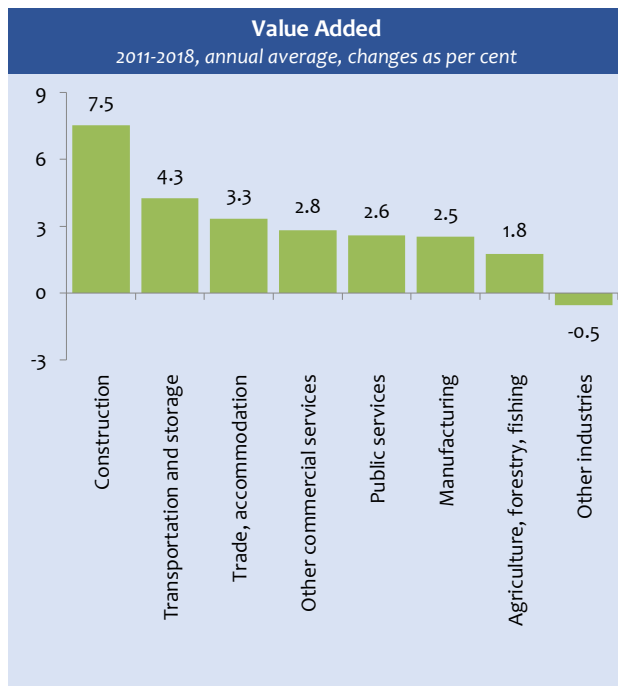
Development Trends of Sectors <i>compared to the corresponding period of the year before, change as per cent</i>					
	2015	2016	2017	2018	2019 Jan-Sep
Gross domestic product	3.3	1.8	3.8	4.6	2.5
Agriculture, forestry and fishing	12.6	-10.5	5.1	2.1	11.5
Mining and quarrying	11.5	-4.4	11.2	3.7	-1.2
Manufacturing	1.0	2.6	6.9	2.7	3.0
Food industry	-4.6	1.8	5.2	-2.9	-0.9
Light industry	-13.2	2.1	7.6	-0.8	-1.2
Wood processing	7.1	8.0	2.1	4.5	0.6
Paper industry and publishing	0.0	3.6	4.5	-3.7	5.9
Chemical industry	-4.1	10.7	11.4	7.0	2.8
Manufacture of other non-metallic mineral products	-9.8	11.6	11.1	1.3	-3.1
Metalworking	34.8	5.4	12.0	3.6	15.3
Manufacture of electrical and optical equipment	16.7	12.6	15.8	12.1	15.8
Manufacture of machinery and equipment	7.9	8.5	21.5	7.0	2.5
Manufacture of vehicles	3.5	-2.9	22.8	7.3	-3.5
Other industries	3.5	0.8	4.3	-1.8	3.9
Electricity, gas, steam and air conditioning supply	22.9	17.9	-1.8	-2.7	-6.9
Construction	-2.4	-14.9	14.3	17.6	3.8
Construction of buildings	-8.2	-11.1	22.4	25.6	7.3
Civil engineering	0.4	-25.7	30.0	11.6	-0.6
Trade	7.4	2.9	2.3	1.8	4.8
Retail trade	4.9	2.3	4.3	3.8	2.7
Transportation and storage	-7.8	6.2	7.5	4.7	-2.4
Freight rail transport	-2.4	-14.1	-8.4	12.5	-12.4
Cargo loaded and unloaded at ports	-6.2	-9.3	-2.0	6.9	-3.0
Freight transport by road	0.5	1.3	7.0	12.8	-4.2
Accommodation and food service activities	6.0	1.5	9.4	5.2	7.9
Information and communication	1.9	5.4	8.7	12.8	1.9
Financial and insurance activities	7.2	0.4	-17.6	1.0	-6.0
Real estate activities	1.5	0.5	-0.5	2.6	1.1
Other commercial services	6.2	1.0	5.6	2.7	6.0
Public administration and defence; compulsory social security	1.5	2.7	3.5	3.2	2.3
Education	2.1	0.7	5.1	2.1	2.6
Human health and social work activities	5.8	1.0	8.5	5.1	9.4
Arts, entertainment and recreation	-4.2	5.0	6.7	4.8	6.7

In the main export sector – manufacturing, growth rates in 2010-2012 were significantly higher than the total economic growth, and the sector became the main driving force of the economy. In other tradable sectors, (e.g., the export-oriented commercial services, transportation and storage), growth after the crisis also resumed faster than in other economic sectors. In 2011-2014, the construction sector, which experienced the largest decline during the crisis, was growing relatively fast.

In 2014-2016, due to a decline in cost competitiveness and geopolitical situation, export slowed down, resulting in slower growth of tradable sectors. Growth continued in all sectors except construction. Domestic market-oriented sectors – trade and commercial services – have contributed the most to the growth. With the national budget expenditure growing, the volume of public services also increased.

Since 2010, when GDP dropped to its lowest level over the last ten years, it has been growing on average by 3.5% per annum. In 2018, Latvia experienced the largest growth over the last seven years. The increase in commercial services and construction volumes had the most substantial effect. Growth continued also in 2019, but it has become more moderate.

Figure 4.2



4.2. MANUFACTURING

In recent years, the sector has made an important contribution to total economic growth.

2014 was a year with the negative sign for manufacturing affected by trends in the foreign markets – slower than expected economic growth in the EU, as well as the economic crisis in Russia.

Figure 4.3

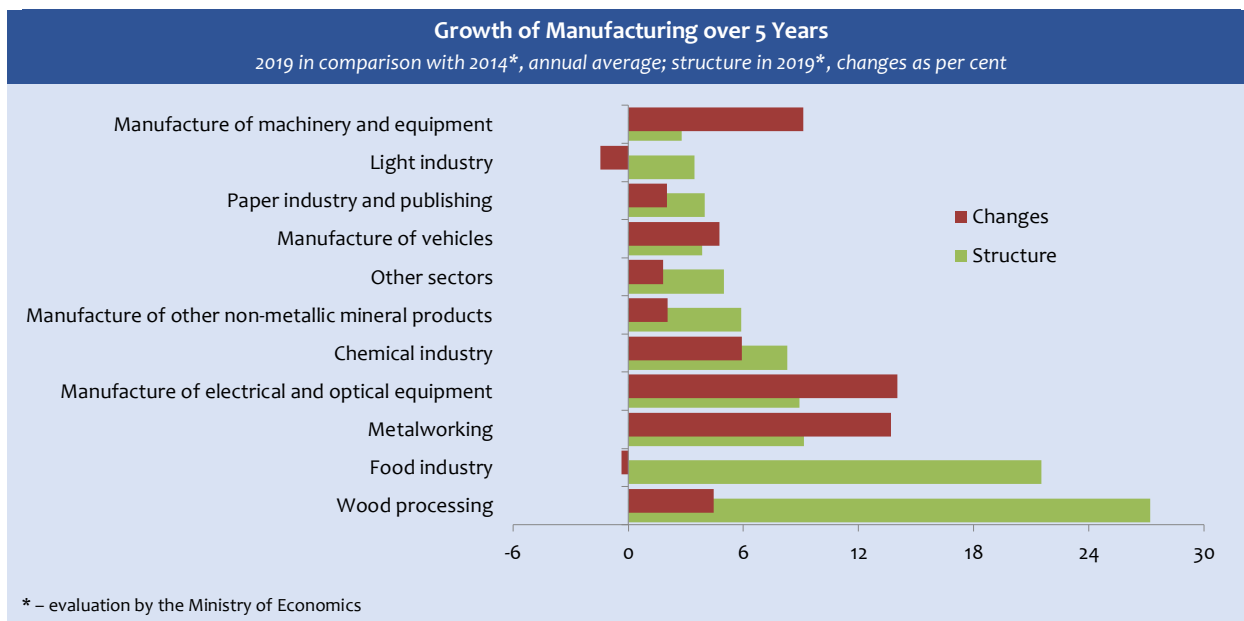
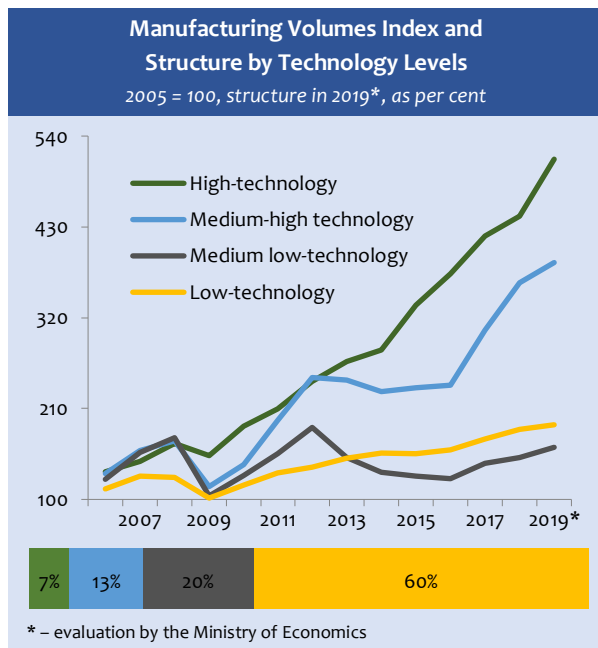


Figure 4.4



From 2015, manufacturing has been stably growing. Wood processing, manufacture of basic metals, and manufacture of computer, electronic and optical products had the

greatest positive contribution to the growth of the manufacturing in 2015-2016. However, in 2015 manufacturing volumes of the food industry shrank significantly affected by the sanctions imposed by Russia on imports of certain food products.

Year 2017, when production volumes increased by 8%, was one of the most successful years in the development of manufacturing. Volumes of all subsectors increased, and the development of food industry and manufacture of electrical and optical equipment made a considerable contribution to the development of the sector. Production volumes in metalworking also increased.

Manufacturing continued to grow also in 2018, yet at a lower rate than a year ago – by 2.7%. Wood processing, the largest sub-sector of the industry, made a significant contribution to total growth of the sector.

Manufacturing continues to grow in 2019. In the first ten months of 2019, its production volumes increased by 2.9%, compared to the previous year. Increase in volumes of metalworking and manufacture of electrical and optical equipment made a considerable contribution to total growth of manufacturing. Production volumes of the chemical industry, paper industry and publishing, wood processing, as well as manufacture of machinery and appliances also increased during this time. The second largest manufacturing sector, manufacture of food products, had a reduction in production volumes.

Table 4.3

Structure and Development Trends of Manufacturing in Jan-Oct 2019 as per cent				
	Output	Occupied posts*	Share of exports	Changes in production volumes
Manufacturing – total	100	100	65.3	2.9
Manufacture of food and beverages	21.5	19.3	37.8	-0.8
Light industry	3.4	9.3	86.4	-1.7
Wood processing	27.2	20.1	71.0	0.7
Paper industry and publishing	4.0	4.3	64.7	6.0
Chemical industry and related industries	8.3	7.2	75.2	5.3
Manufacture of other non-metallic mineral products	5.9	5.3	48.9	-2.3
Manufacture of metals and metal articles	9.1	10.4	68.0	15.3
Manufacture of electrical and optical equipment	8.9	5.0	90.2	13.0
Manufacture of machinery and equipment	2.8	3.3	84.1	1.7
Manufacture of vehicles	3.8	3.3	90.3	-4.8
Other manufacturing industries	5.0	12.4	62.9	2.3

* data on the first half of 2019

In 2017-2018, as producer prices were growing, stable growth was observed also in turnover of manufacturing. The turnover increased rapidly for products sold on the domestic market and abroad.

In the ten months of 2019, manufacture of electronic and optical equipment has made the largest contribution to the

total increase in turnover. The turnover of food industry and metalworking sub-sectors has also increased considerably.

About two thirds of all the products produced in manufacturing are exported. The industries with the share of exports in sales above 90% include manufacture of electrical and optical equipment and manufacture of vehicles. Manufacture of machinery and equipment and light

industry also have extensive sales volumes in exports. Products of the food industry and non-metallic mineral products are mainly sold in the domestic market.

More than two thirds of products produced in manufacturing are sold in markets of the EU countries. Similar volumes are sold in markets of CIS and other countries. The share has not changed significantly in recent years. At the same time, in the nine months of 2019, the share of EU countries in the export structure of manufacturing products has slightly increased, while the share of CIS and third countries has declined.

In recent years, number of occupied posts in manufacturing has been growing very moderately, considerably slower than the increase in production volumes, which indicated a comparatively rapid increase in productivity.

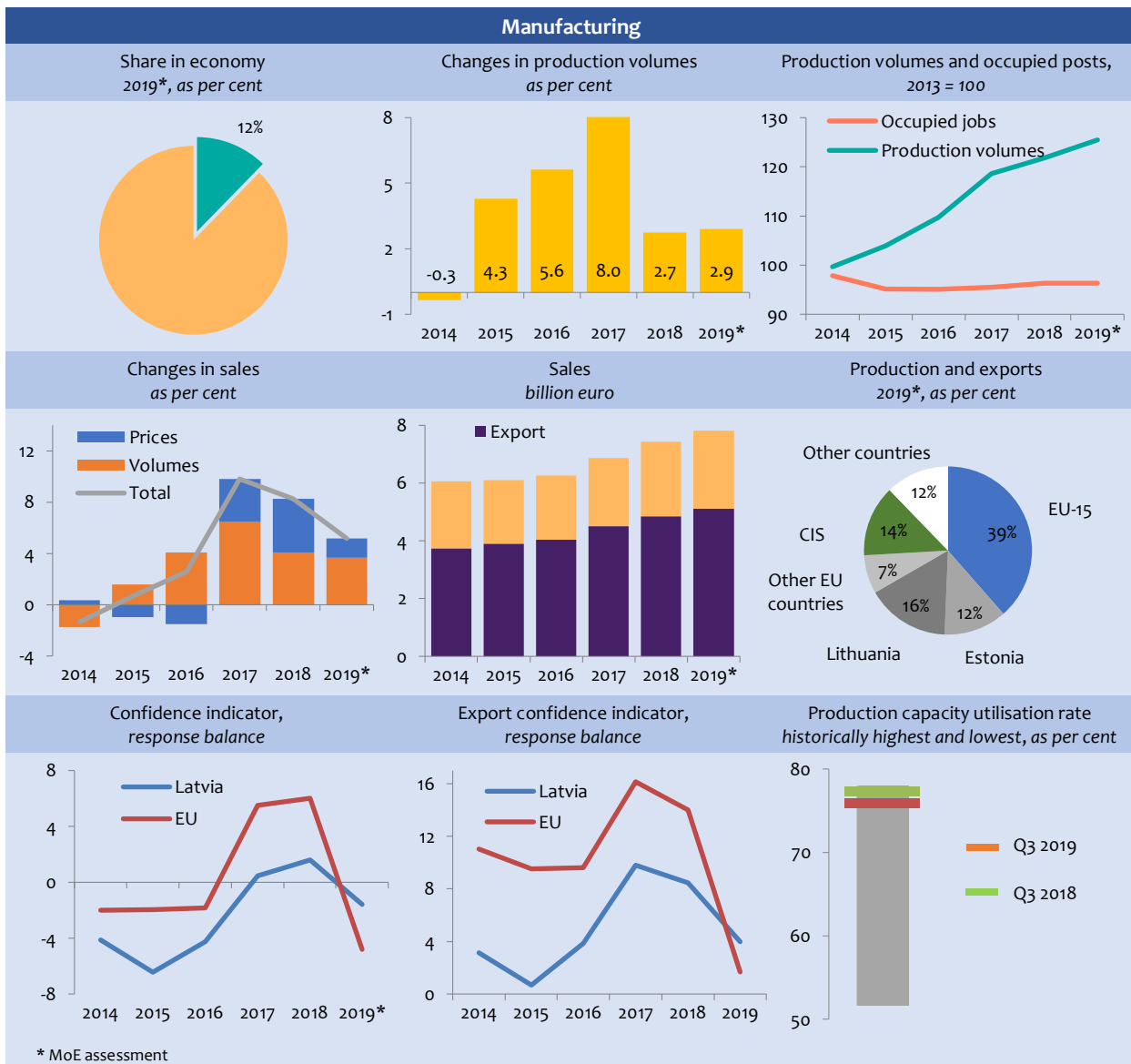
Also, in the three quarters of 2019, the number of occupied posts in manufacturing has increased slightly – by 0.2%.

The increase in the number of jobs in manufacture of non-metallic mineral products, metalworking and manufacture of electronic and optical equipment contributed the most to the increase in the number of jobs. By contrast, labour demand in the light and food industry has reduced.

In 2015-2018, confidence indicators of manufacturing and export improved considerably. In turn, in 2019 industry confidence has a slightly negative evaluation, while export confidence still remains positive. Clearly, export-oriented manufacturing subsectors, such as manufacture of vehicles and manufacture of electronic and optical equipment, have the most positive future outlook.

From 2012 to 2016, the production capacity utilization rate in the manufacturing remained at 72-73%. The capacity utilisation rate has been growing since 2017. In 2019, it exceeded 75%, which is close to historically the highest indicator.

Figure 4.5



Manufacture of food and beverages is the second largest manufacturing sector in terms of output and the number of occupied posts. The sector sells more than a third of its production in external markets. The embargo on food products imposed by Russia in 2014 affected the development of the sector significantly, when the share of products exported to CIS countries declined from 43% in 2014 to 31% in 2018. However, CIS countries are still the largest outlet for products of the industry.

In 2018, production volumes of subsectors of manufacture of beverages and food products slightly shrank. Manufacture of meat products increased but manufacture of milk and dairy products reduced considerably. A similar trend persisted also in 2019, although the reductions were more moderate than a year ago.

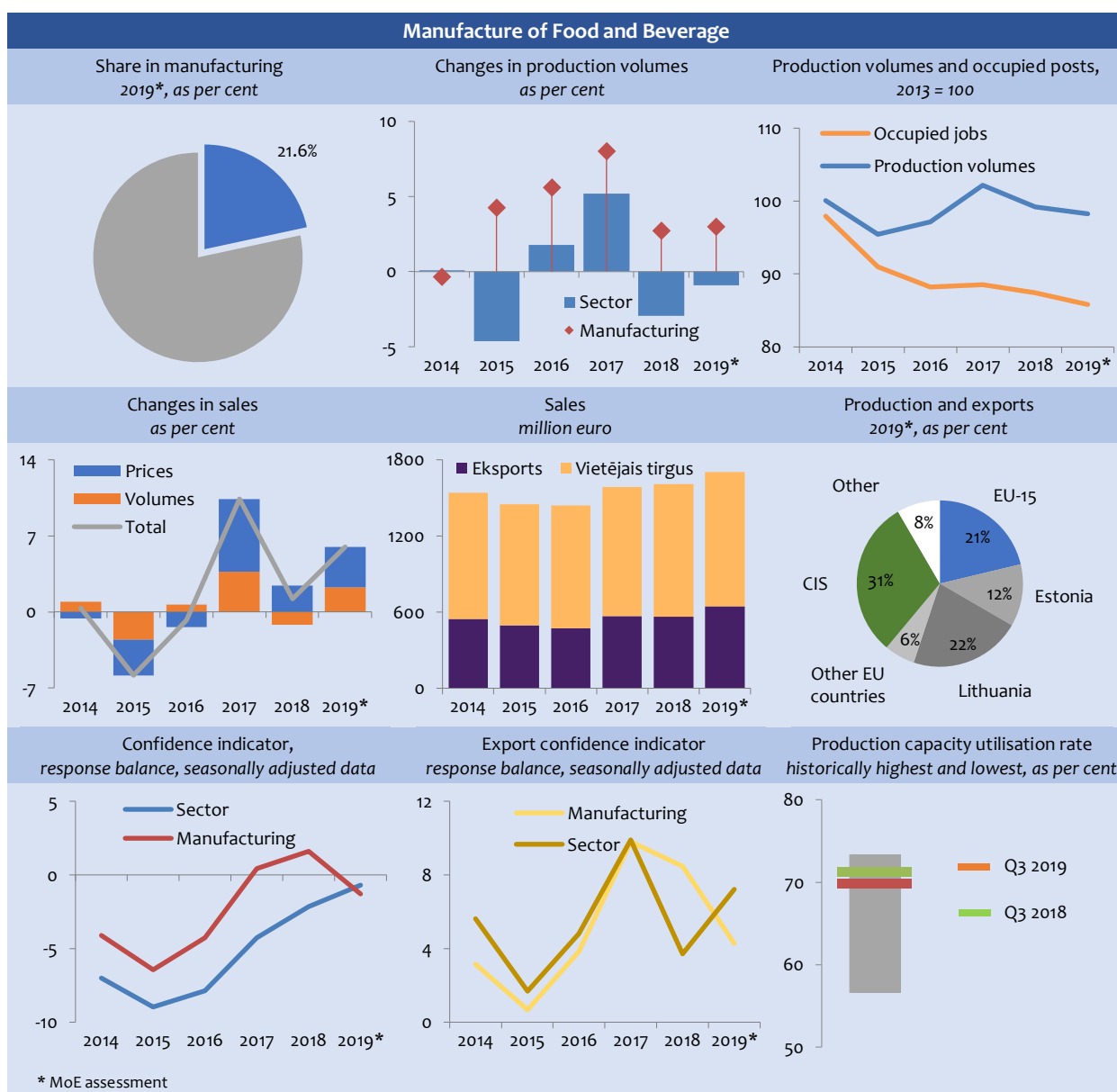
As Producer prices of food products increased, in 2018 and 2019 the turnover of the sector increased as well. Turnover was growing moderately for the products sold on the domestic market, while volumes of exported products, after a small drop in 2018, increased strongly in 2019.

The number of occupied posts in the food industry has been dropping since 2013. In six years, the number of occupied posts in the sector has reduced by 3.4 thousand jobs.

The confidence indicator, which was clearly negative in 2015, gradually improved and in 2019 has exceeded the total manufacturing confidence.

The production capacity utilisation rate in the food industry is considerably lower than in manufacturing on average.

Figure 4.6



Light industry is considerably affected by global trends, and in conditions of open EU labour market the sector cannot rely on advantages of cheap labour force like East Asia does. A considerable reduction in production volumes was observed in the sector in 2014-2015. The sector has recovered since 2016. In 2018, volumes of industry slightly shrank under the effect of the reduction in volumes of manufacture of wearing apparel. Volumes of manufacture of wearing apparel continued to reduce also in the ten months of 2019, which was partially compensated by growth in manufacture of textiles.

In 2018, Producer prices in the light industry did not significantly increase. In 2018, sales volumes of the sector slightly reduced, which was mainly affected by the drop in sales volumes of exported products. By contrast, in the ten months of 2019, as sales of exported products have

increased, total volumes of products also slightly exceeded the level of the previous year.

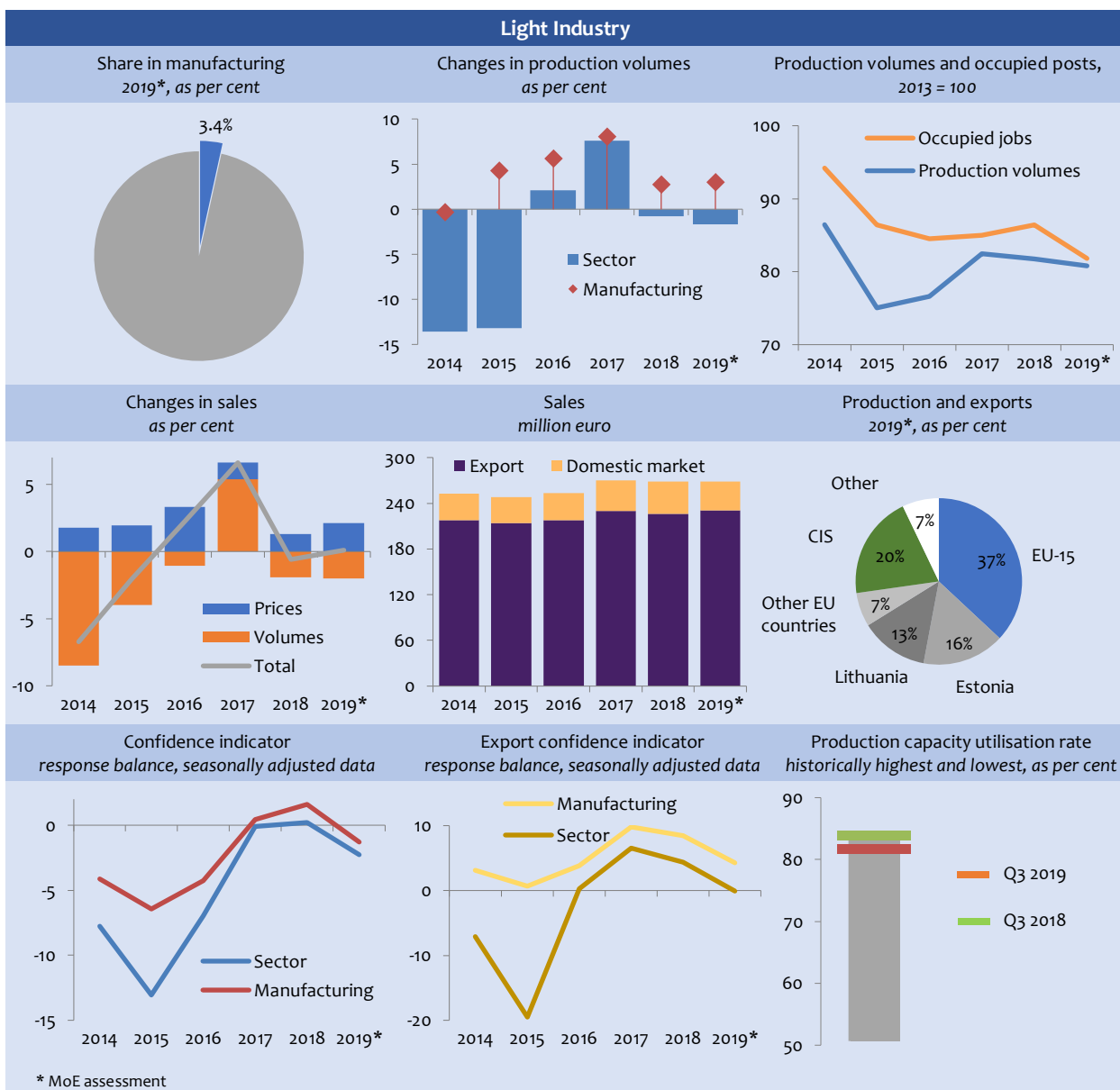
Since 2014, the number of occupied posts in the sector has reduced by 1.6 thousand.

Confidence indicators significantly improved in 2017-2018 reaching a positive industry development vision. However, this indicator has slightly worsened in 2019.

The capacity utilisation rate of the industry is one of the highest in manufacturing and is close to historically the highest mark.

Considering the large share of exports in sales of the sector, its development is closely related to changes in demand and competitiveness in the external markets.

Figure 4.7



Wood processing is the largest manufacturing sector in Latvia. It accounts for more than 1/4 of the total manufacturing output. Recent years have been comparatively successful for the sector, including 2018, when the output volumes exceeded average manufacturing rates. However, it should be noted that the rates of the sector have been moderate in the ten months of 2019, but they are still showing positive growth.

In 2018, producer prices in wood processing increased sharply affecting the increase in turnover of the industry. By contrast, in the ten months of 2019 sales of products of the industry volumes have increased moderately.

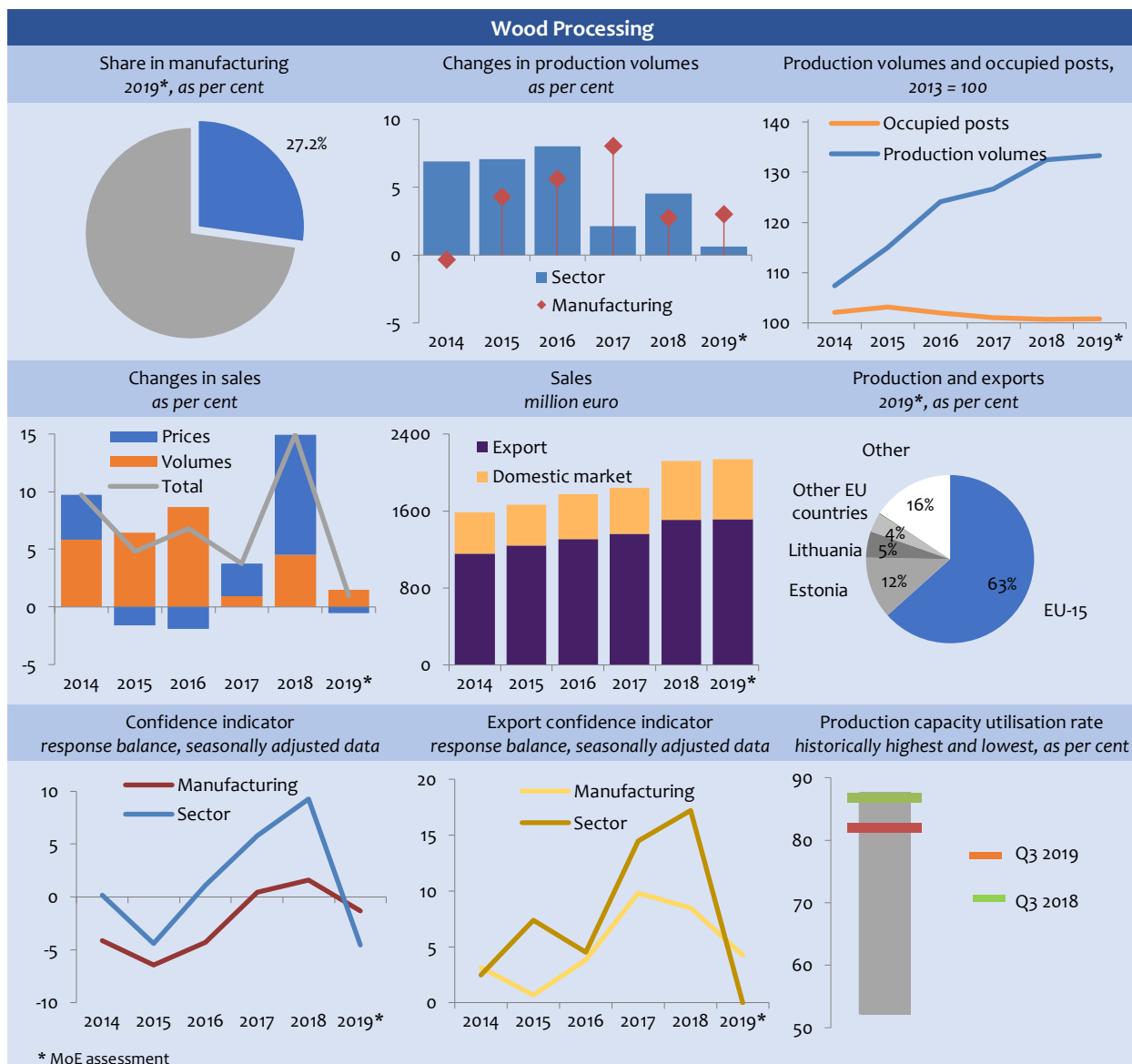
Wood processing is an export-oriented sector, its exports amount to almost one third of all the products exported by manufacturing. EU-15 countries have traditionally been the export market of this sector. Volumes of products sold in the domestic market grew considerably in 2018.

Turnover increase rates have become much slower in 2019. This is related both to *Brexit* and expansion of fir bark beetles in Europe, thus leading to surplus of wood processing products, which, in turn, has significantly affected Producer prices.

Despite stable industry growth, the number of occupied posts in the sector gradually reduced in 2016-2018, which evidences of the rise in productivity of the industry. Similar trends preserved also in 2019.

Confidence indicators of the industry have traditionally been above the average level in manufacturing, although confidence shrank in 2019. Future export opportunities are also evaluated similarly. The capacity utilisation rate of the industry has slightly shrank during the year, however, it still remains at a high level.

Figure 4.8



The *paper industry and publishing* is gradually reorienting from the domestic market to export markets. In 2018 and during the ten months of 2019, about two thirds of the production were exported.

Recently, production volumes in the industry have been volatile. After an increase in 2016-2017, 2018 experienced a decline. By contrast, in the ten months of 2019, volumes of the industry have been growing, mainly affected by significant growth of publishing. Production volumes of other paper articles have been growing more moderately.

The turnover of the industry has been gradually growing in recent years. It has been growing particularly rapidly in the nine months of 2019, facilitated by a considerable increase in exported products and products sold on the domestic

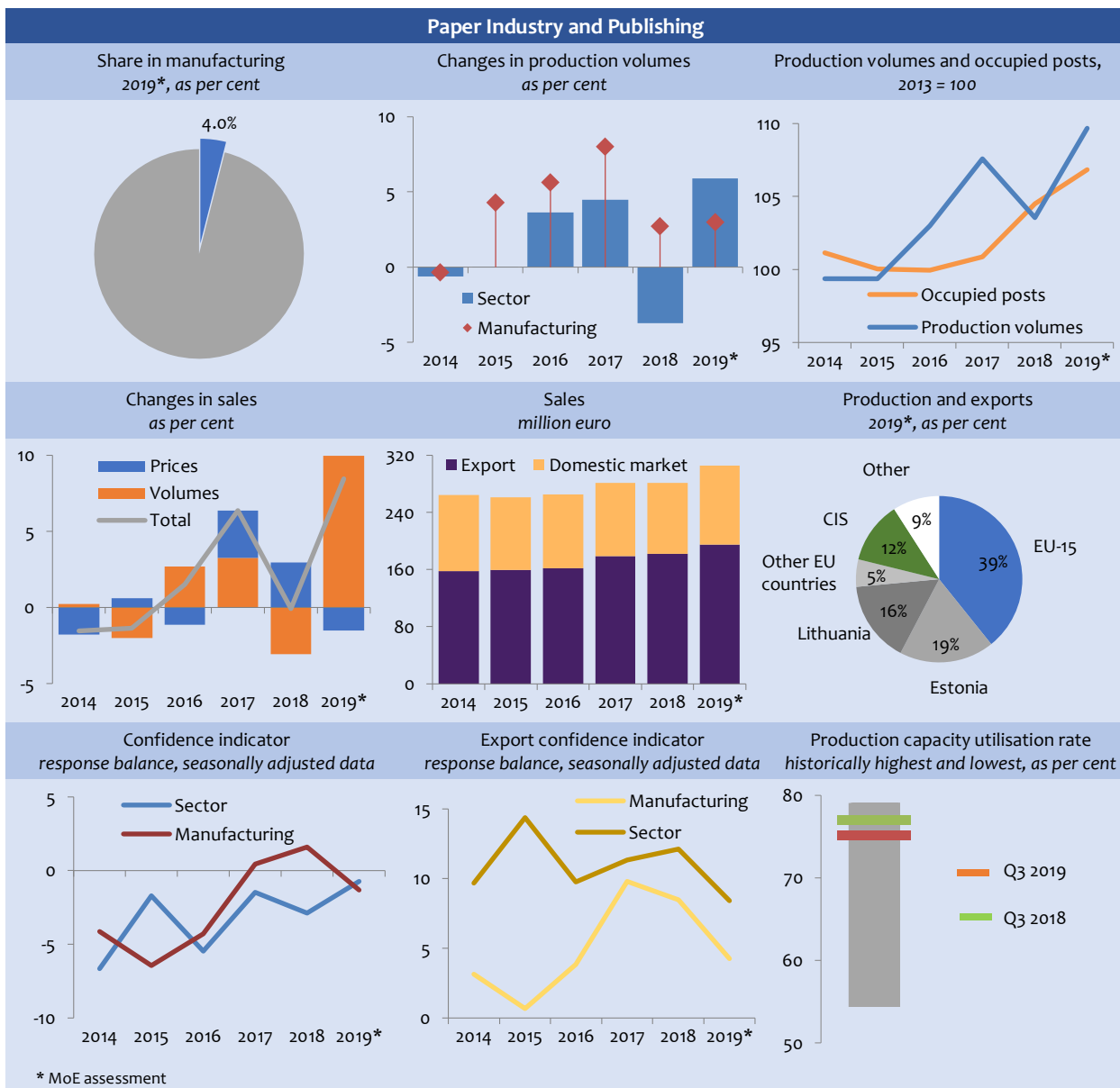
market. The EU countries are the main outlet for the products.

In recent years, the number of occupied posts in the paper industry and publishing has also been growing more rapidly than in manufacturing on average.

Although the confidence indicator of the sector has been very volatile over the years, future export opportunities of the sector are still evaluated positively.

The capacity utilisation rate of the industry in the paper industry and publishing subsector is similar to the average in manufacturing.

Figure 4.9



Chemical industry output volumes increased considerably in 2016-2017, which is partially explained by the improvement of the economic situation in Russia and CIS countries, which is an important outlet for products of the chemical industry. Year 2018 was also successful for the chemical industry, when industry volumes outpaced manufacturing growth rates.

In the ten months of 2019, rates of the sub-sector have slowed down but are still at the average level of manufacturing. Growth is created by the rapid increase in production volumes of the pharmaceutical sector, while volumes of manufacture of chemical products and rubber and plastic products in this period have reduced.

Both in 2017 and 2018, sales volumes of the industry grew considerably. In 2017, the rapid increase was affected by the increase in volumes of exported products, but in 2018

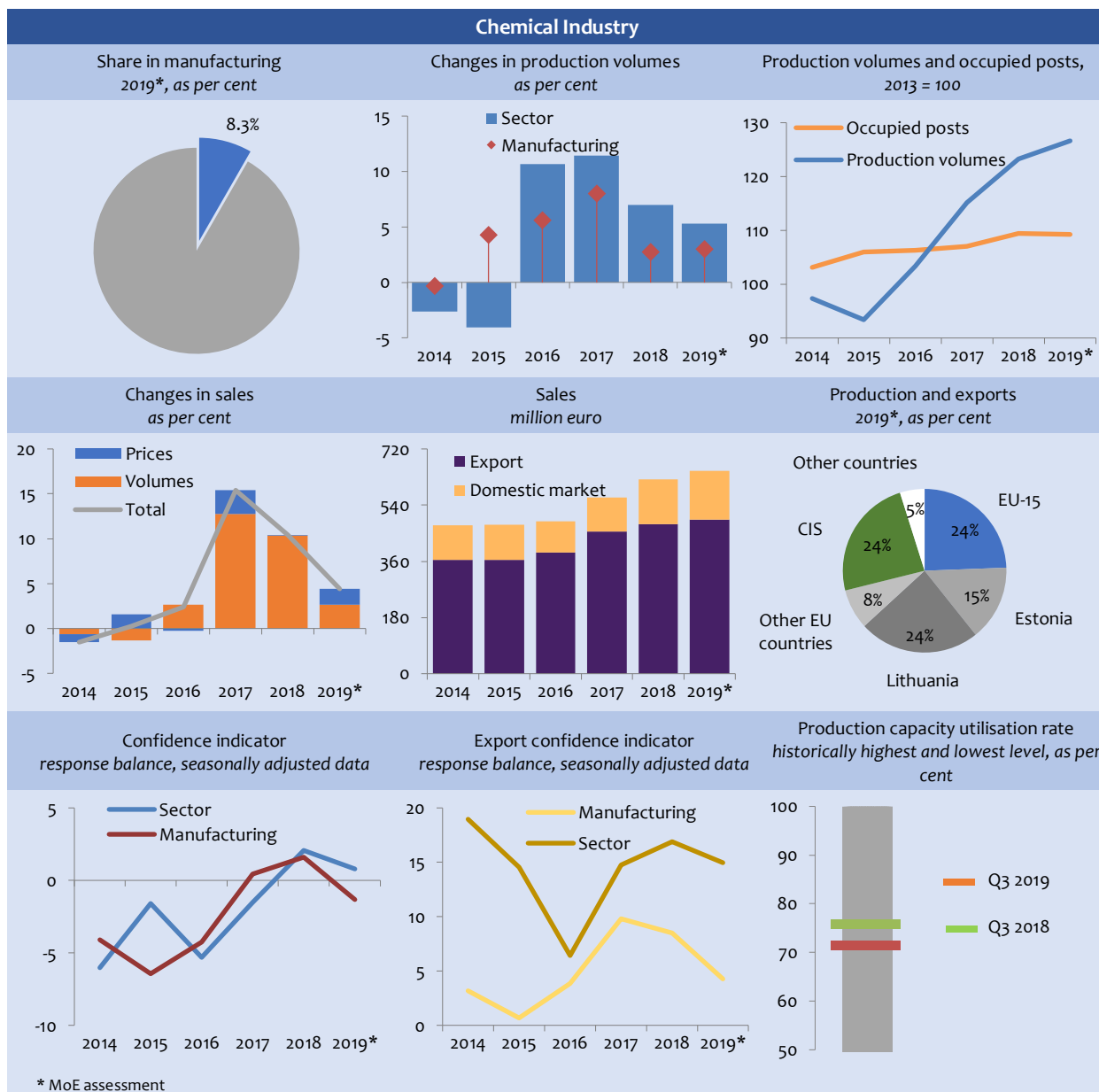
by the increase in volumes of products sold in the domestic market. Sales volumes in the domestic market and export market continue to grow also in the ten months of 2019.

The chemical industry is the only manufacturing sector, where the number of occupied posts is growing year on year. In 2018, their number increased slightly faster, but in the three quarters of 2019 – more moderately.

Good industry growth rates also secured a positive confidence indicator in the chemical industry. Also export opportunities of the sector are estimated as optimistic.

In 2017-2018, the capacity utilisation rate of the sector, which is similar to the average in manufacturing, increased, however, it significantly lags behind historically highest level.

Figure 4.10



Manufacture of other non-metallic mineral products is closely related to the demand of the construction sector. Sharp growth was observed in the sector in 2016-2017. By contrast, as the demand for products of the sub-sector reduced, year 2018 was not favourable for the industry. In the ten months of 2019, in comparison with the previous year, volumes of manufacture of other non-metallic mineral products have declined.

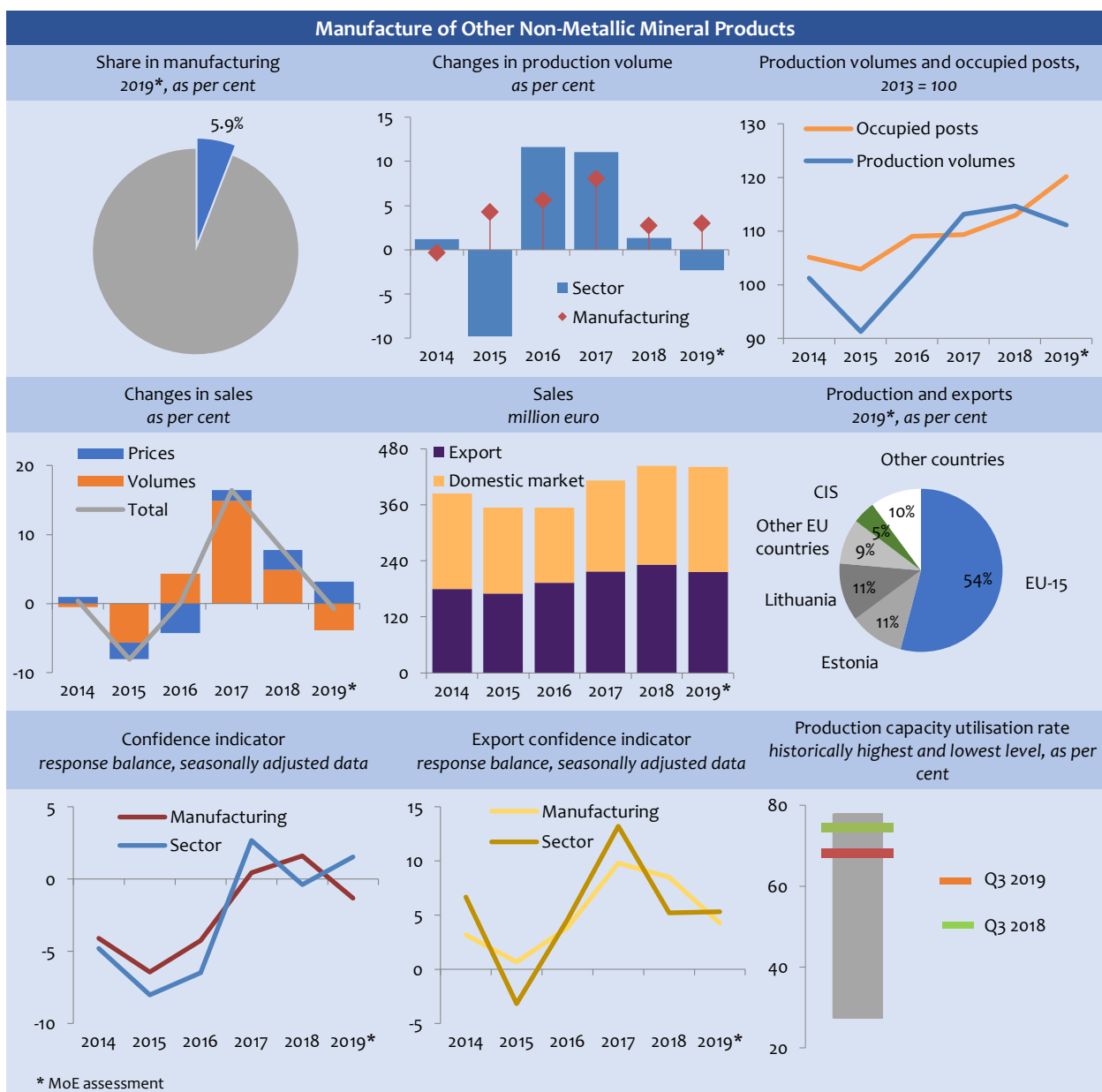
In 2017-2018, sales of products also increased a little bit more rapidly than production volumes of the industry. In 2017-2018, the sales turnover grew at a similar pace in the domestic market and export markets. In the ten months of 2019, sales volumes increased in the domestic market, but reduced in the export market.

The number of occupied posts in the industry has increased moderately in recent years. However, in the three quarters of 2019, the number of occupied posts in manufacture of other non-metallic mineral products has significantly increased making the largest contribution to the increase in jobs in manufacturing among all sectors.

The confidence indicator of the sector has been developing similarly to growth of the sector in recent years. In 2019, confidence of the sector is evaluated positively. The evaluation of export opportunities has also been positive in recent years.

The capacity utilisation rate increased considerably in 2018, but in 2019 it declined and remains among the lowest in manufacturing sub-sectors.

Figure 4.11



In 2015-2017, the *metalworking* sector contributed significantly to the total growth of the manufacturing. Although production volumes of the sub-sector increased more moderately in 2018, they were still above the average level of the industry. Year 2019 was also favourable for the industry. In recent years, growth of the sub-sector has been secured by an increase in the output of finished metal products.

Since more than two thirds of the products produced by the sub-sector are exported, it should be noted that manufacture of basic metals and articles thereof is significantly affected also by competitiveness of the EU steel manufacturing sector on the global market, which has worsened in recent years. The EU countries are the main outlet for the products.

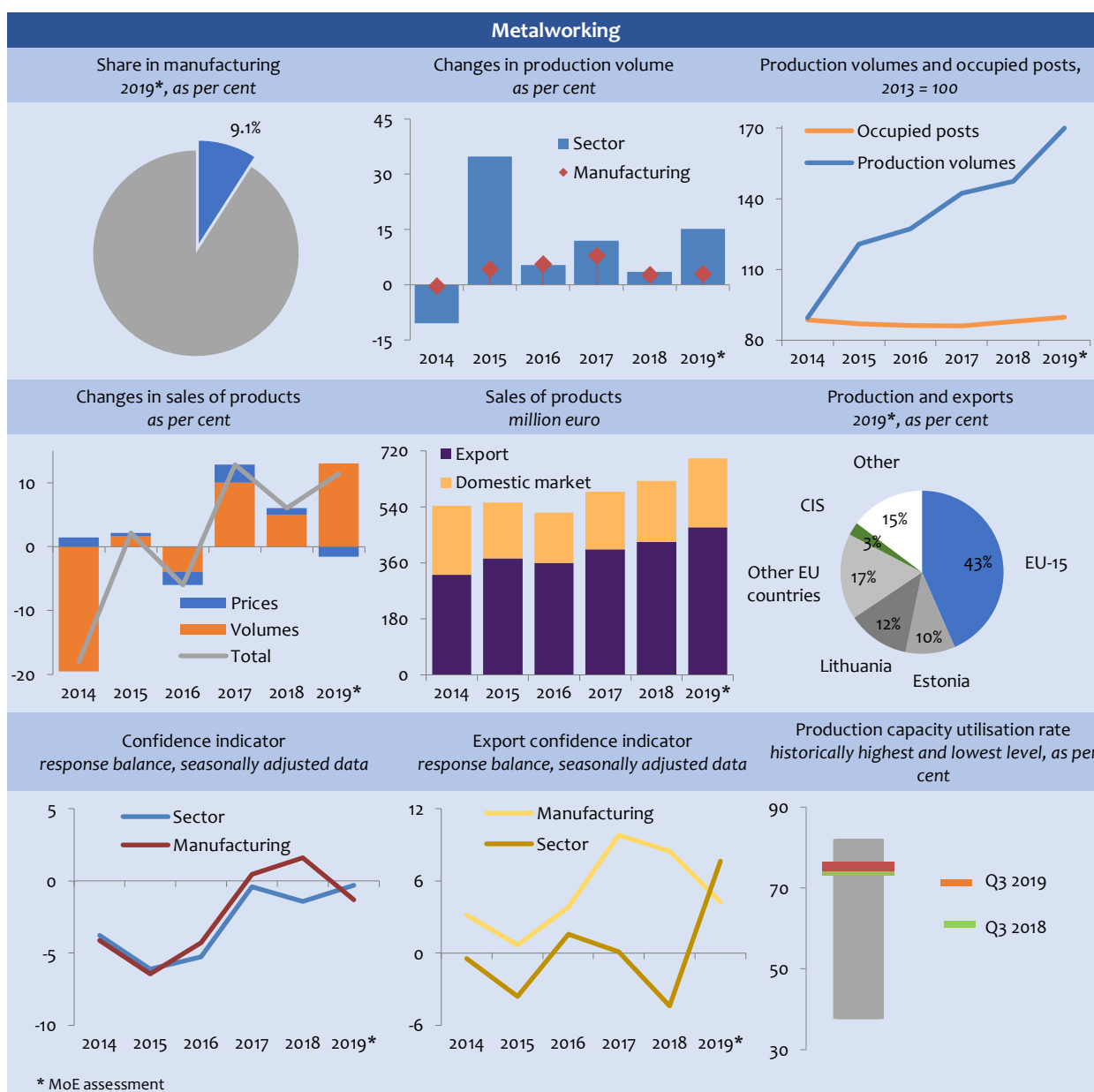
Sales volumes of the sector have also been growing rapidly in recent years. Volumes of products sold in the domestic market and exported products are growing equally rapidly.

The number of occupied posts in the metalworking industry slightly increased in 2017-2018. The number continued to increase also in the first half of 2019.

The confidence indicator of the metalworking sector has improved in recent years, but still remains negative. Export development opportunities are evaluated in a clearly optimistic way in 2019.

Capacity utilisation in metalworking is similar to the average in manufacturing.

Figure 4.12



Manufacture of electrical and optical equipment in recent years has been the most rapidly growing manufacturing sector. Industry growth rates have been considerably higher than in manufacturing on average. Due to the rapid growth of the industry, its share in manufacturing is growing year on year.

Despite fluctuations in Producer prices, sales volumes of the industry are also growing stably. The development of the sector is closely related to external demand, because more than 90% of the production of the said industry is exported. Sales of products are growing equally rapidly on the export and on the domestic market.

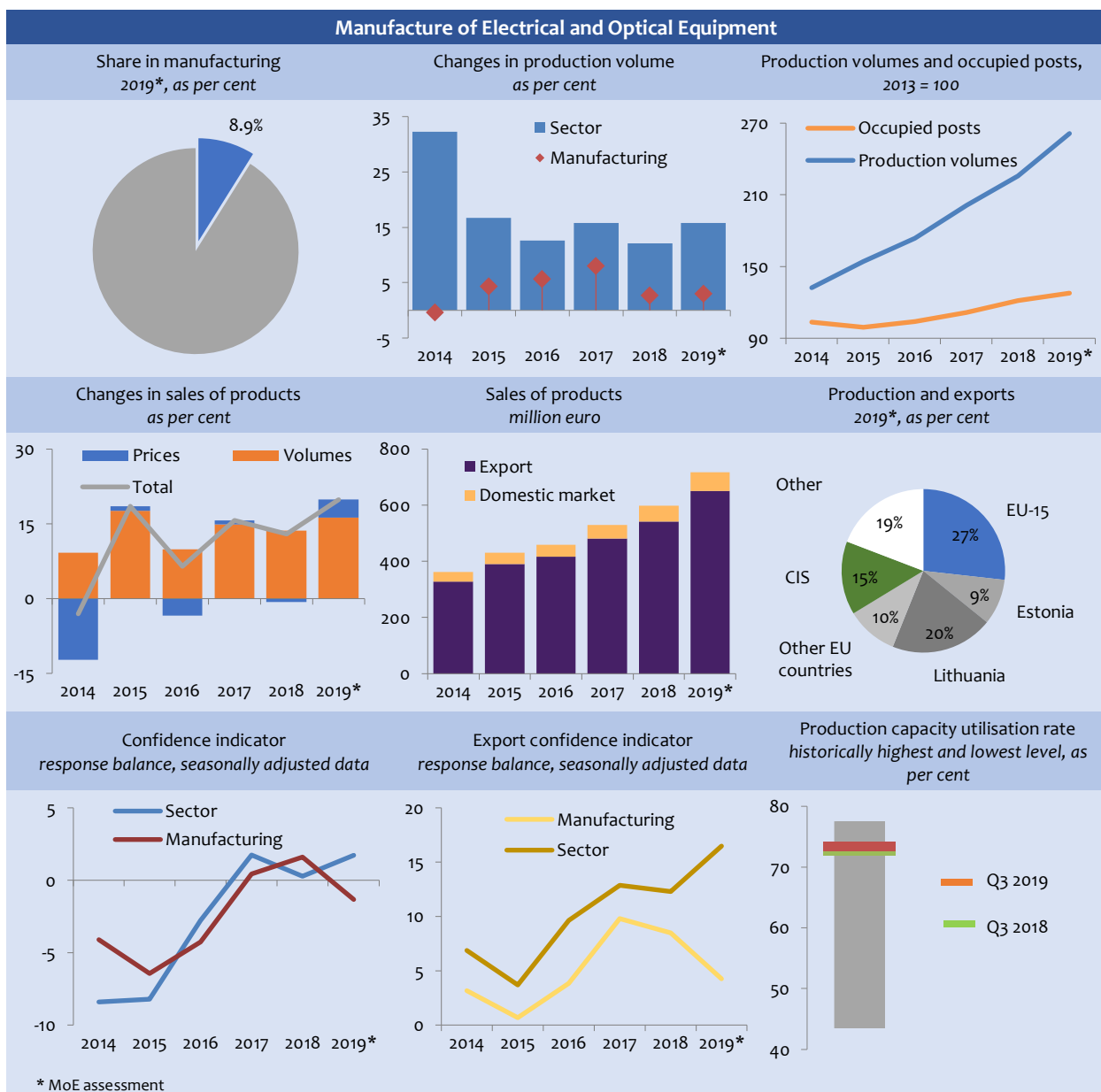
Although most of the industry's growth is ensured by the rise in productivity, the increase in the number of jobs has

also been comparatively rapid in recent years. In 2017-2018 the sub-sector secured half of the increase in the number of occupied posts in manufacturing. The number of jobs is growing stably also in 2019, when in Q2 it was by 1.2 thousand higher than in 2014.

The confidence indicator of production of electrical and optical equipment has improved in recent years, and its future prospects are evaluated positively. Also export opportunities of the sub-sector are estimated as particularly optimistic.

As the output of the sector is growing rapidly, the capacity utilisation rate is becoming increasingly closer to historically the highest level.

Figure 4.13



Growth rates in *manufacture of machinery and equipment* in 2015-2018 were considerably above the average level in manufacturing. Clearly rapid growth was observed in 2017. Since 2018, when external demand reduced, growth rates of the sub-sector have become slower.

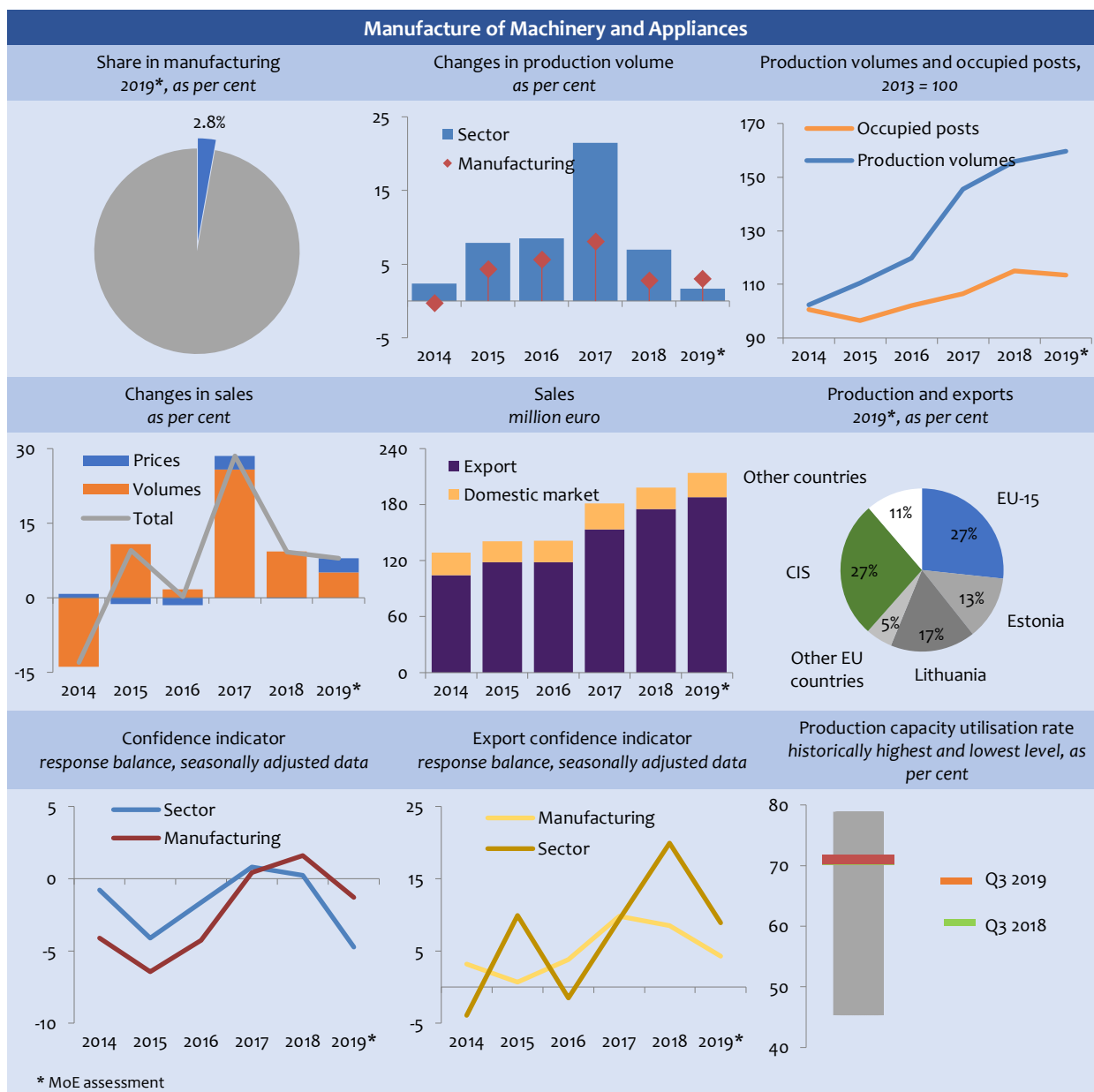
Sales volumes of the sub-sector are also growing stably. Sales volumes in the domestic market by years have been volatile, which is compensated by a rapid rise in volumes of exported products. It should be noted that about 90% of the production of the said industry is exported. The EU countries are the main outlet for the products, although considerable part of products are sold also in CIS countries.

The number of occupied posts in the sector increased in 2017-2018, when it secured a big share of the increase in the number of occupied posts in manufacturing in total. However, the number of occupied posts in the sub-sector slightly shrank in the first half of 2019.

The development of the sector has been evaluated negatively in recent years, in particular in 2019, but the potential of export opportunities is still evaluated in an optimistic way.

Although the output of the sector has been growing year on year, the capacity utilisation rate has not significantly changed and remains slightly below the average level in manufacturing.

Figure 4.14



Manufacture of vehicles is clearly focused on external markets – more than 90% of products of the industry are exported. Since the industry largely depends on new orders, it is characterised by very pronounced fluctuations in production volumes.

Comparatively rapid growth of the sub-sector was observed in 2017-2018, when external demand increased. This was considerably affected by the increase in production volumes of cars and trailers. By contrast, in the ten months of 2019 production volumes of the sub-sector have slightly shrank.

Sales volumes of the sector also grew comparatively rapidly in 2017-2018. Producer prices also had a positive contribution to their growth. In 2018, volumes of products sold on the domestic and also export market increased

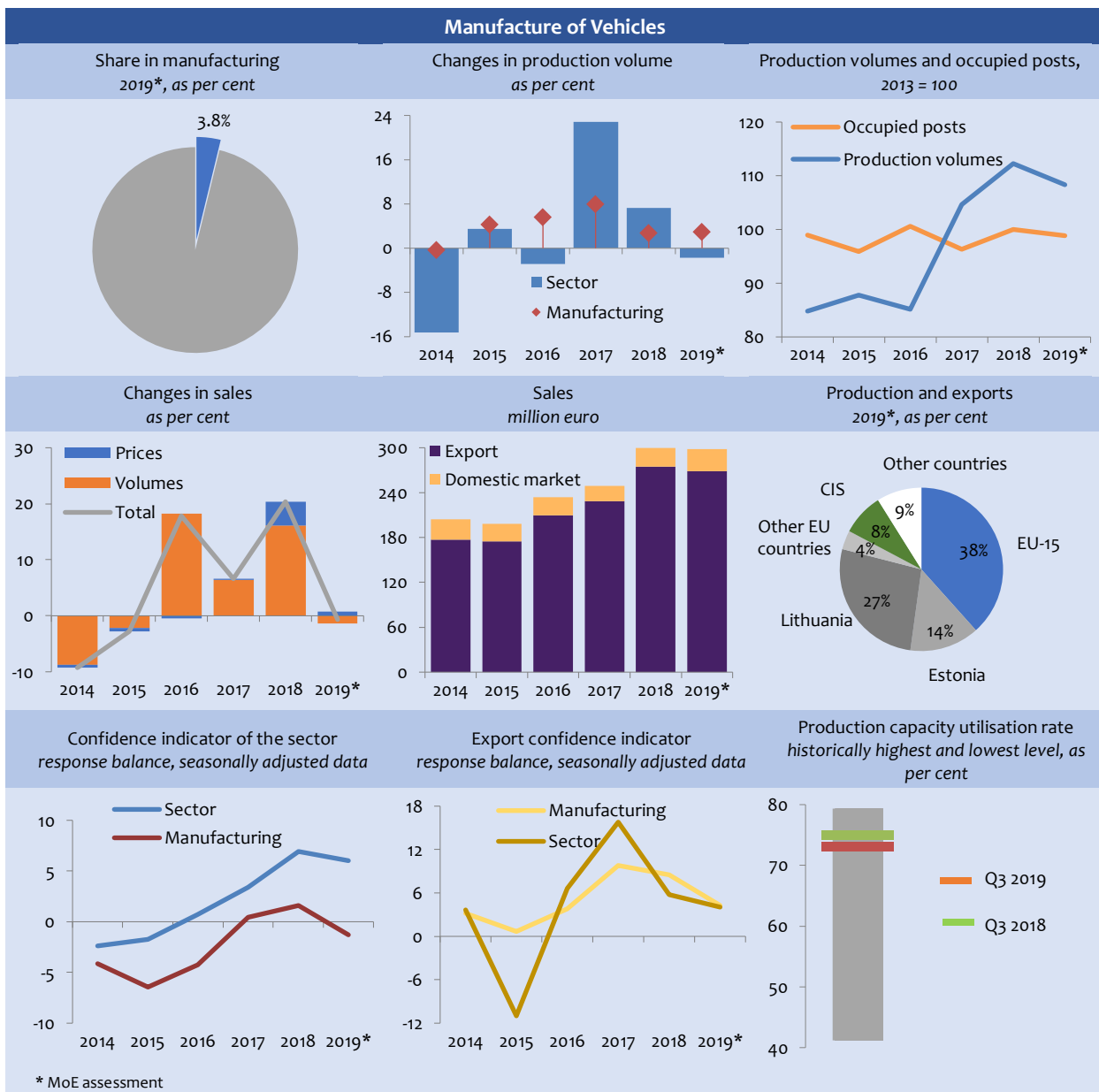
equally rapidly, while in the ten months of 2019 volumes of exported products have slightly reduced.

The number of occupied posts in manufacture of vehicles has not significantly changed in recent years, which means that growth in the industry is mainly based on the increase in productivity.

The confidence indicator in the industry is gradually improving. In the last three years, the development of the industry has been evaluated positively. Also export opportunities of the sector are estimated as optimistic.

As production volumes of the industry are growing, the capacity utilisation rate increases as well, but it is still below the average in manufacturing.

Figure 4.15



4.3. OTHER INDUSTRIES

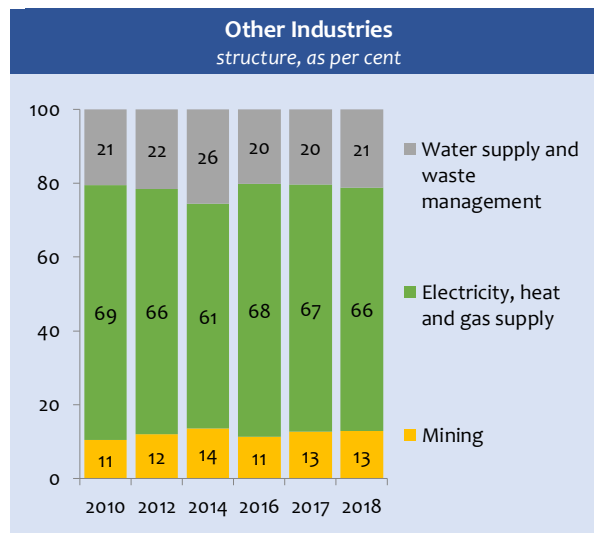
Electricity and gas supply dominate in the structure of **other industries** (mining and quarrying; electricity, gas, steam and air conditioning supply; water supply, sewerage, waste management and remediation activities). After the increase in 2015-2016, the share of other industries in the total value added has been declining since 2017. The dynamics in sales volumes in electricity and gas supply sectors is related to weather, as amounts of electricity and heat produced depend on it.

In 2015-2016, after a long drop in production volumes in the previous years, a rapid increase was observed in other industries. Considering that weather in the winter months was much colder, much more electricity and heat energy was consumed.

In 2017-2018, volumes of other industries showed a small decline affected by the drop in electricity and gas supply, as well as water supply, sewerage and waste management. At the same time, the share of the mining industry increased fostered by a rapid increase in peat extraction volumes.

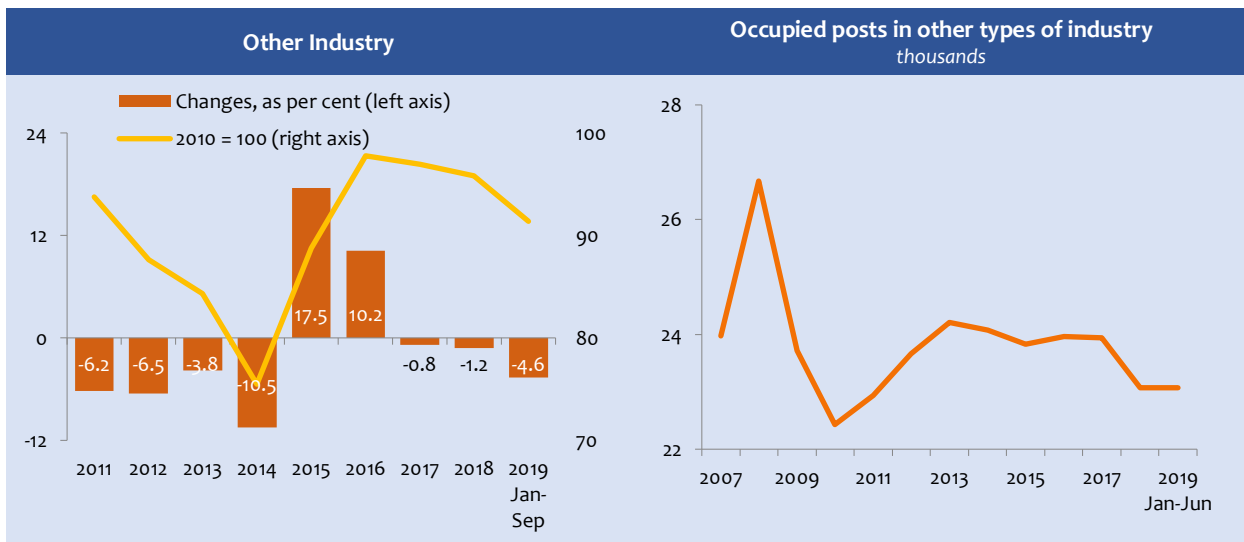
In 2019, a rapid decline has been observed in other industries – the amount of electricity generated by hydropower plants and cogeneration plants, and gas supply to consumers reduced considerably in January-April under the effect of warm and dry weather.

Figure 4.16



The number of occupied posts in all industries has increased since 2010, but the number of jobs has been shrinking in recent years. In 2018, jobs increased in mining only.

Figure 4.17



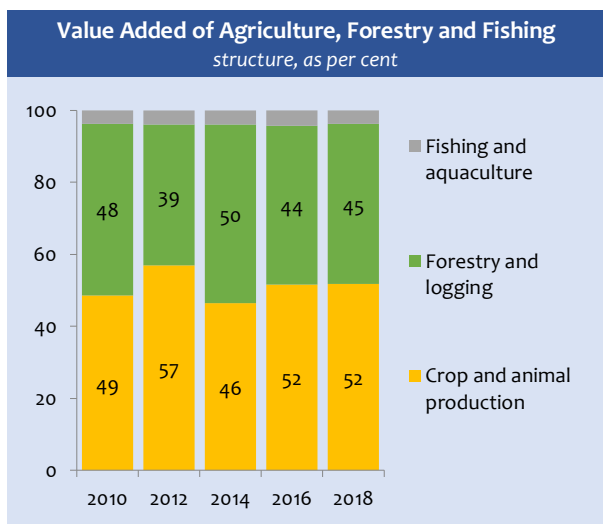
4.4. AGRICULTURE, FORESTRY AND FISHING

Agriculture and forestry dominate in the structure of **agriculture, forestry and fishing**. The activity of the industry is closely related to weather conditions; therefore, growth of the industry is generally volatile. After the increase in 2014-

2015, the share of the industry in the total value added reduced in 2016 due to the decrease in crop production. The share of the industry has increased in recent years.

In 2014, the animal production sector was negatively affected by the restrictions on food imports for dairy products imposed by Russia, while the harvest of crops and volumes of grown vegetables in plant production increased. Forestry was positively affected by growth in wood processing.

Figure 4.18

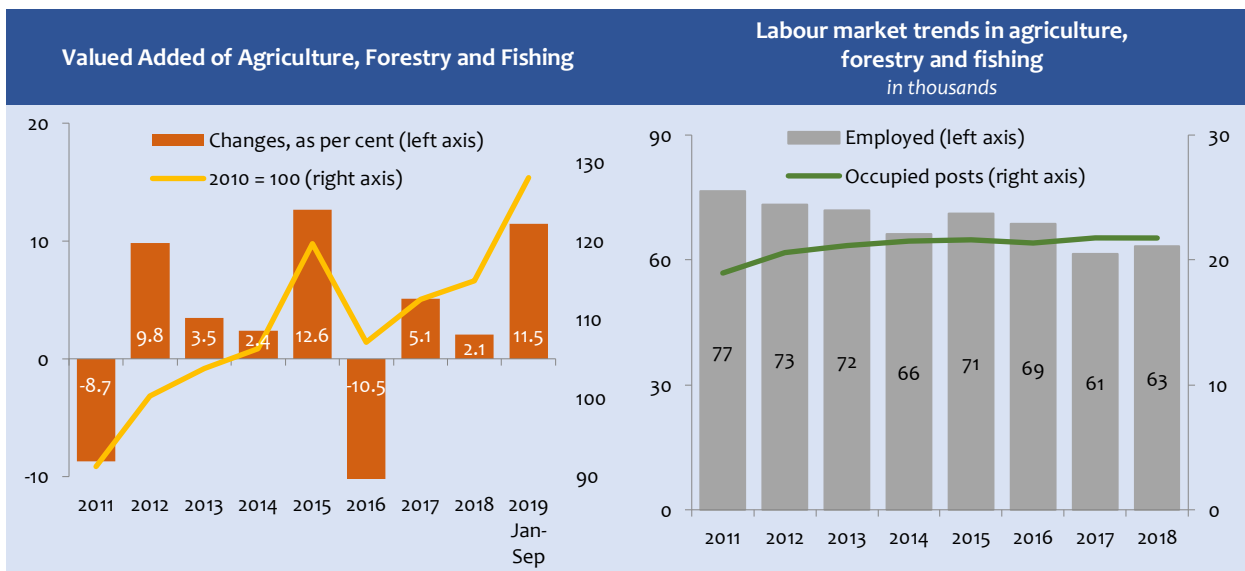


In 2015, despite Russia's embargo on food imports, there was a very rapid growth in agriculture and forestry, fostered by the historically highest harvest of crops.

In 2016, volumes of the industry shrank sharply, which was underpinned by the fall of crop production volumes. Harvest of crops declined due to meteorological conditions; however, it was one of the highest in the history of Latvia, it was higher only in 2015. At the same time, prices of agricultural products shrank which was mainly affected by the falling prices of crop products. It should be noted that the average milk purchase price in 2016 was the lowest since 2010 – 215 euro per ton. It increased sharply in the second half of the year. Volumes of cut wood and forest renewal volumes reduced, average purchase prices of logs continued to reduce.

In 2017, rapid growth was observed in the sector due to the increase in forestry volumes. Volumes of cut wood and forest renewal volumes increased sharply. After a decline over the previous three years, average purchase prices of logs in Latvia increased in 2017. The increase in volumes of agriculture was modest. Although there was unfavourable weather, the historically highest average crop harvest was reached in 2017, caused by productivity of winter crops, because the crops were gathered before the unfavourable weather. By contrast, autumn 2017 was particularly unfavourable – productivity of spring crops has been the lowest in the last six years. The number of exported livestock and pigs in animal production increased despite the effect of the African swine fever. Volumes of meat, milk and egg production also increased. At the same time, prices of agricultural products increased considerably in 2017. Purchase prices of milk increased most rapidly – by 42.6% (to 306 euro per ton).

Figure 4.19



In 2018, very moderate growth was generally observed. The increase was mainly based on growth in forestry. In 2018, volumes of cut wood increased significantly – by 12%, but forest renewal volumes increased much more moderately – by 2%. Afforestation of lands not used in agriculture is growing rapidly. Average purchase prices of logs continued to increase in Latvia.

The volume of products in agriculture reduced by 11.2% in 2018. Crop production volumes reduced by 20.6%, which was caused by the lowest total crop harvest in the last five years and the lowest average crop harvest in the last seven years. The total crop harvest was significantly affected by a long draught period, as well as a considerable reduction of areas of winter sowing due to incessant rains in autumn

2017. Long draught had an unfavourable effect on growing of vegetables; however, the total harvest of potatoes increased. Animal production volumes remained unchanged in 2018. The number of farmed animals reduced, while an increase was observed in the number of poultry. Despite the decline of total number, the number of exported live cattle increased. A small increase was observed in meat production volumes, but milk and egg production volumes declined.

At the same time, prices of agricultural products increased considerably in 2018 caused by the increase of prices in crop production due to smaller harvest. The average purchase price of crops increased to 168.34 euro or by 16% reaching the highest price since 2014. Meanwhile, the average purchase price of meat and milk reduced, but the price of eggs remained unchanged.

In 2019, a rapid increase in volumes of the industry is observed due to favourable weather and rapid growth of crop production. In the nine months of 2019, volumes of forestry increased by 2.7 per cent.

The number of the employed has reduced rapidly, but the number of occupied posts in the industry is growing and has exceeded the pre-crisis level. This is explained by a different data registration system. The employed include self-employed persons, who constitute about half of the total number of the employed in agriculture, forestry and fishing. Occupied posts increase due to the increase in jobs on wage, while the number of employees reduces due to the drop in the number of self-employed, which means that labour force on wages is increasingly used in the industry.

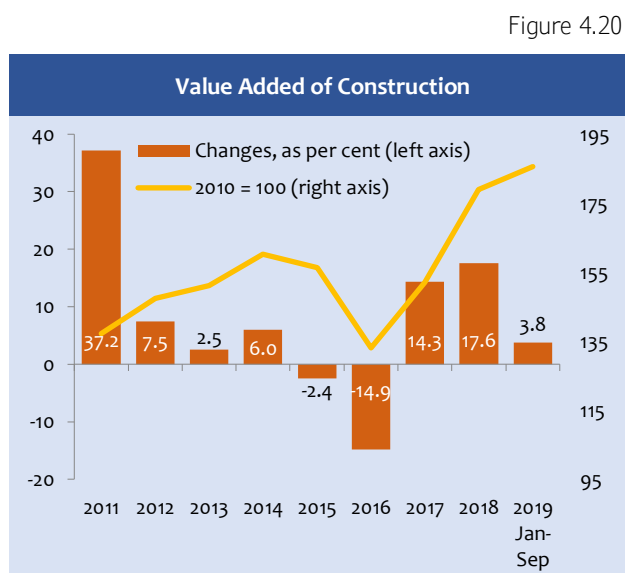
4.5. CONSTRUCTION

Growth of **construction** is largely subject to cyclical fluctuations. Production volumes dramatically declined during the crisis; industry output shrank more than twice in the period from 2008 to 2010.

The demand for services of the industry resumed growth in 2011. The recovery of the construction sector was largely driven by active acquisition of the EU structural funds. Along with the increase in internal demand, the development of the sector was positively affected by the ability to reorient to external markets during the crisis. In 2011, the volume of construction products outside Latvia exceeded the indicator of 2008 more than 5 times. Growth of the construction sector continued in the period from 2012 to 2014.

Overall, during this time the sector was rapidly recovering from the shock caused by the crisis. This was largely fostered by public orders and the European Union structural funds. The annual increase in the average volume of construction products in the post-crisis period in 2011-2014 was 11.2%. It should be noted that pre-crisis volumes have not been reached yet, the industry constituted 70% of the pre-crisis level in 2014. The increase in construction activities also reflected in the increase in the number of granted building permits.

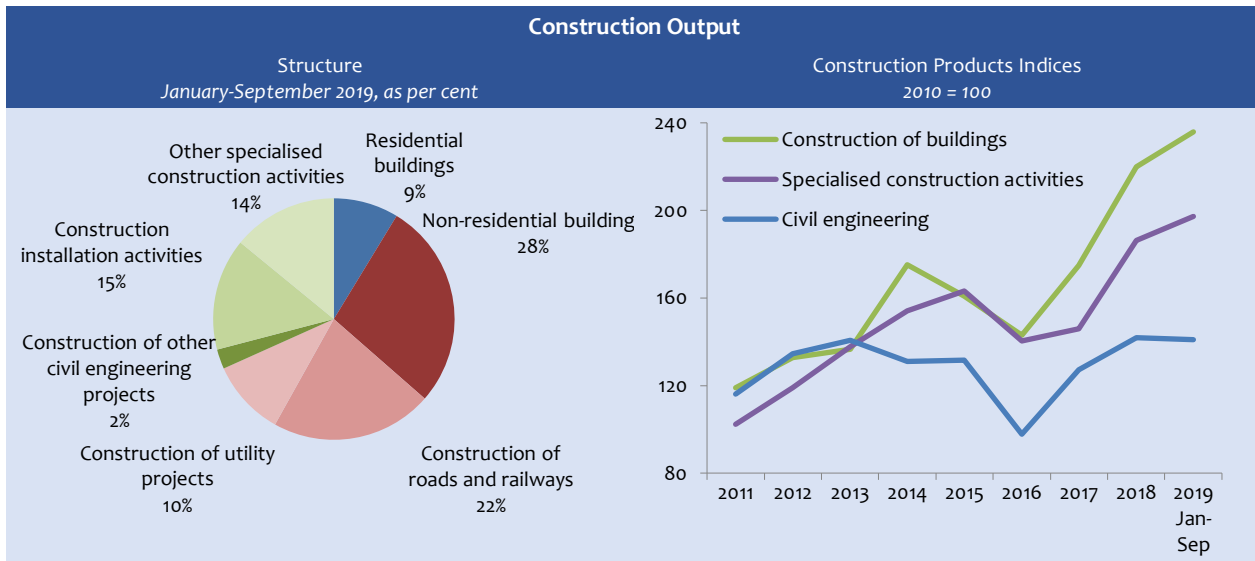
The development of the construction sector ceased for the next two years. It can mainly be attributed to the transition period of the EU structural funds, when investments in construction declined. In 2015-2016, volumes of construction products shrank by 8.6% per year on average. Construction activities shrank in all groups, most rapidly in the group of civil engineering. Negative trends also contributed to the reduction in the number of granted building permits in these years.



The construction sector resumed its growth in 2017 after a two-year break. Rapid growth was observed in 2017-2018. In the period, the average increase in production volumes of the industry was 20.3% per annum. Industry development drivers were the increase in intensity of implementation of projects of EU structural funds after a transition period, as well as the inflow of private investments for construction of large construction objects.

Volumes of products significantly increased in all main groups of construction. The increase in construction of buildings made the biggest contribution, which was 24% on average in 2017-2018. The annual average increase rate in civil engineering was 20.8%, while in specialised construction activities – 15.9 per cent.

Figure 4.21

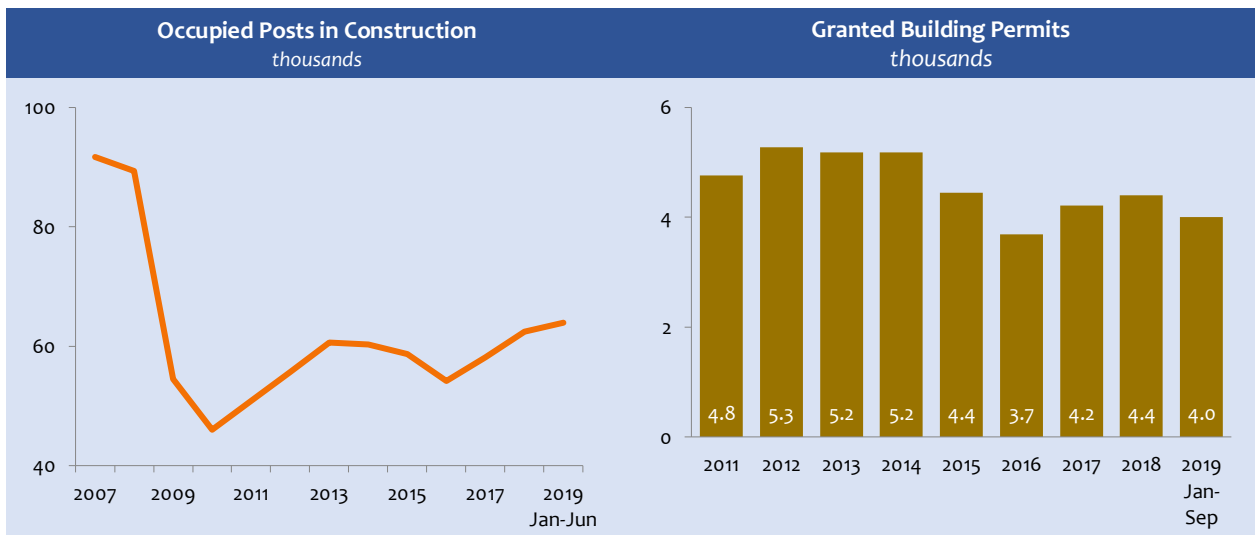


The construction sector continues to grow in 2019, yet at a lower rate than in the last two years. In the 3 quarters of this year, the increase was 3.8%, compared to the 3 quarters of 2018. In 2019, development trends of the sector are affected by the base effect or the high results reached as a result of rapid growth in the previous years. The affecting factors are completion of large private construction projects and the flow of investments from EU structural funds, which has reached its maximum.

The development of construction of buildings and specialised construction activities has affected the comparatively small increase in 2019. Civil engineering, on the contrary, remained at the previous level.

The number of granted building permits has been growing for several years, and in the 3 quarters of 2019 it reached 4006 permits exceeding the indicators of the respective period of 2018 by 17.8%. Most of building permits or almost 3/4 have been granted for construction of new buildings.

Figure 4.22



The export potential of the industry has grown considerably in the last decade. In 2008, the industry almost completely operated in the domestic market, less than 1% of the total volume of construction works were carried out outside Latvia. Since 2017, at least 1/10 of the volume of construction products were exported.

In the last two years, the development of the industry has affected the prices of services provided by builders. The index of construction costs has been growing more rapidly since 2017 than in the previous years. When analysing the increase in construction costs, it should be concluded that wages of workers apply the biggest pressure on the costs.

The construction was actively attracting employees in the period before the crisis. In 2005-2007, the number of occupied posts increased by almost 30 thousand reaching 91.7 thousand. During the economic recession, the number of persons employed in the sector was significantly adjusted reducing almost twice.

The number of the employed started to evenly increase in 2011. A reduction was observed in 2015 and 2016, when

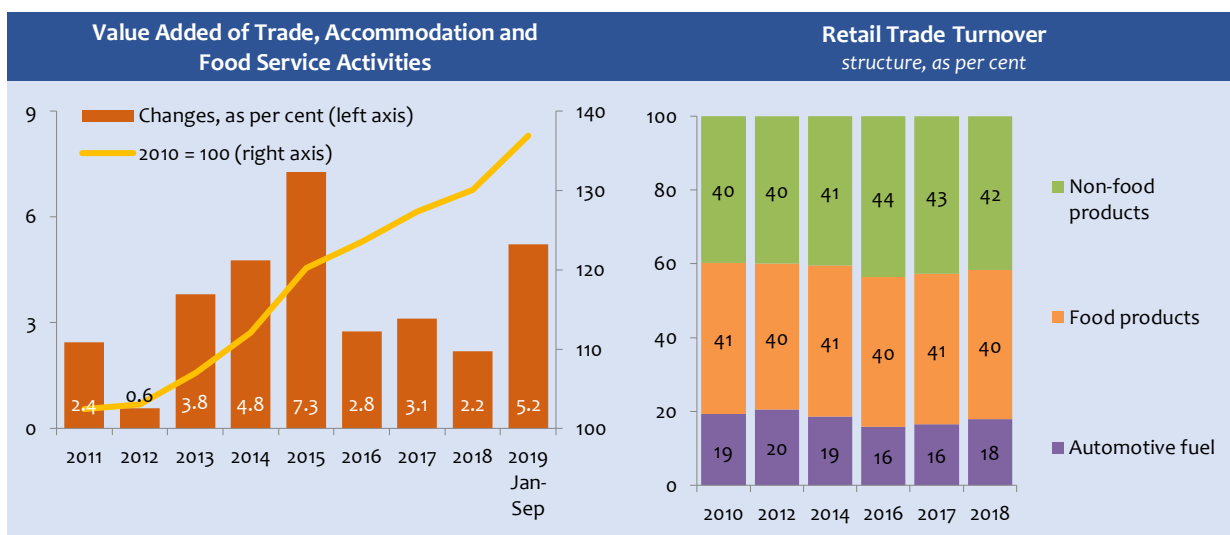
outputs of construction products reduced. Since 2016, the sector has resumed attraction of employees. At present, the number of the employed exceeds 60 thousand and is higher than in 2010; however, increase rates were considerably slower than the increase in outputs. This means that the sector is largely developing at the account of the increase in productivity.

4.6. TRADE, ACCOMMODATION AND FOOD SERVICE ACTIVITIES

Trade dominates in **trade, accommodation and food service activities** – about 90%. Volumes of services provided in the sector have been growing since 2010. The trade sector was positively influenced by an increase in private consumption

and retail turnover. Furthermore, accommodation and food service activities positively affect the development of the tourism sector.

Figure 4.23

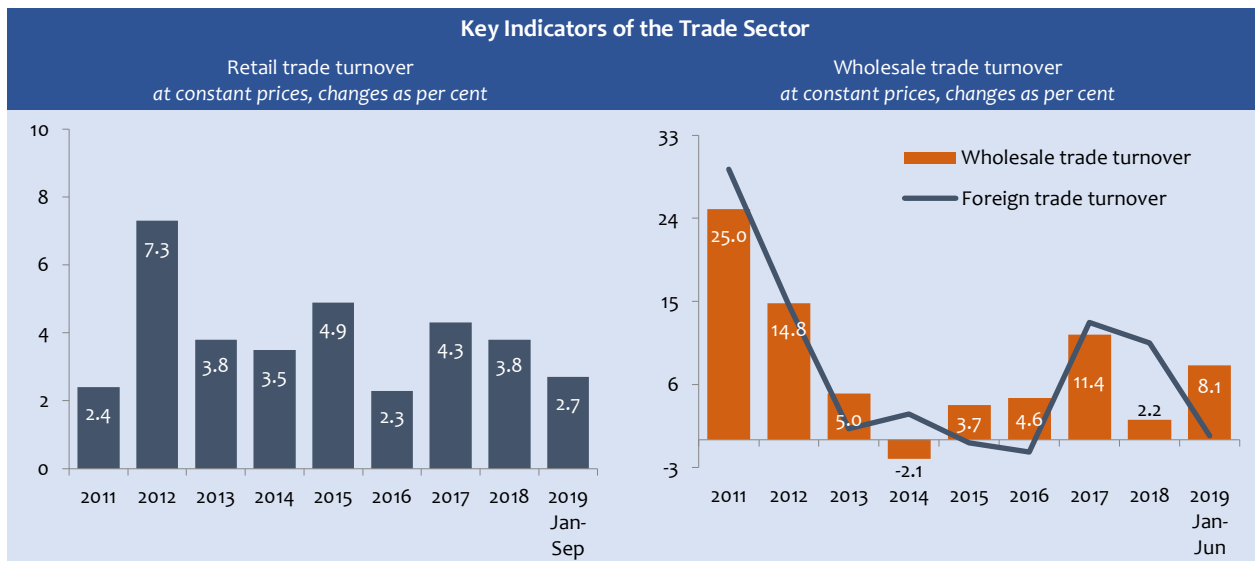


Although retail trade turnover was growing rapidly, overall growth in trade was very moderate in 2010-2012. In 2013-2015, growth in the entire sector was very rapid. In this period, growth rates of both trade and accommodation and food service activities were essentially similar – by 5.2% and 6.1% per year on average, respectively. In this period, retail turnover increased by 4.1% per year on average. Retail volumes increased equally rapidly in the automotive fuel and non-food products group, the increase in volumes of food products was slightly slower. Weaker external trade activities, in turn, affected low increase of wholesale trade.

In 2016-2018, the increase in the volumes of services provided in trade, accommodation and food service

activities was slower than in the previous year, which was affected by slower increase in trade volumes. Volumes in trade grew by 2.3% per year on average, while in accommodation and food service activities – by 5.3%. The increase in wages and improvements in the labour market ensured continuation of growth of retail turnover, which increased by 3.4% per year on average. The dynamics of the total retail trade turnover was most seriously affected by the increase in non-food retail trade volumes, while in the group of automotive fuel and food products retail volumes increased equally rapidly. A significant increase was observed in wholesale volumes – by 6% per year on average secured by a rapid increase in foreign trade turnover in 2017-2018.

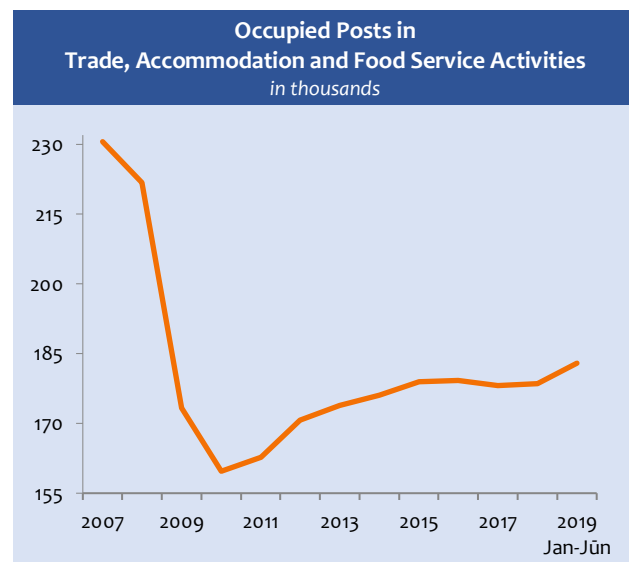
Figure 4.24



Growth of the sector continued in 2019. It has been more rapid than that observed in the previous years. In the three quarters of 2019, volumes in trade grew by 4.8%, while in accommodation and food service activities – by 7.9%. Retail trade turnover increased slower – by 2.7% in the nine months of 2019. The largest rise was observed in volumes of retail trade of non-food products, which account for 55% of total retail trade. Wholesale trade turnover increased very rapidly in the first half of 2019, despite weak foreign trade activity.

The largest share of occupied posts is in trade; however, it has been shrinking in recent years with jobs growing faster in the accommodation and food service activities sector.

Figure 4.25



4.7. TRANSPORTATION AND STORAGE

Transportation and storage is closely related to international transportation, including volumes of freight transported by railway, as well as through ports.

After a sharp increase in the post-crisis period, the sector increased only by 2% per annum on average in the period from 2012 to 2017. Among other things, it was primarily affected by the decline in transit freight transport, mainly due to the Russian transport policy and growing competition. Since the end of 1990s, Russia has been forwarding the goals to develop its own transportation infrastructure to be independent from transit countries.

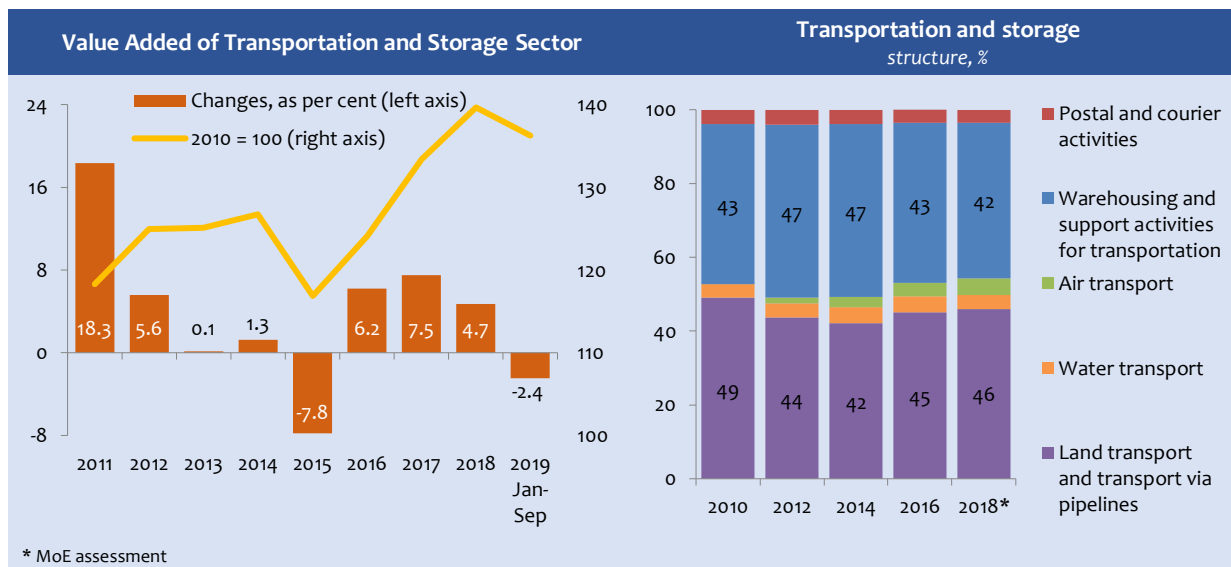
Despite the drop in transit freights by railway and in ports, growth of the sector was fostered by the increase in freight transport by road, as well as the increase in the number of passengers in the airport and seaports. In 2017, the increase in volumes of the sector was the fastest since 2011.

Rapid growth was also observed in 2018. Passenger and freight transportation by all modes of transport increased. Carriage of passengers increased by 15%, freight transport – by 5%, postal and courier activities – by 17.6%, warehousing and support activities for transportation – by 1.2 per cent.

In the 3 quarters of 2019, volumes of the sector have reduced by 2.4% due to the drop in freight transport by 5% and warehousing and support activities for transportation –

by 5%. Freight transport reduced in all modes of transport. In the 3 quarters of 2019, carriage of passengers increased by 3% and postal and courier activities – by 24 %.

Figure 4.26



The biggest share of occupied posts in transportation and storage is in land transport and transport via pipeline and support activities for transportation, where the number of

occupied posts reduces. The sharpest rise in the number of occupied posts in recent years has been in air and water transport sectors.

Figure 4.27

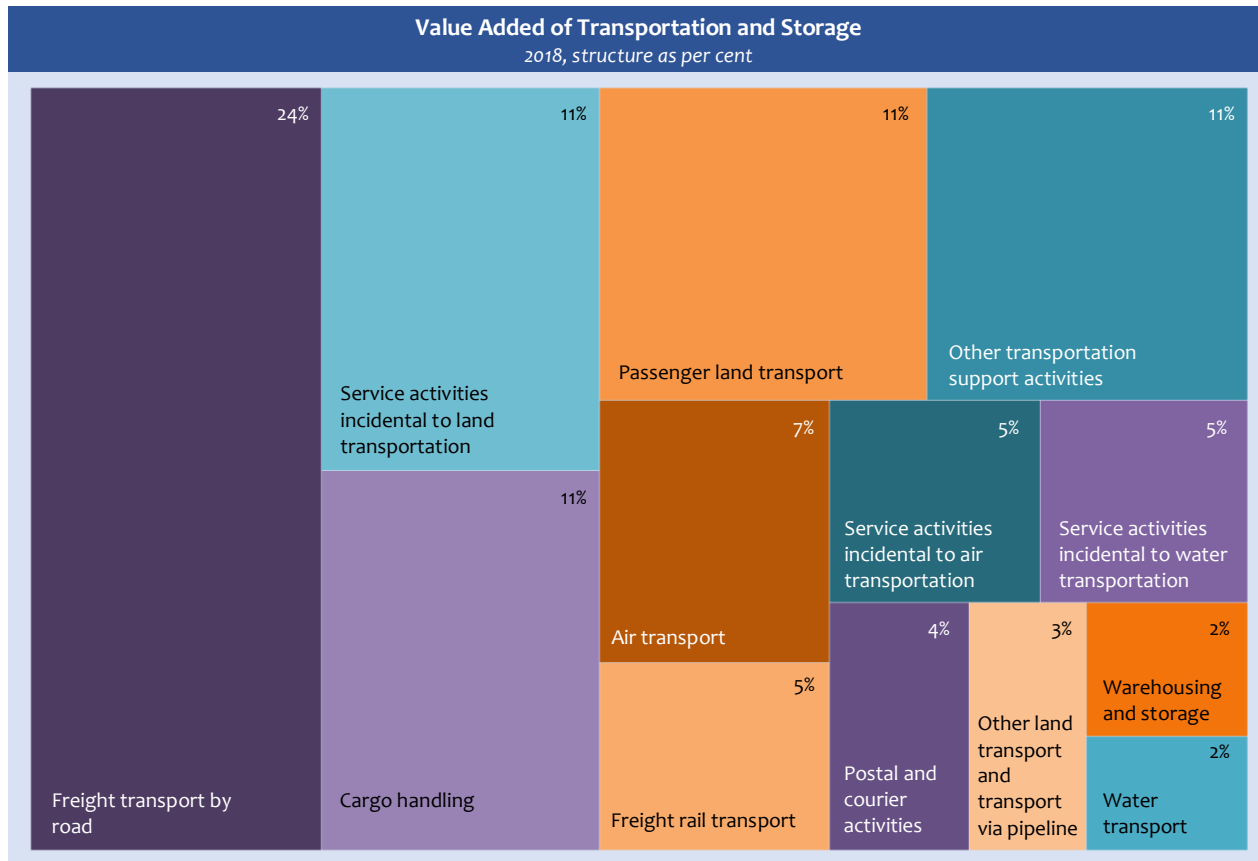
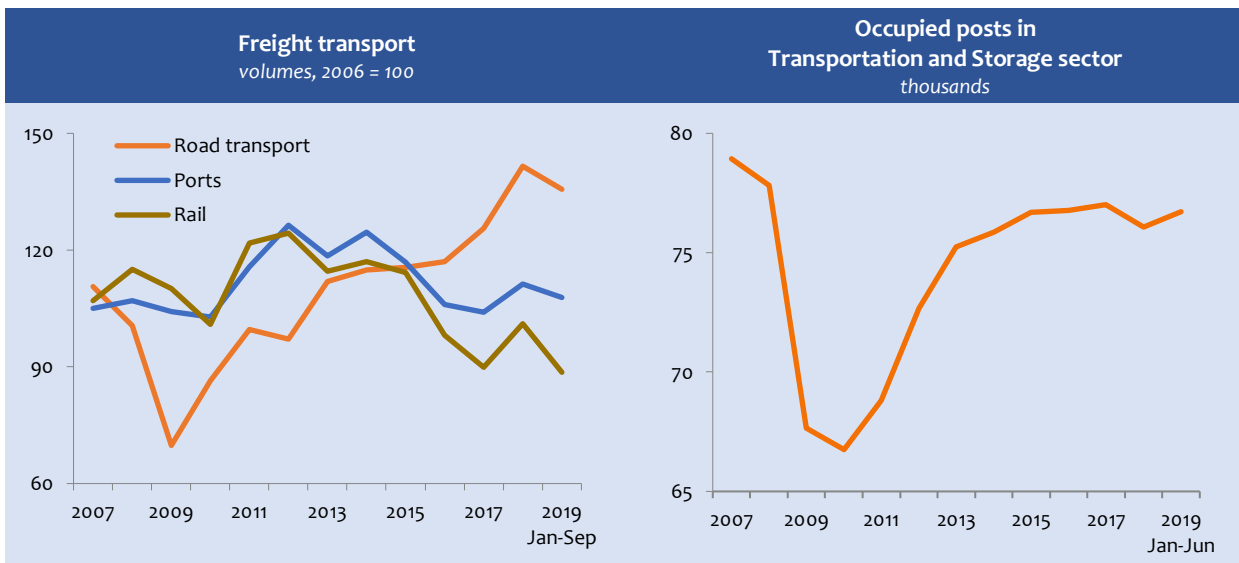


Figure 4.28



4.8. COMMERCIAL SERVICES

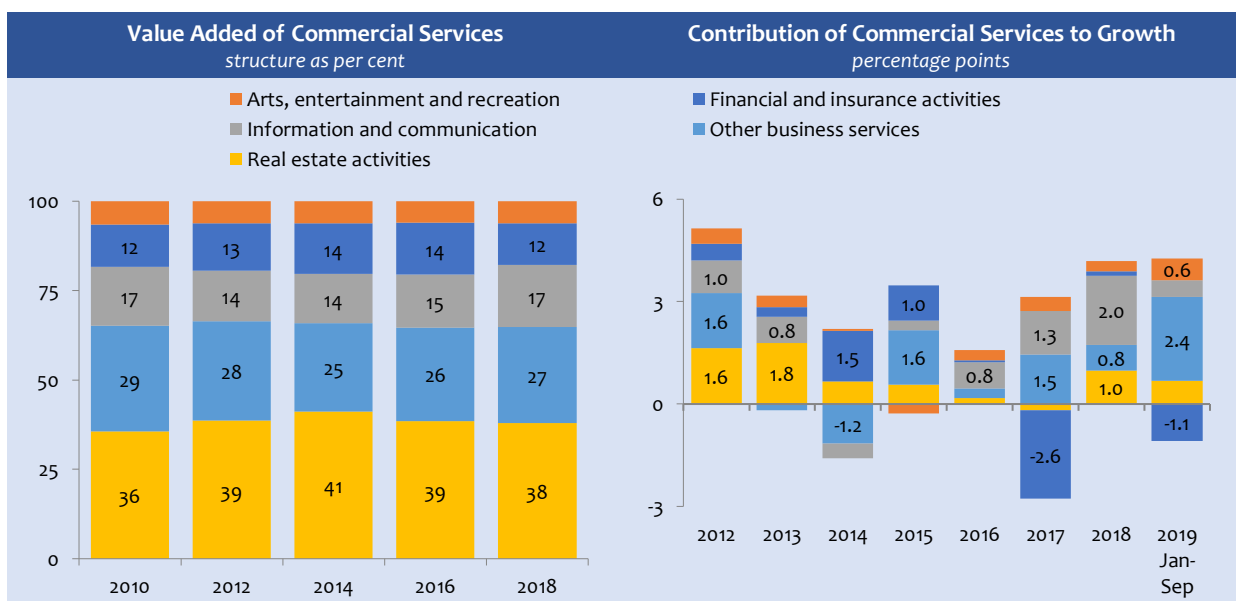
Real estate activities dominated in the structure of **commercial services** (information and communication, financial and insurance activities, real estate activities, professional, scientific and technical activities and administrative activities, arts, entertainment and recreation).

Sharp growth was observed in commercial services in 2011-2013. Volumes of the services grew by 4.2% per year on average. They increased in all the main commercial services

sectors, with the exception of financial and insurance activities.

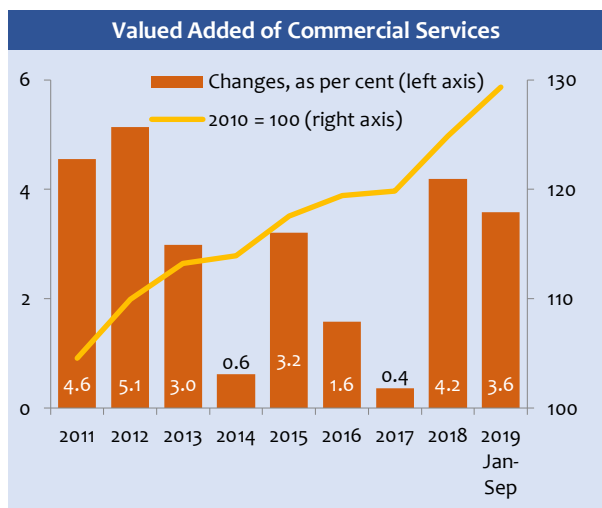
In 2014, growth of the commercial services sector was very weak due to the drop in information and communication, professional, scientific and technical activities and administrative activities. In 2015-2016, volumes of commercial services sectors grew stably; however, they were more moderate than in the post-crisis period.

Figure 4.29



In 2017, volumes of services in commercial services sectors essentially remained unchanged, affected by a rapid decline in volumes of financial and insurance activities triggered by the reduction of non-resident business volumes in Latvia, the decline of the number of employed, and merging of banks.

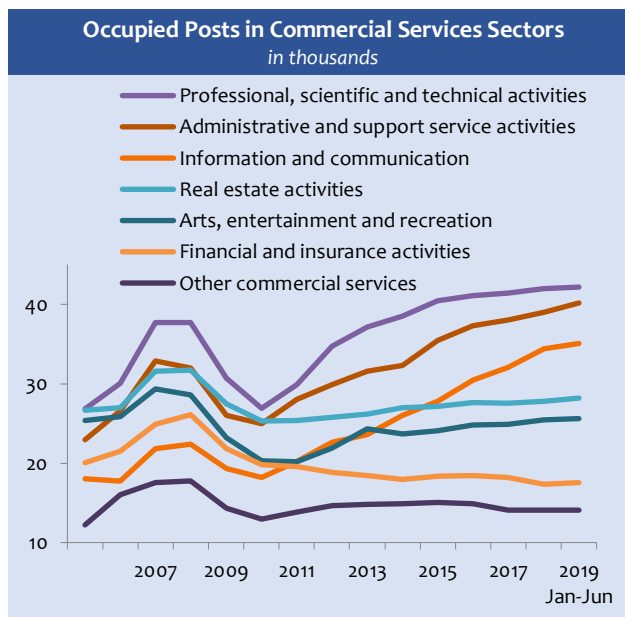
Figure 4.30



In 2018, volumes of services in commercial services sectors grew very rapidly. The increase was primarily based on growth in information and communication sector. Also, in 2019, growth in commercial services sectors continues, albeit at a lower pace than in 2018. In the 3 quarters of 2019, the largest effect came from the increase in volumes

of professional, scientific and technical activities and administrative and support service activities, while volumes of financial and insurance activities reduced.

Figure 4.31

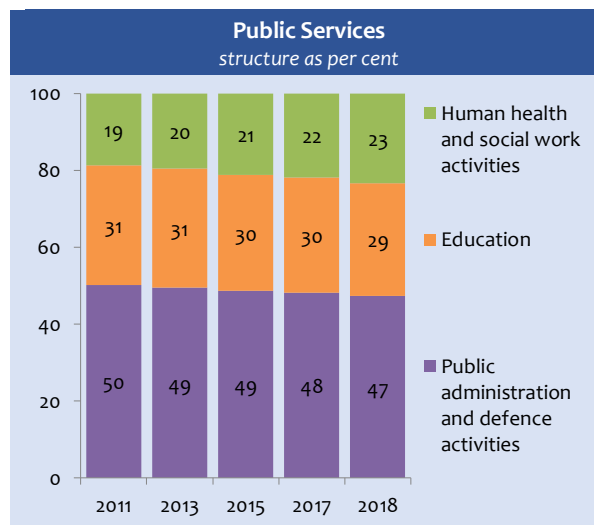


The largest share of occupied posts has been in professional, scientific and technical activities, administrative and support service activities and information and communication sectors, which had the most rapid increase in the number of occupied posts in recent years.

4.9. PUBLIC SERVICES

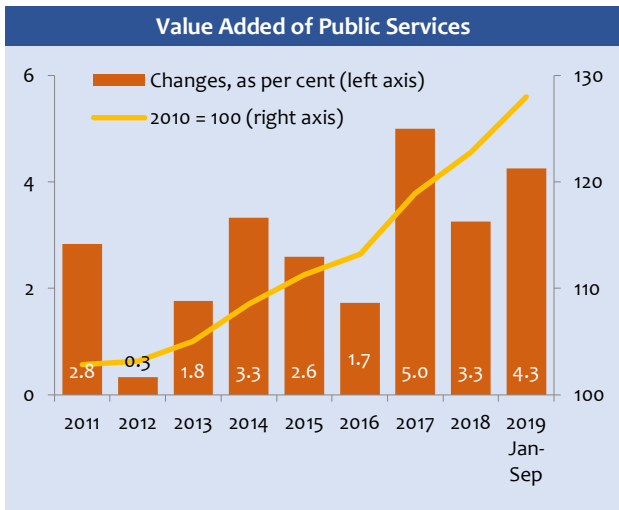
Public administration and defence activities dominate in the structure of public services (public administration and defence activities, education, health and social work activities). The government’s commitment to continue reducing the national budget deficit in the post-crisis period held back a rapid increase in expenditure. In 2012, volumes of public services essentially remained unchanged under the influence of the drop in volumes in public administration and defence activities. With the government expenditure increasing, a steady growth has been observed in the public services sectors since 2013. A slower increase was observed in 2016, when only public administration and defence activities had a stable rise in volumes.

Figure 4.32



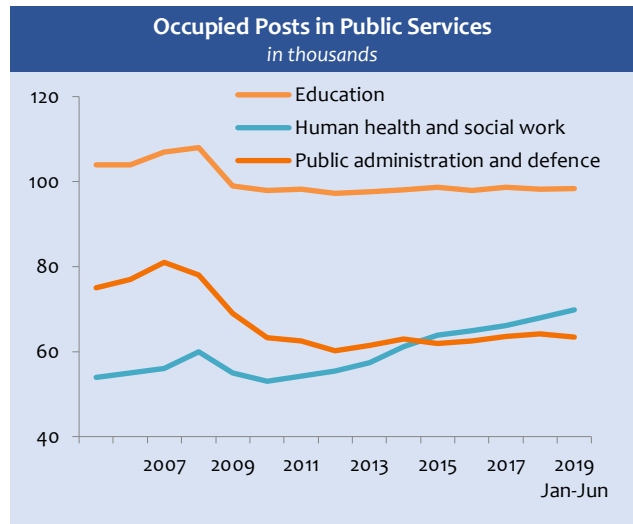
In 2017, growth of public services has been the most rapid since 2006. The sector continued to grow rapidly also in 2018 and 2019. In 2010-2018, its volumes increased by 2.6% per year average. The most rapid increase was observed in health, and the slowest – in public administration and defence activities. Public consumption on the increase of defence capabilities of the state, health and education has increased considerably in recent years.

Figure 4.33



Education has the highest share of occupied posts, while public administration and health have an equal share. The most rapid increase in recent years has been observed in health, while it remained unchanged in public administration and education.

Figure 4.34



5. ECONOMIC DEVELOPMENT FORECASTS

ECONOMIC DEVELOPMENT IN 2020¹

After a relatively fast growth in 2017 and 2018, when GDP grew by 3.8% and 4.6%, respectively, economic growth have become slower in 2019. This was affected by different internal and external factors, which were analysed in the previous chapters. Latvian exporters are influenced by weakening of global economic growth and slower growth in trade partner countries. There is still big uncertainty around the procedure of withdrawal of the United Kingdom from the EU and it is unknown what further economic relationship will form between the United Kingdom and the EU and how it will affect economic development of the entire EU. There is still uncertainty about the outcome of trade wars between the United States and China and their effect on global economic development. Taking into account economic development in the first three quarters of 2019, the Ministry of Economics forecasts that economy will grow by 2.5% in 2019. The above-mentioned factors are expected to remain in force also in 2020.

Private consumption fostered by the increase of wages will be the main economic driver in 2020. The average gross wage in 2020 might increase by 6.5% reaching 1150 euro per month. Private consumption, in turn, might increase by 3.1% in 2020. It will be slightly slower than in the previous years, yet will still make a significant contribution to economic growth.

Investments are important for development of economy. In 2017 and 2018 investment growth rates exceeded the 10%. The rate of investments was considerably more moderate in 2019 when investments from EU funds have reached their maximum. Such a trend is expected to continue also in 2020 and the increase of investments will become slower, reaching 2.5%. Investments in production equipment, constructions will be limited by the entrepreneurs' hesitant attitude in relation to the increased uncertainty in the external environment and the still cautious crediting policies of banks.

Development of Latvia's economy is closely linked to export opportunities, but no significant improvement of the situation in global economy is expected next year. It is

projected that growth in the EU in 2020 will remain at the level of 2019. Slower growth is expected in Latvia's main trade partner countries in 2020. This means that external demand will also be moderate in 2020. Meanwhile, rapidly rising labour costs and slower productivity increase have weakened competitiveness of businesses. The increase in exports of goods and services is expected to be within 1.8% in 2020.

In sectoral breakdown, comparatively solid growth rates in 2020 are expected in the sectors related to exports of services – in accommodation and in the IT sector. Stable growth in 2020 is also expected in the sectors related to private consumption and domestic market oriented sectors – retail trade and other commercial services. Stable confidence indicators or future outlook indicators, which remained high throughout 2019, evidence of comparatively good future outlook for services and trade.

In contrast, confidence indicators in manufacturing and construction have been worsening since the middle of 2019. Businesses are mentioning insufficient demand as the main restrictive factor more and more often.

In 2020, growth in manufacturing will be slower than in 2019 determined by the situation in external markets and weaker export opportunities. The reached maximum of investments from EU funds and lack of large private construction projects will affect construction sector, volumes of which in 2020 will actually remain at the level of 2019.

After comparatively solid growth indicators in 2016-2018, a drop in the volume of services provided was observed in transportation and storage in 2019 and recession is most probably expected in the sector also in 2020. This is related not only to economic processes, but also to the geopolitical situation. For a long time Russia has been reorienting its export freights from the transport corridors through Baltic ports to Russian ports by significantly expanding its port infrastructure, as well as constructing new pipelines.

The Ministry of Economics forecasts that economic growth in 2020 might generally remain at the level of the previous year, i.e. 2.5%. At the same time, the mentioned negative risks remain high.

¹ The latest forecasts of the IMF and EC were used by the Ministry of Economics to analyse external markets and evaluate the global economic

development trends when making forecasts about the economic development (see Chapter 2).

DEVELOPMENT PERSPECTIVES FOR 2021-2025

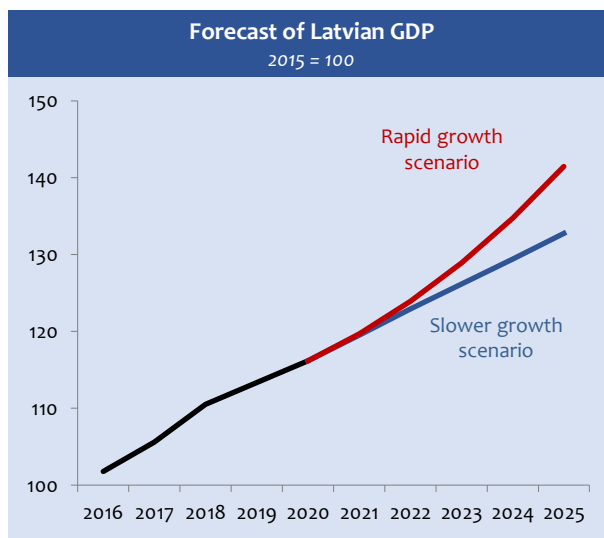
Scenarios of slower and more rapid or target growth are developed for the medium term until 2025. Basic assumptions of the scenarios are based on different trends of global economic developments over the medium term and the efficiency of the structural policy implemented by Latvia.

The growth of Latvia – a small open economy with a relatively high degree of market liberalisation – is affected significantly by the global economic development and improvement of competitiveness.

Further economic development of the EU is particularly important for the Latvian economy.

The main growth driver of the Latvian economy is income from exports and the extension of export possibilities, the ability to get included into international product chains with higher added value products and to create more qualitative final products. At the same time, in the medium term in open labour market conditions the increase in labour costs will remain relatively fast and competitive advantages of labour force costs will continue to decrease. In the medium term, more rapid development is expected in the sectors, which are able to boost their productivity through overcoming the technological lag, modernisation of production and investments, investments in human capital, research and innovation and other factors of the supply side.

Figure 5.1



The slower growth scenario is based on the assumption that the global economic development is uneven, and convergence of wages with Western European countries will continue in conditions of the open labour market in the medium term. This will result in a negative effect on competitiveness of companies in low value added segments. Furthermore, a transition to higher value-added economy will happen gradually.

Table 5.1

	GDP forecasts, expenditure side					
	changes as per cent					
	Fact				Forecasts	
	2016	2017	2018	2019	2020	2021-2025 annual average
Gross domestic product	1.8	3.8	4.6	2.5	2.5	2.7 .. 4.0
Private consumption	1.5	3.1	4.2	3.8	3.1	3.1 .. 4.0
Public consumption	2.9	3.2	4.0	2.8	2.7	2.6 .. 3.2
Gross fixed capital formation	-8.2	11.3	15.8	4.7	2.5	2.7 .. 5.4
Exports	4.0	6.4	4.0	2.4	1.8	2.9 .. 4.2
Imports	3.8	8.4	6.4	2.5	3.0	3.1 .. 4.6

The annual export growth rates during 2021-2025 might be around 2.9% in the scenario of slower growth. Private consumption and investments will grow slowly. By contrast, annual average GDP growth rates in 2021-2025 are estimated to be only 2.7 per cent.

The scenario of a more rapid growth for a medium-term period provides for continued stable growth in the main export markets of Latvia, and the benefits of the economic competitiveness are mainly based on technological factors, improvement of production efficiency and innovation, to a lesser extent on cheap labour and low resource prices. GDP growth rates in the medium term may reach 4% per year.

In this scenario, exports and manufacturing retain a relatively fast growth rate in the medium term, based on both the competitiveness of Latvian producers and growing external demand. At the same time, growth will not be so much related to extensive building of material-intensive production volumes, but to the use of newer technological processes, digital transformation, optimisation of processes, etc. More rapid development due to the above-mentioned factors is expected in high and medium-high tech industries.

In the medium term exports should grow more rapidly than the rest of the economy, investments should increase more rapidly.

One of the fastest developments in the medium term is expected in information and communication services. This is related to the increasingly growing demand for digitalisation of production and services processes, as well as global IT sector development trends.

The dynamics in transportation and storage will be slower, underpinned by the need to search for new types of cargo

and delivery paths to replace persistently shrinking volumes of oil products and hard coal from Russia.

The development of sectors oriented to domestic demand – trade and other business services – will be closely related to the dynamics in private consumption and the demand created by other sectors of national economy.

Table 5.2

Forecast of Latvian GDP by Sectors						
<i>changes as per cent</i>						
	Fact				Forecasts	
	2016	2017	2018	2019	2020	2020-2023 annual average
Gross domestic product	1.8	3.8	4.6	2.5	2.5	2.7 .. 4.0
Agriculture, forestry	-10.5	5.1	2.1	10.3	3.3	2.4 .. 3.2
Manufacturing	2.6	6.9	2.7	2.8	2.3	3.0 .. 4.2
Other industry	10.2	-0.8	-1.2	-2.9	3.0	1.7 .. 3.2
Construction	-14.9	14.3	17.6	3.5	1.9	2.7 .. 4.5
Trade, accommodation	2.8	3.1	2.2	4.9	3.2	3.0 .. 4.0
Transportation and storage	6.2	7.5	4.7	-2.3	-1.4	1.9 .. 4.0
Other business services	1.6	0.4	4.2	2.2	3.0	2.8 .. 4.4
Public services	1.7	5.0	3.3	3.8	2.8	2.5 .. 3.6

6. ECONOMIC STABILITY AND COMPETITIVENESS

6.1. PRICES

CONSUMER PRICES

After the deflation caused by the crisis, consumer prices started to grow again in 2011. External factors started to affect the total price level increasingly more seriously. In 2011-2012, the increase in consumer prices in Latvia was determined by the increase in world prices of food and oil. The increase in prices was also underpinned by internal factors such as the increase in administrated prices of natural gas and heat energy. In 2013-2016, the increase in consumer prices was very moderate. The drop of world food and oil prices had a great influence in this period. The drop in oil prices, in turn, affected the drop of prices of gas and heat energy. The increase in this period was mainly influenced by the rise in prices of services. Water supply and other housing related services, catering services and outpatient services saw the most rapid increase.

In recent years, a rapid increase in prices has been observed. In December 2017, consumer prices increased by 2.2% (12-month inflation), but the annual average inflation was 2.9%. In December 2018, consumer prices increased by 2.6% (12-month inflation), but the annual average inflation was 2.5%. The level of consumer prices was affected by the increase in world prices of food and oil. The

increase in prices of services also had a considerable effect on the level of consumer prices.

Figure 6.1

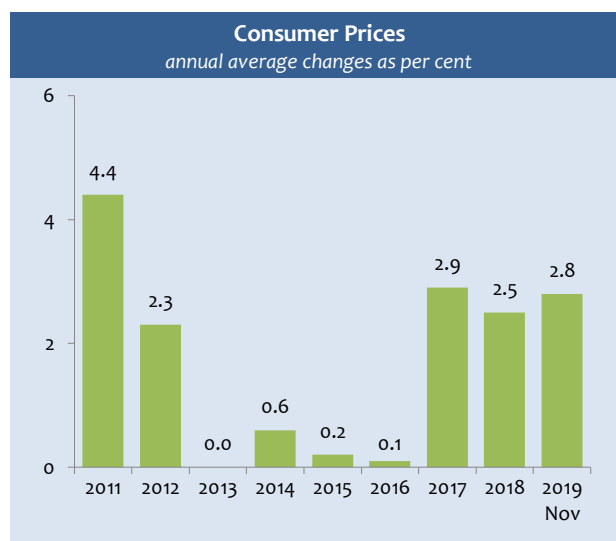


Table 6.1

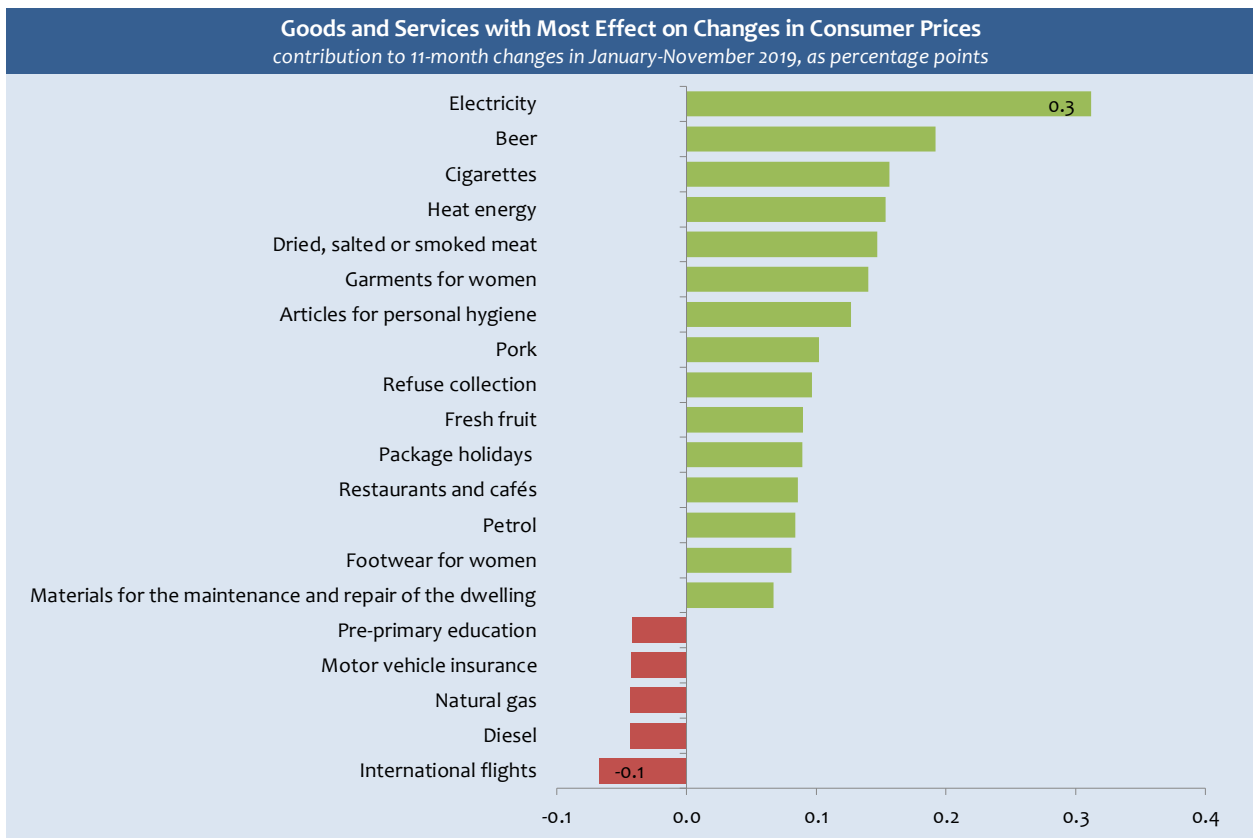
		Compared to the previous month	Compared to the respective month of the previous year	Annual average
2018	July	-0.8	2.6	2.4
	August	-0.1	2.8	2.4
	September	0.6	3.2	2.4
	October	0.7	3.2	2.5
	November	-0.1	3.0	2.5
	December	-0.4	2.6	2.5
2019	January	0.5	3.0	2.6
	February	0.1	2.9	2.7
	March	1.1	2.8	2.8
	April	0.9	3.4	2.9
	May	0.2	3.3	3.0
	June	0.3	3.0	3.0
	July	-1.0	2.9	3.0
	August	0.2	3.2	3.0
	September	0.1	2.6	3.0
	October	0.4	2.3	2.9
	November	-0.3	2.1	2.8

In the eleven months of 2019, the rise of prices was slightly slower than in the corresponding period of the year before. In November 2019, compared to December 2018, consumer prices rose by 2.5%. The annual average inflation in November was 2.8 per cent.

The main factors affecting prices in Latvia in 2019:

- the increase in prices of services had the biggest effect on the rise of prices in the eleven months of 2019 – by 2.3%, which increased the overall level of consumer prices by 0.7 percentage points. The most rapid increase was observed in prices of catering, out-patient, recreation and cultural services (cultural services, television subscription, participation in recreational and sporting events) and package holidays, as well as housing-related services – rent and refuse collection (due to the increase in the natural resources tax for landfilling of waste). In turn, the sharpest drop was in passenger transport services and motor vehicle insurance;
- the increase of prices of electricity (by 10.3%) determined by a significant increase in electricity prices on the stock exchange in the previous year, which was taken into account when concluding new agreements on supply of electricity, in January 2019, and the increase in prices of heat (by 3.7%) due to the increase of the tariff from 1 August of this year, which together increased the overall level of consumer prices by 0.4 percentage points. The increase in prices of electricity and heat was partially compensated by the drop in prices of gas, which has reduced by 7.2% in the eleven months; New tariffs entered into force from 1 January 2019 due to the change of the tariff of the natural gas distribution system and the increase in global prices in the second half of 2018. However, from 1 July the tariffs were reviewed in accordance with the drop of global oil prices in the first half of 2019, and the drop in prices of natural gas was more rapid than the increase in prices at the beginning of the year;
- the increase of prices of food, which was affected by the increase of world prices of food. Food prices have increased by 2.2% in the eleventh months, which increased the overall level of consumer prices by 0.4 percentage points. The increase in prices of meat, bread and cereals, fresh fruit and potatoes had a bigger increasing effect, while dairy products and coffee had a most decreasing effect. Changes in food prices are largely determined by the world price fluctuations. In November 2019, compared to December 2018, global food prices increased by 9.7%, which was affected by a rise in prices in all major food groups, except cereals. Prices of vegetable oils increased most rapidly due to the rapid increase in prices in November. The prices of palm oil were increasing for the fourth month in a row affected by the decline in production and high demand, while the increase in prices of rapeseed and soybean oil was affected by worse supply and high demand from the biodiesel sector. Prices of dairy products and meat increase equally rapidly. A rapid increase in prices of dairy products was observed in January-May underpinned by strong global demand, expecting a drop in exports from largest producer countries due to a seasonal drop in milk production volumes and due to draught, but since June the prices have reduced, export availability has increased and the demand has reduced. Prices of meat have been increasing every month since February fostered by constant demand in Asia, particularly from China;
- prices of alcoholic beverages and tobacco grew by 4.9% due to the increase in the excise tax rate, which together increased the total level of prices by 0.4 percentage points. Beer and cigarettes saw the most rapid increase, while the increase for spirits was slower than expected affected by the previously unplanned reduction of the excise tax rate by 15%, which entered into force from 1 August;
- the increase in prices of clothing and footwear, which in January-November has been the fastest since 2004. In the eleven months of 2019, prices of clothing and footwear increased by 4.6% increasing the overall price level by 0.3 percentage points. The increase in prices is largely explained by growing private consumption;
- the biggest downward effect was the fall in prices in the transport group affected by the drop in prices of passenger transport services mentioned in the services, as well as the reduction of prices of fuels for transport. The drop in fuel prices has a small impact on the reduction in prices – fuel prices in Latvia reduced by 0.5% in January-November. In November 2019, compared to December 2018, world oil prices increased by 10%, but compared to November 2018 reduced by 2.4%. It was affected by a rapid drop in prices of oil products in the last month of the previous year. Since the beginning of the year, world oil prices have been gradually increasing and have reached 75 USD per barrel by the middle of April mainly due to limited extraction of oil by the largest exporting countries, as well as attacks on the oil infrastructure in Saudi Arabia and reinforcement of US sanctions against Iran. In the summer months, a rapid drop was observed in world oil prices, when they reduced to the lowest level in seven months in the first half of August – 57 USD per barrel. This was affected by concerns about slowing down of global economic growth, the US-China trade war and the increase in oil reserves of the United States, which is a sign of a decline in demand, as well as the commitment of Saudi Arabia to act to foster an increase in oil prices. Oil prices increased in September after attacks of drones on the oil infrastructure in Saudi Arabia, but reduced again at the beginning of October to the level of August, when Saudi Arabia has quickly restored its oil extraction. In October-November, prices were generally fluctuating from 57 to 64 USD per barrel due to the tense situation in the north of Syria, news about fluctuations in oil reserves of the United States and concerns that no agreement on further reduction of oil extraction volumes will be reached at the forthcoming OPEC meeting in December.

Figure 6.2



In total, the annual inflation may reach 2.8% in 2019. In 2020, average annual inflation might be slightly lower than that observed in 2019, which will mainly be underpinned by moderate development of global economy, fluctuations in

world oil and food prices. At the same time, inflation in Latvia will still be affected by different supply-side factors related to the increase of excise tax, as well as the demand side promoted by increase in wages.

Figure 6.3

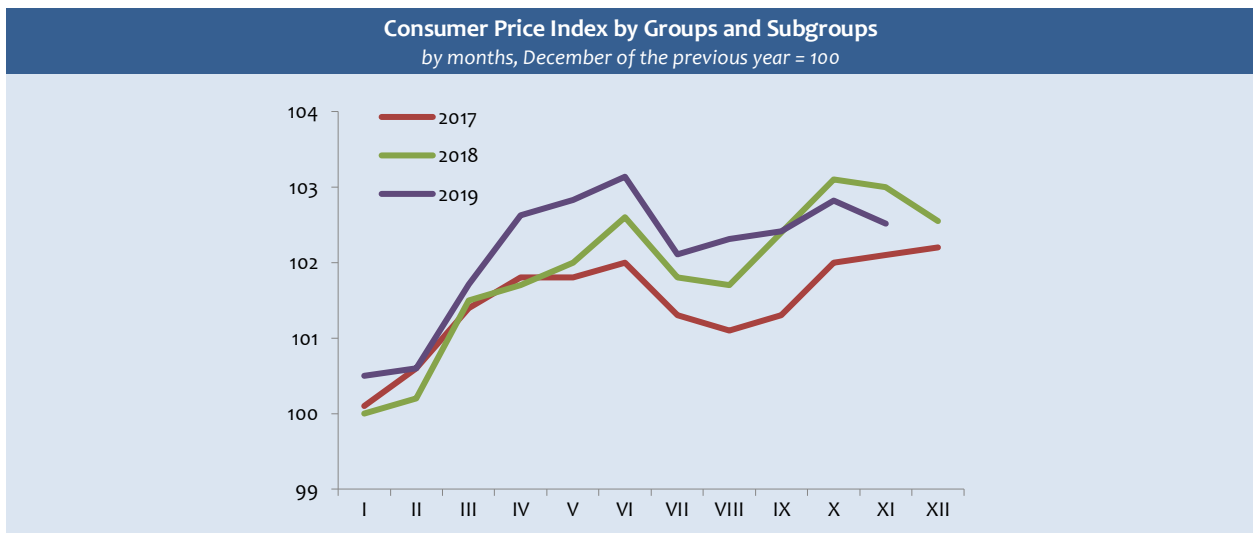


Figure 6.3 continued

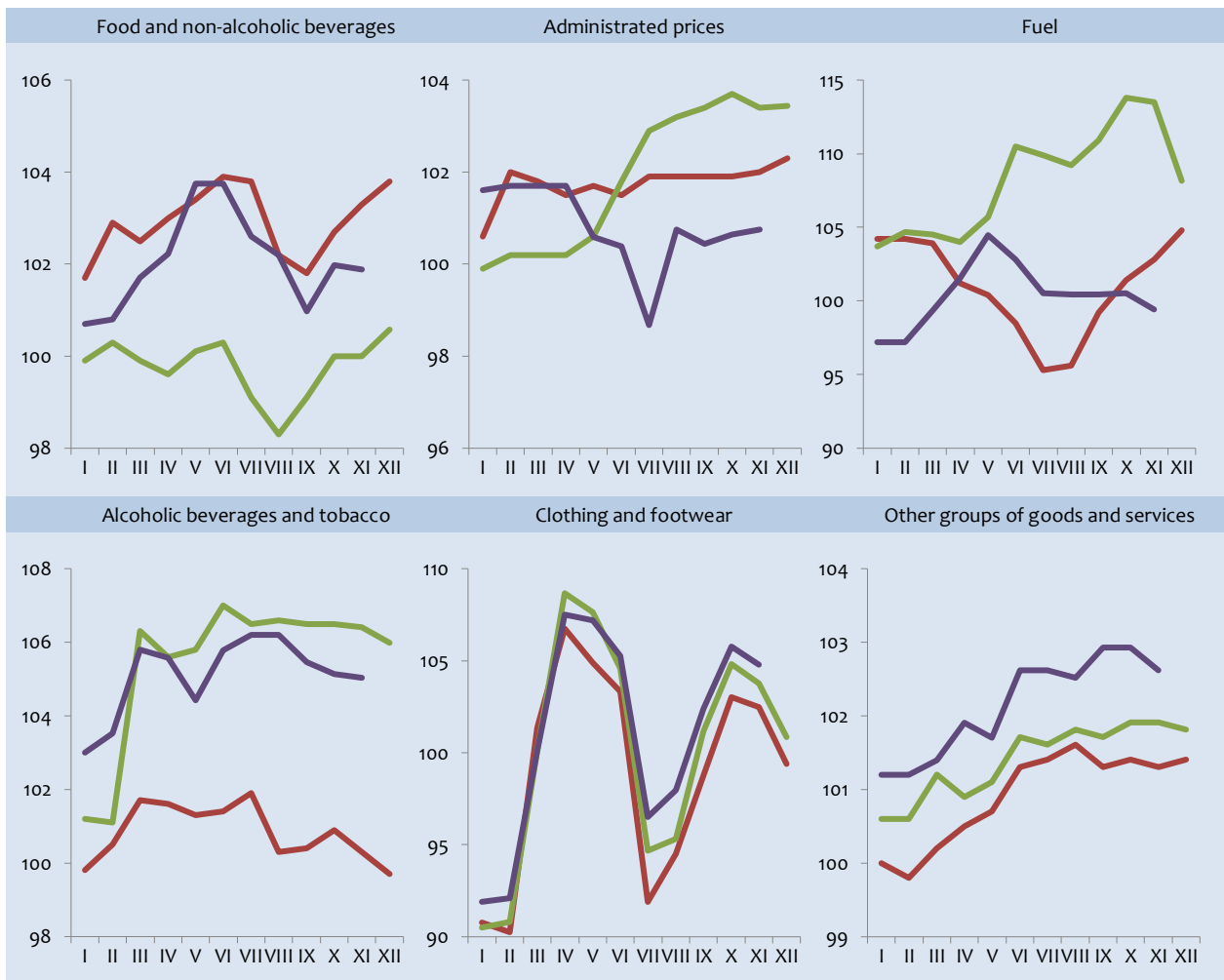
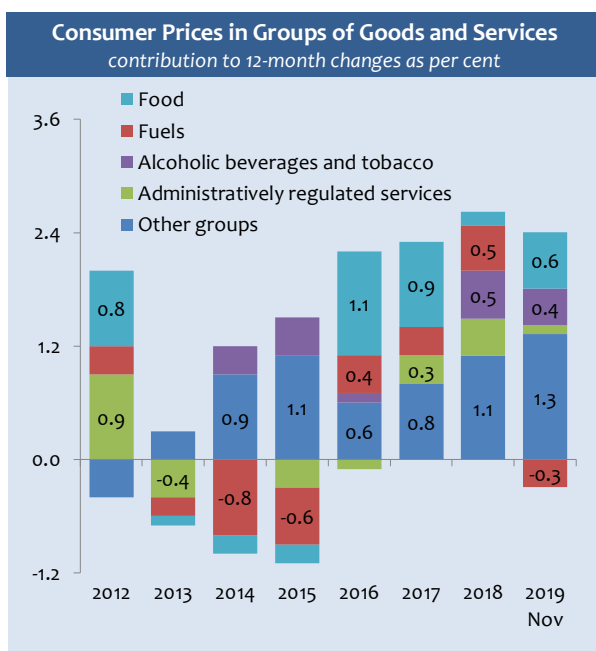


Figure 6.4

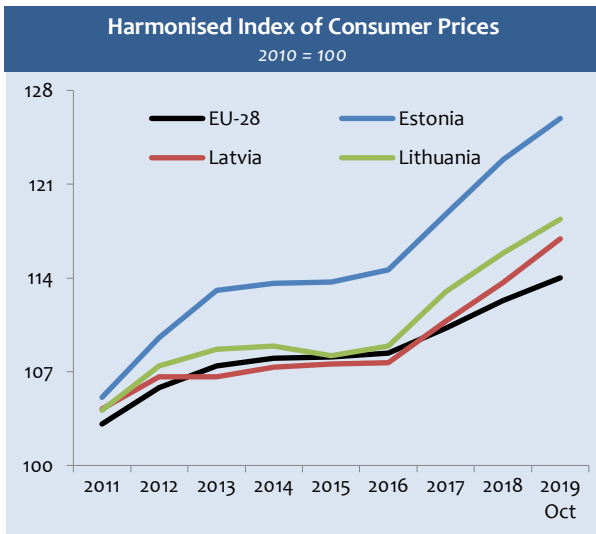


After a more rapid increase in 2011-2013, when inflation in the **European Union** was within 1.5% to 3%, in 2014-2016 the increase in prices was very moderate determined by rather weak economic development in the European Union, as well as the drop in world prices of food and oil. The annual average inflation in the EU in 2014-2016 reached the highest level in 2014, when it was only 0.6 per cent.

Trends similar to those across the EU were observed in the Baltic countries. The most rapid inflation among the Baltic countries was observed in Estonia, but the lowest – in Latvia.

As economic activities and therefore private consumption increase, as well as world prices are growing, inflation in the EU in recent years has grown as well. The average annual inflation was 1.7% in 2017, 1.9% in 2018, and 1.5% – in October 2019. Prices increased in all the main consumption groups, with the exception of communication. The increase in prices of services had the biggest effect. The increase in energy prices had a big effect in 2017-2018, but it significantly reduced in 2019.

Figure 6.5



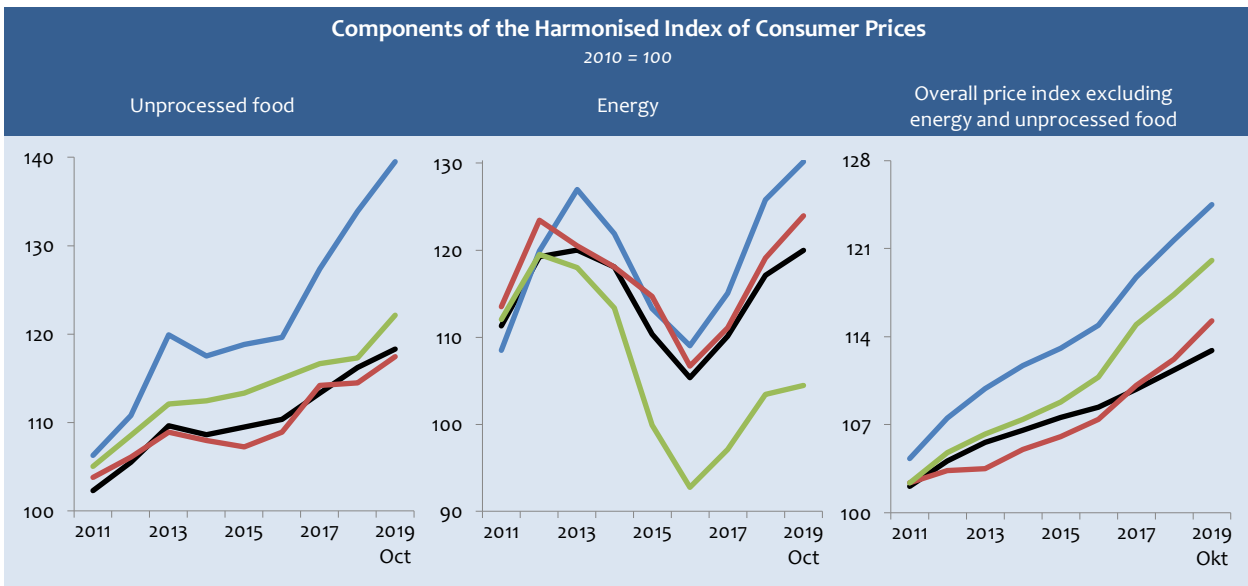
If we compare the Baltic countries, in 2017-2018 the harmonised index of consumer prices grew more rapidly in Estonia, but in 2019 – in Latvia. In 2018, prices in Estonia and Lithuania increased in all main consumption groups with the exception of communication, in Estonia prices

reduced also for education, but in Latvia – prices increased in all groups except furnishings, household appliances and routine household maintenance. The increase in prices of services and energy had the biggest effect in all the three Baltic countries. The increase in prices of alcoholic beverages and tobacco also had a big effect in Estonia.

It should be noted that since 2011 Latvia has been having the lowest core inflation among the Baltic countries affected by a slower increase in private consumption than in the other countries and therefore slower increase in prices of services. Prices of alcoholic beverages and tobacco in Latvia also increased slower, because the equalisation of the excise tax with the EU level in Estonia and Lithuania is more rapid. Only in 2018-2019 prices of alcoholic beverages and tobacco in Latvia were growing more rapidly.

In October 2019, annual average inflation was the highest in Latvia. Prices in Latvia increased in all main consumption groups, in Estonia – in all groups, with the exception of communication, but in Lithuania – in all groups, with the exception of communication and clothing and footwear. The increase in prices of services, food and electricity had the biggest effect in all the three Baltic countries. The increase in prices of alcoholic beverages and tobacco also had a big effect in Latvia.

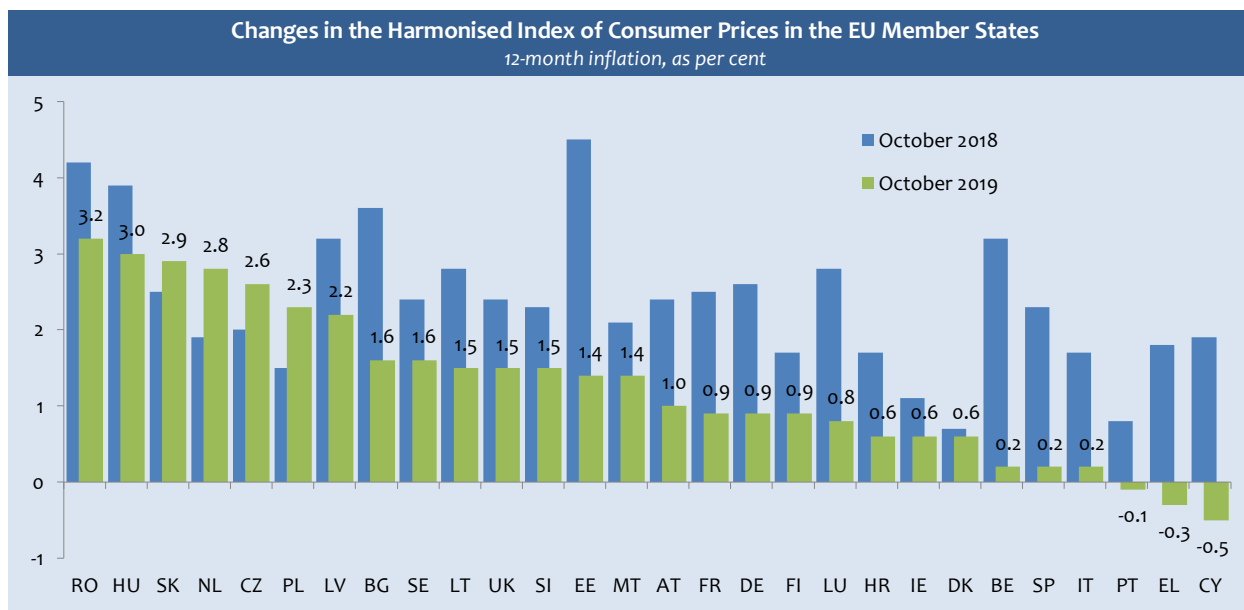
Figure 6.6



In October 2019, compared to October 2018, the price level grew by 1.1% in the EU countries as a whole, and by 0.7% in the Eurozone. Inflation increased most rapidly in the Netherlands, Poland and Czech Republic, but prices fell more

rapidly in Estonia and Belgium. The highest inflation in October 2019 was in Romania and Hungary, but deflation was observed in Cyprus, Greece and Portugal.

Figure 6.7



PRODUCER PRICES

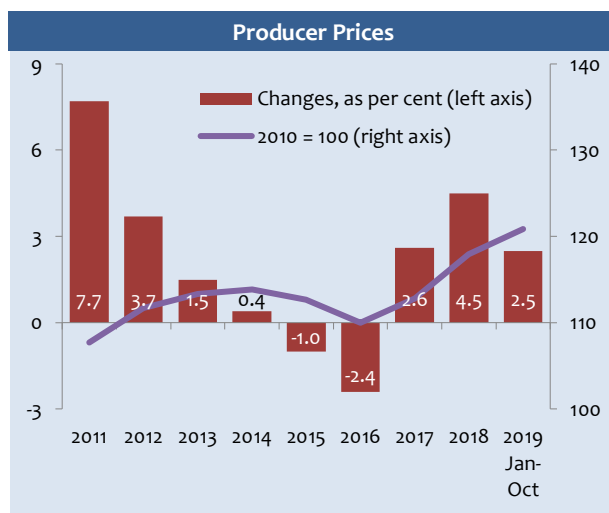
After the rapid increase in 2010-2012, in 2013 and 2014 producer prices were growing very moderately, but in 2015-2016 reduced mainly due to the drop in prices in manufacturing.

Producer prices saw a serious increase in 2017-2018. In 2018, the producer prices of production for domestic market increased by 5.5%, while the producer prices of production exports – by 3.6%. Manufacturing had the biggest effect on the increase in prices.

The rise of producer prices is slowing down in 2019. In January-October 2019, producer prices in the industry increased by 2.5% compared to the relevant period of the year before. Prices of production for domestic market increased by 4.7%, while prices of production for exports – by 0.4%. Producer prices increased in all industrial sectors. Manufacturing and electricity, gas, steam and air conditioning supply had the biggest effect on the increase in producer prices.

A similar trend has been observed in producer prices in manufacturing since 2010. In 2014-2016, producer prices in manufacturing were influenced by the economic situation in the EU and Russia and the drop in global prices of raw materials, in particular energy sources. A sharp increase of prices was observed in 2017-2018, but it slowed down in 2019. In 2018 and in January-October 2019, compared to the previous year, the increase of prices of production for domestic market was more rapid – by 4.7% and 2.7%, respectively, than that for production for exports, which increased by 3.6% and 0.4 per cent, respectively.

Figure 6.8



Slightly more than 60% of the manufacturing production is exported; therefore the overall producer price dynamics of the industry are largely affected by the fluctuations in producer prices of production for exports. The prices of production for exports, in their turn, are mainly determined by the price dynamics of the Latvian key export goods, including timber, metal products, and food, in global markets. It should be noted that in 2017-2018 world prices of energy and raw materials showed a rapid increase, but in 2019 they reduced. The price of production for domestic market, in its turn, is affected by the domestic demand and increasing growth rates.

In terms of sectors, the most significant rise in producer prices in manufacturing in 2018 was experienced in manufacture of wood, but in 2019 – in manufacture of food

products and manufacture of computer, electronic and optical equipment. It should be noted that after the drop in 2018, the world food prices have increased in the ten months of 2019 (by 6.9%). The increase in producer prices in manufacture of food products was due to the increase in prices of production for domestic market and prices of production for exports.

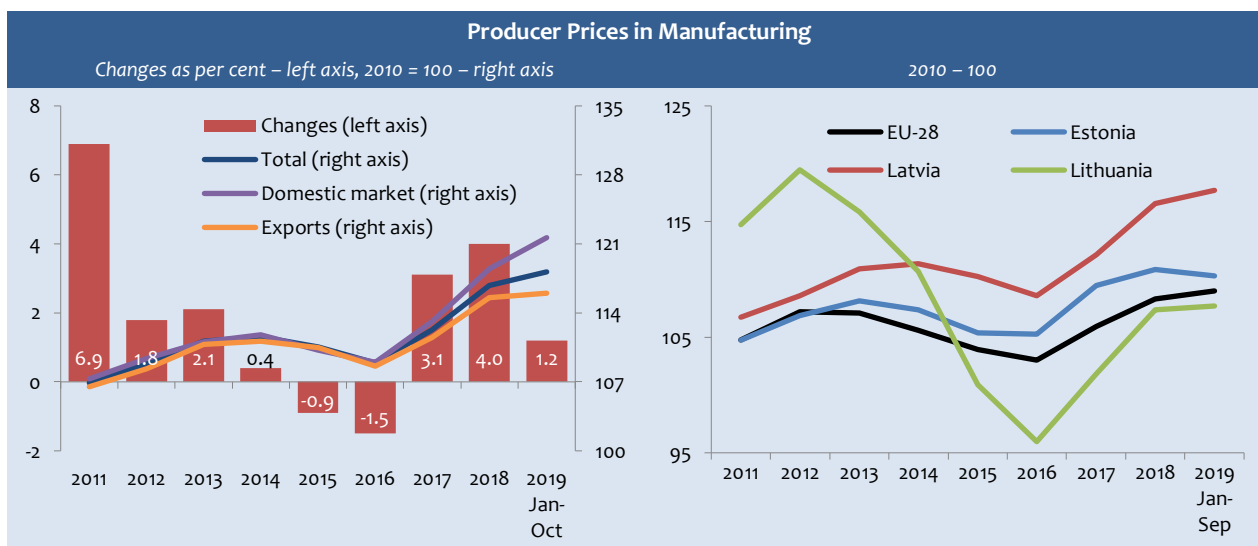
In turn, the most important drop in producer prices in manufacturing in 2018 was in manufacture of chemicals and manufacture of electrical equipment, but in January-October 2019, compared to the corresponding period of the previous year, the biggest effect came from the drop of prices in manufacture of wood and fabricated metal products, where the effect was from the drop in prices of production for exports.

Producer prices in the EU reduced in 2013-2016. It was mainly influenced by a drop in the prices of food, as well as agricultural and industrial raw materials, to some extent determined by a decrease in the global demand, the deteriorating economic situation in other developed countries, as well as the slowdown of global trade growth

and uncertainty about future fiscal consolidation in most developed countries. In 2014 and 2015, this was affected by the economic situation between the EU and Russia due to the crisis in Ukraine. As the economic situation improved and prices of raw materials increased, producer prices in manufacturing in 2017-2018 saw the most rapid increase since 2011 both across the EU and in all the three Baltic countries. However, in 2019, the increase of producer prices slowed down mainly due to the drop in world energy prices and slowdown of global economic growth. When comparing the EU countries, producer prices in manufacturing in January-September 2019, compared to the respective period of the previous year, increased in all the countries, except Ireland, Luxembourg, Estonia and Greece. They increased most rapidly in Sweden, United Kingdom and Malta.

If we compare the Baltic States, producer prices in manufacturing in 2019 increased most rapidly in Latvia. A small increase was observed in Lithuania, and they reduced in Estonia.

Figure 6.9



EXPORT AND IMPORT UNIT VALUE INDICES

In 2012-2014, trade conditions worsened and the import unit value increased more rapidly than the export unit value. The trade conditions improved and returned to the level of 2011 only in 2015.

Since 2016, the trade conditions have been improving sharply. The unit value index for exported goods exceeded the unit value index for imported goods by more than 3 percentage points. The import unit value in 2016 was mostly affected by a decrease in the unit value of coke and refined petroleum products and mining, but in 2017 – by an increase in the export and import unit value of coke and refined petroleum products.

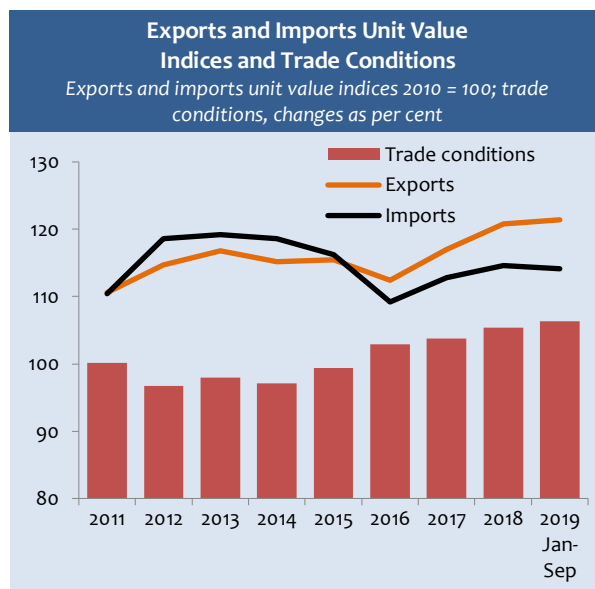
In 2018, the export unit value increased by 3.2%, but the import unit value – by 1.6%. The export unit value in 2018

was mostly affected by an increase in the unit value of wood and products of wood and cork, but import unit value – by that of coke and refined petroleum products. In January-September 2019, the unit value of exported goods increased by 0.5, compared to the respective period of the previous year, while the unit value of imported goods reduced by 0.4%. The unit value index for exported goods exceeded the unit value index for imported goods by more than 7 percentage points. The average export unit value was mostly affected by the increase in the unit value of food products, chemicals, products of agriculture and hunting, and furniture, as well as decrease in motor vehicles, wood and of products of wood, products of forestry and logging, basic metals and fabricated metal products.

The average import unit value was mostly affected by a decrease in the unit value of basic metals, coke and refined

petroleum products, computers, electronic and optical equipment, wood and of products of wood and products of agricultural and hunting, and by a decrease in the unit value of beverages, machinery and equipment, food products and basic pharmaceutical products.

Figure 6.10



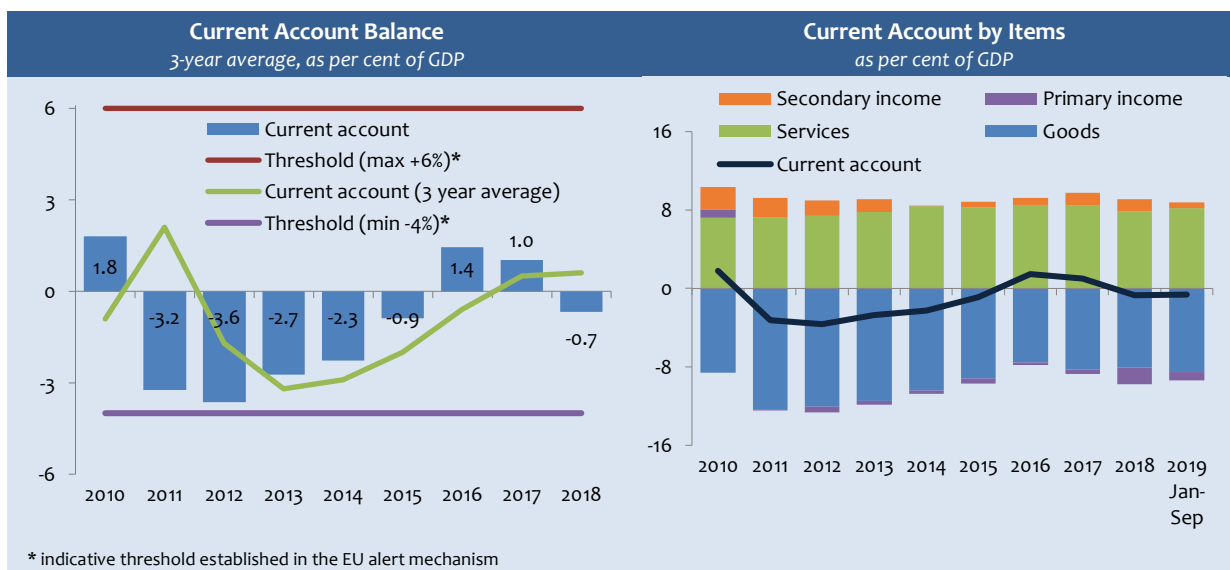
6.2. BALANCE OF PAYMENTS

CURRENT ACCOUNT

The current account of the balance of payments has been at a low level, which does not exceed the indicative thresholds determined in the alert mechanism of the EU, since 2010, and can be assessed as sustainable. Overall, the indicator of the current account balance is close to the level of balance, and annual fluctuations of the indicator are quite insignificant. On average, in the period from 2011 to 2015 current account was in a moderate deficit – at the level of

2.6% of GDP, which reduced year on year. In 2016, the current account balance already was with a surplus – 1.4% of GDP, which was mainly underpinned by a rapid drop in investments. Although a positive balance persisted also in 2017 and in the first half of 2018, the general trend was still turned downwards, and in 2018 current account was generally in a small deficit – 0.7% of GDP. In nine months of 2019, the current account balance was negative (0.6% of GDP), which is almost equivalent to the level of the previous year.

Figure 6.11



The Latvian current account is characterised by high deficit of trade in goods and surplus of trade in services, and in smaller scope net flows of primary income and secondary income.

The condition of the current account is mainly determined by changes in the balance of external trade. Latvia is characterised by an external trade deficit and its comparatively large cyclic fluctuations.

In the period from 2011 to 2017, external trade deficit was at the level of 10.2% of GDP on average. Since 2011, it reduced each year, which was mainly due to imports growing slower than exports. In this period of time, exports of goods at current prices increased on average by 8.4% annually and exceeded the pre-crisis level by 107% in 2017. By contrast, imports of goods grew by 7.8% on average annually and were by 29% higher than in 2007. External trade deficit reached 8.3% of GDP in 2017, which was considerably lower than prior to the crisis (in 2007 – 22.8%).

External trade deficit has been growing since 2017 fostered by a considerable increase in imports of goods, as domestic investments and household consumption were growing. In

2018, exports of goods at current prices were by almost 7.9% higher than a year before, while imports rose by 7.5%, and the negative balance of external trade reached the level of 8.1% of GDP.

The export dynamics of goods in the nine months of 2019 has been much more moderate than a year before (increased by 1.4%) reflecting gradual weakening of external demand. Import growth rates are also slower in comparison with the previous year (increased by 2.2%). The export dynamics of goods were positively affected by the development of exports of agricultural and food products, as well as chemical industry products, while the export value of mineral products, metal and metal articles reduced. Furthermore, the largest positive contribution to the increase in imports of goods was made by groups of goods of aircraft and parts thereof, pharmaceutical products, fertilisers and articles of iron and steel.

Although imports increased almost twice more rapidly than exports, external trade deficit increased insignificantly and in the nine months of 2019 reached 8.5% of GDP.

Table 6.2

Balance of Payments of Latvia as per cent of GDP						
	2014	2015	2016	2017	2018	2019 Jan-Sep
Current account	-2.3	-0.9	1.4	1.0	-0.7	-0.6
Balance on goods	-10.4	-9.2	-7.5	-8.3	-8.1	-8.5
Export	43.9	42.9	42.1	43.6	43.2	41.7
Import	54.3	52.1	49.6	51.9	51.3	50.2
Balance on services	8.4	8.3	8.5	8.4	7.9	8.2
Primary income	-0.3	-0.6	-0.3	-0.5	-1.7	-0.9
Secondary income	0.1	0.6	0.7	1.3	1.2	0.6
Capital account	3.2	2.8	1.0	0.6	1.8	1.6
Financial account	3.3	2.2	3.0	1.5	2.9	2.3
Direct investment	-1.2	-2.5	-0.4	-1.8	-2.3	-2.5
Assets	2.1	0.5	0.8	1.9	-1.0	0.0
Liabilities	3.3	3.0	1.2	3.7	1.3	2.6
Portfolio investment**	0.5	11.8	5.2	6.4	-3.8	-4.0
Assets	6.1	9.7	7.0	5.7	-3.4	0.2
Liabilities	5.7	-2.1	1.8	-0.7	0.5	4.2
Other investment	4.5	-8.4	-2.3	-6.4	9.5	9.0
Assets	7.3	-10.8	1.4	0.3	-1.2	1.5
Liabilities	2.8	-2.5	3.7	6.7	-10.7	-7.5
Reserve assets	-0.5	1.3	0.5	3.3	-0.4	-0.1
Deviation	2.3	0.3	0.6	-0.1	1.7	1.4

* portfolio investment and financial derivatives

The balance on services is positive in Latvia. In 2011-2017, the surplus of the balance on services was 8% of GDP on average. In 2018, dynamics of the imports of services were slightly more rapid than the dynamics of exports, which

provoked a decrease in the surplus of the balance on services. In 2018, the exports of services at current prices were by 6.1%, whereas the imports – by 10% higher than

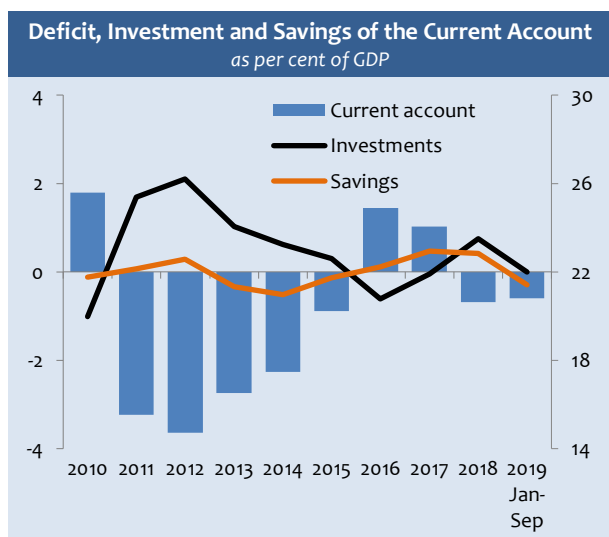
a year before, and the positive balance on services reduced, reached 7.9% of GDP.

In 2019, imports and exports of services increased almost at the same pace. In the nine months of this year, exports of services at current prices were by 6.5%, whereas the imports – by 6.6% higher than a year before. Although the growth rates of imports of services remained comparatively high, imports in absolute terms amount only to half of exports of services thus ensuring a stable surplus in the balance on services. In the nine months of 2019, the surplus of the balance on services reached 8.2% of GDP. Exports of services are largely supported by the increase in transportation, information and communication technology and other business services. Trade mediation related import services made a considerable contribution to the increase in imports of services. Imports of ICT and transport services increased considerably, while imports of financial services reduced.

The positive balance on services covered the deficit of external trade of goods almost by 97% in the 3 quarters of 2019.

The status of the primary income account is largely affected by flows of income from direct investment. The primary income balance in the period from 2011 to 2017 was negative – at the level of 0.4% of GDP on average with relatively small fluctuations. The primary income balance was mainly due to changes to non-residents' investment income, as well as the inflow of EU funds. In 2018, the primary income deficit increased, reaching 1.7% of GDP, while in the nine months of 2019 it reduced to 0.9% of GDP due to the reduction of foreign investment earnings.

Figure 6.12



Changes in the secondary income and capital account are mainly due to flows of finances of the EU funds and contributions made by Latvia into the EU budget. The secondary income balance in Latvia is positive and in the period from 2011 to 2017 it was at the level of 1.1% of GDP on average. In 2018 and in the nine months of 2019, the

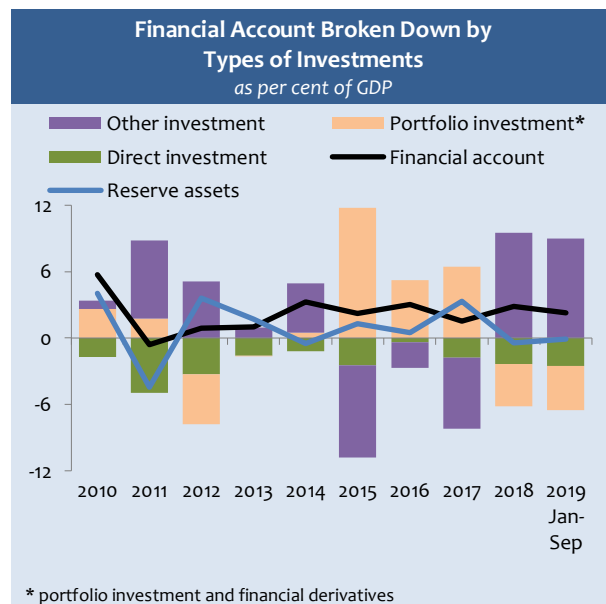
secondary income account had a surplus – 1.2% and 0.6% of GDP, respectively. The inflow of EU structural funds dominates in the capital account. The capital account surplus has been 2.2% on average since 2011, including at the level of 1.8% of GDP in 2018. The positive capital account balance in the nine months of 2019 is slightly lower than a year ago, reaching 1.6% of GDP. Changes in capital account surplus are mainly related to changes in activities of acquisition of EU funds.

The large deficit of the current account in the pre-crisis years showed a significant imbalance between the domestic investment and accruals. A rapid drop in volumes of investments in the years of the crisis has reduced the gap between accruals and investments. In the last three years, accruals have been 22.7% on average, but investments – at the level of 22.1% of GDP. A moderate deficit of the current account balance indicates that there is a balance between the accruals and domestic investment.

CROSS-BORDER FINANCIAL FLOWS

In recent years the status of the financial account balance has been mainly affected by the public sector, that is, financial sector stabilisation measures, measures of the Bank of Latvia for restructuring of debts of the public sector within the scope of an extended asset purchase programme (EAPP). Fluctuations of the financial account were also affected by the drop in deposits of non-residents in Latvian credit institutions.

Figure 6.13



From 2011 to 2017, assets generally increased more than liabilities and the balance of the financial account (assets minus liabilities) was positive – 1.2% of GDP on average. In 2018, assets in foreign countries reduced less than Latvia's foreign liabilities, which evidences that funding on a net basis was flowing out of Latvia. In the nine months of 2019,

Latvian assets abroad have increased, while debt liabilities reduced, and the balance of the financial account is also positive – at the level of 2.3% of GDP.

The increase in Latvian assets abroad was largely affected by participation of the Bank of Latvia in the programme of acquisition of assets within the scope of the Eurosystem monetary policy. Furthermore, the largest drop in foreign debt liabilities was in the credit institutions sector due to the reduction of the balance of deposits of foreign customers in credit institutions.

The inflow of direct investment exceeds the outflow, while the balance of direct investment in recent years has been negative evidencing of inflow of foreign direct investment.

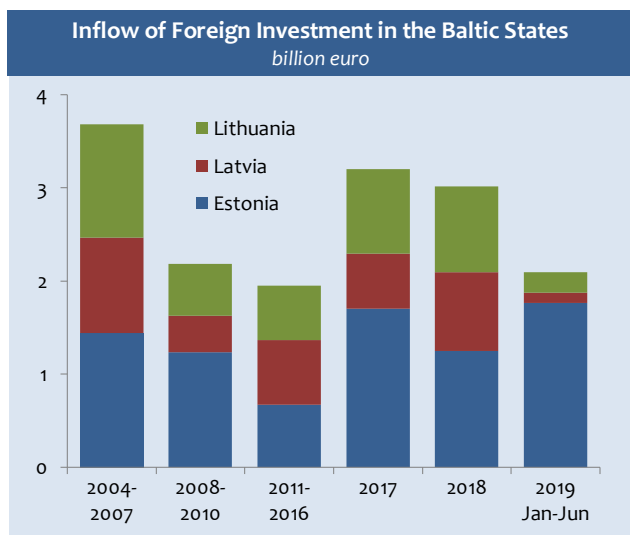
As the liabilities creating debt shrank, the foreign gross debt of Latvia reduced as well. According to the data of the Latvian international investment balance, the gross external debt constituted almost 118% of GDP at the end of September 2019. Also, the gross external debt of the government reached 9812 million euro (32.3% of GDP).

6.3. FOREIGN DIRECT INVESTMENT

Intensity of foreign direct investment (FDI) flows in Latvia, as well as in other Baltic countries is moderate. This is explained by the instability of the global economy and increased geopolitical risks.

From 2011 to 2016, flows of FDI attracted to the Baltic countries in general every year amounted to 2% of GDP on average and were twice smaller than in the years of rapid growth (2004-2007). Since 2017, foreign investors' activity has increased in the Baltic countries reaching almost 3% of GDP, where most of FDI flows were in the Estonian economy (47%), while Latvia and Lithuania attracted 23% and 30% of the total FDI in the Baltic countries, respectively (2017-2018).

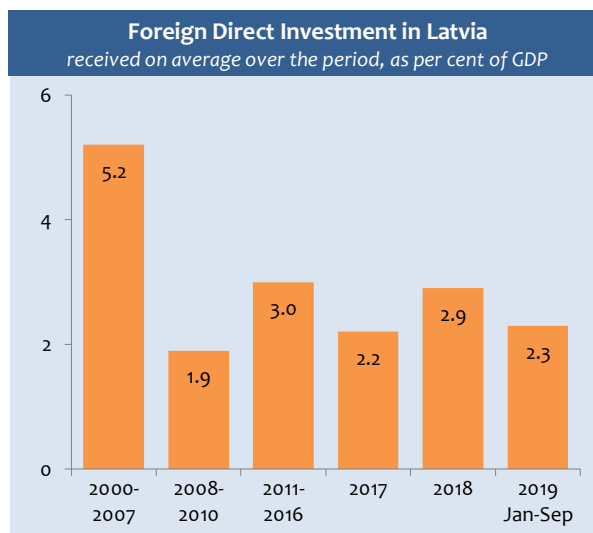
Figure 6.14



It should be noted that a long-term negative cycle of cross-border flows of investments is observed all over the world in general, which is caused by several factors, including growing geopolitical risks and political uncertainty. At the same time, there are structural changes in FDI models, which are related to the fact that the importance of labour costs as a competitive advantage and, therefore, also the

attractiveness of emerging countries for foreign investors reduce under the influence of automation of production. Structural consequences of digital economy for cross-border flows of investments increase as well.

Figure 6.15



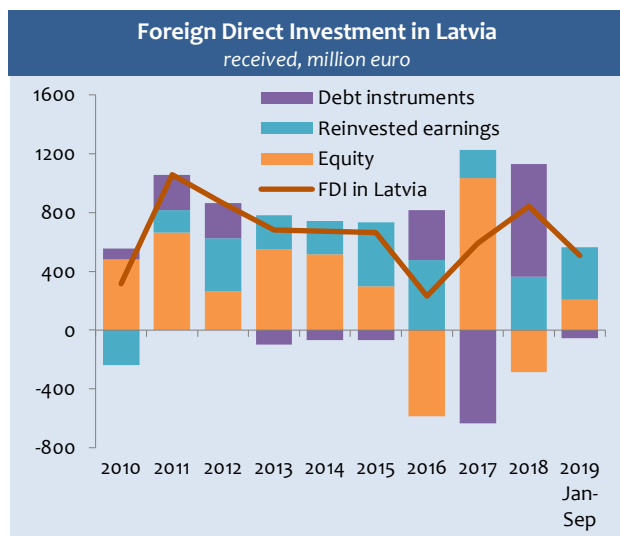
Even though FDI in the economy of Latvia in the last three years have been growing, FDI flows are characterised by pronounced volatility.

In 2017, Latvia attracted 591 million euro in FDI. FDI flows increased almost 2.5 times and reached 2.2% of GDP in comparison with 2016, which was by 1.3 percentage point more than a year before. This was mainly underpinned by extensive investments in share capitals of companies by non-residents.

The dynamics of FDI flows remained positive also in 2018. In 2018, Latvia attracted 842 million euro in FDI. It increased by 42.5% compared to the previous year and reached 2.9% of GDP. The largest FDI flows were present in trade, real estate and financial sectors. A comparatively rapid increase in foreign direct investment in 2018 was also observed in manufacturing. In terms of countries, the

largest flows of investments came to Latvia from Estonia, Sweden, Luxembourg, the Netherlands and Russia.

Figure 6.16



The FDI flows attracted in 2019 are volatile. They amounted to 172 million euro in Q1 remaining at the average quarterly FDI level of the previous year, and FDI flows were negative (62 million euro) in Q2, which was affected by payment of dividends to foreign investors. In Q3 2019, FDI amounted to 397 million euro being considerably higher than in the previous years on average. Overall, attracted FDI flows in the three quarters of 2019 were by 6% higher than a year ago and amounted to 2.3% of GDP.

The amount of FDI accrued in the economy of Latvia at the end of September 2019 reached 15.7 billion euro (51.8% of GDP). They increased by 5.6% during the year mainly due to extensive investment of Estonian and German businesses in the Latvian national economy.

Investments from businesses from the EU countries dominate in the geopolitical structure of FDI accrued in Latvia. At the end of September 2019, FDI of the EU states constituted 77% of all accrued FDI, and almost 73% of this amount were investments of the euro area countries.

Sweden is the major investing country in the economy of Latvia. Although investments of Swedish businesses in the last year reduced at the end of September 2019, they constituted 14.3% of the total accrued FDI (at the end of 2018 – 17.6%). It is mainly the investment in the financial intermediation.

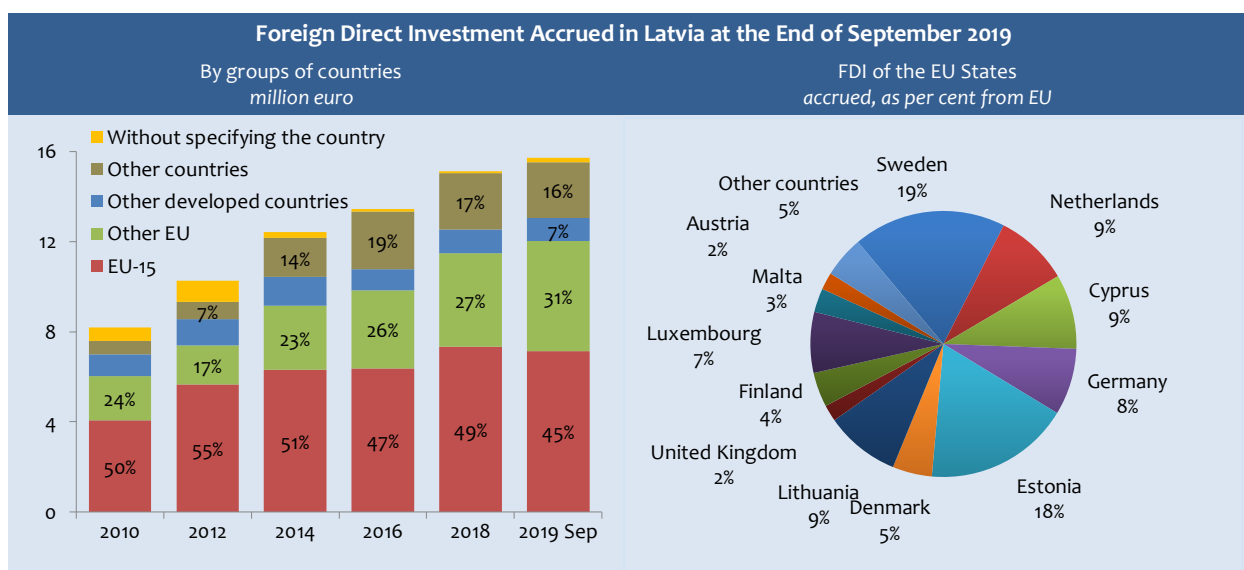
Investments of businesses from Estonia, Luxembourg, Cyprus, Lithuania, the Netherlands, Germany, Luxembourg, Denmark, Finland and Norway are also large. Overall, at the end of September 2019, the amount of investment by these countries constituted almost 83% of the total accrued FDI in the economy of Latvia.

Investments of Russian investors in Latvia have considerably increased in recent years. Since the end of 2011, the accrued direct investment of Russia has increased 4.1 times and Russia was the third major investing country in the economy of Latvia at the end of September 2019 by accrued FDI.

Lithuanian and Estonian businesses also make significant investments in the Latvian economy. At the end of September 2019, the direct investments accrued by the Baltic neighbouring countries constituted almost one fifth of the total accrued FDI.

Entrepreneurs from the Netherlands, Cyprus, Germany, Norway, Denmark, Luxembourg and Finland also make extensive investments. At the end of September of this year, the amount of investment by these countries constituted almost 43% of the total accrued FDI in the economy of Latvia.

Figure 6.17



Activities of Asian investors in Latvia are increasing. At the end of September 2019, the accrued FDI of Asian countries constituted almost 3% of the total FDI in the economy of Latvia, which was 10 times higher compared to the end of 2011.

Most of FDI was attracted in service industries. At the end of September 2019, the accrued FDI in the services sector constituted 76.2% of the accrued FDI in the economy of Latvia. It increased by 69.1% compared to the end of 2011, including by 7.1 per cent since the end of 2018.

Financial mediation services, real estate and trade sectors clearly dominate in the structure of accrued FDI in the services industries. At the end of September 2019 investment of foreign investors in these sectors constituted 73% of accrued FDI in services sectors (56% of total FDI in the Latvian national economy). Investments of non-residents in transportation and storage and in information and communication services have increased in recent years.

At the end of September 2019, the accrued FDI in goods manufacturing sectors constituted almost 24% (in manufacturing – 11.8%) of the total amount of accrued FDI in the economy of Latvia. They almost doubled compared to the end of 2011.

The amount of investment in the manufacturing has increased. From the end of 2011 to the end of September 2019, the amount of accrued FDI in the manufacturing increased by 66%, which was significantly influenced by large investment in wood processing, manufacture of electrical equipment, manufacture of vehicles, as well as manufacture of metal articles. Investments of foreign investors grew rapidly in the manufacturing industry also in 2019.

It should be noted that in the years of economic recession FDI flows in Latvian manufacturing were rather stable, however, Latvia still lags behind Lithuania in terms of FDI accrued in this sector.

Table 6.3

	FDI by Sectors					
	balances at the end of the period			structure as per cent		
	million euro					
	2011	2018	2019 Sep	2011	2018	2019 Sep
Agriculture	263	584	620	2.8	3.8	3.9
Manufacturing	1113	1783	1848	11.9	11.7	11.8
Other industry	386	708	661	4.1	4.7	4.2
Construction	482	712	614	5.2	4.7	4.2
Trade and accommodation	1329	2574	2639	14.3	16.9	16.8
Transportation and storage	400	787	819	4.3	5.2	5.2
Financial intermediation	2534	3650	3674	27.2	24.0	23.4
Real estate activities	1109	2321	2465	11.9	15.3	15.7
Other services	688	1141	1284	7.4	7.5	8.2
Unclassified activity	1019	941	1089	10.9	6.2	6.9
Total	9323	15202	15713	100	100	100

A major role in the attraction of foreign investment in Latvia is played by the Investment and Development Agency of Latvia (IDAL). The strategy of the IDAL for attracting investment is oriented towards qualitative servicing of incoming investment projects and active operation in attracting investment projects through addressing potential investors.

The process of improvement of the FDI attraction policy is ongoing in close cooperation with the Foreign Investors' Council in Latvia (FICIL). The surveys of foreign investors conducted by make it an important contribution to the improvement of the investment environment.

Investors Sentiment Index 2018 or the assessment of foreign investors working in Latvia for the potential of the competitiveness of the economy and the investment environment was published in January 2019.

The results of the survey of foreign investors evidences of a positive assessment of the Latvian investment environment

in general. The investors noted that it has improved compared to 2017. However, there are shortcomings weakening the investment environment. Corruption and public administration efficiency, as well as insufficient quality and unavailability of labour force have been noted as the most acute problems. Uncertainty, shadow economy and shortcomings of the education system have been noted as chronic problems of the Latvian investment environment. At the same time, investors note positive changes in the quality of business law, demography and healthcare system, as well as tax system. In the study, foreign investors also provide several recommendations on how to solve the most acute problems, for example, some recommendations in the area of labour availability include promotion of regional mobility and development of housing, better transportation systems on a local scale, as well as strengthening of regional centres. Overall, foreign investors recognise that although progress in improving the investment environment has been reached, there is still potential for its improvement.

6.4. MONETARY INDICATORS

The banking sector is generally operating with profit, however, the development of crediting is still evaluated as weak – crediting of business is evaluated as irregular, while crediting of households has positive signs. Volumes of deposits are still shrinking – mainly affected by the decline in volumes of deposits of non-residents.

In Q2 2019, the performance indicators of all Latvian banks were in line with the regulatory requirements. The capitalization level of the banking sector remained at a high level. In Q2 2019, the average capital adequacy ratio of the banking sector reached 22.56% (the regulatory minimum is 8%). Return on assets (ROA)¹ of the banking sector has increased to 1.22%, while the return on equity (ROE)² has increased to 9.92 per cent (EU average – 6.8%).

In accordance with the information from FCMC, bank profitability reduced, but it is still positive – banks operated with a profit of 121.5 million euro in the first half of 2019, which is by 10.1% less than in the corresponding period of the previous year. Most of Latvian banks operated with profit in this period.

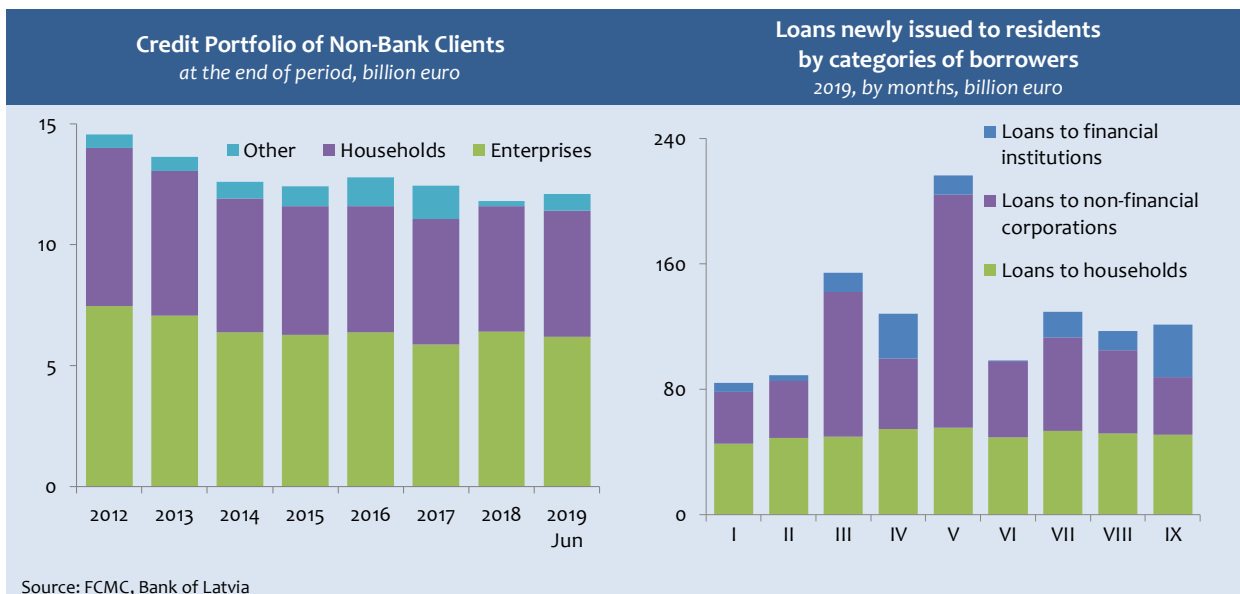
An increase in the Latvian **bank assets** was observed in late 2013, which was largely due to the upcoming introduction

of the euro – people's cash savings in lats went into bank accounts. Consequently, the amount of cash in circulation significantly decreased and the use of non-cash means of payments significantly increased. However, when the euro replaced lats, the amount of cash in circulation increased significantly. Since the introduction of the euro, the growth of the amount of cash in circulation has been moderate, and no significant fluctuations are observed. At the end of September 2019, 4427 million euro were in circulation as cash, which is by 3.3% more than in September of the previous year.

Since the beginning of 2016, the amount of assets of the banking sector has been increasing gradually. In Q2 2019, the assets amounted to 21.9 billion euro, which is by 9.6% more than a year before. The share of non-bank credits in total assets amounted to 61.5%, while the share of debt securities remained moderate (10.2%).

Banks are still cautious in the implementation of more active crediting. According to the FCMC data **outstanding amounts of loans to non-banks** decreased by 2.8% at the end of Q2 2019 compared to the corresponding period of the year before.

Figure 6.18



New crediting is developing moderately – positive trends are observed in crediting of households, while the development of crediting of enterprises is uneven. Loans amounting to 128.35 million euro have been newly issued by 30 September 2019.

Positive trends are observed in **crediting of households**. As income and therefore savings of households are growing, their creditworthiness improves. Therefore, the volume of new credits issued for acquisition of housing is also gradually growing. Housing crediting is still hindered by insufficient household income for the first instalment, which usually ranges from 10 to 30% of the total amount of the

¹ ROA – profit/loss to assets ratio

² ROE – profit/loss to capital and reserves ratio

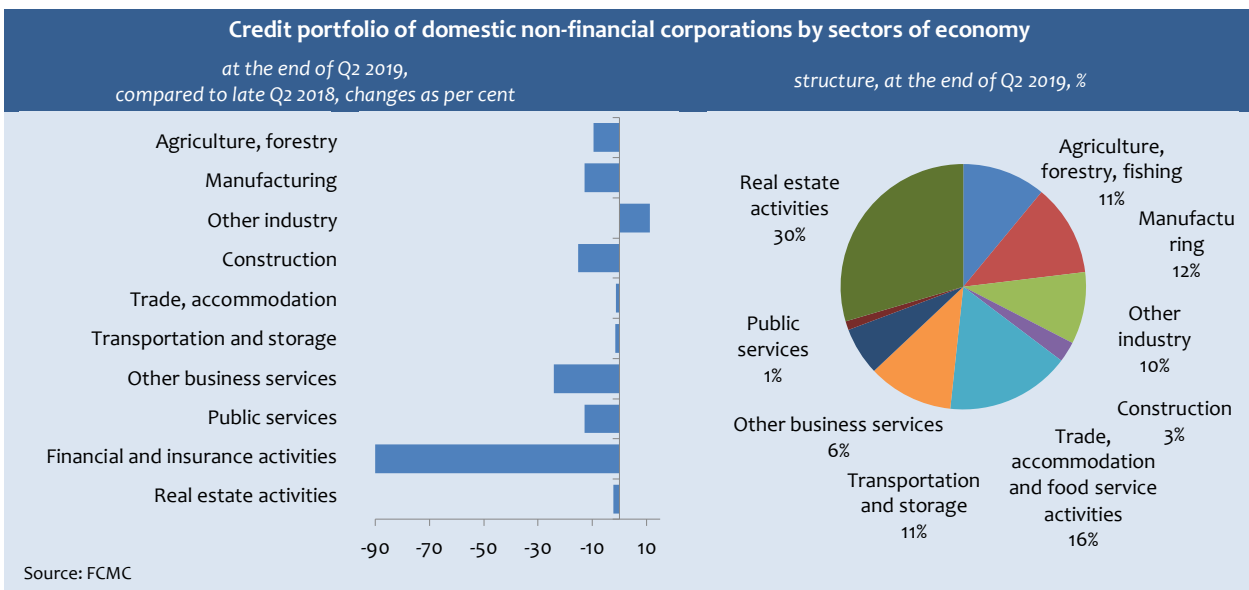
credit. The support programme for acquisition of housing property, which provides for loans for families with children for the house purchase or construction of housing property, can be evaluated positively. From 1 March 2018, the range of beneficiaries of the housing guarantee programme has been extended and also young specialists aged below 35 having no children as dependents and families with children up to 23 years of age (inclusive) can receive state support for acquisition of a home. Most of the loans granted to households are loans for acquisition of a home, reconstruction and repair. In total, dynamics of household credits are still negative, and the proportion of household credits in the total credit portfolio is shrinking.

Crediting of business is still developing unevenly. There are also enterprises, which do not qualify for credits, because

they are operating in the shadow economy. Crediting of business is also affected by the availability of funding from the EU structural funds. Sectors like financial and insurance activities, real estate activities and trade are newly credited the most among sectors of the national economy. The most rapid increase in the volume of newly issued credits is observed in these sectors.

Also, the dynamics of the total business credit portfolio are still negative. In accordance with FCMC data, the volume of credits issued to non-financial corporations shrank by 6.6% in Q2 2019 compared to the corresponding period of the previous year. An even more rapid decline was observed in the category of small and medium-sized enterprises, where volumes of issued loans shrank by 15.4% compared to Q2 2018.

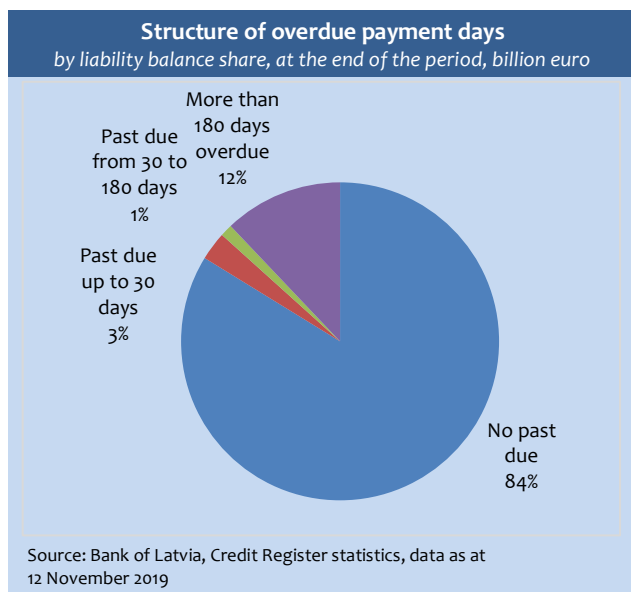
Figure 6.19



In terms of volume, most of the credits by industry at the end of Q2 2019 were granted in real estate activities (30% of total loans granted) and trade, accommodation and food service activities (16%), as well as manufacturing (12%). There was a relatively large share of credits also in transportation and storage and agriculture (11%).

In 2009, the **quality of the credit portfolio** worsened considerably, and in Q2 2010 the highest indicators in loans with overdue payments was reached – almost 1/3 of loans had overdue payments. The quality of credit portfolio has been gradually improving since 2011, mainly due to improvement of the economic situation, as well as writing off of bad debts. In accordance with the Credit Register statistics, at the end of Q2 2019 the amount of liabilities with overdue payments in the total credit portfolio of banks was 16 per cent.

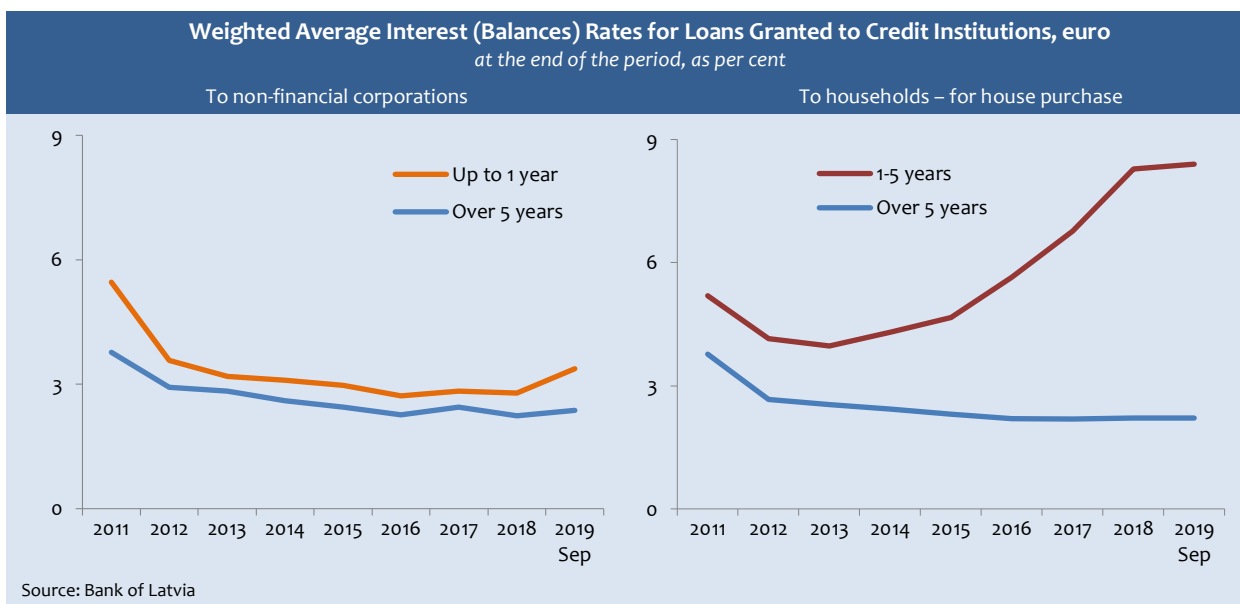
Figure 6.20



Overall, non-bank clients forbore loan portfolio consist of 77% of non-performing exposures and 23% of performing exposures. In accordance with information from FCMC, an improvement of the quality of the credit portfolio was observed in the segment of domestic household housing and consumer loans, where the share of non-performing loans in Q2 2019 in these portfolios shrank to 3.9% and 3.3 per cent, respectively.

Long-term **interest rates** (on outstanding amounts) for credits granted to non-financial companies slightly increased in 2019 and amounted to 2.37% in September 2019. Short-term interest rates for non-financial companies also increased and reached one of the highest indicators (3.38%), but their fluctuations are more pronounced. Long-term interest rates (on outstanding amounts) for credits granted to households for house purchase have been decreasing since 2012, however, a small increase was observed in 2019, and the interest rate increased to 2.22% in September 2019. Short-term interest rates for credits issued to households for house purchase also slightly increased and in September amounted to 4.37 per cent.

Figure 6.21

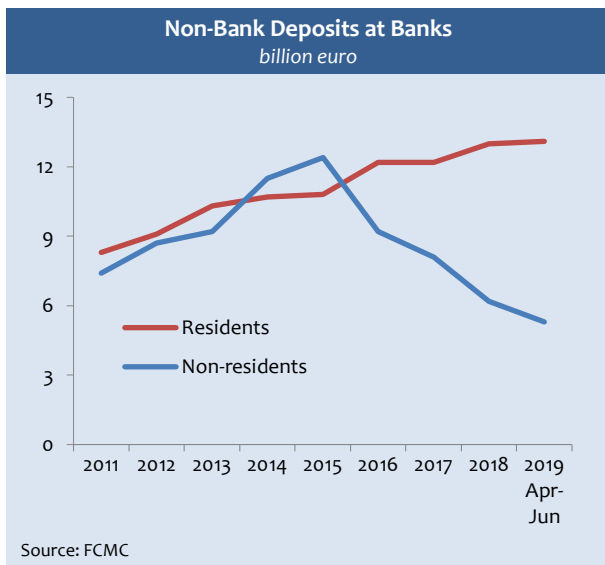


From 2010 to the end of 2015, **volumes of deposits** increased considerably. The credit portfolio of banks has been shrinking since early 2016. In Q2 2019, deposits amounted to 18.4 billion euro, which was by 8.9% less than in the corresponding period a year before. Changes in the structure and in the dynamics of deposits were caused by the drop in volumes of deposits of non-residents. The share of deposits of foreign customers (customers from other EU countries and other countries) declined from 53% in Q2 2015 to 29% in Q2 2019, of which 4% are the deposits of CIS countries, 13% – deposits of other EU countries and 3% – deposits of other countries. The total volume of deposits of non-residents in Q2 2019 amounted to 5.3 billion euro, which is by almost 1/3 less than a year before. Higher requirements in relation to liquidity and capital adequacy

are set for the banks working with non-resident deposits. Small commercial institutions mainly work with money of non-residents in Latvia.

Volumes of non-resident deposits retain a positive increase, and in Q2 2019 they were by 4.8% higher than in the corresponding period of the year before.

Figure 6.22



6.5. FISCAL POLICY AND PUBLIC DEBT

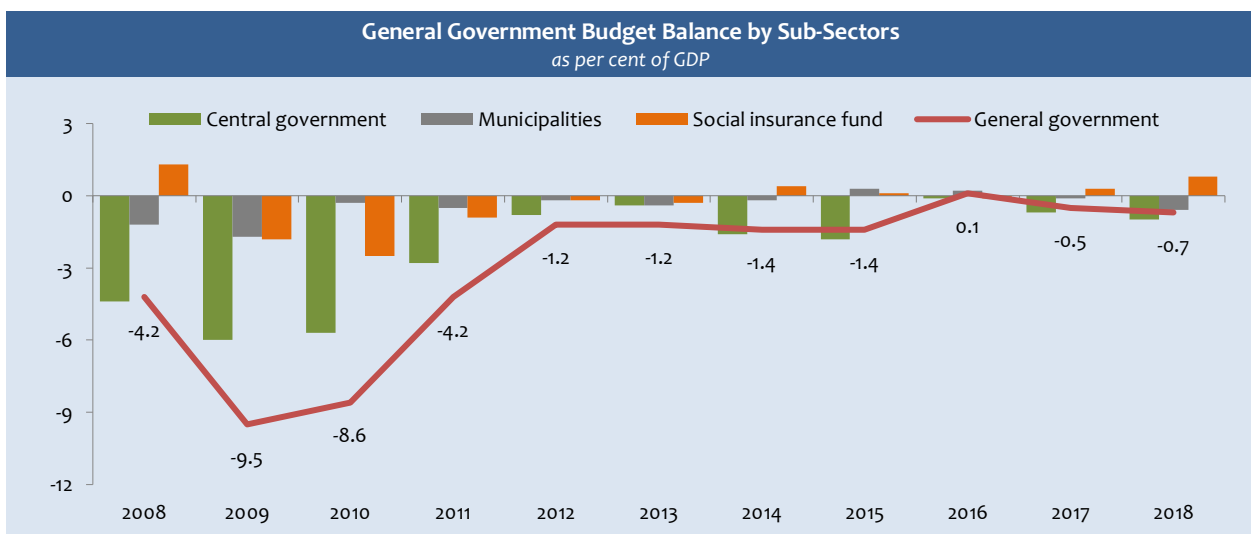
The fiscal policy of Latvia is focused on ensuring sustainable economic growth and implementation of a responsible fiscal policy in line with the conditions of the fiscal discipline.

Since 2011, Latvia has returned to growth, and significant improvements have been achieved in the fiscal position (see Table 6.5 and Figure 6.23). General government budget deficit according to the European system of accounts reduced from 9.5% of GDP in 2009 to 1.4% of GDP in 2014-2015. In 2016, the budget had a surplus of 0.1% of GDP for the first time since 1998, but in 2017 and 2018 the budget had a small deficit.

Table 6.5

General Government Budget					
	2014	2015	2016	2017	2018
Income, billion euro	8.6	8.9	9.3	10.0	11.0
as per cent of GDP	36.6	36.6	36.9	37.5	37.8
Expenditure, billion euro	9.0	9.3	9.2	10.2	11.2
as per cent of GDP	38.0	38.0	36.9	38.0	38.5
Balance, billion euro	-0.34	-0.33	0.02	-0.14	-0.2
as per cent of GDP	-1.4	-1.4	0.1	-0.5	-0.7

Figure 6.23



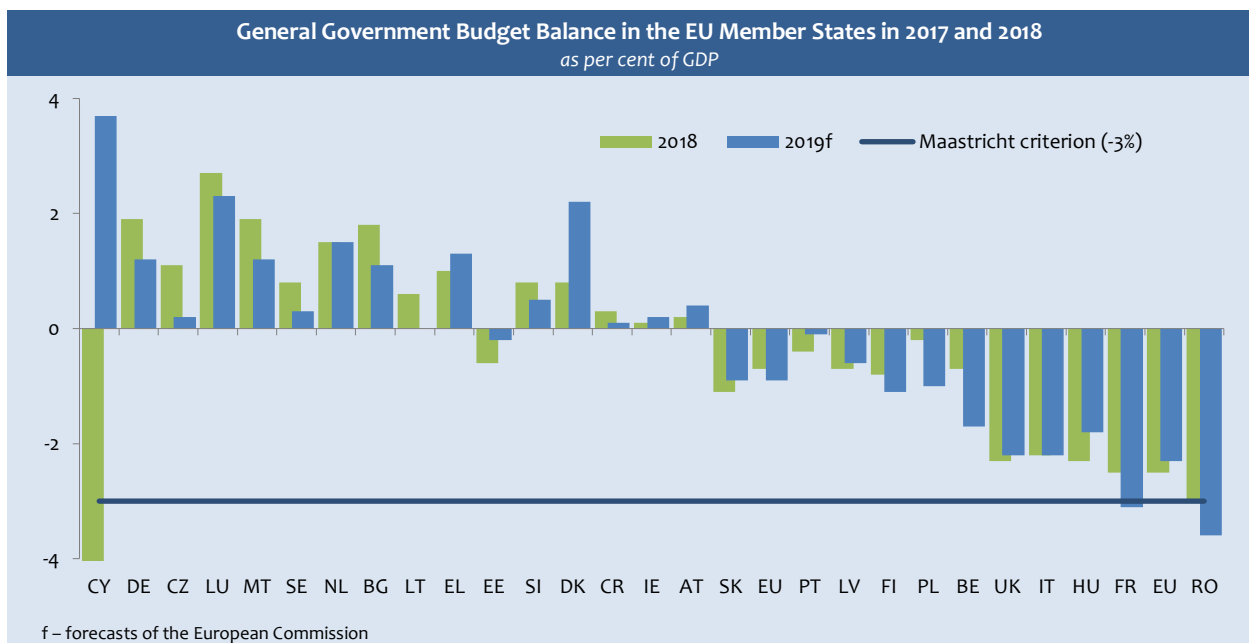
In 2018, the general government budget deficit amounted to 0.7% of GDP.

In 2018, the budget deficit was in central government and local government budgets. There was a surplus in the Social Insurance Fund (see Figure 6.23).

As it is seen on Figure 6.24, in 2018, the Latvian budget balance to GDP showed an average performance among all

the EU countries. The overall situation of the EU in the budget is improving. The average level of budget deficit of the EU in 2018 was 0.7% of GDP (in 2017 – 1% of GDP, in 2016 – 1.7% of GDP). 14 EU countries had a surplus in the state budget in 2018. Budget deficit of only two countries (Romania and Cyprus) was equal to or exceeded the Maastricht criteria, which is 3% of GDP.

Figure 6.24



In accordance with the EC's forecasts in autumn 2019, the average level of budget deficit in the EU is expected to be 0.9% of GDP, while in 2020 – 1.1%. The highest budget deficit in 2019 and 2020, which may exceed 3.5% of GDP, is expected in Romania.

The Saeima adopted the state budget with a deficit of 0.5% of GDP for 2019. In 2019, the fiscal security reserve of 0.1% of GDP is anticipated.

In accordance with the information published by the State Treasury, in the ten months of 2019 a surplus of 444 million euro have formed in the consolidated general budget, and its amount was by 70.7 million euro smaller than in the corresponding period of 2018.

The general government budget deficit of 2020 is planned in the amount of 0.3% of GDP, estimating a general government budget revenue forecast of 36.3% of GDP, and an expenditure forecast of 36.6% of GDP.

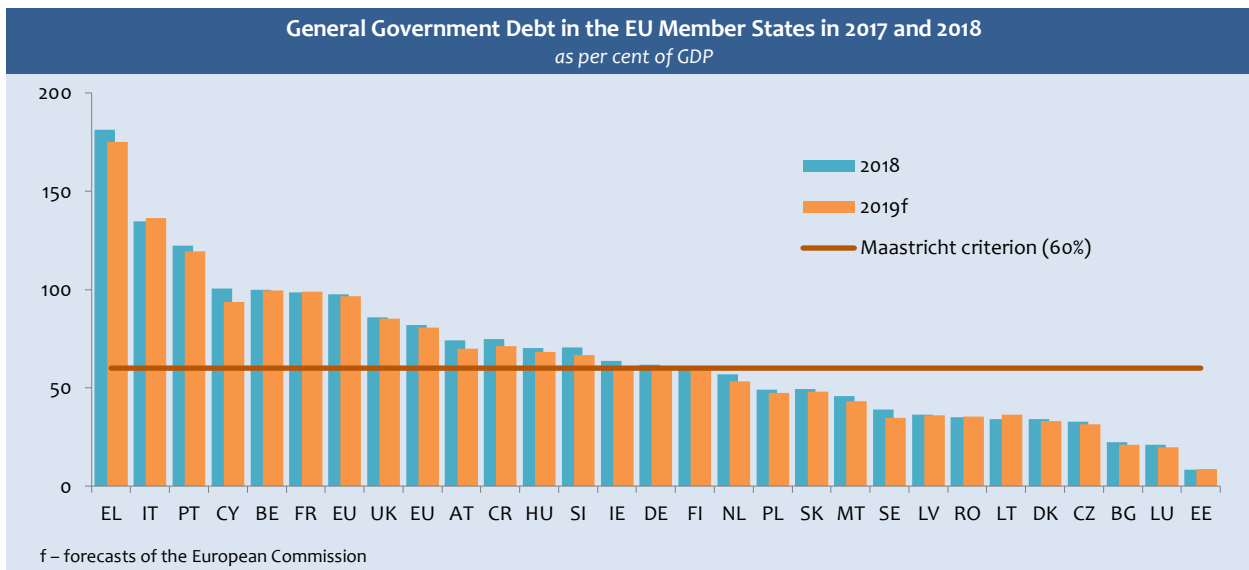
The medium-term budget framework provides that the permissible general government budget deficit is 0.2% of GDP in 2021, but a surplus of 0.1% of GDP is expected in 2022.

The **general government debt** in Latvia is still one of the lowest in the EU (see Figure 6.25). It was 10.6 billion euro or 36.4% of GDP in 2018.

The average level of public debt in the EU in 2018 was 80.4% of GDP (in 2017 – 82.1% of GDP, in 2016 – 83.6% of GDP). In 14 EU member states, the public debt in 2018 exceeded the Maastricht criteria, which is 60% of GDP. The highest public debt to GDP in 2018 was detected in Greece, Italy, Portugal, Cyprus, Belgium, France, and Spain, whereas the lowest general government debt to GDP was registered in Estonia, Luxembourg, and Bulgaria. As indicated by the forecasts of the EC for autumn 2019, the average level of public debt in the EU will slightly decrease in 2019 and will continue to slightly decrease also in 2020.

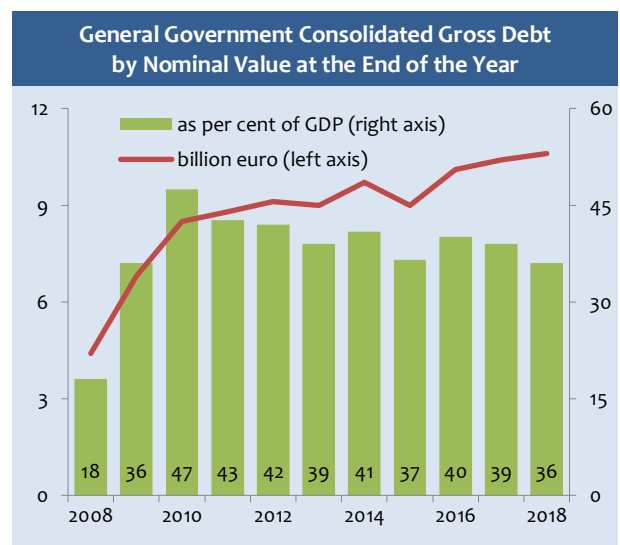
Until 2007, public debt has been growing in Latvia moderately. In order to provide funding for performance of financial liabilities, the general government debt started to grow more rapidly starting from 2008, and it reached 8.5 billion euro or 47.3% of GDP at the end of 2010. Since the end of 2011, the general government debt has had a tendency to decrease. It was 10.6 billion euro or 36.4% of GDP in 2018 (see Figure 6.26). At the end of Q2 2019, government debt amounted to 12.9 billion euro. In 2020, government debt is planned in the amount of 37% of GDP.

Figure 6.25



By implementing well-timed loan measures according to the medium-term strategy and by continuing implementation of a sustainable fiscal policy, it is possible to refinance the currently undertaken debt liabilities of the central government under favourable conditions in terms of interest rates and maturity, and to achieve a decrease and stabilisation of the level of the general government debt at a sustainable level in a long-term perspective, convincingly complying with the criteria concerning the amount of general government debt specified in the Maastricht Treaty.

Figure 6.26



6.6. BUDGET REVENUE AND EXPENDITURE

BUDGET REVENUE¹

With the economic situation improving, the budget revenue has been increasing since 2011. From 2010 to 2018, **consolidated general budget revenue** increased 1.6 times. In 2018, budget revenues amounted to 10.9 billion euro or for 13.1% more than in 2017. Budget revenue continued to increase also in 2019 – an increase by 4.1% in the ten

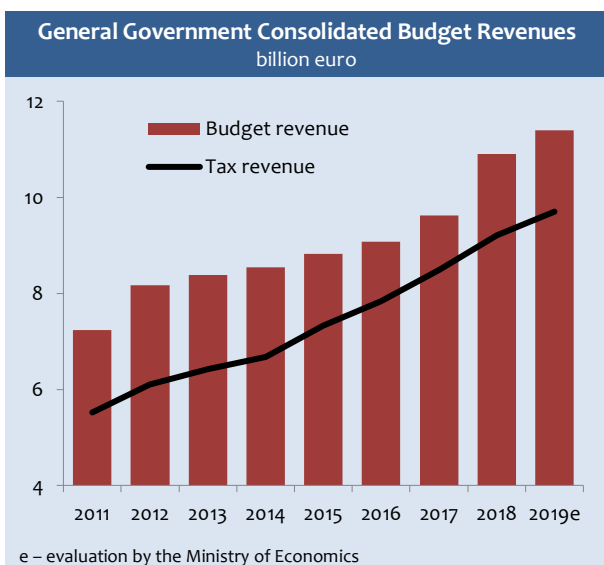
months compared to the corresponding period in 2018, and amounted to 9.4 billion euro.

Approximately 3/4 of all budget revenues consist of tax revenues. Tax revenue has been growing stably since 2011, when there has been the most rapid increase in tax collection in recent years.

¹ The official data of monthly reports of the Treasury was used in this chapter

In summer 2017 Saeima approved an extensive tax reform, which entered into force from 1 January 2018. The purpose of the Tax Reform is to ensure a stable and predictable tax policy until at least 2021 focussed on the growth of national economy and increase in welfare of the population, incl. reduction in income inequality, at the same time ensuring sufficient, predictable and qualitative tax income for financing of national and local government functions shifting the tax wedge away from labour towards consumption, environment and property taxes. The key measures implemented within the scope of the reform are oriented towards reducing the tax wedge of the labour force, increasing income of low-earning employees and families with children.

Figure 6.27



Employment tax revenues continue to grow fostered by the average increase in gross wages in the country. Until 2015, the increase in employment taxes was moderate, while in 2016 it reached the most rapid increase in the post-crisis period. In 2018, employment tax revenues increased by 8.9% and continue to grow also in 2019 – by 8.8% in the ten months. Employment taxes account for more than a half of all tax revenues since 2016.

Within the scope of the tax reform, on 1 January 2018 the minimum wage increased from 380 euro to 430 euro, a progressive personal income tax system was introduced, a differentiated non-taxable minimum was increased in different groups of income and the tax relief for a dependent person was increased, as well as the rate of mandatory state social insurance contributions was increased diverting these funds for financing of the healthcare sector, and other changes were made.

Also in 2019, when measures of the tax reform to reduce employment taxes and income inequality continued, the differentiated non-taxable minimum has increased, the allowance for a dependent person has increased, as well as other changes have taken place in employment taxes since 1 January.

Personal income tax revenues have been growing since 2012 greatly affected by the improvement of the situation in the labour market. Personal income tax revenues increased more rapidly in 2017 – by 10.7%, while the increase in revenues in 2018 was slower – only by 2.1%, which was largely affected by the changes made within the tax reform. In 2019, personal income tax revenue continues to increase – by 9.9 per cent in the ten months.

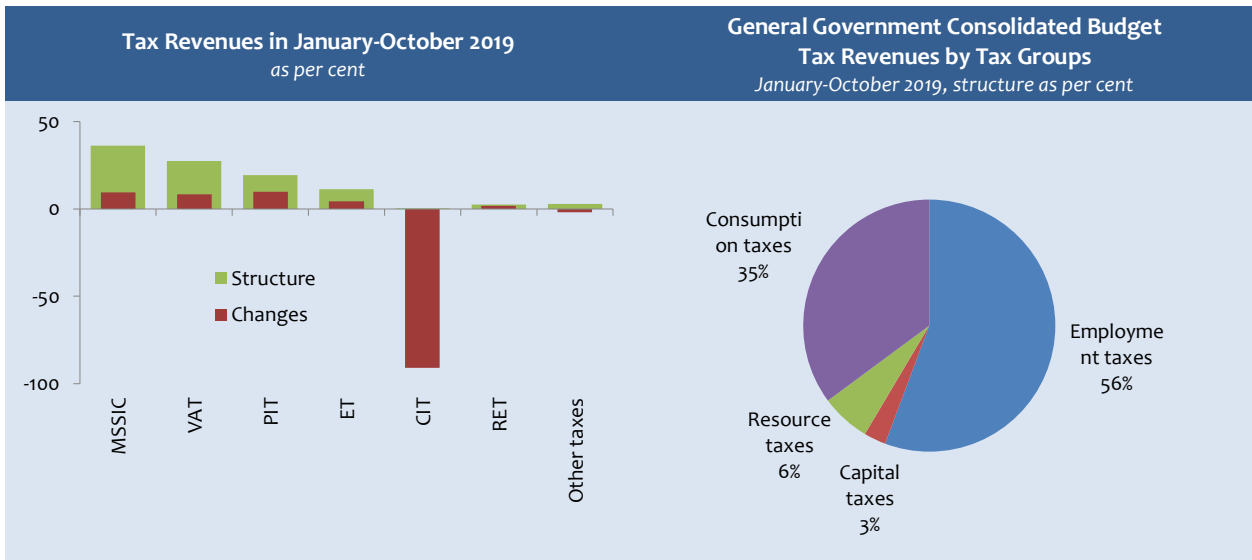
Table 6.6

	Budget Revenue as per cent of GDP					
	2014	2015	2016	2017	2018	2019 Jan-Oct
General government consolidated budget revenues	36.1	36.3	36.2	35.6	36.9	31.5
I Tax revenues	28.3	30.1	31.3	31.4	25.6	26.4
1. Indirect taxes	11.0	11.3	11.7	11.6	12.0	10.4
– value-added tax	7.6	7.8	8.1	8.1	8.3	7.2
– excise tax	3.2	3.3	3.4	3.4	3.5	3.0
– customs duty	0.2	0.2	0.2	0.2	0.1	0.1
2. Income taxes and property taxes	8.2	8.3	8.7	8.7	7.6	5.8
– corporate income tax	1.5	1.6	1.7	1.6	1.0	0.1
– personal income tax	5.9	5.9	6.1	6.3	5.9	5.1
– real estate tax	0.8	0.8	0.9	0.8	0.8	0.7
3. Social insurance contributions	8.4	8.4	10.2	10.3	10.8	9.6
4. Other taxes	0.8	2.1	0.8	0.8	-4.8	0.6
II Other revenues	7.9	6.2	4.9	4.2	11.2	5.2

Revenues from mandatory state social insurance contributions have been growing since 2011. They increased most rapidly in 2016 – by 24.2% more than in 2015 and amounted to 2.5 billion euro, which was largely affected by the introduction of the solidarity tax. In 2018, revenues from

mandatory insurance contributions increased more moderately – by 14.3% and amounted to 3.2 billion euro. The revenue increases also in 2019 – by 9.5 per cent in the ten months.

Figure 6.28



Consumption tax revenues constitute slightly more than a third of all tax revenues. Consumption tax revenues are growing. This is largely affected by an increase in private consumption and, therefore, an increase in retail turnover. In 2018, consumption tax revenue to the state budget grew by 11.4%. The increase continued also in 2019 – by 7.7% compared to the ten months of 2018, and was 2.8 billion euro.

Within the scope of the tax reform, from 1 January 2018 the application of reverse VAT payment procedure has been extended to include construction services, and this procedure has been introduced for deliveries of construction products, deliveries of electronic household appliances and electrical household appliances, deliveries of metal articles and related services, as well as deliveries of game consoles. The excise tax for alcoholic beverages and tobacco products has been raised with a timetable for gradual increase of its rates until 2020. Also in 2019, as measures of the tax reform continued, changes have been made to VAT, excise and vehicle operation taxes.

Value added tax revenue has been growing since 2010. In 2018, revenues amounted to 2.5 billion euro and grew by 12.3% compared to 2017, which was the fastest growth in the last five years. The value added tax revenue continued to increase also in 2019 – by 8.3 per cent in the ten months.

Revenue from the consumption share of the excise tax has been growing since 2011. In 2018, excise tax revenues amounted to 465.4 million euro, which is for 14.8% more than in 2017. The increase continued also in 2019.

Capital tax revenues were growing until 2017. Their increase in the post-crisis period was largely affected by the low base

effect, because corporate income tax revenues reduced considerably during the crisis as business activities narrowed and the number of insolvent companies increased. By contrast, the increase of the real estate tax rate during budget consolidation gave a comparatively smaller effect, because the share of this tax is comparatively low. Since 2018, the capital tax revenues have been decreasing. In 2018, they reduced by 19.4% while in the ten months of 2019 – by 54%. This is largely affected by the changes made within the tax reform in the field of corporate income tax.

Within the scope of the tax reform, from 1 January 2018 the turnover threshold for payers of the microenterprise tax reduced, PET rates for different types of income were equalised, as well as a new corporate income tax payment procedure was introduced envisaging that the CIT rate is 20%, and it should be paid only from that part of profit, which is distributed or paid in dividends or also used for the purposes, which are not directly related to business development, and corporate income tax no longer applies to reinvested profit.

In 2011, revenues from corporate income tax resumed growth, however the revenues decreased by 2.1% in 2014. This was largely related to a reduction in tax payments and an increase in the amount repaid. From 2015 to 2017, the increase in revenues continued, however, not at such a fast pace as previously. In 2018, tax revenues started to reduce – by 28.6%, while in the ten months of 2019 – by 91%, compared to the relevant period of the 2018. So rapid decline was largely affected by changes in the corporate income tax payment procedure.

Real estate tax revenues have been growing since 2009. However, revenues decreased by 2.2% and amounted to 223.1 million euro in 2018. The decrease was mainly affected by the reduction of cadastral value of the land, the purpose of use of which was residential construction and which has an encumbrance, cultural monument, registered in the cadastral information system, as well as the tax allowances set by local governments. In the ten months of 2019, revenues increased by 2 per cent compared to the corresponding period of the previous year.

Resource taxes are the smallest group of taxes, which composed 6.4% of all tax revenues in 2018. Resource tax revenues have been growing since 2011, and resource tax revenues increased by 12.7 per cent in 2018, compared to 2017.

The changes introduced within the scope of the tax reform as of 1 January 2018 increased the excise tax for fuel and introduced other changes.

Natural resources tax revenue has been generally growing since 2010. Natural resource tax revenues increased by 43.5% in 2017, compared to 2016, and amounted to 25.6 million euro. Natural resources tax revenues saw the most rapid increase in percentage. The rapid increase was affected by changes in regulatory enactments, which entered into force from 1 January 2017. They extended the range of taxable objects and individual taxable objects, thus increasing tax rates. In 2018, the increase in revenues was more moderate – by 13.4%. Natural resources tax revenue continue to grow also in 2019.

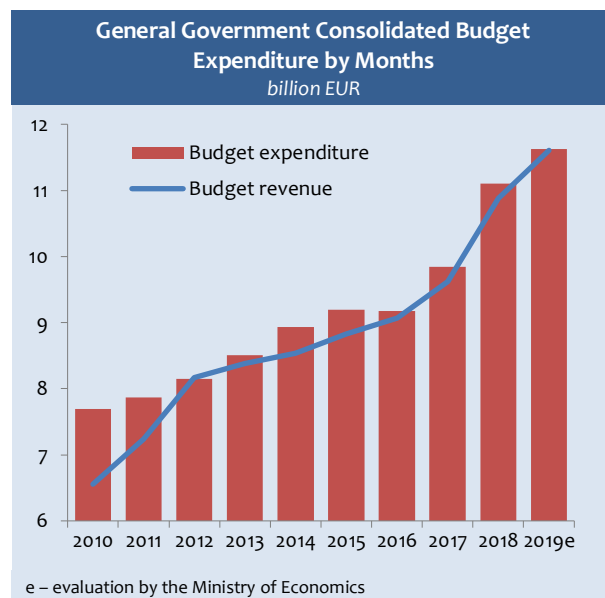
Starting from 2011, revenues from excise tax on oil products and natural gas have been generally growing. In 2018, the revenues amounted to 564.5 million euro – by 12.5% more than in 2017. Tax revenues continue to increase also in 2019.

BUDGET EXPENDITURE

After an extensive cutting down of expenditure during the economic crisis, the **general government consolidated budget expenditure** has been gradually increasing since 2011, with the exception of 2016, when general government budget expenditure reduced by 0.3% compared to 2015. In 2018, total general government budget expenditure amounted to 11.1 billion euro, which is by 12.7% more than in 2017. General government consolidated budget expenditure continues to increase in 2019 – it has increased by 5.1% in the ten months and amounted to 9 billion euro.

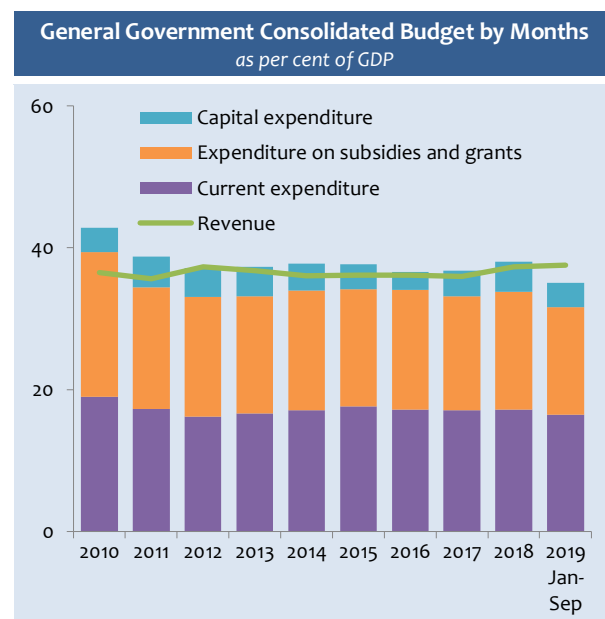
Expenditure on subsidies and grants has been generally growing since 2012. Expenditure on subsidies and grants increased by 13.1% in 2018, compared to 2017, and amounted 5.3 billion euro. In 2019, expenditure on subsidies and grants continues to increase – by 3.2 per cent in the ten months.

Figure 6.29



When cutting the budget expenditure during the crisis, **capital expenditure** was one of the first to be limited. From 2011 to 2013, capital investments increased due to active acquisition of the EU fund, but they have been decreasing since 2014 and reached the lowest level in the last 5 years in 2016 – drop by 25.3% compared to 2015. The reduction in capital expenditure is was mainly underpinned by the reduction of expenditure in local government budgets, where investments to ensure basic activity and for the implementation of EU funded projects reduced.

Figure 6.30



Starting from 2017, capital expenditure has been growing and amounted to 1.1 billion euro, which is by half more than

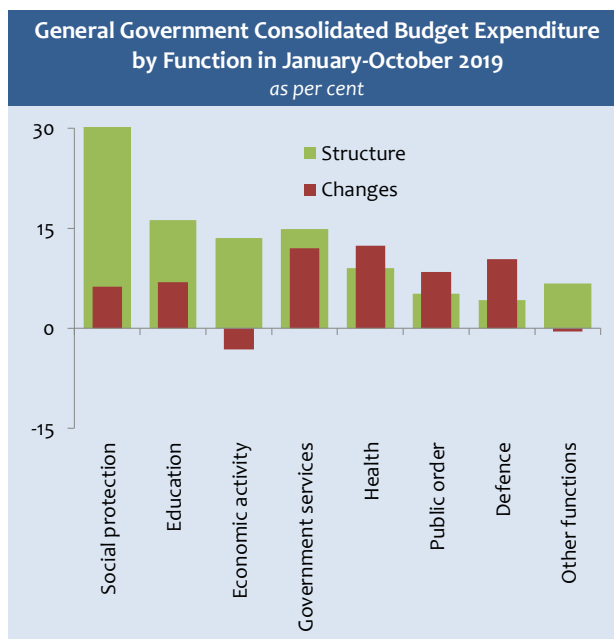
in 2016. The increase in capital investments continues in 2018 (by 31.6%) and they amounted to 1.4 billion euro compared to 2018. Capital expenditure have increased by 1.6 per cent in the ten months of 2019.

Current expenditure reduced most significantly during the crisis. To reduce the national general government consolidated expenditure, certain areas of public administration were optimised – cutting the number of employees and wages in ministries and public authorities, as well as reducing the number of state agencies and hospitals. These expenditures were reduced the most during the crisis. Current expenditure has been growing more rapidly since 2013. It increased by 9% in 2018, compared to 2017, and amounted 5.5 billion euro. Current expenditure continues to increase also in 2019 – by 7.2 per cent.

In accordance with budget expenditure by functional categories, the overall structure has not significantly changed in recent years. Social protection, education and economic activity contributed the most to the increase in expenditure.

In 2018, expenditure on defence, general government services and health increased most rapidly, and economic activity, recreation, culture and religion and education saw a more moderate increase.

Figure 6.31



6.7. PRODUCTIVITY AND COMPETITIVENESS

PRODUCTIVITY

Latvian economic growth is supported by the increase in productivity. Its dynamics in the last three years have been more rapid than in the EU on average. From 2016 to 2018, productivity increased by 9.1% (by 2.5% on average in EU-28). In 2018, productivity (GDP per employed) in the Latvian national economy generally reached almost 49% (69.1% according to PPS) of the EU average and, compared to 2015, the productivity gap reduced by 6.3 percentage points. However, in comparison with several developed countries of the EU, the productivity gap is still large.

In the long-term view, the productivity dynamics is more moderate than before the crisis. In 1996-2007 productivity of Latvia increased by 6.2% per year on average and was an important economic growth driver. The integration of the country in the EU Single Market had a positive impact on the productivity dynamics strengthening economic growth and accelerating the convergence process. During this period, the productivity gap among the EU countries narrowed by almost 25 percentage points. Productivity was growing slower in 2008-2018 – by 2% per year on average under the

influence of cyclical and structural factors. In the first years of economic recession (2008-2009), productivity reduced by almost 3%, which was rather insignificant compared to the drop in GDP (by 17.4%) mainly due to the strong adjustments in the labour market. Although the effects of the crisis have not been long and positive productivity dynamics has resumed since 2010, however its annual growth rates are almost 3 times slower than before the crisis (1996-2007). It should be noted that productivity dynamics has showed a positive trend in recent years (2016-2018).

Productivity is growing more rapidly in tradable¹ sectors. From 2016 to 2018, tradable sectors grew by 3.9% per year on average, non-tradable – by 1.8% per year. Transportation and storage, manufacturing and trade have made the biggest contribution to total productivity increase in the national economy. Productivity in these sectors increased by 25.3%, 11.1% and 7.8% compared to 2015. Productivity in mining, energy, as well as medicine and social care increased by more than 10%. Dynamics were positive also in others excluding financial intermediation,

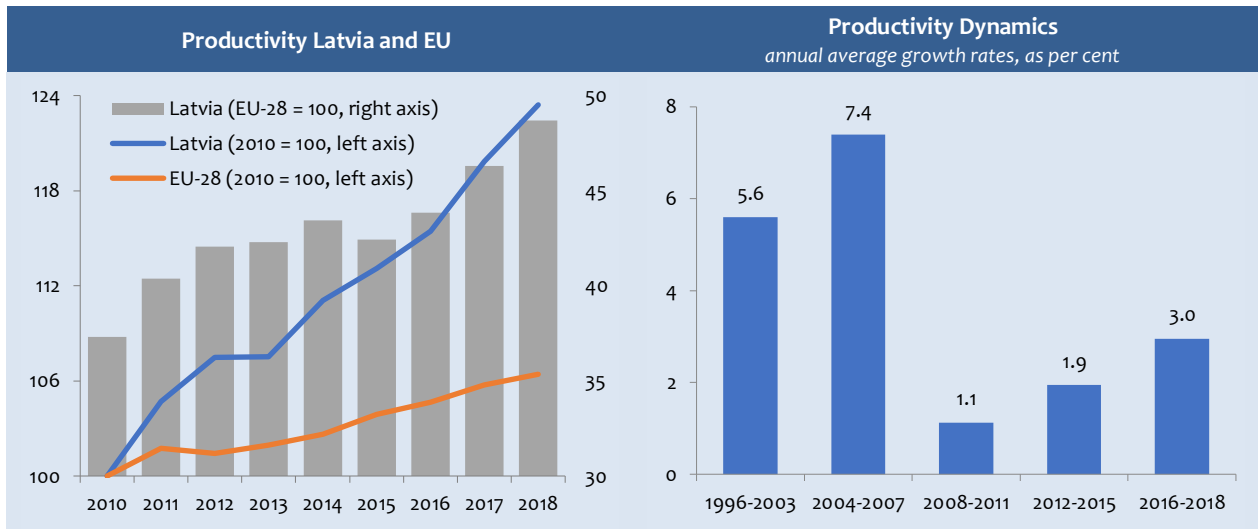
¹ Tradable sectors: agriculture, forestry and fishing; industry (except construction); wholesale trade and retail trade; transportation, accommodation and food service activities

when productivity of work in 2018 was by 16% lower than in 2015.

Productivity in manufacturing increased by 3.6% per year on average or almost 3 times more rapidly than in the EU on average in the last three years (2016-2018), thus

fostering the productivity convergence process. Although the industry productivity gap has reduced by 4.3 percentage points compared to 2016, it is still large. In 2018, productivity in manufacturing was 36.4% (51.6% according to PPS) of the EU average, and this is one of the lowest indicators.

Figure 6.32



The low productivity rate in manufacturing is mainly caused by the dominance of low-tech sectors in the structure of the industry. In 2018, 67% of the total number of employees in manufacturing were from low tech sectors, and almost half of them worked in the food industry and wood processing, which are traditional Latvian industries, competitive advantages of which are largely based on the availability of comparatively cheap labour force. The share of high-tech industries among the employees in manufacturing was 3%, i.e. almost two and a half times less than in the EU on average. Although the share of these sectors is growing, their effect on productivity of the industry and total productivity of the Latvian economy is still insignificant.

The possibilities of increasing the productivity level of the Latvian industry are mainly related to its ability to carry out technological modernisation and innovation, to extend participation in global value chains, to increase qualifications of labour force and improve internal mobility of labour force across the country. The structural transformation of manufacturing and the entire Latvian economy also has

considerable effects on higher value added and higher productivity activities.

COST AND PRICE COMPETITIVENESS

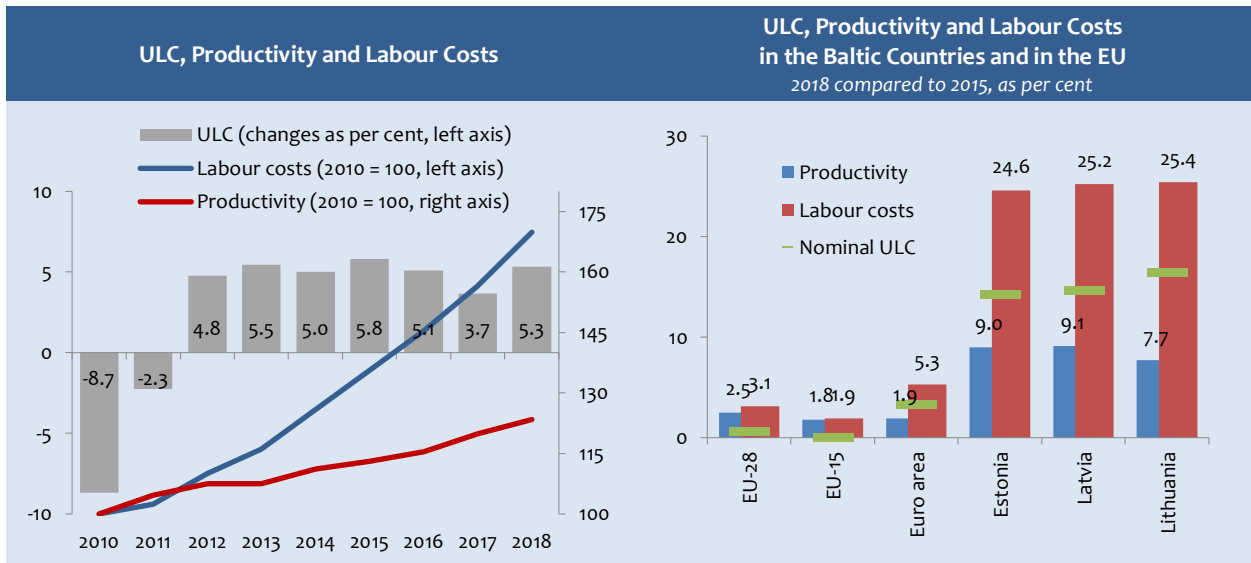
Latvia is in one of the leading positions by productivity growth rates among the EU Member States, yet wages have been growing faster than productivity, weakening competitiveness of Latvian businessmen in the field of costs. The increase in nominal unit labour costs (ULC) also evidences of the growing risks of losses in cost competitiveness¹.

Strong growth of nominal ULC is observed in all the Baltic countries. In the last three years, nominal ULC increased by 14.7% in Latvia, by 14.3% in Estonia and by 16.5% in Lithuania, which is much faster than in the EU on average (0.6%), and the threshold set for this indicator in the EU Alert Mechanism for countries of the Euro area (MIP) has been exceeded.

¹ ULC is a relationship between labour costs and productivity. If productivity is growing faster than the wages, then ULC is decreasing, which is an

indication that competitiveness of state costs increases, and the other way around.

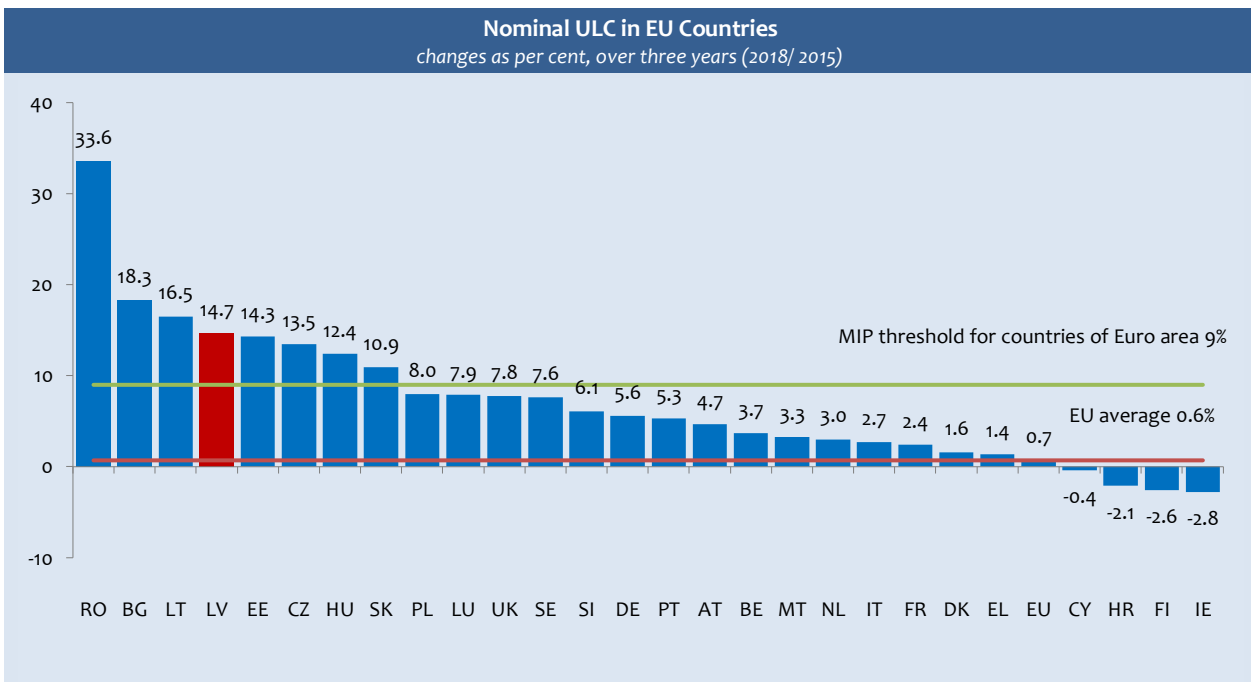
Figure 6.33



In the pre-crisis years (2004-2007) wages of the employed increased almost five times faster than productivity, which also had a reflection in a rapid increase in product unit labour costs (ULC).

The serious adjustments to product and labour markets, created by the crisis in 2009-2011 bridged the gap between

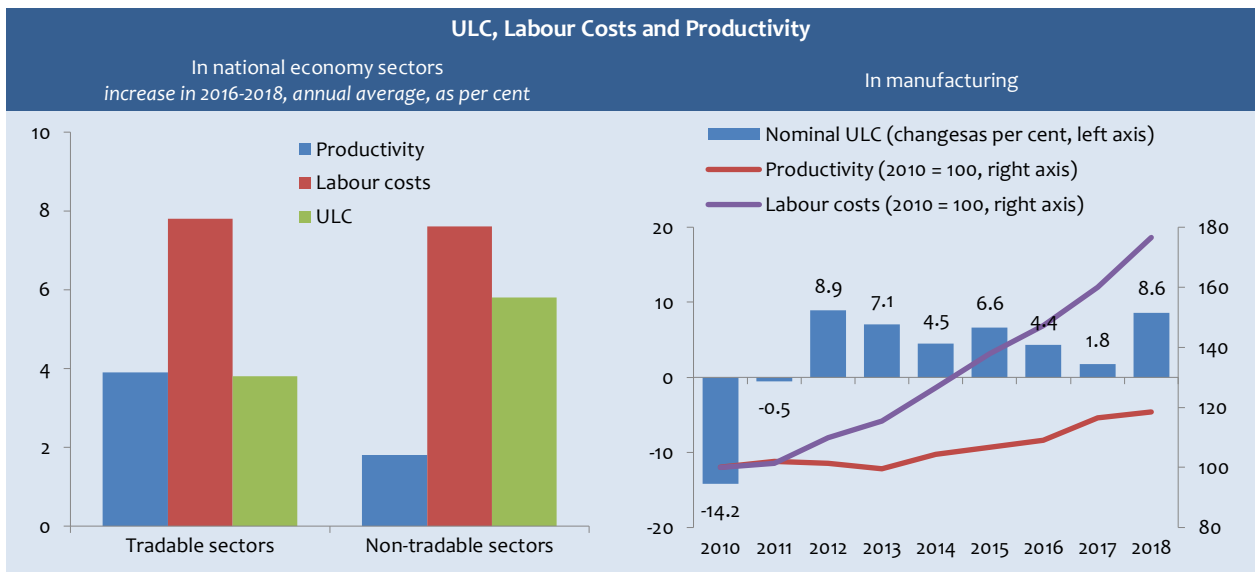
the dynamics of productivity and labour costs. A more rapid drop in labour costs in comparison with productivity in 2009 and a rise in productivity in 2010 and 2011 determined a decrease in ULC on average by 7.5% per year, which indicated an improvement in the cost competitiveness of the Latvian producers.



However, after the economic recovery ULC increased as well. Particularly rapid dynamics of nominal ULC have been observed in recent years. This was affected by a strong increase in wages and a comparatively more moderate increase in labour productivity.

In 2016-2018, nominal labour costs increased by 7.8% per year on average, i.e., almost 2.5 times faster than productivity, and nominal ULC increased by almost 4.7 per cent per year on average.

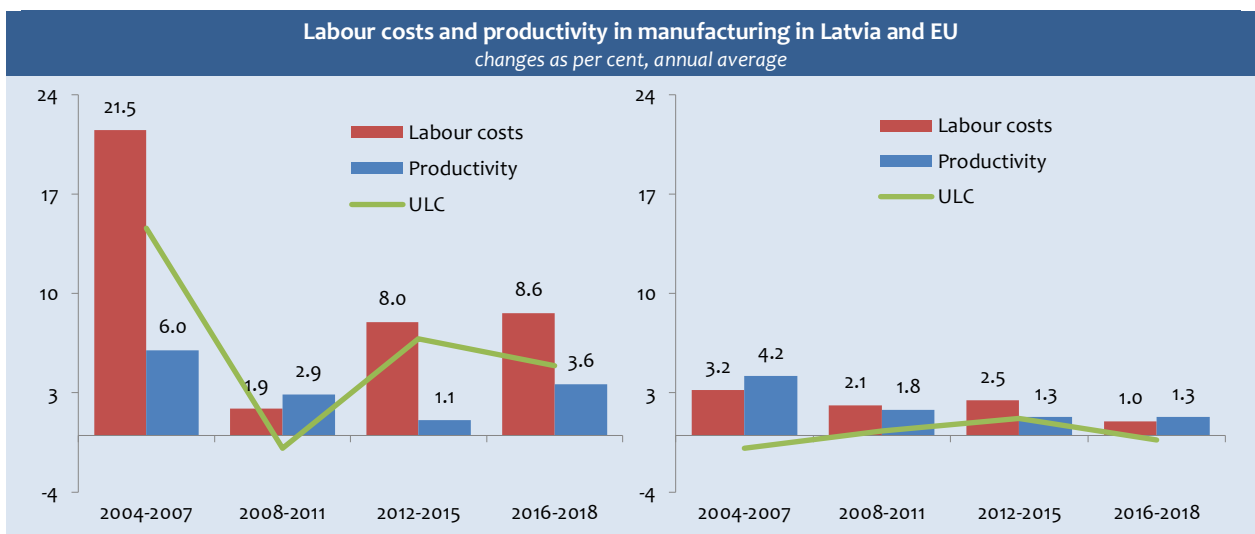
Figure 6.34



A strong increase in labour costs is affected both by wage convergence processes in the integrated EU labour market and more tense situation in the domestic labour market. A

falling unemployment rate and a growing number of vacant jobs evidences that a mismatch between labour demand and supply in the Latvian labour market increases.

Figure 6.35



Cost competitiveness reduction risks are observed in tradable and non-tradable sectors. Although the dynamics of labour costs in the last three years (2016-2018) in both groups of sectors were very similar – they increased by almost 7.5% on average every year, however, productivity in tradable sectors increased twice more rapidly than in non-tradable sectors – by 3.2% and 1.8%, respectively. Therefore, also the nominal ULC increase in tradable sectors was more moderate. Financial services, as well as water supply and public utilities face the highest rise in nominal ULC affected not only by the increase in labour costs, but also by the drop in productivity. There is also a large increase in nominal ULC in the field of information and communication.

In manufacturing the gap between productivity and labour costs increase rates is slightly more moderate than in the national economy on average, however it has increased in the last three years. Annual changes in nominal ULC are rather volatile being mainly affected by factors on the goods market, while labour costs show stable upward dynamics. Labour costs in manufacturing have been growing three times faster than productivity in recent years (2016-2018).

The labour costs dynamics in Latvian manufacturing exceeds significantly EU average labour costs and nominal ULC growth rates. Taking into account that the EU countries are our main trade partners, such trends evidence of growth threats for reduction of cost competitiveness. The

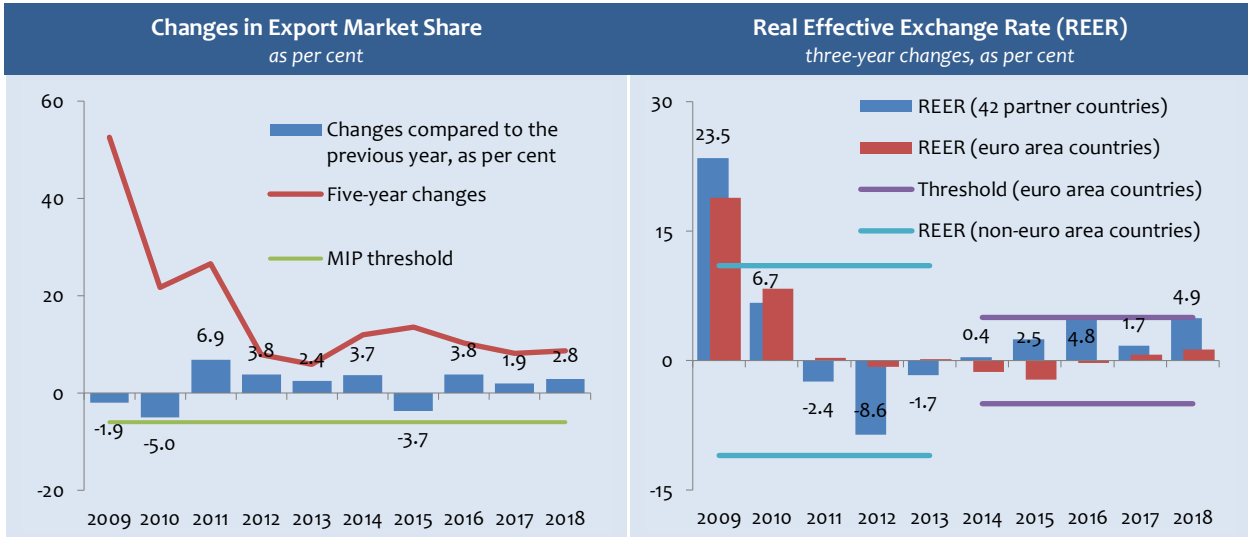
competitiveness of Latvian producers in external markets is also adversely affected by slower wage increase rates in high income countries of the EU.

The share of Latvia in export markets is growing despite negative trends in the cost competitiveness indicator (ULC). Since 2014, the share of Latvian exports on global markets of goods and services increased by 8.6%, and this means that Latvia still retains its competitiveness in external

markets. However, data about changes in the annual market share evidence that positive trends become increasingly more moderate.

The real effective exchange rate (REER) dynamics are rather moderate. The consumer price index (CPI) based REER to 42 trade partner countries has increased by 4.9% in the last three years (2016-2018) (incl. to euro area countries – by 1.3%) and has almost reached the threshold set by MIP.

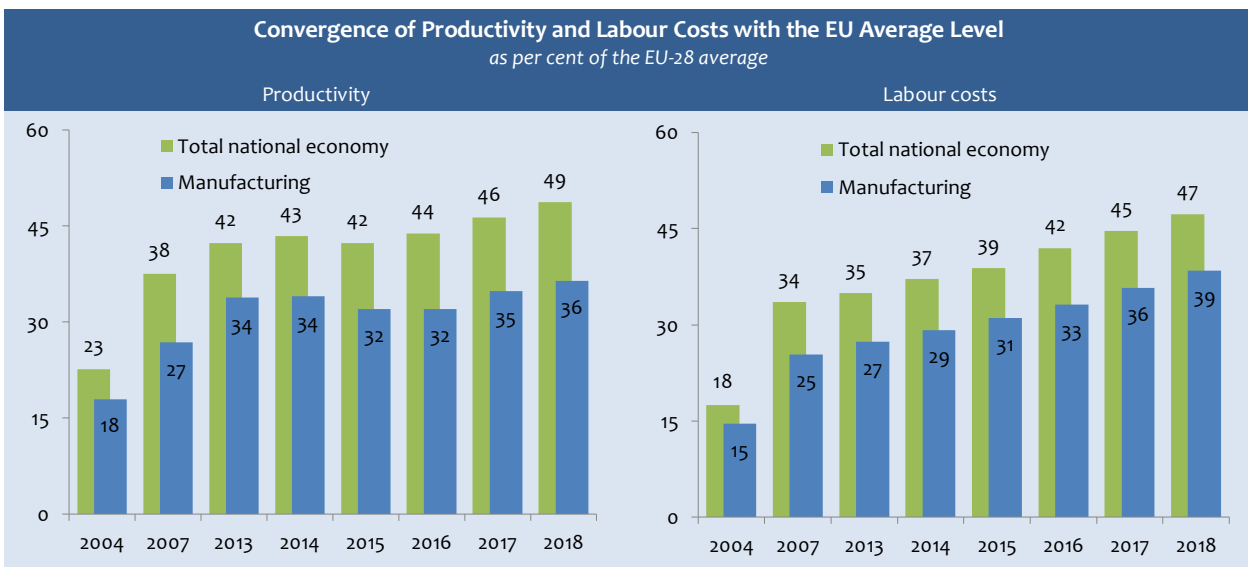
Figure 6.36



However, it should be noted that the increase in the export share along with the rapid increase in labour costs means that the increase in wages is compensated in prices only partially. The dynamics of the GDP deflator and the CPI-based REER evidence of that.

In Latvia, as well as in its neighbouring countries Lithuania and Estonia, the dynamics of price competitiveness (GDP deflator based REER) are growing slower than the cost competitiveness indicator (ULC-based REER) evidencing that the rise in labour costs affected the reduction in the cost-to-price ratio rather than are compensated completely in the rise in prices.

Figure 6.37



This means that the increase in labour costs, which is not compensated by a corresponding rise in productivity, may have a negative effect on the share of company's profits, which entrepreneurs will be forced to adjust to keep price competitiveness in external markets.

Trends in recent years show that as economic activities are growing, price and cost competitiveness indicators get worse, and wage convergence is one the most important factors here.

Labour costs in Latvia are one of the lowest in EU Member States. In 2018, labour costs per employed in the economy of Latvia were 47.2% of the EU average in total, whereas in

the manufacturing industry – 38.5%. Compared to 2015, in 2018, labour cost gap has decreased by 8.3 percentage points, while in terms of productivity index in the national economy fell by 6.3 percentage points in total, but in manufacturing – by 4.4 percentage point. This means that the wage convergence process is faster than productivity convergence. On open EU labour markets, wage equalisation (convergence) is unavoidable, and this has to be taken into account. Therefore, strengthening of Latvia's competitiveness will largely depend on the ability to reduce the productivity gap.

6.8. ALERT MECHANISM

According to the economic and fiscal policy surveillance rules adopted in 2011, a **macroeconomic imbalance procedure** (MIP) was created in the EU in addition to the existing excessive budget deficit procedure. The procedure aims to identify imbalances that hinder the uniform development of Member State economies and to spur the right policy responses. The implementation of the MIP is embedded in the European Semester of economic policy coordination (see chapter 8.1) so as to ensure consistency with the analyses and recommendations made under other economic surveillance tools.

On 17 November 2019, the European Commission published an **Alert Mechanism Report**¹ (AMR) 2020, which states that no macroeconomic imbalances have been stated in Latvia, although three indicators exceed the set limits or thresholds: net international investment position (NIIP), nominal unit labour cost (ULC) index and increase in housing prices (see Table 6.1).

It is noted in the AMR that Latvian current account has a small deficit, but NIIP, which mainly reflects government debt and FDI, has rapidly improved, although it still exceeds the set threshold. Cost competitiveness indicators have deteriorated, because the real effective currency exchange rate has increased and unit labour costs continued to increase relatively strongly promoted by a stable increase in wages. Pressure on the increase in wages is expected to preserve due to shrinking labour supply. The increase of the export market share has slowed down, but still remains positive. The real increase in prices of housing is dynamic

and it slightly accelerated in 2018. Private debt continued to reduced, because the increase in loans remained low. The level of public debt is also comparatively low with a trend to reduce moderately. Declining unemployment and growing economic activity are observed on the labour market.

Indicators of the macroeconomic imbalance procedure (both the primary list and the auxiliary list) have been selected so as to better and faster warn about potential macroeconomic imbalances, as well as help to characterise the processes ongoing in the economy.

External imbalances and competitiveness are characterised by current account balance, net international investment position, real effective exchange rate, export market share and nominal unit labour cost index.

The current account balance of Latvia has not exceeded the thresholds since 2010 and was positive in 2018. The countries, where the current account balance exceeds the upper threshold, are the Netherlands, Malta, Germany and Denmark, and it exceeds the lower threshold in Cyprus and the United Kingdom. The rapid increase in Latvian GDP has left a positive impact on the current account. In this indicator Latvia was among the most rapidly growing EU-28 countries in 2018 (a higher increase was only in Ireland, Malta, Hungary, Poland and Estonia).

¹ https://ec.europa.eu/info/publications/2019-european-semester-alert-mechanism-report_en

Table 6.7

List of Indicators of the Macroeconomic Imbalance Procedure for Latvia									
	Thresholds	2011	2012	2013	2014	2015	2016	2017	2018
External imbalances and competitiveness									
Current account balance (% of GDP, 3 year average)	-4%/6%	2.1	-1.7	-3.2	-2.9	-2.0	-0.6	0.5	0.6
Net international investment position (% of GDP)	-35%	-74.7	-67.5	-66.7	-67.1	-64.1	-59.0	-56.2	-49.0
Real effective exchange rate – 42 trading partners, HICP deflator (3 year % change)	±5%* & ±11%	-2.4	-8.6	-1.7	0.4	2.5	4.8	1.7	4.9
Export market share – % of world exports (5 year % change)	-6%	26.5	7.9	5.9	12.0	13.5	10.2	8.2	8.6
Nominal unit labour cost index (3 year % change)	9%* & 12%	-20.6	-6.5	8.0	16.0	17.2	16.7	15.2	14.7
Internal imbalances									
Deflated house prices (% y-o-y change)	6%	4.0	-0.2	6.7	4.3	-2.4	7.3	5.6	6.6
Private sector credit flow (as % of GDP, consolidated)	14%	-2.4	-5.4	-0.6	-4.4	-0.5	2.3	2.4	-0.2
Private sector debt (as % of GDP, consolidated)	133%	115.2	96.8	91.0	82.2	80.4	80.5	76.9	70.3
General government sector debt (as % of GDP)	60%	43.1	41.6	39.4	40.9	36.7	40.2	38.6	36.4
Unemployment rate (3 year average)	10%	17.7	16.9	14.4	12.6	10.9	10.1	9.4	8.6
Total financial sector liabilities (% y-o-y change)	16.5%	-6.2	5.6	5.7	11.4	13.2	4.7	6.2	-3.0
New employment indicators									
Activity rate – % of total population aged 15-64 (3 year % change)	-0.2 percentage points	-1.4	0.9	1.0	1.8	1.3	2.3	2.4	2.0
Long-term unemployment rate – % of economically active population (3 year % change)	0.5 percentage points	6.9	3.3	-3.1	-4.2	-3.3	-1.7	-1.3	-1.4
Youth unemployment rate – % of economically active population (3 year % change)	2 percentage points	17.4	-4.8	-13.0	-11.4	-12.2	-5.9	-2.6	-4.1
*– countries of Euro area. Note: highlighted number exceed the limits or thresholds set in the alert mechanism. Source: MIP Scoreboard, Eurostat									

The net international investment position of Latvia improved to -49% of GDP in 2018, however it still exceeds the threshold – -35% of GDP (see Figure 6.37). 11 more EU-28 countries are in a similar situation, where the indicator exceeds -100% of GDP (Cyprus, Greece, Ireland and Portugal). However, it is noted in AMR that the countries having NIIP slightly exceeding the threshold has incoming FDI as one of way of attracting foreign capital, which is evaluated positively, because this ensures sustainability of the debt. In 2018, FDI constituted 33.3% of the total attracted foreign capital in Latvia.

Since 2010, the real effective exchange rate of Latvia has been slightly exceeding the thresholds, but after its accession to the euro area also the thresholds intended for euro area countries. Out of EU-28 countries, in 2018, the real effective exchange rate of Belgium, Germany, Estonia and the United Kingdom exceeded the thresholds.

The export market share of Latvia is constantly growing, however, the rates are no longer that rapid after the increase in 2010. A reduction in the export market share exceeding the threshold in 2018 was observed only in Sweden. In 2018, positive trends in the increase of the

export market share in euro area countries slowed down, because the euro exchange rate increased.

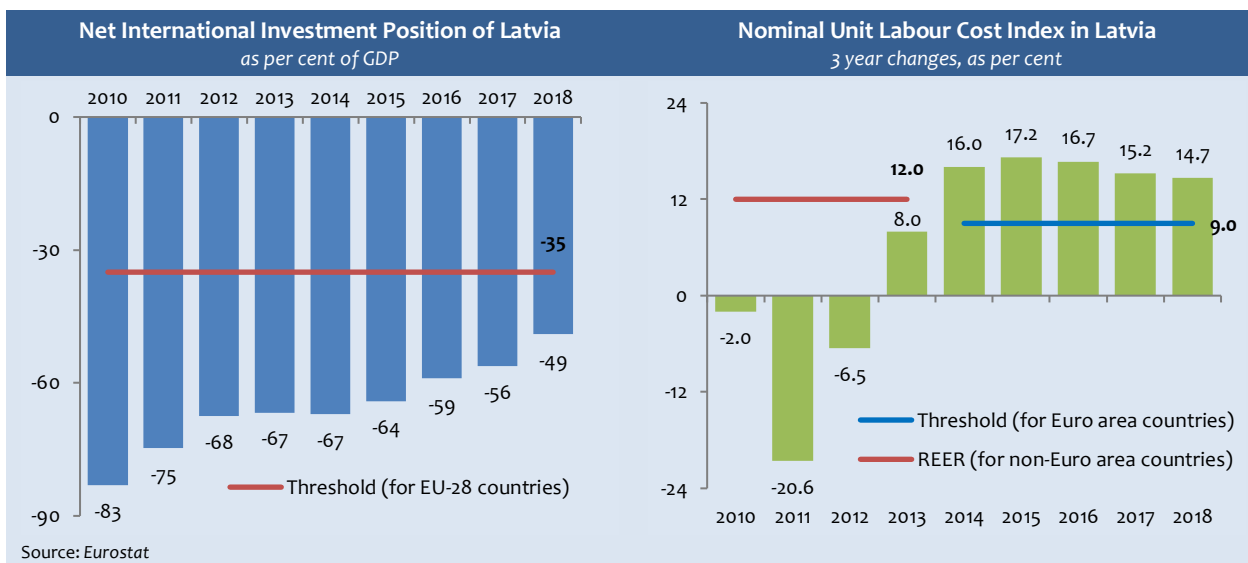
Since the accession of Latvia to the euro area in 2014, the nominal unit labour cost index exceeds the threshold set for euro area countries (see Figure 6.37). There is a similar situation in Romania, Bulgaria, Lithuania, Estonia, Czech Republic, Hungary and Slovakia. For more information on price and cost competitiveness in Chapter 6.7.

Internal imbalances are characterised by deflated house prices, private sector, private sector debt, general government debt, unemployment rate and financial sector liabilities together.

After 2010, the house price index of Latvia exceeded the threshold in 2013, 2016 and 2018 (see Figure 6.38). Out of EU-28 countries, Hungary, Portugal, Ireland, the Netherlands, Slovenia and Czech Republic also exceeded the house price index threshold in 2018.

The private sector credit flow of Latvia has not exceeded the threshold since 2010. In 2018, this indicator did not exceed this threshold in any of EU-28 countries.

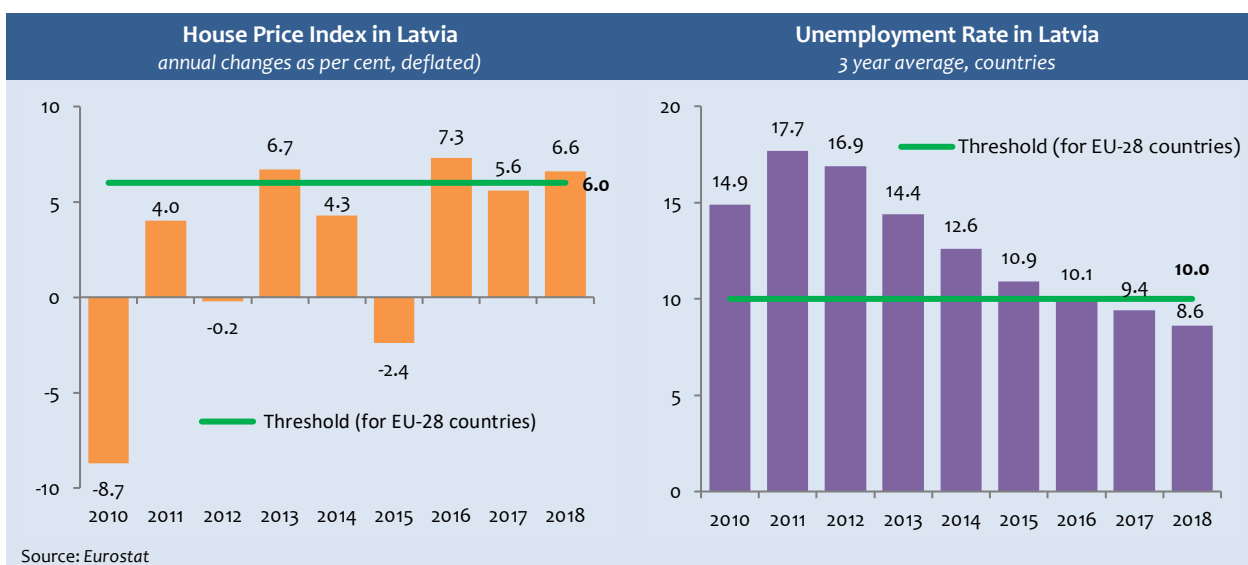
Figure 6.37



The private sector debt exceeded the threshold in Latvia only in 2010. After 2010, the private sector debt continues to decrease. In 2018, this indicator exceeded this threshold in 12 of EU-28 countries.

The general government debt of Latvia reached its highest level (47.3% of GDP) on 2010, however, it did not exceed the threshold. Then government debt reduced to 36.4% in 2018 with small variations. In 2018, this indicator exceeded this threshold in 14 of EU-28 countries.

Figure 6.38



The three-year average unemployment rate in Latvia exceeded the 10% threshold from 2010 to 2016. It reached the highest value in 2011, but then reduced. It was 8.6% in 2018 (see Figure 6.38). In 2018, out of EU-28 countries the 3-year average unemployment rate exceeded the 10% threshold in Greece, Spain, Croatia, Cyprus and Italy.

The list of MIP indicators includes indicators characterising **employment** such as changes in the level of economically active population, changes in the long-term unemployment rate, and changes in the youth unemployment rate. Youth unemployment is also characterised by an auxiliary indicator – youths not in employment, education or training.

The increase in total financial sector liabilities in Latvia has not exceeded the set 16.5% threshold since 2010. In 2018, out of EU-28 countries, this indicator exceeded this threshold only in Finland.

The long-term unemployment and youth unemployment rates in Latvia reached the highest level in 2010, but then reduced. Similarly, the number of youths not in employment, education or training, was the highest in 2010.

In 2018, long-term unemployment was 3.1% of the economically active population, youth unemployment was 12.2% of all the population aged 15-24, but 7.8% of youths aged 15 to 24 not in employment, education or training. Therefore, after 2012 long-term unemployment and youth unemployment indicators no longer exceeded the thresholds.

In 2018, none of EU-28 countries had 3 year changes in percentage points in the long-term unemployment rate, and

3 year changes in youth unemployment did not exceed the threshold either.

Three year changes in percentage points in the economically active population level in Latvia exceeded the threshold in 2011, but then showed an increase. In 2018, out of EU-28 countries, this indicator exceeded this threshold only in Spain and Croatia.

6.9. LATVIA IN INTERNATIONAL RATINGS

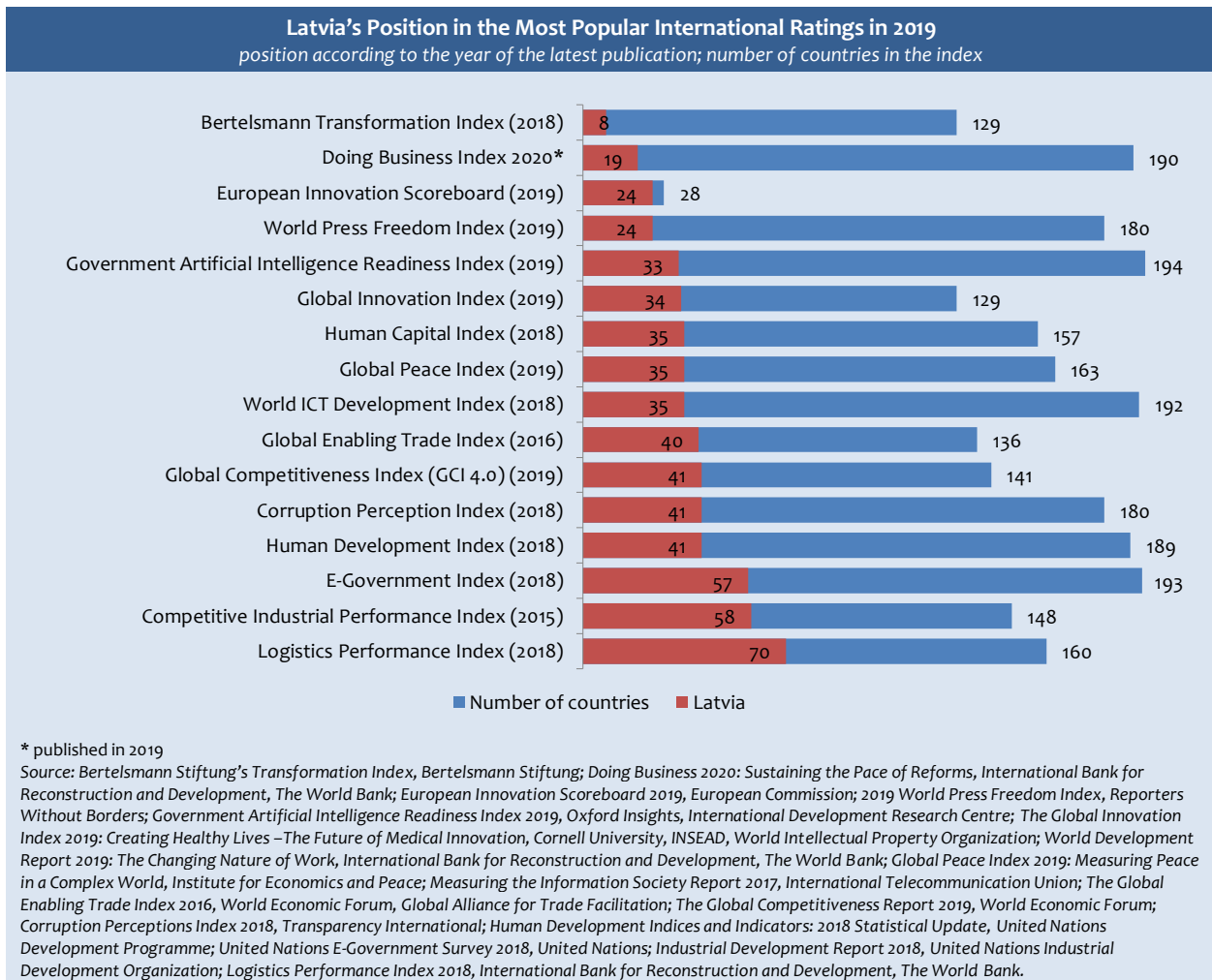
INDEXES

The indexes created by the United Nations (UN), the World Bank group, the World Economic Forum and other organisations characterise Latvia as a country, which carries out many reforms to improve its competitiveness improving the business environment, human resources, ICT

infrastructure and other areas, at the same time ensuring also free press and without endangering other countries of the world in a military way.

The indexes have been arranged starting from the highest place reached (see Figure 6.40), but their descriptions are broken down into main thematic groups.

Figure 6.40



Comprehensive indexes

In 2019, in the new **Global Competitiveness Index (GCI 4.0)** of the World Economic Forum Latvia occupied the 41st place among 141 countries of the world (Estonia – 31st place, Lithuania – 39th place) having moved up one position compared to the evaluation of 2018. The index is composed of 12 pillars characterising the business environment, human capital, market (products, labour, financial) and innovation ecosystem. Taking into account the growing impact of digitalisation on the development of competitiveness, the new GCI methodology was changed and is named GCI 4.0. The performance of the previous year was also recalculated according to it. It allows to evaluate the changes that have taken place during the year, which can be characterised by the evaluation (compared to the

leading country) and by the change in the place during the year.

Having analysed the progress of Latvia in competitiveness by the evaluation, it should be concluded that the performance of Latvia in 12 pillars has improved or remained unchanged in 9 pillars (the evaluation of the “Financial system” pillar improved the most affected by the evaluation of SME funding and venture capital availability), and worsened in 3 pillars (in the “Health” pillar the most affected by reduction in the healthy life years). By contrast, by the occupied place, Latvia’s position has remained unchanged or improved in 8 pillars (see Table 6.8). At the same time, it should be noted that despite the improvement in the evaluation, the place obtained in “Market size” and “Innovation capacity” pillars has worsened, because progress of other countries was more rapid.

Table 6.8

Place of the Baltic Countries in GCI 4.0 2019					
	Latvia			Lithuania	Estonia
	place 2019	improvement in place compared to 2018	change in evaluation compared to 2018	place 2019	place 2019
Total index	41	+1	+0.7	39	31
Environment					
Institutions	47	+2	+1.4	34	21
Infrastructure	43	+4	+2.9	39	45
ICT use	15	-4	-0.7	12	16
Macroeconomic stability	1	0	0	1	1
Human capital					
Health	84	-8	-2.0	85	52
Skills	22	+1	+1.8	24	15
Markets					
Product market	47	+2	-1.2	58	29
Labour market	28	+1	+0.5	24	19
Financial system	85	+9	+3.6	75	52
Market size	95	-1	+0.4	76	99
Innovation ecosystem					
Business dynamism	40	+7	+1.6	45	27
Innovation capacity	54	-2	+0.4	42	34

Source: The Global Competitiveness Report 2019, World Economic Forum

In the **Human Development Index 2018** created by the UN Development Programme, which includes life expectancy, literacy, education level, GDP per capita and other indicators, in 2017 Latvia was ranked 41st (Estonia – 30th, Lithuania – 35th) among 189 countries of the world.

Indexes characterising institutional environment

In the **Transformation Index 2018** created by Bertelsmann Stiftung, which evaluates the quality of democracy, market economy and political governance Latvia is placed 8th among 129 countries of the world (Estonia shares the 1st place, Lithuania is the 4th).

In the **Corruption Perceptions Index 2018** created by the International anti-corruption organisation *Transparency International*, Latvia was ranked 41st (Estonia – 18th, Lithuania – 38th) among 180 countries of the world worsening its position by one positions compared to the result of 2017, although the index value has not changed.

In the **2019 World Press Freedom Index** created by the International press and freedom of expression organisation “Reporters Without Borders”, in 2019 Latvia was ranked 24th (Estonia – 11th, Lithuania – 30th) among 180 countries of the world keeping its position of 2018.

In the **Global Peace Index 2019** created by the Institute for Economics and Peace, in 2019 Latvia was ranked 35th

(Estonia – 37th, Lithuania – 38th) among 163 countries. Compared to the result of 2018, the place of Latvia has worsened by 5 positions, because expenses on state defence have increased.

Indexes characterising ICT development

In the **Global ICT Development Index 2017** created by the International Telecommunications Union, which provides comprehensive information on the assessment of the condition of the ICT market, including infrastructure development (mobile and fixed) and government policy, Latvia was placed 35th among 192 countries of the world (Estonia – 17th place, Lithuania – 41st).

In the **E-Government Survey** created by the UN Department of Economic and Social Affairs, which analyses the progress of using e-government, in 2018 Latvia was ranked 57th (Estonia – 16th, Lithuania – 40th) among 193 countries of the world worsening its performance by 12 positions compared to the result of 2016, although the index value in this period has increased.

In the **Government Artificial Intelligence Readiness Index 2019** created by *Oxford Insights* and the International Development Research Centre, in 2019 Latvia was ranked 33rd. (Estonia – 23rd, Lithuania – 37th) among 194 countries.

Indexes characterising business environment

The **Doing Business** survey by the World Bank group is an international, comparative rating of business environment, which annually measures entrepreneurship regulating administrative procedures and their application in various countries of the world.

In the competition among 190 countries *Doing Business 2020* Latvia occupies the 19th place as the year before. When evaluating the position among the EU countries, Latvia occupies one of the highest positions in the *Doing Business 2020* survey. Only Denmark (4th place), the United Kingdom (8th place), Sweden (10th place), Lithuania (11th place) and Estonia (18th place) have a higher evaluation.

The creators of the *Doing Business 2020* study have used a new methodology, and have therefore recalculated evaluations of indicators for the 4 previous years, however, have not specified places of countries. If we compare the evaluation of Latvia in 2020 and 2019, values of 9 groups of indicators have improved or remained unchanged, but the result of 1 group of indicators had worsened (see Table 6.9). The evaluation of the "Paying Taxes" index has reduced, because the ration of paid taxes and social contributions has increased compared to company profits.

Table 6.9

	Evaluations of Baltic Countries by Indicators in <i>Doing Business 2020</i>							
	Latvia			Lithuania		Estonia		
	place	assessment	change in assessment compared to <i>Doing Business 2019</i> *	place	assessment	place	assessment	
Total index	19	80.3	0	11	81.6	18	80.6	
Starting a Business	24	94.1	0	34	93.3	14	95.4	
Dealing with Construction Permits	56	73.5	0	10	84.9	19	82.6	
Getting Electricity	61	82.3	+0.1	15	92.9	53	83.3	
Registering Property	25	82.3	0	4	93.0	6	91.0	
Getting Credit	15	85.0	0	48	70.0	48	70.0	
Protecting Minority Investors	45	68.0	0	37	70.0	79	58.0	
Paying Taxes	16	89.0	-0.7	18	88.8	12	89.9	
Trading Across Borders	28	95.3	0	19	97.8	17	99.9	
Enforcing Contracts	15	73.5	0	7	78.8	8	76.1	
Resolving Insolvency	55	59.6	+0.2	89	46.7	54	60.1	

* The results of *Doing Business 2019* have been recalculated based on *Doing Business 2020* methodology
Source: *Doing Business 2020*, International Bank for Reconstruction and Development, The World Bank

In 2018, in the **Competitive Industrial Performance Index 2015** created by the UN Industrial Development Organization, which analyses the ability of industrial enterprises of countries to produce and export by transforming them competitively and structurally, Latvia was placed 58th among 148 countries of the world (Estonia – 50th place, Lithuania – 40th).

In the **Global Enabling Trade Index 2016** created by the World Economic Forum and the Global Alliance for Trade

Facilitation, which evaluates the ability of countries to facilitate flows of goods across borders, Latvia was placed 40th among 136 countries of the world (Estonia – 14th place, Lithuania – 29th).

In the **Logistics Performance Index 2018** created by the World Bank group, which evaluates how effectively delivery chains connect enterprises to markets or logistical activities, Latvia was placed 70th among 160 countries of the world (Estonia – 36th place, Lithuania – 54th). On average, in the

period from 2012 to 2018 Latvia occupied the 55th place in this index (Estonia – 36th, Lithuania – 43rd).

Indexes characterising innovation environment

In the **Global Innovation Index 2019** created by the Cornell University, European Institute of Business Administration and the World Intellectual Property Organisation Latvia was ranked 34th (Estonia – 24th, Lithuania – 38th) among 129 countries of the world keeping its position of 2018. The following indicators were emphasised as strengths of Latvia: pupil-teacher ratio in secondary education, tertiary enrolment, compliance with environmental management system standards, ease of getting credit, females with advanced degrees, expenditure on research and development financed by abroad, growth rate of gross domestic product per worker by purchasing power parity, as well as increase in creative industry products.

In the **European Innovation Scoreboard 2019** created by the European Commission Latvia is placed 24th among 28 EU countries, like a year ago (Estonia – 12th place, Lithuania – 21st place) and is included in the group of *moderate innovators* for the fourth year in a row. Finance and support, employment and impacts innovation-friendly environment are Latvia's strongest innovation dimensions. Innovators, research systems and firm investments are the weakest innovation dimensions.

In the **Human Capital Index 2018** created by the World Bank group, which measures productivity of employees of the next generation to complete education and full health standard, Latvia occupied the 35th place (Estonia – 29th, Lithuania – 37th) among 157 countries.

CREDIT RATINGS

The credit rating of a country is the evaluation of its creditworthiness, which is an essential indicator for potential creditors and investors. The higher it is, the more beneficial terms of borrowing of financial resources are, which allows to reduce service costs of the state debt. The credit rating reflects the condition of economy and governance of a country.

The credit rating of Latvia is determined by the following international rating agencies: *Moody's Investors Service*, *Fitch Ratings* and *S&P Global Ratings*, as well as the Japanese rating agency *R&I*.

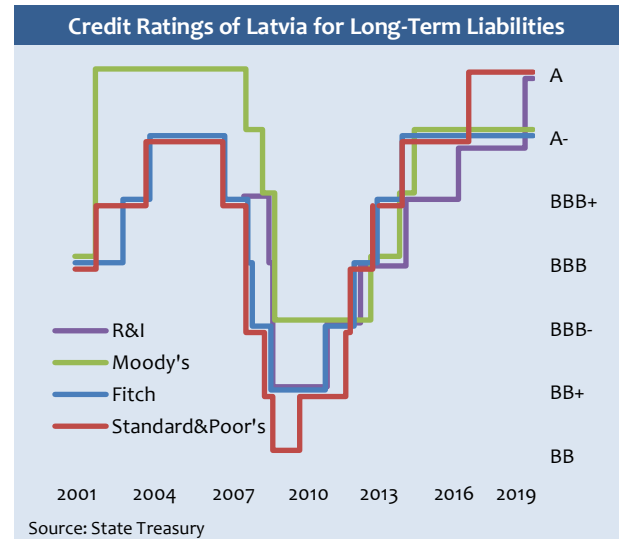
According to the assessment of credit rating agencies, Latvia holds a stable position in group A of the credit rating, which is evaluated as low risk class.

In 2019, all the credit rating agencies kept the previously defined credit ratings for Latvia setting a stable future outlook (see Figure 6.41).

In May 2019, the international rating agency *Moody's Investors Service* noted in its assessment Latvia's ability to keep strong growth rates and a comparatively low government debt level. Despite the existing geopolitical risks, the ability of the Latvian economy to adapt to changes

has been noted as positive. The agency justifies the stable outlook of the rating by the government's stable fiscal policy and commitment to implement measures to reduce money laundering and terrorist financing risk in the financial sector. The matter of demography has been noted as Latvia's long-term challenge, which can have a negative impact on economic competitiveness.

Figure 6.41



In September 2019, the international rating agency *S&P Global Ratings* noted in its assessment that Latvia's economy kept developing moderately with growth rates slightly above 3%, as well as is able to keep its fiscal deficit at a low level. Fiscal results of previous years and the low government debt level have been noted as the factors strengthening Latvia's rating. The Latvia's challenge in the limited resources situation will be to ensure planned reform activities and growing needs in areas like health, welfare and education. A considerable progress has been achieved in strengthening of the financial sector, however, significant reputation risks cannot be excluded, if Latvia is included in the "grey list". No-deal *Brexit* was noted as an external risk in wood processing, but its impact on Latvia's foreign trade and economy will be small.

In October 2019, the international rating agency *Fitch Ratings* noted in its assessment that the state financial policy successfully implemented by Latvia with a moderate budget deficit, as well as comparatively low general government debt level allow to keep Latvia's credit rating at the invariably high level. Measures in the prevention of money laundering and terrorism financing, strengthening of surveillance in the financial sector, as well as changes in business models of banks have been appreciated. However, increase of the rating is limited by GDP per capita and external net debt like in the group of countries with the rating below A, as well as demographic and labour market challenges.

In December 2019, the Japanese credit rating agency *R&I* increased the credit rating of Latvia from A- to A setting a stable outlook. It has been concluded in the assessment that Latvia's economic growth will continue to be supported by

strong domestic demand. The labour market remains strong, wages are growing. Disciplined fiscal management ensures low government budget deficit and government debt level. The share of services to non-residents has reduced in the banking sector. However, medium-term demographic problems may negatively affect economic growth and social area.

The credit rating of Baltic countries is determined by the following international rating agencies: *Moody's Investors Service*, *Fitch Ratings* and *S&P Global Ratings*. Estonia has the highest credit rating among the Baltic countries, but credit ratings of Latvia and Lithuania are similar.

Table 6.10

Credit Ratings of the Baltic Countries for Long-Term Liabilities in 2019			
	Moody's Investors Service	S&P Global Ratings	Fitch Ratings
Estonia	A1/Stable	AA-/Stable	AA-/Stable
Lithuania	A3/Positive	A/Stable	A-/Positive
Latvia	A3/Stable	A/Stable	A-/Stable

Source: *Moody's Investors Service*, *S&P Global Ratings*, *Fitch Ratings*

The credit rating of Estonia is two levels higher than the credit rating of Latvia and Lithuania. In 2019, all the three international rating agencies kept the credit rating and the future outlook of Estonia at the present level secured by factors like stable political environment and institutional governance, good macroeconomic indicators, invariable fiscal policy course of the new government, and strong banking sector. Geopolitical risks, limited labour market and reputational risks in the banking sector have been noted as risk factors.

In 2019, all the three international rating agencies kept the credit rating of Lithuania also at the present level, but *Moody's Investors Service* increased the outlook of the Lithuanian credit rating from stable to positive. This was secured by factors like balanced economic growth, stable financial status of the state, stable institutions governance, levelling of emigration and immigration, successful fiscal policy. Demographic problems, geopolitical risks and limited labour market have been noted as risk factors.

7. LABOUR MARKET

7.1. EMPLOYMENT AND UNEMPLOYMENT

Along with the increase in economic activities, visible improvements in the labour market can be observed – unemployment continues to fall and the employment rate increases. Meanwhile, challenges arise demographic trends and labour market regional disparities rises, which limit the attraction of new employees in more rapidly growing sectors and economically stronger regional centres. It should be taken into account that the low base effect in the labour market has been lost – labour force participation and employment indicators have reached their historically highest levels, therefore, the possibilities to attract labour force from the economically inactive part of the population have almost gone.

On the other hand, economic growth in recent years has been largely based on productivity increase, therefore, the job growth has overall remained moderate and in line with labour supply trends.

Since mid-2010, the **number of employed** has been gradually increasing. According to the labour force survey data the number of employed has grown by 58.7 thousand or on average of 7.3 thousand per year from 2010 to 2018. This was largely affected by the increase in economic activities in the economy – since 2010, GDP has increased by almost 1/3. In total, 917.8 thousand people aged 15 to 74 were

employed in Q3 2019, which was by 0.2% less than in the corresponding period of 2018.

Figure 7.1

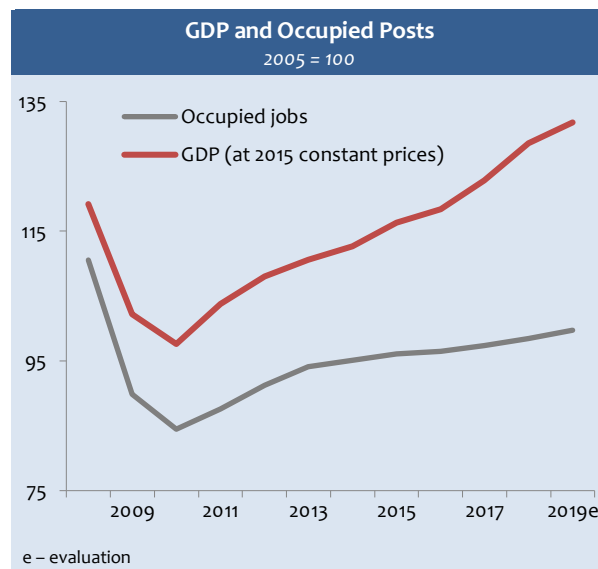
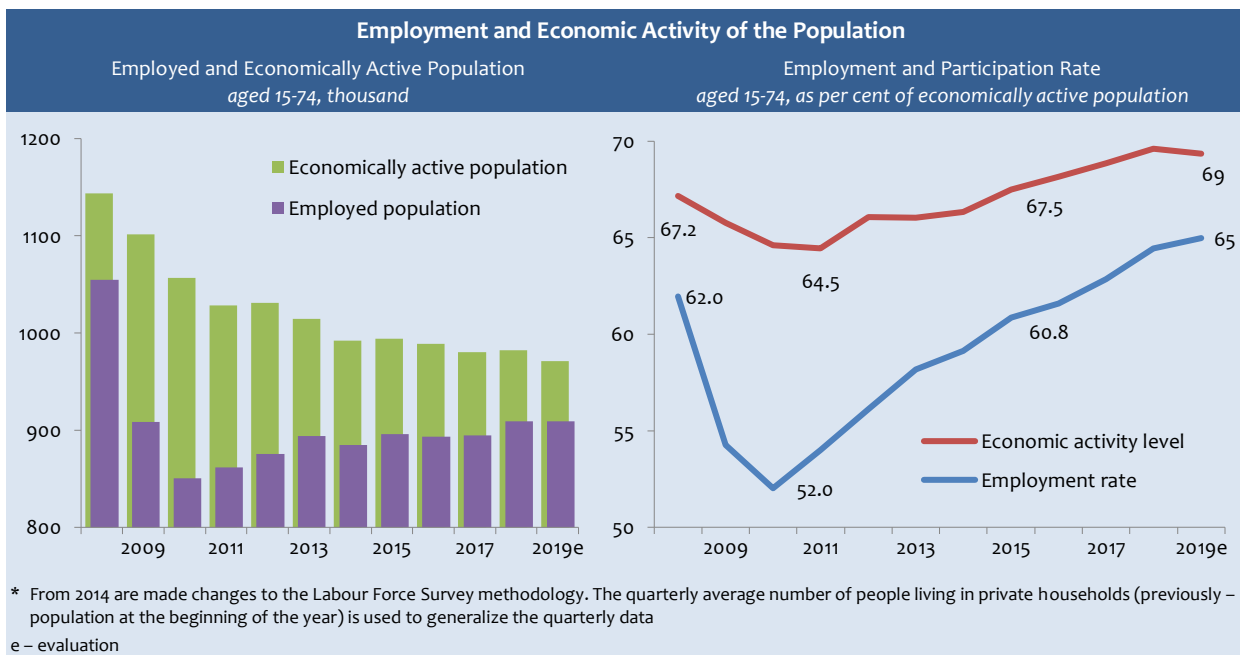


Figure 7.2



It should be taken into account that growth is still largely based on the increase in productivity and not so much on the increase in the number of employees. In Q3 2019, the

number of the employed in absolute terms was still by 15% or (162.2 thousand) smaller than in the corresponding period of 2007.

Despite that the number of employed still lags the pre-crisis level, the **employment rate** has reached its historically the highest level – in Q3 2019 65.6% of the population aged 15 to 74 were employed, which is by 2.6 percentage points higher than in the corresponding period of 2007.

The increase in the employment rate is mainly attributed to the drop in the number of working age population compared to the number of the employed. Since 2007, the population aged 15 to 74 has reduced by almost 318 thousands. In Q3 2019, there were 1398.1 thousand people in private households, which was by 11.5 thousand less than a year before.

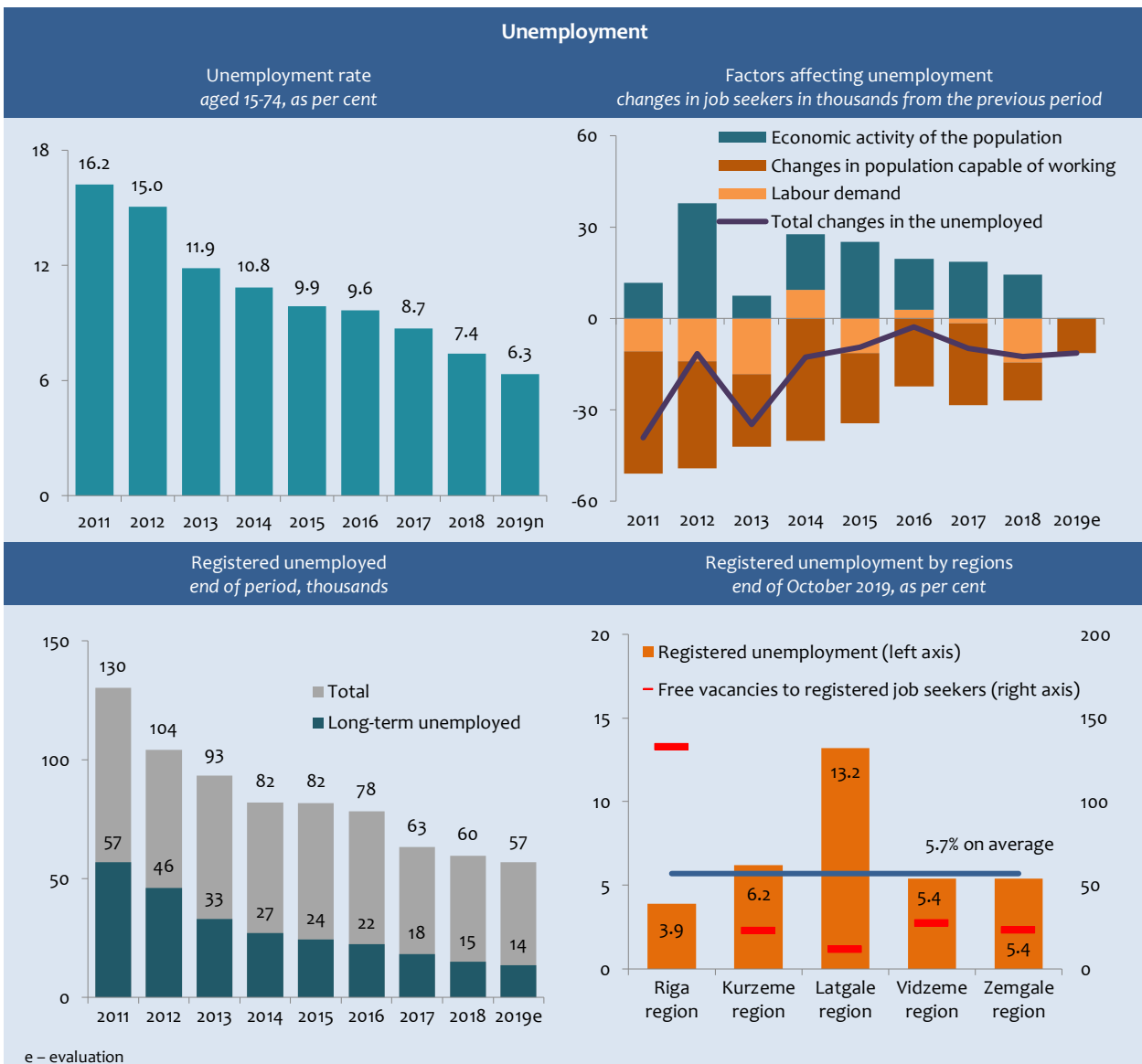
At the same time, the demographic trends also affect the decline of economically active population or potential labour supply. Since 2010, the economically active population aged 15 to 74 has reduced by 89 thousands. The dynamics of the

economically active population were seriously affected by demographic trends – decline of working age population and changes in the age structure of the population.

Meanwhile, the negative impact of demographic trends on labour supply was reduced by the increase in economic activity of the population. Similarly, to the employment rate, the economic activity of the population has reached the highest level ever – 70.1% in Q3 2019.

Since 2010, the **unemployment rate** has decreased by 12.5 percentage points. In Q3 2019, the unemployment rate in the age group 15-74 was 6%. In Q3 2019, the number of the unemployed persons decreased to 58.9 thousand, which was by 9.8 thousand less than in the corresponding period of 2018.

Figure 7.3



Unemployment reduced in the previous years due to labour demand – the increase in employment of the population and demographic trends – the reduction in the economically active population.

Although the demand side has been a significant labour marketing driver in the past 2 years, because of relatively moderate increase in new jobs – only about half of the drop in unemployment in the last 5 years can be explained by demand factors. About 46% of the unemployment drop has been determined by the declining economically active population, which in turn has been fostered by demographic trends.

Although the unemployment rate reduced considerably in the previous years, it still remains slightly higher than in EU-28 on average. In Q2 2019, the unemployment rate was 6.2% in EU-28 on average, while it was 6.4% in the respective period in Latvia – by 0.2 percentage points higher.

A more rapid drop in unemployment is still hindered by regional labour market disparities – registered unemployment rate in the Latgale region is more than three times higher than in the Riga region.

Although the uneven distribution of labour resources and vacancies by regions is currently one of the most notable structural inadequacies of the labour market, though it is not the only one. Challenges rise also the high share of long-term unemployed people – still almost 1/4 of registered unemployed persons have been out of employment longer than a year. It has to be taken into account that a high long-term unemployment rate may lead to an increase in structural unemployment, namely, the longer these people are unemployed, the greater the probability for them to lose their professional skills and abilities. Moreover, there is a risk that part of the current unemployed might have problems to find a job in the future, because their skills might not meet the needs of labour market, considering the structural changes within sectoral labour demand.

It should be noted that also the shift of the Beveridge curve to the right is indicating to a structural problem in the labour market – despite the increase in vacancies, the share of job seekers in the labour market remains relatively high.

Figure 7.4

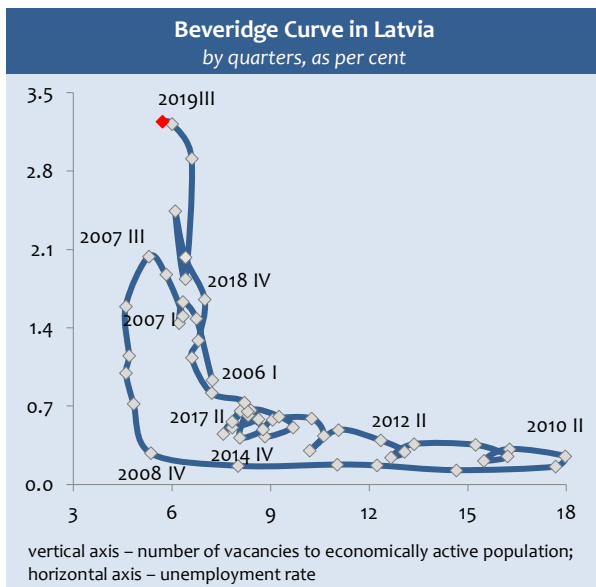
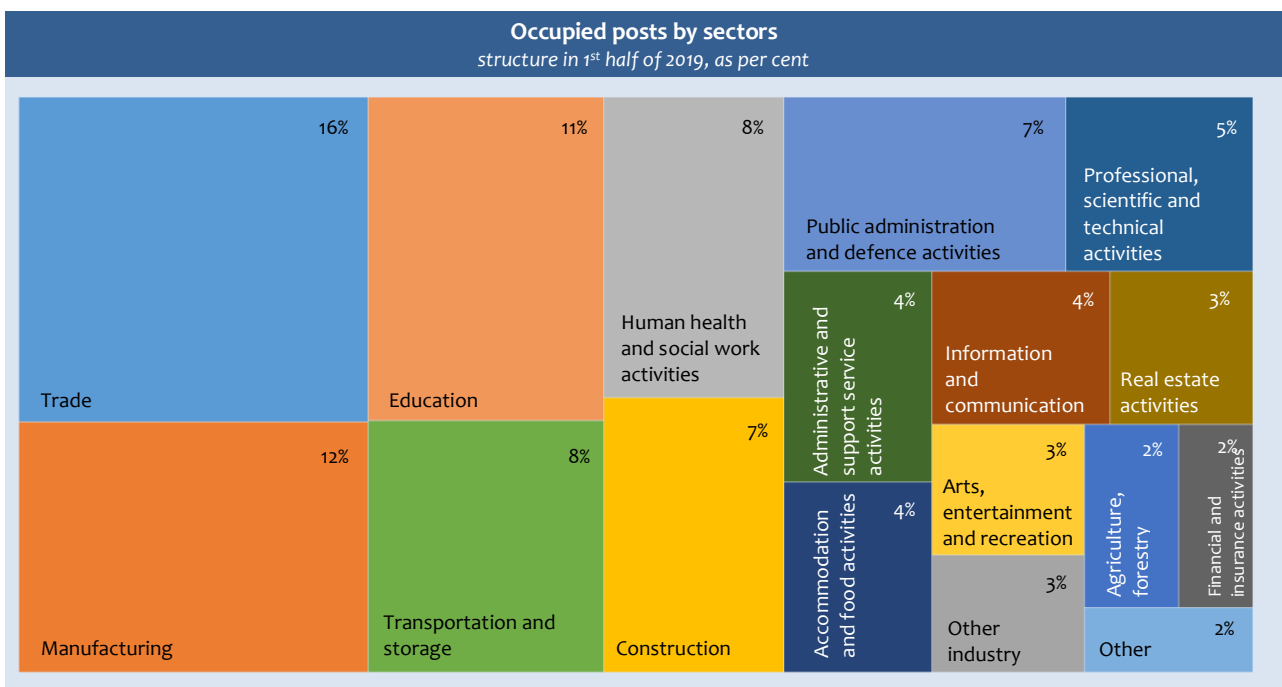


Figure 7.5



At the same time, it must be taken into account that the match of labour demand and supply is not only affected by skills mismatches, but also the wages levels, which not always met the expectations of job seekers. Therefore, there remain vacancies, although the unemployment rate is high.

Along with the increase in economic activity since the middle of 2010 an increase in the number of jobs has been observed in almost all economic sectors, with the exception of the financial services sector, where the number of occupied posts has reduced.

The highest increase in the number of jobs was in construction, health and social care, as well as ICT services, which together made more than 1/3 of the total increase in the number of occupied posts in the period from Q2 2010 to Q2 2019. At the same time, taking into account centralisation and digitalisation of financial services, the number of occupied posts in the financial services sector has reduced by almost 11% or 2.1 thousand jobs.

It should be noted that similar trends were observed also in 2019 – almost 1/3 of the increase in the total number of occupied posts in Q2 2019, compared to the relevant period of 2018, was secured by construction and health and social

care. Over the year, the number of jobs in construction increased by 2.1 thousand, while in social care – by 2.3 thousand.

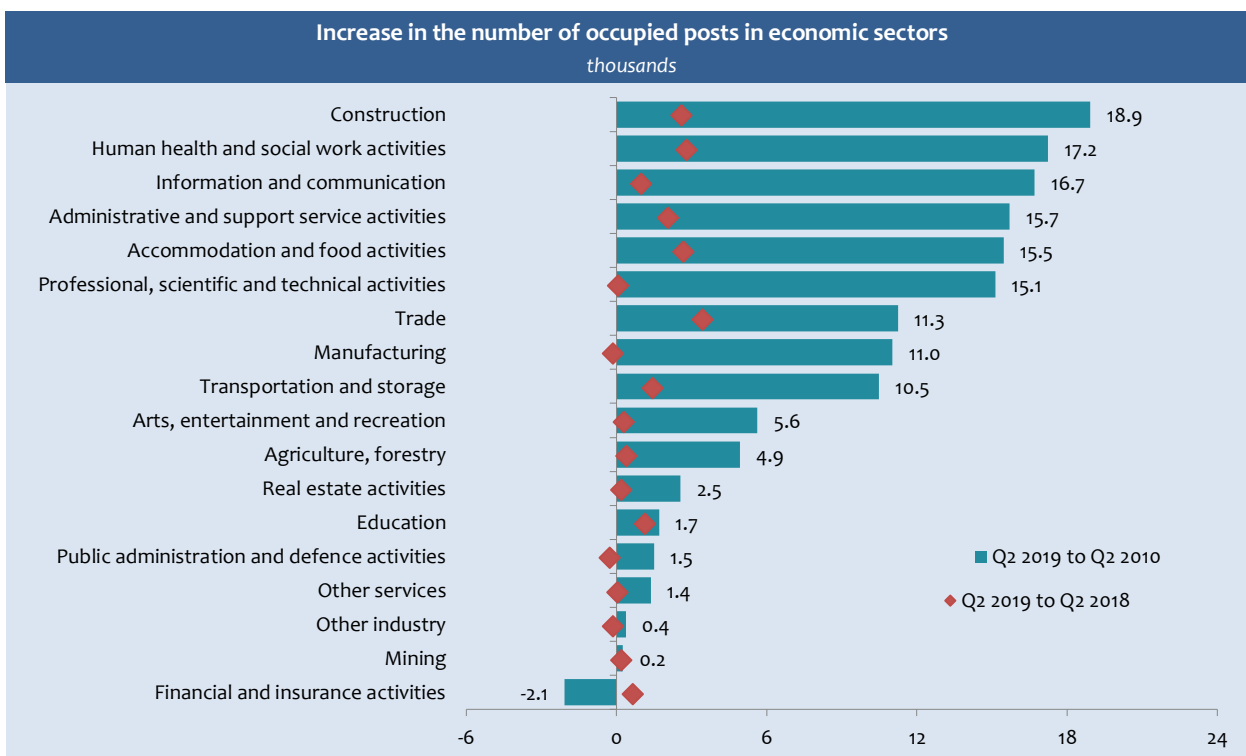
The most important increase in occupied posts in 2019 is observed in trade, where the number of jobs has increased by 2.8 thousand.

At the same time, the biggest number of jobs in 2019 was in public administration and manufacturing. It should be noted that growth in manufacturing was largely based on productivity growth in previous years – growth in the sector has been above 4% per year since mid-2016, the number of occupied posts grew only by 0.6% per year on average.

The most significant increase in the number of jobs is observed in the private sector – by 16.1 thousand in the first half of 2019. After an almost 30% reduction in jobs in the period of crisis, the number occupied posts in the private sector has returned to the level of 2006.

At the same time, there has been a decrease in the number of jobs in the public sector – the number of occupied posts reduced by about 650 jobs in the first half of 2019.

Figure 7.6



7.2. WAGES

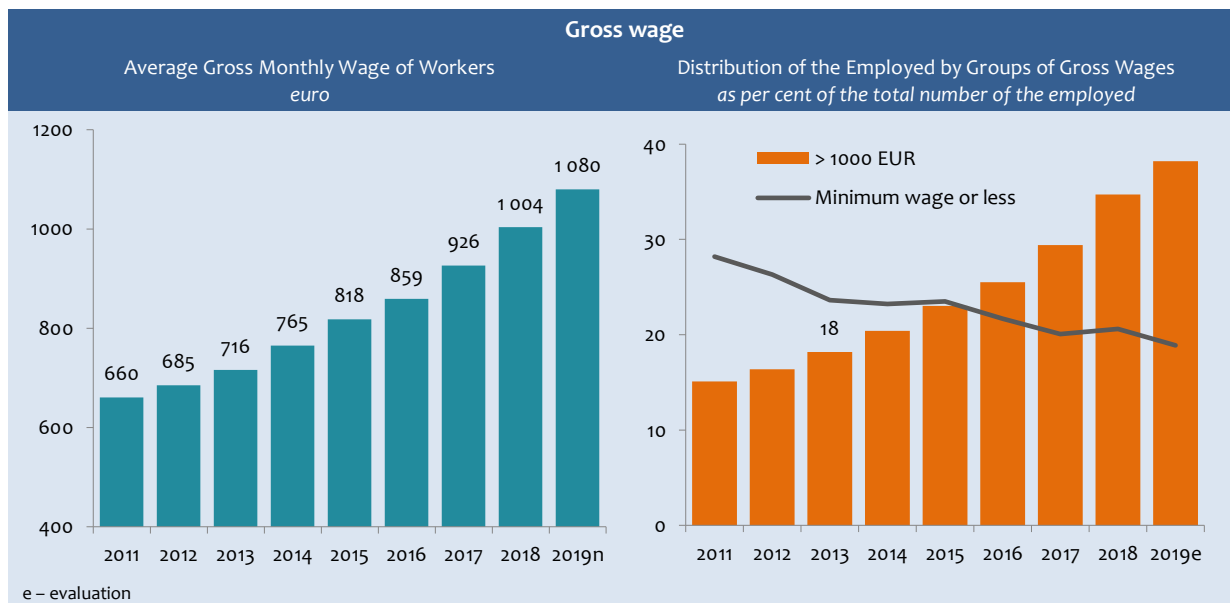
Along with the activity increase in labour market, also the wage growth has resumed since the end of 2010. In Q3 2019, the average gross wage reached 1091 euro, which was

by 8.3% more than in the corresponding period of 2018. The increase in labour demand and the reduction in the population capable of working affect labour availability on

the labour market increasingly more keeping pressure also on wages.

It should be noted that the increase in wages has been above 6% in the last four years, and this was partially secured also by a stable increase in productivity of labour force.

Figure 7.7



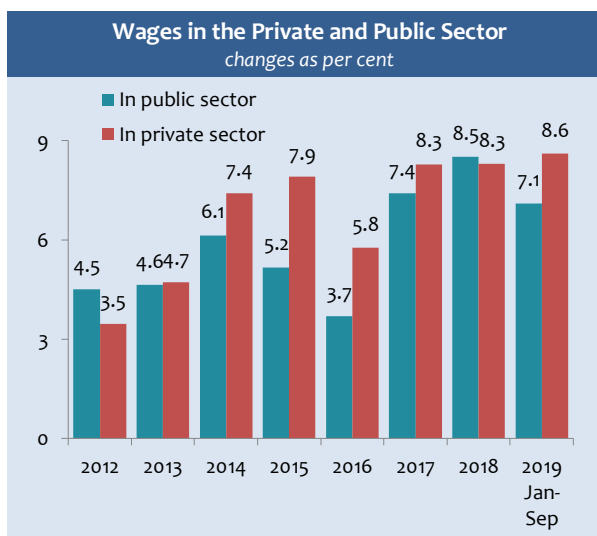
It should be noted that a positive trend is observed also in wage structure. Despite the fact that the minimum wage has grown rapidly in the previous years – by almost 70% (from approximately 256 euro in 2010 to 430 euro in 2019), nevertheless the share of the employed receiving the minimal wage or less has reduced by 7.6 percentage points. Furthermore, the share of the employed receiving more than 1000 euro has increased by more than 24 percentage points in this period. These were about 2/5 of all the employed in Q2 2019.

At the same time, a decrease in wages was observed in other services – by 1.1%, mainly in activities of public and political organisations (-2.7%).

The highest wages in Q3 2019 were still in financial services exceeding the average wage in the national economy almost twice. There is a high level of wages also in ICT services – 1725 euro on average. At the same time, there is still the lowest level of wages in accommodation and food services activities.

Figure 7.8

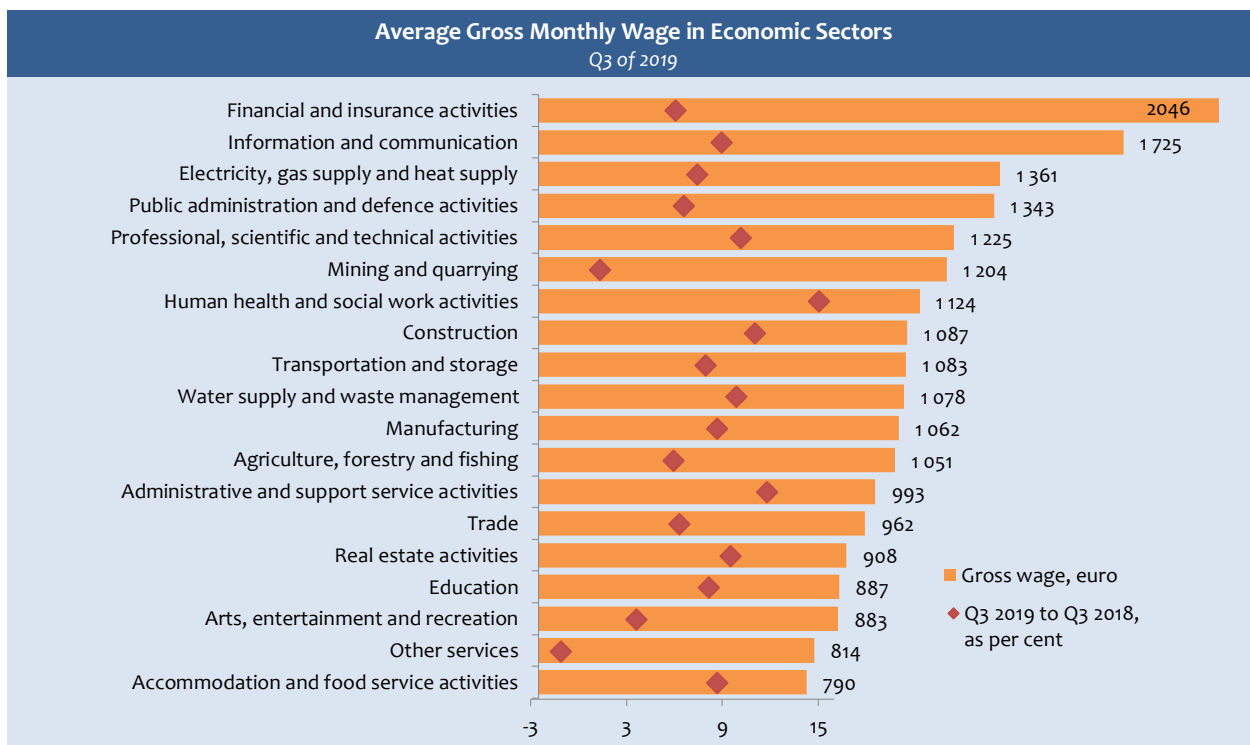
Since 2010, wages have increased in both the private and public sector. At the same time, an increase in the private sector has been tangibly more rapid in recent years. This was largely related to different labour demand dynamics among sectors. The number of jobs occupied in the private sectors has grown by almost 22%, but in the public sector – only by 1.6 per cent since 2011.



In 2018, budget amounting to more than 90 million euro was diverted to the increase of wages of medical personal, which reflected also in the general dynamics of wages in the sector.

Wages increased in almost all main sectors of the national economy in Q3 2019, compared to the same period in 2018. The fastest growth of wages was observed in health. The increase of average wage in the sector in Q3 2019 reaches 15%, however, the total wages in the sectors still exceed the average in the national economy only slightly.

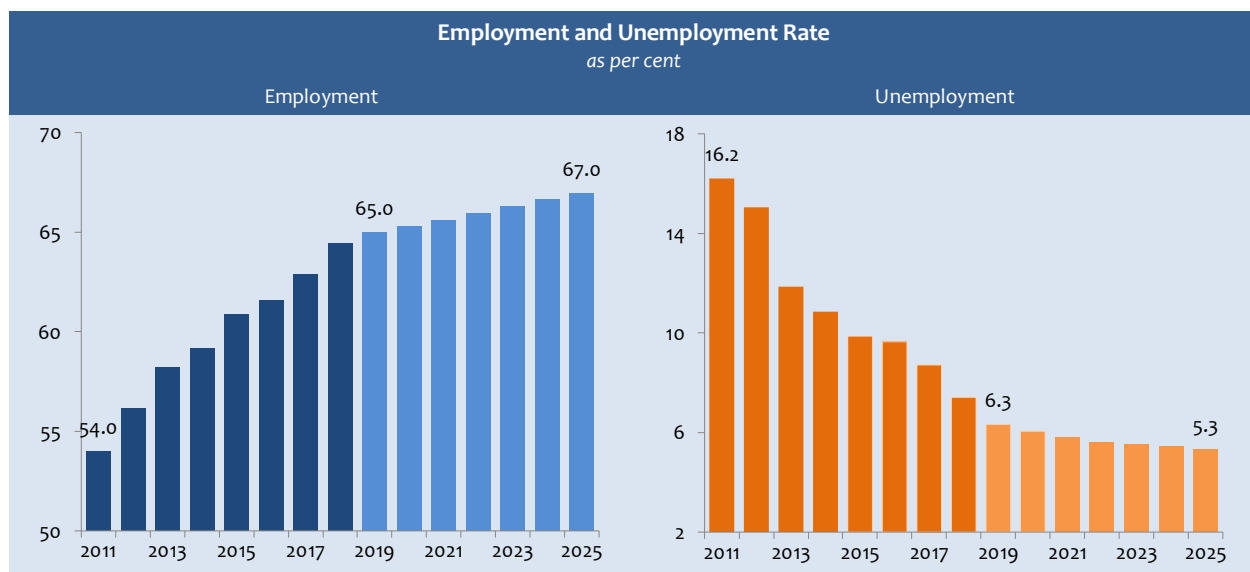
Figure 7.9



7.3. LABOUR MARKET FORECASTS

The labour market forecasts until 2025 are prepared in accordance with the medium-term economic growth forecasts (see Chapter 5).

Figure 7.10

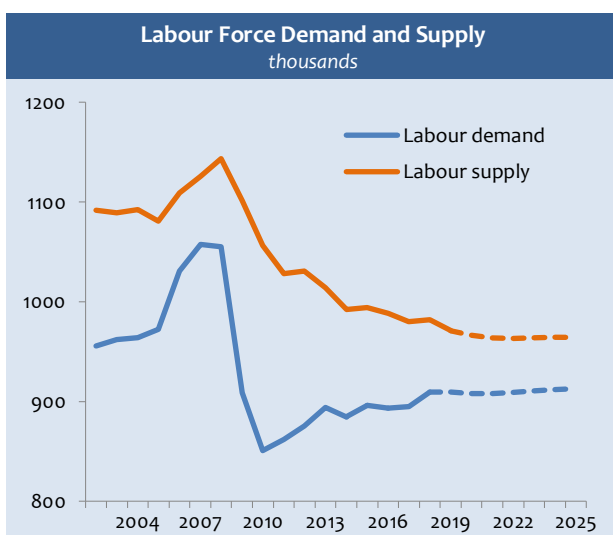


Despite economic growth becoming slower in the next five years, the situation in the labour market will still largely be determined by supply side factors – labour supply falling under the influence of demographic trends, therefore, the general situation on the labour market will remain tense. Unemployment rate is still expected to get close to 6% in 2020, while it may slide down below the 6% mark in individual months. The number of job seekers might reduce by about 3 thousand in 2020, compared to 2019, sliding down to 58 thousand per year on average.

Taking into account slower economic growth, as well as increasingly growing labour force productivity in almost all sectors of national economy, it is expected that in 2020 the number of the employed might generally reduce by 0.2% on average or by about 1.5 thousand compared to 2019. At the same time, despite the reduction in the number of the employed, the employment rate continues to increase taking into account the reduction in the number of population capable of working. Overall, the employment rate might increase by 0.3 percentage points in 2020 compared to 2019 and might reach 65.3% among the population aged 15-74. In total, the average number of employed in 2020 might slide down to about 908 thousand, and might remain at a similar level until 2021.

The increase in the number of the employed might resume in the second half of 2021, when the new period of EU funds starts. Overall no considerable increase in labour demand is expected in the medium term (until 2025), since economic growth will mainly be determined by the increase in productivity. Similarly, the negative demographic trends – aging workforce, regional disproportions of the labour market, as well as mismatch between labour demand and supply will hinder a more rapid employment growth.

Figure 7.11

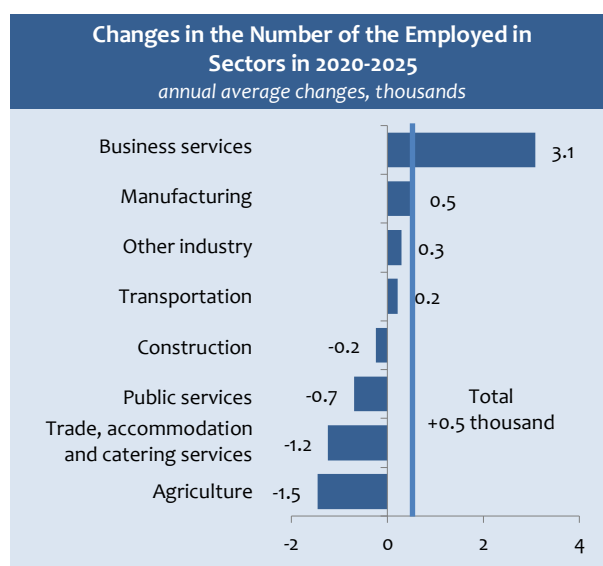


It is expected that the number of employed might generally increase by almost 4 thousand in 2025, compared to 2019. Thus, the number of employed could reach 913 thousand in 2025, while the share of employed in the population aged 15-74 years could increase to almost 67 percent.

Unemployment will also continue to fall in the medium term, and the problem of labour shortage will become more pronounced. In total, unemployment rate could reduce to 5.3 per cent by 2025.

The reduction in unemployment and labour reserves in the next years will be largely determined by the reduction in the number of the population capable of working, as well as ageing of existing labour force and leaving of the labour market. Despite an active increase in economic activity rate, the economically active population might shrink by 6.6 thousand in 2020-2025. According to the forecasts of the Ministry of Economics, the number of people aged 15-74 might decrease by more than 36 thousand compared to 2019.

Figure 7.12



In terms of sectors, the most important increase in the employed in 2020 might be observed in business services – professional, scientific and technical activities, as well as ICT services. In total, the number of the employed might increase in the sector by almost 4 thousand in 2020. The number of employed in business services might increase by more than 18 thousand in 2025 compared to 2019.

A small increase in the number of employees might also return in industrial sectors in the next years. Overall, the number of employed in manufacturing might increase by slightly more than 3 thousand by 2025, compared to 2019. Overall, the increase in the number of employees in traditional tradable sectors will remain slow, because growth of sectors will mainly be based on the productivity increase, which plays a decisive role in ensuring competitiveness.

The most significant drop in the number of employed is expected in the primary sector until 2025 – mainly in the agriculture and forestry, as well as trade and the public services.

Decrease in labour demand in the agricultural sector is mainly attributable to efficiency enhancement of the

industry – formation of farmers' cooperatives and large farms, introduction of systematic production organisation, introduction of more complex technological solutions in the production process.

Automatization of jobs and the reduction in the number of the employed is also expected in trade, taking into account the increasingly growing self-service cash register systems, as well as entry of automated trade solutions in the sector.

Overall, the number of employed in trade might decrease by almost 11 thousand in 2025, compared to 2019.

The number of the employed is also expected to reduce in public services sectors, mainly in public administration and education. Overall, by 2025 the number of employed in public administration might decrease by 2.5 thousand, while in education – by 3.7 thousand, compared to 2019.

7.4. EMPLOYMENT POLICY

The creation of more jobs of better quality is one of the main goals of the EU employment policy, also defined in the Europe 2020 strategy (see Chapter 8.1). Governments of countries are primarily responsible for employment and social policy. The EU funding supports and complements their attempts.

The quantitative aim set by Latvia within the context of implementing the *EU 2020 strategy* is to achieve employment rate of 73% in the age group 20-64 by 2020. The target for 2020 was reached back in 2016. In 2018, the employment rate in age group 20-64 reached 76.8 per cent.

LABOUR MARKET CHALLENGES AND POLICY DIRECTIONS

Taking into account negative demographic trends, the main Latvian labour market and also economic challenges are related to ageing of the labour force and shortage of labour force (employees with relevant qualifications) in all economic sectors. Shortage of working hands can become a factor hindering the growth in the future. The labour market forecasts show that labour force availability matters become increasingly more topical (see Chapter 7.3).

It should be taken into account that the demographic situation in Latvia is mainly affected by economic migration of the population, therefore, tangible improvements in the Latvian labour market are necessary to change migration flows. Measures to foster birth rates are also important. However, changes in demographic trends may have a tangible effect only in the long-term, therefore, measures to foster labour force availability through education supply, active labour market measures (promotion of economic activity of the population), sound labour force migration policy, including support in remigration are important in the medium and short term. At the same time, it should be emphasised that sustainability of economic growth of Latvia cannot be related to the attraction of cheap labour force from third countries.

Labour market mismatches aggravate pronounced regional labour market differences. New jobs mainly appear in more economically active regions and larger cities, while less developed regions have the biggest number of job seekers.

Registered unemployment rate in the Latgale Region is still almost four times higher than in the Riga Region, which has more than 4/5 of all vacancies. In the coming years, the regional disparities can significantly impede a balanced development of the labour market. Meanwhile, the regional equalization of the labour market is hampered by the low regional mobility of labour force, i.e., the ability to rapidly change their place of work and residence.

To promote employment, policy directions are planned and implemented in relation to both labour supply and labour demand. The key elements of the employment policy of Latvia:

- supporting the labour demand – stimulation of economic activities and entrepreneurship, including reduction of the labour taxes, the fight against undeclared employment, indirect and direct support measures for businesses ensured by the government, measures to reduce administrative barriers, business incubators, etc. (see Chapters 9-11);
- strengthening the labour supply – increasing the competitiveness of the unemployed and people at risk of unemployment in the labour market, including skills development according to the labour market needs, lifelong learning measures, advice for starting a business, etc.;
- facilitating the process of aligning the labour supply and demand, including the improvement of the education system, involvement of employers' organizations in the improvement of the quality of education, forecasting the compliance of the labour market supply with the labour market demand, educating the labour market participants, including pupils and students, on labour market and career issues.

Social dialogue is an important element in the implementation of the employment policy. LDDK (Employers' Confederation of Latvia) and LBAS (Free Trade Union Confederation of Latvia) are involved in the provision of the social dialogue at national, regional and sectoral level. Employment partnership involves other cooperation partners, including local governments of Latvia and the Latvian Association of Local and Regional Governments.

In order to foster changes in the labour market providing specialists required for economics and, thus, contributing to growing economy, the **Employment Board** composed of three ministers (of economics, education and science and welfare) that was created in 2016 continues work. The goal of this Board is to coordinate inter-departmental cooperation in planning, implementation, and monitoring of labour market reform, thereby reducing the disproportion in the Latvian labour market. The Employment Board has paid special attention to the matters of investment in human capital and the development of skills of labour force (in particular, low qualification labour force). The Board has agreed to include in the priority re-arrangements:

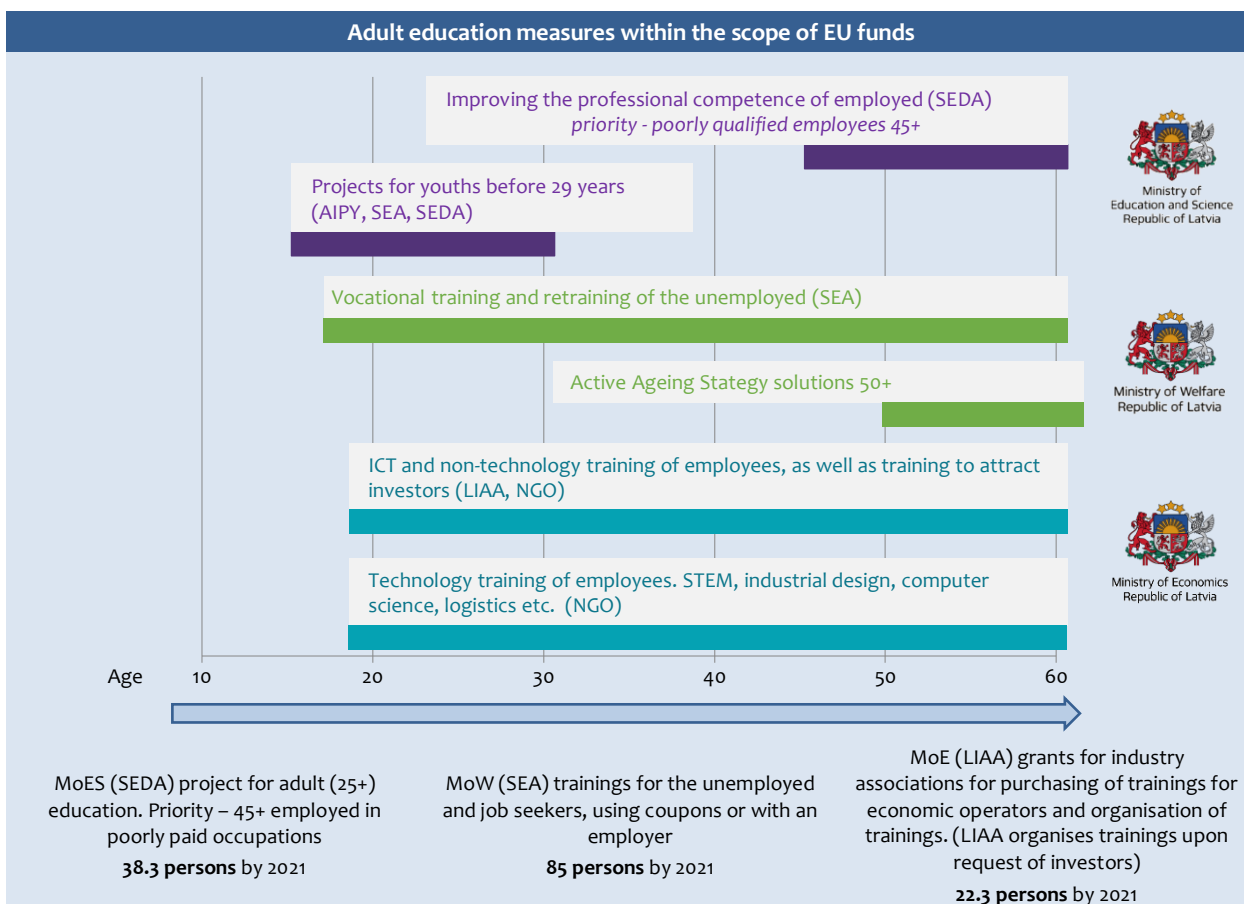
- creation of a sustainable and comprehensive education system;
- modern and qualitative general education;
- increase of the number of students in STEM directions;
- more active involvement of employers in the creation of education supply;
- improvement of skills and employment of youths.

In October 2019, the Board agreed to undertake the role of a strategic coordinator of the system of anticipating changes in the labour market to ensure more harmonised cooperation between all the parties involved in anticipation of labour market changes and introduction of necessary anticipatory changes, thus enabling society to adapt to the expected changes in a more timely manner (for information on the system of anticipating changes in the labour market see Box 7.1).

ADULT EDUCATION

Taking into account that changes in formal education give a tangible effect in the long-term, adult (labour force) education also plays a big role in the reduction of labour market mismatches, when available labour force is shrinking. However, the involvement of the population in adult education is twice lower than the target set in Latvian policy planning documents – to reach that 15% of the population aged 25 to 64 are involved in adult education measures by 2020.

Figure 7.13



Since 2017, the employed have the possibility to increase their professional competence and competitiveness by applying to studies within the EU funds adult education programmes Improving the professional competence of employees implemented by the State Education Development Agency. The 4th application round closed in June 2019, where more than 14 thousand people applied for training. Most applications were received for training in ICT and manufacture of electronic and optical equipment, as well as lifelong learning competences. In this round more than 9 thousand people started training after training groups had been stuffed.

Overall, 26.4 thousand people have involved in the training by November 2019, of which almost 17 thousand have completed their training. It is planned to announce the next application round in the first half of 2020.

The Ministry of Economics has developed a state support programme to train employees of companies and improve their skills upon request of employees for introduction of technological and non-technological innovations:

- *Support for employed learning (technology learning).* The aim of this measure is to provide the merchants with labour force holding the relevant qualification, thus contributing to an increase in productivity and development and putting into production of new or improved products and technologies. Two project selection rounds are planned. The total ERDF funding is 18 million euro. In spring 2016, 10 projects of the first selection round implemented by the 10 largest sectoral associations were approved. These associations

represent manufacturing subsectors, the ICT sector or accommodation and food service activities sector. The period for implementation of the first selection round is until 31 December 2022. By Q4 2019, 11.7 thousand of non-unique persons employed with 606 merchants have been trained. The second selection round was announced in October 2019 providing ERDF investments for associations and foundations representing manufacturing, the ICT sector or being international business services centres. The implementation is planned to be started in 2020 and implemented by 31 December 2022.

- *Support for ICT and non-technology learning, as well as learning aimed at attracting investors (non-technology learning).* The measure is developed with the aim to promote the productivity and work efficiency of self-employed persons, as well as merchants, by raising the employees' qualifications and skills in ICT areas, to provide merchants with employees holding the relevant qualification, promoting introduction of nontechnological innovations (products, processes, marketing or organisation) in merchants, as well as to provide support for learning thereby attracting investments in the country. The ERDF funding is 6.9 million euro. 3 projects implemented by the LCCI, LICTA, and LIAA, the were approved in 2016. The period for implementation of the programme is until 31 December 2020. By Q4 2019, 4.2 thousand of non-unique persons employed with 943 merchants have been trained.

Box 7.1

System of anticipating changes in the labour market (SACLM)

In the coming decades, the Latvian economy will face significant structural changes. In order to prepare for and adapt to the changes it is necessary to make anticipating changes in the labour market.

The research *Possibilities of establishment of the system of anticipating changes in the labour market and linking of medium and long-term market forecasts with the action policy* ordered by the Ministry of Economics completed in May 2019. The research was conducted by SIA "AC Konsultācijas".

The aim of the research was to research and improve the existing system of anticipating changes in the labour market (hereinafter referred to as SACLM) to provide for a timely and more coordinated mutual cooperation among state institutions and non-governmental organisations, in the anticipation of the changes in the labour market and the implementation of the necessary changes, including an extended use of medium and long-term labour market forecasts in the formation of the action policy. Reduced shortage of labour force is expected as a result, because inadequacies in the labour market would be reduced in a timely manner. Labour force would be more relevant to the needs of the future labour market.

The main improvements to the SACLM to be made in Latvia are related to strengthening of institutional cooperation, creation of an organisational cooperation model of the organisations involved in the implementation of SACLM, improvement and availability of the forecasts developed by Ministry of Economics, as well as adaptation of the education curriculum to the demand of the labour market.

The matters related to SACLM were discussed at the meeting of the Employment Board in October 2019, where it was decided on undertaking the functions of a SACLM coordinator as well.

The Ministry of Economics in cooperation with the State Employment Agency continue work on the creation of a platform for online reflection of labour market forecasts. The platform is expected to ensure the availability of labour market forecasts to a wider range of stakeholders. At present, the medium- and long-term labour market forecasts developed by the Ministry of Economics are available in the form of an informative report.

Guidelines for interpretation and use of medium- and long-term labour market forecasts developed and available on the website of the Ministry of Economics. This is an informative material mainly intended for career advisers, the purpose of which is to provide information and instructions how to understand, interpret and take into account the medium- and long-term labour market forecasts of the Ministry of Economics.

Furthermore, 49.4 thousand people in total were involved in the activities for improvement of skills implemented by the State Employment Agency (SEA) for the unemployed and job seekers in 2018.

The provision of a qualitative supply of education to adults plays a crucial role for providers of education services (education institutions) and employers.

INTERNAL LABOUR MOBILITY

The availability of labour force in territories with higher economic activity is delayed by the availability of high-quality housing for the population with average income. Within the scope of cooperation with OECD, having evaluated foreign good practices, proposals for effective support instruments for ensuring availability of housing in Latvia will be developed.

Since March 2018 the attraction of qualified labour force to regions has been facilitated by the state support available to young highly-qualified specialists for acquisition of a home within the scope of the ALTUM housing guarantee programme (for more detailed information on the activities see chapter 14 on the housing policy).

Moreover, regional mobility support is also available within the scope of active employment measures. Also, in order to resolve regional unemployment challenges, persons employed by employers can receive financial compensation to cover expenses of transport and rental of a dwelling in the first four months after starting the legal employment relationship.

SMART IMMIGRATION

The shortage of highly qualified specialists, which is currently experienced by a number of companies, particularly in knowledge and technology intensive sectors, is hindering Latvia's economic growth, growth in business productivity and attraction of investments, and therefore also the creation of well-paid jobs. The reduction of shortage of highly qualified labour force is set as one of priorities of the Ministry of Economics. The aim of the smart migration policy is to promote the attraction of highly qualified professionals from third countries. It should be emphasised that activities to promote smart immigration do not focus on cancellation or facilitation of immigration of labour force from third countries in total, but focus on the improvement of the process for the Latvian employer to be able to attract qualified employees as soon as possible. Thus, for instance, the period for application of a vacancy has been shortened from a month to 10 days, if an employer wants to invite a foreigner from a third country for employment.

In order to ensure development of the ICT sector and satisfy the demand of other sectors for ICT specialists, the Ministry of Economics established targeted trilateral cooperation between national regulatory authorities, leading ICT companies and higher education representatives for Latvia to create an innovative study programme in the ICT area.

The Baltic IT bachelor of excellence programme was created by the University of Latvia and the Riga Technical University (RTU) in cooperation with the University at Buffalo (United States), and it is coordinated by RTU Riga Business School. 22 youths started studies in this programme in its first year (2019).

A joint IT education platform called "Baltic IT Society" or BITS was also created. The platform will collect IT education programmes to promote the preparation in Latvia of new IT professionals, who are ready for the international market.

REMIGRATION

One of solutions for the reduction of shortage in labour force in Latvia is to foster the return of the population living abroad. The availability of well-paid job offers is an important factor in promotion of remigration. However, the matters related to social guarantees, taxes, work environment and cultures, reintegration support measures, in particular the availability of kindergartens and schools and other matters are equally important. At the same time, it is also necessary to create and maintain a closer link with those who have left and to ensure the availability of latest information on job and life opportunities in Latvia.

From the beginning of 2019, the *Diaspora Law* has entered into force, which, inter alia, sets specific measures for promotion and support of remigration.

A targeted remigration support measure is a network of five regional remigration coordinators created by MoEPRD in 2018 in cooperation with planning regions, providing one regional coordinator in each planning region. Potential remigrants have the possibility to receive free of charge a consultation and support of the regional coordinator in resolution of matters of particular importance for them, which are related to their return to the specific region in Latvia. Furthermore, remigrants had the opportunity to participate in the competition of projects for starting or developing economic activity in Latvia. 9 projects received a business support grant in 2018. The maximum funding available per project was 9 thousand euro.

In order to connect professional nationals living abroad and companies in Latvia, including by fostering Latvian employers to get actively involved in promotion of remigration, private investments have also started in recent years, for example, Tele2 movement *Latvija strādā*, the work and information portal *YourMove.lv* has been created, etc.

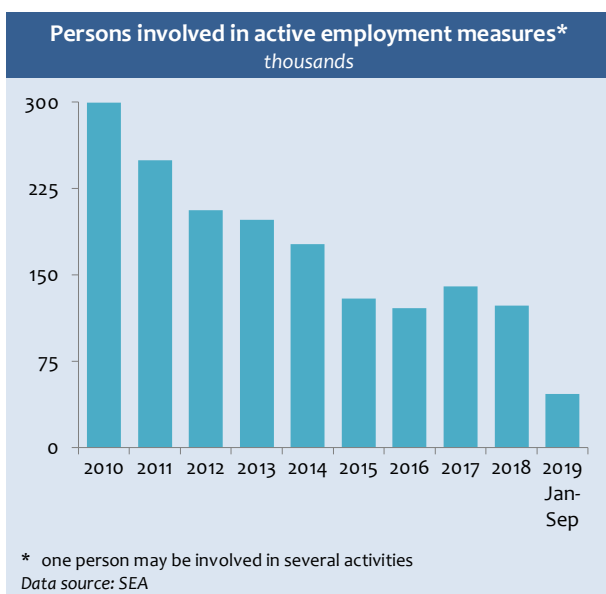
ACTIVE EMPLOYMENT MEASURES

The national policy in the field of unemployment reduction and support for the unemployed, job seeker and persons subject to risk of unemployment is implemented by the State Employment Agency. The active and preventive labour market measures that are being implemented foster economic activity and competitiveness of the population in the labour market.

The most important measures implemented by SEA:

- training measures – vocational training, retraining and improvement of professional skills, training with an employer, acquisition of non-formal education;
- measures to increase competitiveness;
- paid temporary public service jobs;
- measures for certain groups of persons (subsidised jobs);
- measures for starting a business or self-employment;
- measures to promote youth employment;
- activation measures for long-term unemployed;
- support for regional mobility.

Figure 7.14



During the economic crisis, the demand for active employment measures was growing also due to a considerable increase in unemployment. Almost 300 thousand people were involved in the active employment measures in 2010. When the market situation has improved, the involvement in active employment measures has reduced. In 2018, 123.2 thousand people were involved in active employment measures (one person may be involved in several activities). The funding for active labour market policy measures reduced as well – from 91.1 million euro in 2010 to 39.2 million euro in 2018.

At present, special attention is paid to those population groups, for whom it is most difficult to return to the labour market and who need more targeted support to promote their economic activity and inclusion in the labour market. These are long-term unemployed, youths not in education or employment, unemployed of preretirement age, as well as people with disability.

Improvements to active labour market policy tools and the support provided to the unemployed are provided for in the *Inclusive Employment Guidelines 2015-2020*. The measures included in the guidelines focus on the creation of an inclusive labour market, making full use of the human potential of Latvia, also by reducing the social consequences of unemployment, supporting the return of unemployed people to the labour market and keeping the people at risk of social exclusion in the labour market for as long as possible, as well as improving the quality of jobs.

In April 2019, the OECD study “Link between people and their jobs: Latvia” completed. It analysed the active labour market policy measures implemented by Latvia, as well as OECD experts have provided their vision of the improvement of the active labour market policy. The results of the study are intended to be used to decide on the improvement of efficiency of the measures.

PART II. ECONOMIC POLICY PRIORITIES

8. INCLUSION OF LATVIA INTO THE EU ECONOMIC AND STRUCTURAL POLICIES

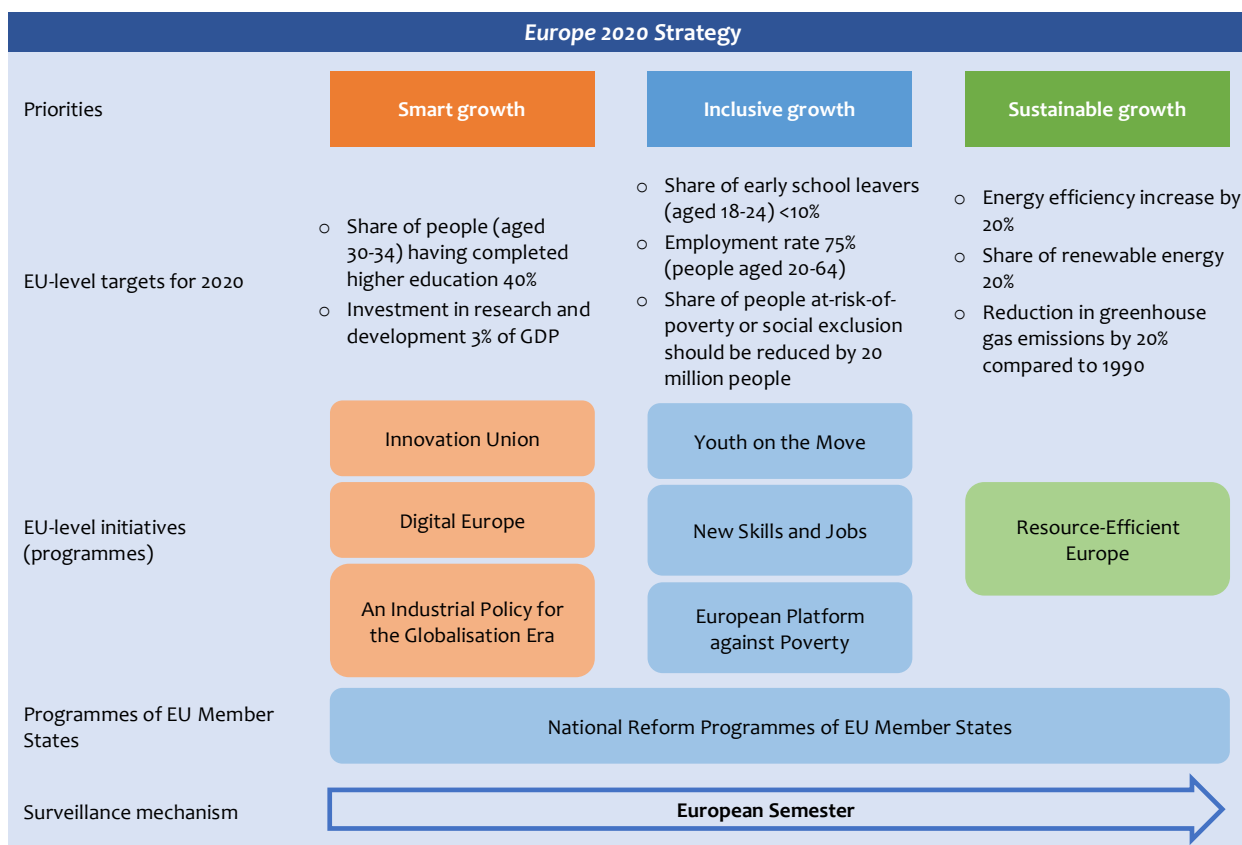
8.1. EUROPEAN SEMESTER

On 3 March 2010 the European Commission (EC) published a communication *Europe 2020: strategy for smart, sustainable and inclusive growth* (hereinafter – *Europe 2020 strategy*). On 17 June 2010 the European Council officially approved the *Europe 2020 strategy* (see Figure 8.1) and its key elements: EU-level quantitative targets for 2020, *Integrated Guidelines* (are developed according to the Articles 121 and 148 of the *Treaty on the Functioning of the European Union*, which contains key economic and employment policies, as well as serves as the basis for the development of *National Reform Programmes* of EU Member States). On the basis of the adopted *Europe 2020 strategy*, EU Member States are obliged to draft every spring and to

submit until the mid-April to the EC their *National Reform Programmes* along with *Stability or Convergence Programmes* (drafted and implemented for the fulfilment of requirements of the *Stability and Growth Pact*).

Based on the multilateral surveillance, which is performed at the EU level, the EC may provide a policy warning, if the economic policy of any EU Member State fails to comply with the EU *Integrated Guidelines* and objectives set at the EU level. The national reform programmes are linked also to the EU budget, because a large part of the measures is co-financed from the EU budget.

Figure 8.1



In order to ensure the implementation of the Europe 2020 strategy and abovementioned national programmes of EU Member States, as well as provide annual recommendations

to EU Member States, an annual EU economic policy implementation supervision tool – the European Semester – was introduced on 1 January 2011 (see Figure 8.2).

Figure 8.2

European Semester Process							
European Semester: Partnership between the EU and Member States							
	November-February	March	April	May	June	July	September-October
European Commission	Annual Growth Survey and Alert Mechanism Report Publication of recommendations for the euro area	EC Country Reports on EU Member States		EC proposal for EU Council's recommendations to EU Member States			EU-level review
European Council / EU Council	Discussions				Discussion of recommendations	Approval of recommendations	
European Parliament	Discussions						
Member States		Approval and submission of National Reform Programmes and Stability or Convergence programmes to the EC					National level decisions

The European Semester starts every year on November, when the EC publishes the key documents, the evaluation of which starts the European Semester of the next year, and these are the *Annual Growth Survey*, *Alert Mechanism Report*, *Draft Joint Employment Report* and *EC proposal for EU Council's recommendations for the Euro area*. In the abovementioned documents the EC evaluates the economic situation across the EU, progress towards the targets of the *Europe 2020 strategy* and offers economic policy priorities for the next year. These documents serve as a basis for further discussions between EU Member States and the EC at different meetings of the EU Council.

On 17 December 2019, the EC published the **2020 European Semester "Autumn Package"**. Compared to the documents of the European Semester "Autumn Package" from the previous years, some novelties have been made this year, taking into account also the new priorities of the EC. The *Annual Growth Survey* has been renamed into the *Annual Sustainable Growth Strategy*. The novelties also included integration of the UN sustainable development goals into the European Semester and annual monitoring of their fulfilment, as well as publishing of the *Single Market Performance Report*. Similarly to the previous years, this year's European Semester "Autumn Package" also includes the *Alert Mechanism Report*, the *Draft Joint Employment Report* and the *EC proposals for EU Council's recommendations for the Euro area*.

In the *Annual Sustainable Growth Strategy 2020* the EC offers to focus further on four interrelated and mutually reinforcing dimensions:

- environmental sustainability;
- productivity gains;
- social fairness;
- macro-economic stability.

The EC believes that in the future at the level of the EU and EU Member States it is necessary to focus on the implementation of structural reforms and investments in the abovementioned dimensions.

The *Alert Mechanism Report 2020* (see Chapter 6.8), similarly to the previous reports, is based on the analysis of indicators characterising macroeconomic imbalances. It also indicates the EU Member States having macroeconomic imbalances and provides that the EC will prepare *In-Depth Reviews* about these EU Member States. In accordance with the *Alert Mechanism Report 2020*, no macroeconomic imbalances have been observed in Latvia, however, the EC will further analyse and monitor growing labour costs in Latvia, which may create risks of macroeconomic imbalances in the future. Macroeconomic imbalances have been stated in thirteen EU Member States and the EC is planning to prepare *In-Depth Reviews* about them, which will be integrated in the *2020 Country Reports*. These Member States are Bulgaria, France, Greece, Croatia, Italy, Ireland, Cyprus, the Netherlands, Portugal, Romania, Spain, Germany and Sweden.

In the *EC proposal for EU Council's recommendations for the Euro area*, in 2020-2021 the Euro area countries are invited to implement measures to achieve inclusive and sustainable growth, as well as increase competitiveness. It also urges each Euro area country to implement proper fiscal policies, as well as further coordination of fiscal policies within the Euro group. The recommendations also invite to achieve progress in deepening the Economic and Monetary Union, namely, to complete the creation of the *Bank Union* and the *Capital Markets Union*, as well as to strengthen the international role of the euro currency.

The *Draft Joint Employment Report* reflects the EC's analysis of employment and social situation in the EU. The *Single*

Market Performance Report includes the EC's analysis of the situation in goods and services markets.

Box 8.1

EC's 2019 Country Report Latvia

The 2019 *Country Report Latvia* evaluates the development and prospects of the Latvian economy taking into account the *Annual Growth Survey* which was published by the EC on 21 November 2018 and started the 2019 European Semester. The 2019 *Country Report Latvia* also reviews the policy response since mid-2018, notably as regards the progress achieved by the country in the implementation of the country-specific recommendations adopted by the EU Council in July 2018.

Latvia has made limited progress in addressing the recommendations of the EU Council of 2018. There has been some progress in improving public governance efficiency in related areas (for example, passing the whistleblower protection law, improving insolvency process), improving accessibility and quality of the health care, making vocational education and training more relevant to the labour market (for example, work based learning is being rolled-out). There has been limited progress in reducing tax burden on labour, in particular on low-income earners. In accordance with the EC assessment, no progress was made on improving the adequacy of a minimum income benefits.

The 2019 *Country Report Latvia* also identified problems and challenges:

- the share of capital taxation is set to decline, while the tax burden on low wages remains high after the tax reform;
- despite a sharp reduction in bank deposits by non-residents, improvements in Latvia's anti-money laundering strategy are warranted, to control the remaining banking risks.
- the education system faces a challenge to consolidate resources while improving quality and efficiency;
- Latvia's labour market performance is positive overall but employment conditions differ across regions and skill levels;
- the adequacy of social benefits remains low;
- low public spending for healthcare, and unhealthy lifestyle choices, are the main reasons for the population's poor health;
- Latvia invests very little in research and development (R&D);
- better internal labour mobility is crucial to economic growth outside Riga. Moving for work to places outside the capital region is made difficult by a lack of rental housing;
- Latvia is close to meeting its renewable energy target for 2020, but more efforts are needed to improve energy efficiency;
- Latvia's waste recycling rate is low and there is little progress in recent years. Latvia still landfills most of its municipal waste;
- Latvia has slightly improved its score on the corruption perception index, but corruption remains a concern.

Annual *Country Reports* which are published at the end of February are another important element of the European Semester (see Box 8.1). In these reports, the EC reflects its evaluation of the situation in each EU Member State, progress of implemented structural reforms and recommendations of the EU Council. These reports form the basis for the development of national programmes of EU Member States.

In accordance with the European Semester process (see Figure 8.2), every year EU Member States should draft and by mid-April submit to the EC national programmes (the *National Reform Programme, Stability or Convergence Programme*).

The *National Reform Programme of Latvia for the Implementation of the Europe 2020 Strategy* (hereinafter – NRP of Latvia) was approved by the Cabinet of Ministers on 26 April 2011 together with the *Convergence Programme of Latvia 2011-2014*. Both programmes were submitted to the EC on 29 April 2011. Since then, every year Latvia drafts and submits to the EC Progress reports on the implementation of the NRP of Latvia.

The NRP of Latvia describes the medium-term macroeconomic scenario, main macro-structural bottlenecks of Latvia and key measures for eliminating them, as well as national targets of Latvia for 2020 in the context of the *Europe 2020 strategy* and key measures for achieving them.

Latvia's aim is to promote growth and jobs, by ensuring the growth of GDP in the medium term by 4-5% and a high employment rate of 73% by 2020.

The NRP of Latvia reflects quantitative targets of Latvia for 2020 in the context of the *Europe 2020 strategy* (Latvian quantitative targets). These have been set taking into account the medium-term development scenario of the Latvian economy, as well as targets of the Sustainable Development Strategy of Latvia – *Latvia 2030*, and are reflected also in the *National Development Plan 2014 – 2020* ("NDP2020"), which was approved by the Saeima on 20 December 2012.

According to the quantitative targets of Latvia, the plans for 2020 are to achieve an employment rate of 73% among the population aged 20-64, to increase investments in research and development (R&D) to 1.5% of GDP, to increase the share of the population having acquired tertiary education to 34-36%, to reduce the share of early school leavers to 10%, to reduce the share of persons at risk of poverty to 21%, to increase the share of renewable energy sources in gross energy consumption to 40%, etc.

According to the European Semester process, the Cabinet of Ministers approved the eighth *Progress Report on the Implementation of the NRP of Latvia* (hereinafter – the Progress Report) and the *Latvia's Stability Programme for 2019-2022* on 15 April 2019. Both documents were submitted to the EC on 15 April 2019.

The Progress Report contains an updated medium-term macroeconomic scenario described in the NRP of Latvia, evaluates the progress of Latvia in addressing the recommendations adopted by the EU Council in July 2018, gives a detailed description of the NRP policy directions,

including national quantitative targets of Latvia in the context of the *Europe 2020 strategy* (see Table 8.1), and reflects information on the use of EU funds and Latvia's investment needs in the 2021-2027 programming period.

Table 8.1

Progress Towards the Achievement of Latvia's Targets in the Context of the Europe 2020 Strategy		
	Fact	Target 2020
Employment rate (population aged 20-64, %)	76.8	73.0
Investment in research and development (R&D), as per cent of GDP	0.63	1.5
Tertiary education (share of population aged 30-34 having completed tertiary education, %)	42.7	34-36
Share of early school leavers aged 18-24, %	8.3	10.0
Share of people at-risk-of-poverty, %	23.3	21.0
Energy efficiency (energy savings compared to 2008, Mtoe)	0.534	0.67
Share of renewable energy in the final consumption of gross energy, %	39.0	40.0
Total greenhouse gas emissions, Mt CO ₂ equivalent	12.1	12.2

When evaluating the national programmes submitted by the EU Member States and their implementation, on 5 June 2019 the EC published proposals for EU Council's country-specific recommendations for the EU Member States, which were approved by the European Council on 2 July 2019 after discussions at different meetings of the EU Council (see Box 8.2). The 2019 European Semester completed with the approval of these recommendations by the EU Council.

The measures planned by the government for the fulfilment of EU Council's country-specific recommendations and targets of the *Europe 2020 strategy* are included in the government's action plan. EU Council's country-specific recommendations to Latvia is a substantial element when setting national priorities, formulating necessary reform and policy measures, as well as successfully implementing *National Reform Programme of Latvia* and *Latvia's Stability Programme*.

Box 8.2

The EU Council's country-specific recommendations for Latvia 2019

The following recommendations are made for Latvia for 2019-2020:

- ensure that the nominal growth rate of net primary government expenditure does not exceed 3.5% in 2020, corresponding to an annual structural adjustment of 0.5% of GDP. Reduce taxation for low-income earners by shifting it to other sources, particularly capital and property, and by improving tax compliance. Ensure effective supervision and the enforcement of the anti-money-laundering framework;
- address social exclusion notably by improving the adequacy of minimum income benefits, minimum old-age pensions and income support for people with disabilities. Increase the quality and efficiency of education and training in particular of low-skilled workers and jobseekers, including by strengthening the participation in vocational education and training and adult learning. Increase the accessibility, quality and cost-effectiveness of the healthcare system;
- focus investment-related economic policy on innovation, the provision of affordable housing, transport, in particular on its sustainability, resource efficiency and energy efficiency, energy interconnections and digital infrastructure, taking into account regional disparities;
- strengthen the accountability and efficiency of the public sector, in particular with regard to local authorities and state-owned and municipal enterprises and the conflict of interest regime.

It should be noted that the *National Reform Programme of Latvia* and the *Latvia's Stability Programme* are being implemented in close cooperation with the European Commission. The progress on the implementation of both programmes is discussed regularly in bilateral dialogues between Latvia and the EC. The Ministry of Economics will continue monitoring the implementation of measures

addressing the NRP of Latvia and EU Council's country-specific recommendations, and the information on the progress in the implementation of these measures will be included in the *Progress Report on the Implementation of the National Reform Programme of Latvia within the Europe 2020 strategy* for 2020.

8.2. USE OF EUROPEAN UNION STRUCTURAL FUNDS AND THE COHESION FUND

As an EU Member State, Latvia benefits from financial assistance coming from the EU's structural funds and the Cohesion Fund, which are tools for the implementation of the EU's regional cohesion policy.

GENERAL CHARACTERISTICS IN THE 2014-2020 PROGRAMMING PERIOD

In accordance with the EU Council decision on the EU's multiannual financial framework for 2014 – 2020 Latvia has received 4.4 billion euro for the implementation of Cohesion Policy targets using EU funds (ERDF, ESF and CF). This means that in this period Latvia will be the fourth largest net beneficiary among all other EU Member States and will receive about 3 thousand euro per capita from the EU budget in the 2014-2020 period. Therefore, Latvia currently receives from the EU budget 4 times more than contributes into it.

In accordance with the MoF's assessment, investments from EU funds provided 1.2 percentage points of the real GDP growth in 2018, increased exports of Latvian goods and services by 0.5 percentage points, but imports – by 1.6 percentage points.

In October 2019, investments projects with 3.8 billion euro co-funding from EU funds, i.e., 86.4% of total funding of 4.4 billion euro from EU funds in the 2014-2020 programming period, are being actively implemented. By October 2019, expenses for the total amount of 1.4 billion euro (31.8% of the total funding of the EU funds) have been declared to the EC.

The annual report on the implementation of the operational programme "Growth and Employment" in 2018 was submitted to the EC on 28 June 2019. In annual report the EC has been informed about successful fulfilment of the preconditions set for Latvia to enable it to use performance reserve funding of 6%. By the decision of 18 August 2019 the EC has allowed Latvia to use the performance reserve funding of 6%. Therefore, CM at its meeting of 11 October 2019 adopted important decisions on further use of the performance reserve funding making it available for investment into real economy.

PROGRESS TOWARDS THE IMPLEMENTATION OF ACTIVITIES IN THE COMPETENCE OF THE MINISTRY OF ECONOMICS

Within the EU funds programming period 2014-2020, MoE is responsible for 20 different support measures with the total funding from the EU funds amounting to 754.8 million euro in three priority axes:

- research, technological development and innovation;

- competitiveness of the small and medium-sized enterprises;
- shift towards a low-carbon economy in all sectors.

Total public funds for all measures of Ministry of Economics amount to 907.2 million euro, and by the end of 2017 the selection and implementation of projects has started in all the measures under responsibility of MoE. Projects for 608.1 million euro or 80.6% from the funding available from the EU funds in total are being implemented in 2019. 244.2 million euro were actually paid to implementers of projects from 2014 to 2019 (see Table 8.2).

Four new project selection rounds were held in 2019:

- measure 3.1.1.5 "Support for investment into the creation and reconstruction of production facilities and infrastructure", round 2, until 30 April 2019. The ERDF funding available within the scope of the second project application selection round was 25.4 million euro and private co-funding no less than 21.7 million euro. The purpose is to promote extensions of undertakings operating in manufacturing and creation of new undertakings by supporting the creation of production buildings in regions.
- measure 4.2.1.2 "Promoting the increase in energy efficiency of public buildings", round 1, till the 28th of February, 2020. The total public funding available within the first selection round amounts to 80.4 million euro, including ERDF funding of 68.4 million euro, and funding from the state budget in the amount of 12 million euro. The purpose is to promote the increase in energy efficiency, smart energy management and renewable energy use in national regulatory authorities or authorities subordinated to them, or in buildings owned, possessed or used by a derived public person performing administration tasks delegated by the state.
- measure 4.2.1.2 "Promoting the increase in energy efficiency of public buildings", round 2, till the 29th of May, 2020. The total public funding available within the second selection round amounts to 34.7 million euro, including ERDF funding of 29.5 million euro, and funding from the state budget in the amount of 5.2 million euro. The purpose is to promote the increase in energy efficiency, smart energy management and renewable energy use in buildings and engineering structures owned or used by the beneficiary. Within the scope of limited selection of projects, projects may be submitted by the beneficiaries specified in Annex 1 to CM Regulations No. 13 of 4 January 2018 "Implementing Regulations for Measure 4.2.1.2 "Promoting the Enhancement of Energy Efficiency in Public Buildings" of Specific Objective 4.2.1 "Promoting the Enhancement of Energy Efficiency in Public and Residential Buildings" of the Operational Programme "Growth and Employment", and the maximum size of public funding available for covering eligible costs is defined in

accordance with the distribution of the funding specified in Annex 1 to the CM Regulations. In accordance with Annex 1 to the CM Regulations, project applicants are:

1. a public benefit organisation;
2. a public limited liability company and a limited liability company, 100% of capital shares of which belong to the state;
3. the State Joint Stock Company "Valsts nekustamie īpašumi";
4. direct national regulatory authorities or authorities subordinated to them, or derived public persons

performing administration tasks delegated by the state, companies fulfilling the administration tasks delegated by the state, 100% of capital shares of which belong to a ministry or a derived public person.

- activity 1.2.2.1 "Support for employee training", round 2, until 9 December 2019. The ERDF available within the scope of the second project application selection round is 9 million euro. The aim is to provide the companies with labour force holding the relevant qualification, thus contributing to an increase in productivity and development and putting into production of new or improved products and technologies.

Table 8.2

Progress of the implementation of activities in competence of the Ministry of Economics as at 31 October 2019				
Priority axes	Measures	Portion of funding from the EU Funds in 2014-2020 million euro	Total payments made million euro	Paid to beneficiaries as per cent of total allocation
1. Research, technological development and innovation	1.2.1.1. Support for development of new products and technologies within the competence centres	64.3	24.7	38.4%
	1.2.1.2. Support for improvement of technology transfer system	30.0	3.2	10.6%
	1.2.1.4. Support in introduction of new products into production	60.0	10.3	17.2%
	1.2.2.1. Support for employed training	18.0	5.5	30.5%
	1.2.2.2. Innovation motivation programme	4.8	1.9	39.4%
	1.2.2.3. Support for ICT and non-technology training, as well as training aimed at attracting investors	6.9	1.3	19.3%
3. Competitiveness of the small and medium-sized enterprises	3.1.1.1. Loan guarantees	44.8	19.1	42.7%
	3.1.1.2. Mezzanine loans	7.0	2.9	41.4%
	3.1.1.4. Microcredits and start loans	4.0	2.0	50.0%
	3.1.1.5. Support for investment into the creation and reconstruction of production facilities and infrastructure	50.5	11.1	21.9%
	3.1.1.6. Regional business incubators and an incubator for creative industries	27.9	5.4	19.4%
	3.1.2.1. Risk capital	32.2	16.1	50.0%
	3.1.2.2. Technology accelerator	13.0	6.5	50.0%
	3.2.1.1. Cluster programme	6.2	3.7	59.7%
3.2.1.2. International competitiveness	51.5	31.6	61.4%	
4. Shift towards a low-carbon economy in all sectors	4.1.1. Energy efficiency of manufacturing enterprises	25.7	8.1	31.4%
	4.2.1.1. Promoting the increase in energy efficiency of residential buildings	150.0	51.3	34.2%
	4.2.1.2. Promoting the increase in energy efficiency of public buildings	97.9	16.2	16.5%
	4.3.1. Energy efficiency of district heating	60.0	23.3	38.8%
Total		754.8	244.2	32.3%

MULTIANNUAL EU BUDGET FOR 2021-2027

On 2 May 2018, the EC published the communication “A Modern Budget for a Union that Protects, Empowers and Defends”¹, which marked the EC’s vision of the new EU’s multiannual budgetary framework for 2021-2027.

The EC believes that procedure of the new EC budget after 2020 should be simplified, more flexible and should generally be an EU budget with a greater focus on main priorities and measures with EU’s value added. The EC also wants to reinforce the link between the EU budget and the European Semester and the fulfilment of the EU Council’s country-specific recommendations (see Chapter 8.1).

When preparing the EC’s communication on the multiannual EU budget after 2020, the EC took into account current EU’s challenges. One of the challenges is the withdrawal of the United Kingdom from the EU, which was one of the biggest net payers to the EU budget. The EU is also currently facing several other challenges: technological changes, demographic changes and population ageing process, climate change, unemployment rate in the EU, in particular among youth, new security threats, refugee crisis and worsening of the geopolitical situation.

Considering the abovementioned challenges, the multiannual EU budget for 2021-2027 will experience changes, which will affect also related policies, for example, the Cohesion Policy, the Common Agricultural Policy, etc.

Within the scope of the Cohesion Policy, there are plans to strengthen and reform also the **European Social Fund (ESF)** by creating the ESF+ Fund, which will unite ESF, the Youth Employment Initiative, the Fund for European Aid to the Most Deprived, the Employment and Social Innovation programme and the Health programme.

The EC believes that the new EU budget should be closer linked to strengthening of the Economic and Monetary Union². For this purpose, the EC offers a new **Reform Support Programme**. Its purpose will be to provide technical and financial support to EU Member States for the implementation of reforms, and it will be separate but complementary to the future European Structural and Investment Funds (ESIF)³.

The Reform Support Programme also includes a *Reform Delivery Tool* aiming to provide support to all the EU Member States in the implementation of key structural reforms in the context of the European Semester (see Chapter 8.1), for example, reforms related to the product and labour market, reforms in education, tax system, capital market development, as well as reforms to improve the business

environment, human capital and the efficiency of public administration.

The *Reform Support Programme* will also include the *Convergence Facility*, to support those EU Member States, which have not introduced the euro yet, in introducing the single currency of the EU. If the EU Member States do not take necessary measures to introduce the euro by 2023, the allocations intended for the Convergence Facility will be redirected to the Reform Delivery Tool. The participation of EU Member States in all three abovementioned reform support programmes is planned to be voluntary, and the EU Member States will still be completely responsible for the implementation of reforms.

The **European Investment Stabilisation Function** will be another important element of the new EU budget in accordance with the EC’s proposal. The purpose of the function will be to mitigate the effects of macroeconomic shocks in the euro area during the crisis. The EC offers to guarantee loans from the EU budget, and they will be available to the EU Member States, which strictly comply with the criteria set for fiscal and economic policies. This stabilisation function will also ensure an interest rate subsidy to provide budgets of EU Member States with the necessary funding to retain their investment level. The subsidy is planned to be funded from contributions of the euro area countries.

The EC believes that over time the *European Investment Stabilisation Function* might be supplemented with other sources of financing outside the EU budget, for example, an insurance mechanism financed from voluntary contributions of the EU Member States, the European Stabilisation Mechanism and the prospective European Monetary Fund. The *European Investment Stabilisation Function* will be available also to those EU Member States, which are outside the euro area, if they invest in this function.

Active discussions are currently ongoing at the EU level between EU Member States and the EC on the new multiannual EU budget for 2021-2027 and related laws and regulations. The outcome of these discussions cannot be predicted right now. In accordance with **national interests** Latvia objects the proposed reduction of funding for the Cohesion Policy and the Common Agricultural Policy. Latvia believes that the EU still needs to promote economic, social and territorial cohesion, to equalise the welfare level between less developed and developed EU regions, as well as equalise direct payments in agriculture. Latvia appreciates the EC’s proposal to increase funding for research, innovation and the Connecting Europe Facility (which also includes support for the *Rail Baltica* project).

¹ https://eur-lex.europa.eu/resource.html?uri=cellar:c2bc7dbd-4fc3-11e8-be1d-01aa75ed71a1.0007.02/DOC_1&format=PDF

² In June 2015 the Five Presidents’ Report (President of the European Commission, President of the Euro Summit, President of the Eurogroup, President of the European Central Bank and President of the European Parliament) Completing Europe’s Economic and Monetary Union was published. It is planned in several stages until 2025, where one of them is related to the establishment of the Economic and Fiscal Union, incl. the

establishment of the Structural Reform Support Programme and closer link of the EU multiannual budgetary framework to the process of strengthening of the Economic and Monetary Union. More information: http://europa.eu/rapid/press-release_IP-17-5005_lv.htm.

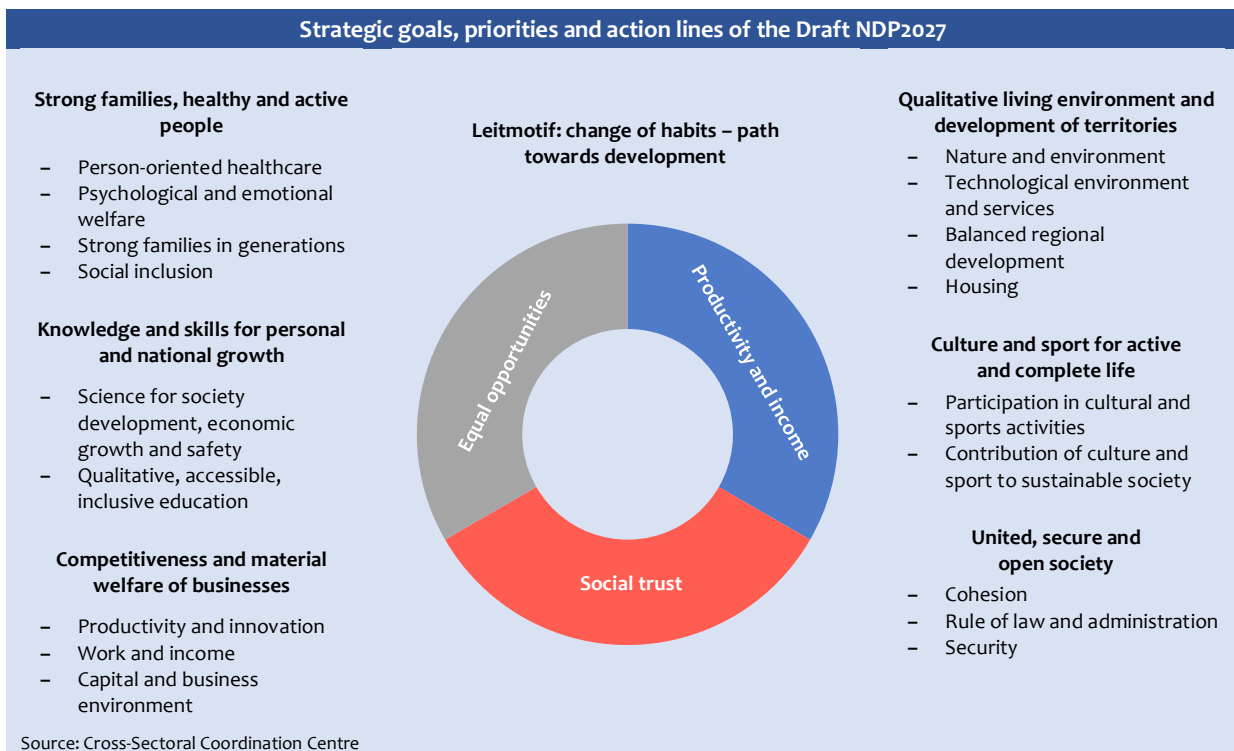
³ ESIF includes the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund.

PLANNING OF EU FUNDS FOR 2021-2027

In parallel to discussions at the EU level – the *National Development Plan for 2021-2027* (hereinafter – NDP2027) is being drafted under management of the Cross-Sectoral Coordination Centre in Latvia. The *National Development Plan of Latvia* is the main document in the country, according to which EU funds are being planned and EU fund

programmes are being implemented. Currently, the public consultation phase of the Draft NDP2027 has been completed. In accordance with the version of the document provided for public consultation of the draft NDP2027, strategic goals of NDP2027 are productivity and income, social trust and equal opportunities. Each strategic goal has its priorities and each priority has action lines (see Figure 8.3).

Figure 8.3



It should be noted that the NDP2027 will be closely linked to the European Semester (see Chapter 8.1), the *National Reform Programme of Latvia*, the investment needs reflected in the *2019 Country Report Latvia*, Annex D and the EU Council's country-specific recommendations for Latvia,

where investment needs of Latvia are defined in accordance with the EC's analysis.

The NDP2027 is planned to be forwarded to the CM and the Saeima for approval in January 2020.

8.3. EU SINGLE MARKET

The EU Single Market unites 31 country (28 EU Member States and 3 countries of the European Economic Area (EEA) – Norway, Iceland and Liechtenstein) having over 500 million consumers. The EU Single Market refers to a territory without internal borders providing free circulation of goods, services and capital, as well as free movement of people. After a coordinated work within the EU, unified principles and rules for economic operators have been developed, border control has been removed, a more competitive business environment has been created, consumers have been provided with a wider range of goods and services,

new jobs were created, the population was provided the possibility to live, work and study in other Member States, a single currency was introduced, as well as many other benefits were provided.

The EU Single Market continues to improve and adapt in the rapidly changing modern world to promote sustainability, development of the EU economy and the welfare of its population. In 2015, the EC adopted two strategies – the *EU*

*Single Market Strategy*¹ and the *EU Digital Single Market Strategy*², which set out necessary action for further reinforcement and improvement of functioning of the EU Single and EU Digital Single Market. Both strategies provide multiannual targets, which need to be implemented at the EU level and which directly affect the market development and competitiveness of all EU Member States in different sectors.

In March 2019, European Council urged the EU and Member States not only to act actively to strengthen and deepen the single market, but also asked the EC by March 2020 to develop a long-term action plan with an integrated, future-oriented approach to single market, which should unite all the relevant policy areas, remove unjustified obstacles, prevent the occurrence of new obstacles, in particular with regard to the freedom of provision of services and digitalisation. The EC's vision is expected to be a consecutive continuation of the future challenges identified in the EU Single Market and the EU Digital Single Market Strategy, which will have a closer link to other policy areas, in particular emphasising the integrated nature of the single market and the need for digital development.

In accordance with Articles 34-36 and 49-62 of the *Treaty on the Functioning of the European Union* (TFEU), the MoE supervises and coordinates the freedom of provision of goods and services and the right to do business in Latvia. It is also competent to identify legal provisions which may potentially or actually hinder the use of freedoms of the EU Single Market, including by evaluating pending laws and regulations.

Point of Single Contact (PSC) has been established on the MoE website³ for better governance of the EU Single Market providing all the information on the EU information and aid services. The main purpose of the EU Point of Single Contact is to help businessmen to use all the advantages related to the EU Single Market, as well as to provide practical assistance in relation to the limitations of the freedom of provision of goods and services.

The **technical regulations notification procedure** serves as a preventive, uniform and transparent monitoring tool to evaluate and prevent the inclusion of such requirements into laws and regulations, which might create barriers for free movement of goods and services. Not only responsible authorities of EU Member States, but any economic operator can participate in the process of coordination of technical regulations, and provide its comments and objections regarding drafts prepared by other EU Member States, which might potentially affect economic operator's product exports or cross-border provision of services. The information on draft technical regulations notified by Member States is freely available in the *database of the Technical Regulations Information System (TRIS)*⁴, where draft technical regulations can be viewed in Latvian. If any economic operator has any objections to draft technical

regulations of other countries which might potentially or actually affect sales of its product in the market of the respective EU country, the economic operator has the right to submit its objections to the responsible ministry which is competent to coordinate this policy area in Latvia.

To ensure administrative cooperation between EU and EEA's national regulatory authorities, the EC has created an **Internal Market Information System (IMI)**. The IMI allows to contact responsible authorities of the EU and EEA countries at national, regional and local level in a fast and effective way. Using the IMI system, authorities of Member States can verify the information indicated in applications of legal entities and individuals, authenticity of documents issued in other Member States, and clarify other matters according to EU laws and regulations. Hence, the applicant is free from bureaucratic barriers in different cross-border matters in the EU Single Market. MoE is the national coordinator of the IMI system in Latvia. IMI helps to implement 56 administrative cooperation procedures in 14 different policy areas.

For example, the *Services Directive (2006/123/EC)* obliges Member States to inform about services which can cause significant harm to human health, life and the environment, therefore, the IMI system has an *Alert mechanism* which ensures cooperation between supervisory authorities for risk prevention. 124 Latvian responsible authorities are registered in the IMI system in different areas – 63 authorities deal with the services area, 29 – with professional qualifications, 9 – with posting of workers, 5 – with patients' rights, 1 – with e-commerce, 2 – with train drivers' licences, 31 – with public procurement (one authority can deal with several areas). In 2016, a *European Professional Card* in the IMI system was created within the scope of *Directive 2013/55/EU* which is issued to those representatives of regulated professions who want to pursue the same profession in another EU Member State or a Member State of the European Economic Area. From 2017, requests *regarding EU type-approvals for non-road mobile machinery* are processed under *Regulation 2016/1628*. From 2018, information requests and notifications are processed in the cross-border context under the *General Data Protection Regulation (2016/679)*. From 2018, a register of public documents has been created within the scope of *Regulation 2016/1191* enabling to view typical documents issued in other Member State and examples of forged documents, while from February 2019 information requests in the area of public documents are processed. Since September 2019 IMI has been processing requests for arms shipments and issuing of licences. In 2020, a new module for *resolution of cases and exchange of information within the European Judicial Network* is planned to be created.

From January to October 2019 Latvia sent 38 information requests to other Member States within the IMI system: 37 in professional qualifications area and 1 on patients' rights. Latvia received 107 information requests: 104 in the

¹ Upgrading the Single Market: more opportunities for people and business COM(2015) 550 final, 28.10.2015.

² A Digital Single Market Strategy for Europe COM (2015) 192 final, 06.05.2015.

³ https://www.em.gov.lv/leiropas_savieniba/es_vienota_tirgus_centrs

⁴ <http://ec.europa.eu/growth/tools-databases/tris/lv/search>

professional qualifications area, 2 in the service area, 2 in the patients' rights.

SOLVIT Centre – an alternative EU Single Market problem solving network, created by the EC and the Member States, has been operating in Latvia since 2004. Its task is to find a fast and practical solution of the EU Single Market issues caused by activities of public authorities in case of incorrect application of EU law. In situations, when a resident or a businessman is experiencing unfair decisions taken by responsible authorities of other Member States, the SOLVIT Centre operates as a free problem-solving tool. There are SOLVIT Centres in each EU Member State (also in Iceland, Norway and Liechtenstein). From January to October 2019 Latvian SOLVIT Centre received 27 complaints as a Home Center (problems of Latvian citizens in other EU countries) and 11 complaints as a Lead Center (problems of EU citizens in Latvia). To submit a complaint to SOLVIT Centre, the case must meet the following criteria: 1) the decision has been taken by a public authority; 2) the public authority is located in another Member State (cross-border element); 3) EU's legal norms (regulations, directives, etc.) have been violated. Most frequently Latvian SOLVIT Centre solves cases related to social benefits and residence permits, restrictions on freedom of provision of goods and services, repayment of value added tax and recognition of professional qualifications.

On 26 April 2019, MoE in cooperation with the EC organised the Single Market Forum Workshop **"Digital Single Market tools – opportunities for SMEs cross-border growth"** that was held at the SEB bank Innovation Centre. The future of the EU Single Market and the use of artificial intelligence in the private sector within small and medium-sized enterprises were discussed during the workshop. It has been

recognised that in the age of rapidly developing digital tools and platforms, when business has no territorial limits and potential cooperation partner may be located across the ocean, it is important to know how to use modern technology opportunities for own benefit and how to identify potential obstacles. It has also been concluded that the advantages currently offered by artificial intelligence can be used in different sectors, for example, trade, manufacturing, transport, logistics, agriculture, etc.

To promote commercial activities and innovation in the services sector, as well as gradual modernisation and simplification of state administration, one of Latvia's priorities is promotion of the **freedom of provision of services**. In the services area, the requirements of laws and regulations are analysed regularly and recommendations for required changes are prepared to reduce an administrative burden on undertakings in cooperation with non-governmental organisations and national regulatory authorities. Administrative barriers and procedures are reviewed by respectively removing or simplifying requirements for issue of permits, licences, certificates, certifications and other documents, as well as creating the possibility to carry out the necessary procedures electronically.

One of the tools fostering modernisation of public administration aimed at reducing delays in decision making by the authorities, costs and unfavourable consequences incurred by SMEs is the tacit consent principle. This principle defines that in case a responsible institution fails to make a timely decision on the application for a permit, it shall be considered that the service provider has received the permit and is entitled to start service provision.

9. IMPROVEMENT OF THE BUSINESS ENVIRONMENT

Measures for improvement of the business environment in Latvia have been implemented since 1999. The Ministry of Economics, with the participation of a wide range of sectoral ministries and organizations representing entrepreneurs, prepares the *Action Plan for Improvement of the Business Environment* (hereinafter referred to as the *Business Plan*), which is updated and approved by the government every other year. The *Business Plan* is a business policy making tool, which hears and solves the problems identified by businesses, and it has so far helped to introduce more than 540 different measures for improvement of the business environment.

Targeted reforms and close cooperation with the business community has enabled Latvia to achieve high results in

international ratings, namely, the World Bank's *Doing Business 2020* rating Latvia is placed 19th among 190 countries. As regards the assessment of the business-friendly environment, Latvia is ranked 5th among the EU member states.

On 22 May 2019, the Cabinet of Ministers approved the current version of the *Business Plan* (see Box 9.1) aiming to create an attractive business environment for businesses: affordable and clear services, smaller administrative burden, and including 40 measures, which have effect also on Latvia's indicators in the *World Bank's Doing Business* study. The period of effect of the *Business Plan* is four years – 2019-2022.

Box 9.1

Action Plan for Improvement of the Business Environment 2019-2022

Basic principles included in the *Business Plan* approved by CM on 22 May 2019: customer-oriented public administration, digitalisation of services, competitiveness of the tax system, openness of the business environment, legality, promotion of innovation. In the *Business Plan*, special attention is drawn to promotion of innovation, human capital and protection of investor rights, which are important components of a developed business environment.

Basic principles included in the *Business Plan*: customer-oriented public administration, digitalisation of services, competitiveness of the tax system, openness of the business environment, legality, promotion of innovation.

The *Business Plan* includes 12 sections important for the business environment:

1. Starting a business.
2. Construction process.
3. Registering property.
4. Protecting minority investors.
5. Accountancy and taxes.
6. Trading across borders – customs.
7. Enforcing contracts.
8. Getting electricity.
9. Restructuring.
10. Human capital.
11. Digitalisation and accessibility of state services.
12. Promoting Innovation.

The *Business Plan* has been developed in close cooperation with public institutions and organisations representing businesses, includes measures developed based on the challenges identified by social, cooperation partners and public institutions, as well as taking into account the challenges noted in *Doing Business* and the *Global Competitiveness Index*. At the same time, the action lines identified in the recommendations prepared on an annual basis by the Foreign Investors' Council in Latvia and reflecting the challenges identified by foreign investors in Latvia have been taken into account.

The *Business Plan* for the next period has been drafted by discussing the activities in the *Business Plan* working group approved by the Minister of Economics, which includes representatives from state institutions, as well as organisations representing businesses.

The Ministry of Economics is constantly maintaining a dialogue with businesses. The first and the main instrument of implementation of the dialogue is involvement of businesses in drafting of the *Action Plan for Improvement of the Business Environment*. The MoE in cooperation with sectoral ministries and the Employers' Confederation of Latvia, Latvian Chamber of Commerce and Industry, Foreign Investors' Council in Latvia constantly take care of the

development and implementation of measures for the improvement of business environment. At the same time, the opinion of each company is taken into account and submitted challenges are evaluated in the process of drafting of the *Action Plan for Improvement of the Business Environment*.

Another important measure in the dialogue with businesses are visits to companies, during which MoE listens to the challenges submitted by businesses, studies each visited company and thus gets a better idea of real needs of businesses and the possibilities to provide different support to businesses.

REDUCTION OF BUREAUCRACY

In order to reduce the bureaucratic burden for businesses, on 20 August 2019 CM approved the informative statement prepared by SC "On the implementation of the "zero bureaucracy" approach in the process of development of regulatory enactments", which obliges all ministries to ensure observation of the "zero bureaucracy" principle in the process of drafting of draft regulatory enactments starting from 1 November 2019, while SC should provide methodological and advisory support to ministries.

Main conditions of the process of implementation of the approach:

- furthermore, when submitting a draft regulatory enactment that increases administrative burden or creates new liability costs for businesses for approval to CM, the ministry should at the same time submit a draft regulatory enactment, which reduces administrative burden or cancels compliance requirements in an equivalent scope for the same target group (the threshold, starting from which a monetary evaluation of the burden is required, are 2000 euro for the target group per year);
- there might be another solution for reduction of administrative burden, which is not in competence of the submitting ministry. In this case, the ministry responsible for the respective area shall participate in the development of the regulatory package and shall provide its opinion;
- a package of draft regulatory enactments is created – an annotation and related regulatory enactments. Calculations of increase and reduction of administrative burden and compliance costs, the description of the earmarked subsidy are included in the initial impact assessment of the draft regulatory enactment (annotation);
- when drafting a regulatory enactment, the ministry shall calculate administrative burden and liability costs for the target group of businesses, which will be imposed in addition by the implementation of this regulatory enactment. The approach includes any new regulatory enactment or amendment of any existing regulation, which creates annual administrative burden or creates annual compliance costs for businesses;
- the ministry shall be liable to involve organisations representing interests of businesses at the initial stage of development of any draft regulatory enactment;
- the ministry shall coordinate any draft regulatory enactment, including calculation of administrative

burden and compliance costs (the cost compensation scenario) with the organisations representing interests of businesses, whose opinion must be enclosed in the package of draft regulatory enactments;

- opinions about such draft regulatory enactments must be submitted to SC, MoE, MoJ and MoF. SC shall evaluate compliance with conditions of the approach, including the quality of the community participation process and calculation of the burden (cost compensation scenario) during development of the draft regulatory enactment. MoE shall evaluate the draft regulatory enactment as an authority responsible for the business environment and development.

Exceptions (draft regulatory enactments not subject to the approach) are budget formation and tax policy, fulfilment of mandatory minimum EU requirements, international treaties and liabilities, regulation of emergencies, as well as situations, when the matter must be solved immediately due to such unfavourable consequences, which affect significant community (incl. consumer) interests or international, financial, economic or security interests of the state, evaluating each case separately.

The approach provides that the State Chancellery and the Ministry of Economics are coordinating authorities, and they ensure observation of the "zero bureaucracy" principle in cooperation with line ministries.

ENHANCEMENT OF TAX SYSTEM

An absolutely new CIT regulation was introduced since 1 January 2018, which envisages a 0% rate for reinvested profit. Therefore, the calculation and payment of CIT is postponed until income is distributed, applying a 20% rate at the time of distribution of profits from the gross income to be distributed.

The above-mentioned changes in the tax policy will promote investments of companies in development, as well as economic growth in the country in general. It is expected that the corporate income tax of 0% for reinvested profit will improve financial indicators of companies and promote an increase in equity (retained earnings). At present, many companies have small or negative equity. Insufficiency of equity prevents companies from attracting external funding, increasing their creditworthiness. Investments create new opportunities for increasing competitiveness of companies. Therefore, it is expected that as the tax policy changes, the turnover, profit and productivity of companies increases. This will promote issuing of loans by commercial banks. Therefore, faster economic growth, increase in exports and increase in competitiveness are expected.

At the same time, work is currently ongoing under supervision of the Ministry of Finance to introduce a measure, which intends to reduce the number of taxes administered by SRS and to ensure that several tax payments can be made to one tax account administered by

SRS, thus reducing administrative burden on taxpayers and enhancing the tax administration process.

IMPROVEMENT OF THE INSOLVENCY REGULATION

Reforms that have been carried in the area of insolvency in recent years, including by implementing the guidelines and the plan, are positively evaluated by businesses. In early 2019, the Foreign Investors' Council in Latvia published a report "FICIL Foreign Investment index in 2015 – 2018", which is an evaluation of developments in the Latvian investment climate by foreign investors. In this evaluation, foreign investors evaluated progress in insolvency administration as one of the best decisions or policy initiatives, which have been introduced by the Latvian government in the last five years.

In early 2019, IMF, evaluating the reforms implemented by Latvia in the area of insolvency within the scope of the project "Justice for development" co-financed by the European Social Fund, specific objective 3.4.1 "To improve the competence of the staff of courts and law enforcement authorities to promote improvement of business environment", came up with an assessment report on the insolvency regulation in Latvia, which, inter alia, emphasised that the legal protection proceedings (LPP), which are one of the main tools for reorganisation of viable companies in Latvia, did not fulfil its function. There is a limited number of cases, when LPP end successfully, and several changes would be necessary to introduce a balance between reorganisation and liquidation in the Latvian insolvency system, to facilitate rehabilitation and long-term growth of viable companies.

A case history "Resolving insolvency", which is available on www.latvija.lv, has been developed in order to promote than companies regain their solvency using LPP mechanisms. The Insolvency Control Service has published information on LPP regulation and in cooperation with the Ministry of Economics, the Valmiera Business Incubator and the Sigulda Business Incubator provided an informative lecture and discussion on restructuring possibilities in Latvia.

In order to ensure identification and resolution of financial difficulties in a timely manner, the *Action Plan for Improvement of the Business Environment* aims to evaluate by 1 July 2020 the profile of companies facing financial difficulties the most often to develop an early warning tool or tools, based on the above-mentioned, which would be most appropriate for Latvia.

In early 2019, MoE started the implementation of *Interreg Baltic Sea Region transnational cooperation programme project "RestartBSR" ("Restart SMEs in the Baltic Sea Region")*. The purpose of the project is to build institutional capacity for representatives of the innovation area to support businesses in financial difficulty. Capacity building activities will ensure smaller number of insolvency proceedings in such companies, foster performance of the Baltic Sea Region in non-technological innovations and

increase the number of companies able to resume business, which will, in turn, result in total growth of the region, as well as preservation of jobs and increase in their number. To achieve the goal, within the project it is necessary to analyse best practices, develop tools for supporting companies in financial difficulties, as well as develop recommendations for policy implementers for further actions to handle the existing situation.

INTRODUCTION OF THE "CONSULT FIRST" PRINCIPLE IN PUBLIC ADMINISTRATION

In order to move towards excellent business and change mutual cooperation and promote mutual understanding of duties to be performed between supervisory authorities and businesses, in 2017 the Ministry of Economics started the "Consult first" initiative.

The purpose of the "Consult first" principle is to achieve understanding between businesses and supervisory authorities to ensure that businesses, first of all, know and understand their duties, and, second, fulfil them fairly. The implementation of the principle will allow to reach a better result in observation of regulatory enactments and therefore fair competition in the market, creating a stable business environment favourable for investments.

Guidelines on the application of the "Consult first" principle have been developed in cooperation with supervisory authorities that include best practice examples to promote efficiency and customer-oriented activities in institutions. On 15 June 2017 23 Latvian institutions, the Prime Minister and the Minister of Economics signed a cooperation memorandum assuming a commitment to introduce the "Consult first" principle in the work of Latvian supervisory authorities.

In order to ensure the effective implementation of the "Consult first" project, at the end of 2017 the Ministry of Economics drafted an institution evaluation methodology to be able to evaluate progress of supervisory authorities in introduction of the "Consult first" principle in the next years on a regular basis. According to the drafted evaluation methodology, surveys of customers of authorities, a self-assessment of institutions and evaluation by experts are organised, which help to evaluate success of institutions in introduction of the "Consult first" principle.

The first evaluations of supervisory authorities were presented on 29 March 2019 at the ceremonial award event, where supervisory authorities, which are the most responsive to businesses were awarded. The Food and Veterinary Service was recognised as the leader of the "Consult first" initiative in 2018. At the same time, the State Revenue Service, the Consumer Rights Protection Centre, the Central Statistical Bureau and the State Plant Protection Service received the highest evaluation in five nominations.

The results of the second evaluation of 22 supervisory authorities were presented on 4 December 2019 at the ceremonial award event, where supervisory authorities, which are the most responsive to businesses, were awarded.

The leader of the “Consult first” initiative in 2019 was the State Agency of Medicines, which also received the award in the “Choice of Businesses” nomination. The State Revenue Service, the Food and Veterinary Service, the Register of Enterprises and the Central Statistical Bureau also obtained the highest assessment in different nomination categories. In addition, in 2019, two special awards were awarded in the nomination “Annual Growth” – they went to the State Labour Inspectorate and the Health Inspectorate, which demonstrated the most rapid progress in implementing the “Consult First” principle. In progressing towards the goal to improve cooperation between businesses and supervisory authorities in order to promote compliance with national requirements, another six authorities apply the “Consult first” principle in their activities joined the initiative in 2019.

DIGITALISATION OF THE BUSINESS ENVIRONMENT

The information necessary for business is available electronically, as well as e-services are available in one place on the portal of Government Services www.latvija.lv. The Portal fulfils the functions defined in the *Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, which was transposed in the Latvian legal systems by the Freedom to Provide Services Law*, – each EU member state should have a single electronic contact point, where detailed information should be available on public services related to business in the services areas, and it should provide the possibility to fulfil electronically necessary administrative requirements for the provision of services in the member state. The Portal is also included in the EU single portal of contact points “EU-GO” on public services available in EU member states to those companies, which provide services. Information about life situations, interinstitutional information and functionality in the section for the persons is cooperated by SRDA in cooperation with institutions involved, but the section for companies – by the Ministry of Economics.

The main principles of operation of the Portal are defined in the *Information Society Development Guidelines for 2014-2020*, and the legal regulation is stipulated in several CM regulations.

In cooperation with MoEPRD, work has started on the introduction and implementation of Regulation (EU) 2018/1724 of the European Parliament and of the Council of 2 October 2018 establishing a *single digital gateway* to provide access to information, to procedures and to assistance and problem-solving services and amending Regulation (EU) No 1024/2012.

Problems with functionality of the Portal:

- at present the persons and companies face a challenge when they need to find relevant, up-to-date and understandable information online, as well as to unambiguously identify and find necessary services (e-services). This process is often time-consuming and

complicated or even impossible. If such information is available from institutions, it is not always available electronically, and most frequently it is organised according to the administrative competence of institutions rather than from the point of view of the population and companies (integrating services of different institutions and covering the situation of the individual completely);

- at national level Latvia does not have one single contact point (business portal) to obtain information on business by its operation cycles – starting of business, requirements during operations of the company and closing, consultations about law, exports, support, taxes, permits, etc. Informative business environment is fragmented, part of information is available from LIAA, part from MoE, the Register of Enterprises, the State Revenue Service and on other websites. It should be taken into account that a single contact point covers only part of the functionality necessary to support businesses.

In the context of identified challenges MoEPRD in cooperation with MoE and other public authorities have started work on transformation of the portal, creation of a new design to enable the population and companies to easily and conveniently find necessary information and receive public services electronically. Therefore, in order to foster improvement of functionality and the quality of content of the business section of the Portal, MoE has addressed other ministries and agencies subordinated to them regarding the need to update information about available services in a user-friendly way and in accordance with the requirements of the *Services Directive*. The stated work will continue in 2020, including by improving the information and services available on the Portal in accordance with the *requirements of the Single Digital Gateway Regulation*.

Therefore, in order to foster the improvement of functionality and content of the business section of the Portal, SIA “PricewaterhouseCoopers” at the assignment of MoE has developed a study “Concept of the business section of Portal www.latvija.lv. Evaluation of the current situation and future development proposals”, which provides strategic proposals for the development of the business section of the Portal. The proposals from the study have been submitted to MoEPRD, as well discussions with ensured.

In order to ensure the development of the new business section on www.latvija.lv, on 11 January 2019 the State Regional Development Agency concluded a *cooperation agreement on the implementation of the project “Service provision and management platform”* with MoE, which provides that MoE participated in commenting on the requirements to solutions as a cooperation partner, as well as develops content for the business section of the portal.

In order to make proposals for the development of the portal, on 7 February 2019 the Ministry of Economics concluded a procurement contract with Megadizains SIA on organisation of a design workshop on the portal www.latvija.lv to improve usability of the business section. A digital prototype for the business registration section and

a company registration e-service (establishment of a limited liability company with one founder) were developed under the contract, based on usability tests and design workshop

conclusions. The proposals were submitted to the SRDA and MoEPRD for the offered solutions to be taken into account, when developing the new portal www.latvija.lv.

10. INNOVATION AND NEW TECHNOLOGIES

The main goals and directions of Latvian industry, innovation and R&D until 2020 are set in several policy planning documents – *National Development Plan of Latvia 2014–2020*, *National Industrial Policy Guidelines 2013–2020*, as well as *Guidelines for Science, Technology Development and Innovation for 2014–2020*. An important precondition for transition to innovative economy is strengthening of the Latvian innovation system by eliminating its deficiencies and facilitating mutual cooperation between all subjects of the innovation system – businesses, science and education, as well as financial and legislative systems.

The main challenges for the improvement of the innovation system are:

- weak cooperation between the business sector and science;
- insufficient use of the creative and intellectual capital in the creation of innovations, comparatively low innovation capacity and knowledge absorption capacity in the business sector, as well as lack of new and progressive innovation and research-based jobs;
- weak commercialisation potential of research results;
- shortage of employees in science and research, a poorly developed and fragmented science and research infrastructure, as well as small number of laboratories with modern equipment for the implementation of technology intensive projects.

Important directions in promotion of innovation and new technologies are:

- establishment of a knowledge transfer system supporting innovation;
- creation of start-ups;
- creation and support of competence centres;
- promotion of digitalisation (Industry 4.0);
- development of strategic value chain ecosystems.

ESTABLISHMENT OF A KNOWLEDGE TRANSFER SYSTEM SUPPORTING INNOVATION

LIAA, which at the same time ensures the establishment of a Single Technology Transfer Centre, is a central element, a mediator in the ecosystem of innovations, which promotes the awareness and development of technology transfer in public research organisations, improves their industrial property management policy, as well as promotes the takeover of international knowledge and skills for the organisation of technology transfer processes and ensures

introduction of a commercialisation fund and innovation vouchers support instruments.

A knowledge transfer system supporting innovations in the 2014-2020 programming period of EU funds is implemented within the framework of activity 1.2.1.2 “Support for Improvement of Technology Transfer System” of the Specific Objective 1.2.1 “To increase investments of private sector in R&D” of the Operational Programme “Growth and Employment”. The purpose of improvement of the knowledge and technology transfer system is to improve cooperation skills of the research and business sector, closer link of scientific activity with the demand from the business sector, satisfying the needs of companies for new technologies and innovative solutions.

The *Technology Transfer Programme* provides an opportunity to commercialise or convert into new products and services the results of research funded from public resources, and the private sector will thus ensure further development and introduction into market of the research results. Moreover, the purpose of the *Technology Transfer Programme* is to make a contribution to the achievement of the goals of the *Latvian Smart Specialisation Strategy*, foster commercialisation of state-funded research results available to research organisations in Latvia and abroad, as well as to promote innovation activities in small and medium-sized enterprises, including in start-ups through technology transfer. Thus, companies get support for new or substantially improved product of technology development. By now 41 projects for commercialisation of ideas have received support, 183 start-ups have been supported for participation in exhibitions and visits to potential investors, as well as 78 innovation vouchers have been issued within the scope of the *Technology Transfer Programme*. It is planned to continue these activities to support economic operators and research organisations in 2020.

CREATION OF START-UPS

Development of start-ups is an important chain link in the innovation system and promotes the change of the paradigm to modern and innovative economy. Over the last 4 years the Ministry of Economics and the bodies subordinated to it have been actively working on the creation of uniform supply for the start-up ecosystem. The Latvian start-up ecosystem has become more visible also in the international context. Every year at least 5 local events and festivals with international coverage bring together start-ups and their representatives.

On 1 January 2017 the *Law On Aid for the Activities of Start-up Companies* entered into force giving a clear signal to entrepreneurs, society and policy makers that start-ups are an important source of innovation in the national economy, as well as they promote the attraction of investments, foster the creation of new business models, development of talents

and strengthen the venture capital sector. In order to extend the range of beneficiaries of the aid and reduce bureaucratic burden for businesses, *Amendments to the Law On Aid for the Activities of Start-up Companies* entered into force on 10 May 2018. At present, discussions have started on further amendments to the *Law On Aid for the Activities of Start-up Companies*, which are planned to be submitted to CM by the end of the year.

A representation of Latvia in the Silicon Valley started its work in February 2018 serving as a networking place and an investor attraction point. In 2018, more than 150 start-ups received support from LIAA for participation in exhibitions, conferences and direct visits in foreign countries.

In 2018, 3 acceleration funds (Overkill Ventures, BuildIT and the Commercialisation Reactor) started to work with each of the funds having ERDF funding of 5 million euro of the total funding of 15 million euro.

An important element in the use of support programmes is their popularisation for the international range of interested persons. For this purpose, an informative portal for start-ups, StartupLatvia.eu, was opened in June 2018. This portal offers a comprehensive overview of support or Welcome Pack available to start-ups in Latvia and general information about the state and activities of the ecosystem.

By the end of 2019, the Latvian start-up community have met at three forums organised by the Ministry of Economics and the Latvian Start-up Association Startin.lv. The first forum was organised at the beginning of 2018, where the development, opportunities and challenges of the start-up ecosystem were discussed together with representatives of start-ups, public, private and academic sector, as well as practical suggestions for improvement of further cooperation and improvement of support were obtained. The second forum was held in September 2018, where cooperation opportunities, the cooperation potential and challenges were discussed together with representatives of the start-up ecosystem, large industry enterprises and government bodies. Representatives of the entire ecosystem, including from state institutions, participated in the forum. The start-up community forum of 2019 included a cycle of discussions "Promoting the Start-Up Ecosystem and Intersectoral Cooperation: Challenges and Opportunities" and the hackathon of ideas "Intersectoral Cooperation Opportunities and Cooperation Models". The top of Baltic start-up brands uniting all the representatives of the start-up ecosystem, start-up associations and the Ministries of Economics of the Baltic countries was organised for the first time within the scope of the forum to attractively determine the strongest start-up brand of the Baltic countries.

In order to strengthen the ecosystem of Latvian local start-ups and cooperation among its representatives, a memorandum of cooperation was concluded in 2019 between the Ministry of Economics, the Latvian Start-up Association, the Latvian Business Angel Network and the Latvian Private and Venture Capital Association.

The study by Gateway&Partners SIA "Evaluation of the Latvian start-up ecosystem, identification of its current

status and development of proposals based on it" was completed in 2019, and society learned about its results at the media breakfast. Media publications and infographics on summarised data and statistics were developed in addition. Riga Venture Summit 2019, an event for policy makers, start-ups and venture capital industry representatives, several seminars in higher education institutions and companies were organised to promote the involvement of students in the start-up ecosystem. A cycle of expert discussions #21gsLatvija was organised with the topics of the first three discussions being – Employee Stock Options, Latvian Brand, and Digital Skills.

Two X-industry hackathons were organised in 2018 in cooperation with the Latvian IT cluster, which contributed to intersectoral cooperation among tech industry companies, corporations and experienced mentors, which are vitally important nowadays due the development of digital business.

It is planned that the work on promotion of cooperation between start-ups and state capital companies will continue in 2020, thus creating mutually beneficial solutions to increase innovation capacity. It is planned to continue to strengthen cooperation with representatives of the start-up ecosystem and organisations representing them to promote public awareness of the role of start-ups in the innovation system. MoE has drafted an informative report "On examples and prospects of use of the blockchain technology and further actions to promote the development of the area". Based on this, a tax Blockchain hackathon was organised in Riga in April to search for blockchain technology based solutions for the public sector in the field of big data, modern technologies, tax fraud and cash accounting system. The hackathon was organised by the Ministry of Economics in cooperation with the State Revenue Service and the start-up accelerator Startup Wise Guys. It is planned that the first pilot projects in cooperation with SRS, the Register of Enterprises and other national regulatory authorities might be implemented in 2020-2021.

CREATION AND SUPPORT OF COMPETENCE CENTRES

One of the most important tasks is to build understanding of companies about research, development and innovation as drivers of growing productivity and competitiveness of companies.

The purpose of activity 1.2.1.1 "Support for Development of New Products and Technologies within the Competence Centres" of specific objective 1.2.1 "To increase investments of private sector in R&D" of the Operational Programme "Growth and Employment" (Activity 1.2.1.1) is to increase competitiveness of economic operators by promoting cooperation between the research sector and the industrial sector when implementing projects developing new products and technologies and introducing them in production. The main challenges of activity 1.2.1.1 are to ensure the achievement of investment results and active involvement of

beneficiaries of funding in the creation of international and intersectoral platforms.

191 research projects were approved, of which 174 were completed, in all the 8 competence centres within the scope of the second round (2016 – December 2018). The co-funding of companies involved in R&D projects as at 31 December 2018 was 21 million euro. 149 economic operators have received support with turnover of undertakings after the implementation of research results in economic activity or their commercialisation being 151 million euro, 492 new jobs have been created, 238 scientific articles have been published in indexed journals in international databases (Scopus, Web of Science) within the scope of the second round.

As at October 2019, 137 research projects have been approved, including more than 30 intersectoral research projects, within the scope of the fourth round. The main challenge of the fourth round is to promote cooperation between different sectors, which would ensure sharing and exchange of information, resources, technologies, methods to jointly develop high value-added products or services.

The programme provides a perfect opportunity to study good innovation practices. The contributions received from ERDF have increased the number of innovations, productivity, export capability and other indicators, which considerably increase general competitiveness of industries.

PROMOTION OF DIGITALISATION (INDUSTRY 4.0)

In order to promote digital transformation in Latvian companies, a Latvian Industrial Digitalisation Development Guide and a strategy for deployment of the Industry 4.0 platform have been developed. The platform provides for exchange of up-to-date information among stakeholders promoting intersectoral cooperation in the implementation of different development projects using digital solutions, as well as promotes international cooperation to represent interests of Latvian businesses. The platform provides for mutual interaction between the science sector, the state and the industry.

The purpose of the set of *Industry 4.0* deployment measures in Latvia is to promote understanding of the *Industry 4.0* concept and to create conditions corresponding to action fostering intersectoral cooperation based on the use of digital solutions for development of innovations in cooperation with smart human capital rich in knowledge.

Within the scope of *Industry 4.0* concept Latvia is developing the digitalisation process at the level of industry. In recent years, this process has been introduced and has already helped to improve production processes in several largest industrial enterprises helping them to become more productive, for example, AS Dobeles dzirnavnieks, AS UPB, SIA Peruza, Valmieras Stiklašķiedra, Latvijas Finieris, Agrofirma Tērvete, Baltic Ovo. *Industry 4.0* concept is based on the use of digital solutions for the development of innovations and technologies. An innovative and digitalised

production process is ensured with higher efficiency. Companies get increasingly more interested in developing the industry process using advantages of data and opportunities offered by automation.

In 2018, a pilot project was started in cooperation with the German – Baltic Chamber of Commerce, which envisages the development of digitalisation and implementation in production processes in manufacturing industries, enabling companies to cooperate with global leaders, developers of smart technologies from Germany, mainly ICT companies. The purpose of this initiative allowed companies to cooperate in the implementation of new technologies and improvement of existing technologies using the latest available technologies and data processing. Bilateral visits of German experts to Latvian companies were organised and took place. A general comparative overview on the current level of development of digitalisation and the use of new opportunities has been created based on their results. Experimental activities, which provided for integration of smart technologies for improvement of production processes, were conducted in five Latvian companies.

DIG-IN, a digitalisation and innovation forum, was held on 15 February 2019. During the event, foreign and Latvian experts provided opinions on innovations, digitalisation, importance of cooperation between *Industry 4.0* and industry cooperation, opportunities and benefits provided by them for the implementation of new technological solutions into companies. To certify that industries are ready to cooperate and form unified interest positions, a Memorandum of Cooperation was concluded among 11 parties at the DIG-IN forum, which includes 8 Competence Centres, MoE, MoEPRD and the German – Baltic Chamber of Commerce, which are representatives of German *Industry 4.0*.

Taking into account the guidelines of the EC and European scale, Latvia focuses attention also on integration of new technology solutions in Latvian production companies. Latvia keeps focusing on promotion of digitalisation and improvement of existing solutions, enabling manufacturing companies to cooperate with developers of smart technologies, mainly ICT companies, ensuring the latest available technologies and data processing opportunities.

DEVELOPMENT OF STRATEGIC ECOSYSTEMS

In order to stimulate production of more technology-intensive products and services with higher value added and export potential and inclusion into higher levels of global value chains, it is necessary to promote development of strategic value chains with potentially high value added at national level. By extending integration of participants of one value chain a value chain ecosystem is formed including closer and indirect private, public and academic environment cooperation partners at local and international scale. The business ecosystem is a network of interrelated companies, for example, suppliers and distributors, who interact, mainly supplementing or supplying main components creating value in their products or services.

In 2018, the Ministry of Economics carried out mapping of three potential value chain ecosystems – in the field of biomedicine, smart city and smart materials.

Since September 2018, the Ministry of Economics has been implementing in test mode the development of a strategic value chain ecosystem based on a special method, which is based on a structured dialogue and coordinated action among the parties involved (the triple helix principle), creating an effective collaboration platform. The theoretical justification base of the method is based on the theory of clusters as a competitiveness promotion tool, which has been adapted to the respective format and supplemented with innovative elements, for example, the use of design thinking elements. The approach of the Ministry of Economics consists of two blocks of actions – mapping and cooperation (hereinafter referred to as K-2 APPROACH), within the scope of which a number of specific and interrelated activities are implemented.

The purpose of mapping is to identify value chains with high added value, their main participants and the general

business ecosystem based on quantitative and qualitative analysis methods. The quantitative analysis method consists of the analysis of macrodata, while the section of the qualitative method consists of structured interviews with industry representatives (representatives of the private, academic, non-governmental and public sector). The purpose of the interviews is to identify the current situation, private sector investment areas and development directions, as well as scientific capacity of the academic sector in the specific area. A strategic workshop based on design thinking methods is organised to deeper analyse the potential of proposed development areas and potential development scenarios. More than 40 representatives of the private, academic, non-governmental and public sector participate in the workshop uniting into pre-defined interest groups of development areas, within the scope of which industry representatives discuss global trends and challenges, map the ecosystem of cooperation partners and, having evaluated the most competitive sub-direction, sketch potential cooperation projects.

Box 10.1

Biomedicine value chain ecosystem

In order to develop the biomedicine value chain ecosystem to an independently functioning set (institutionalisation), which would be also to take the leading role in the European research and innovation environment in the defined period of time and would be able to integrate into global value chains, the Ministry of Economics in cooperation with the Investment and Development Agency of Latvia, the Ministry of Health and other organisations of the public, private and science sector since May 2018 have been implementing several activities:

- the value chain ecosystem has been mapped and strategic development directions have been determined by identifying 3 development priorities – gene sequencing, pharmacy and the creation of a data lake platform;
- a visit of the Groups of Leaders (taking into account the qualitative analysis, identified leading industry representatives, who proactively work together on the development of the value chain ecosystem (public administration, academic sector and industry representatives) and the work group of representatives of the Ministry of Economics to San Francisco (United States). This visit was an important step, which not only ensured valuable exchange of experience with global industry leaders, but also allowed the Ministry of Economics supported by industry leaders to address potential cooperation partners and investors, excellence and capacity of the industry for international cooperation has been presented, the scope of the strategic industry development project has been extended and new participants on a global scale, for example, Microsoft Research, have been involved.

The Group of Leaders is currently working on the *Long-Term Strategy Development for Cyber Security for 2020-2027*. In order to implement the strategy, it is necessary to create an effective governance platform (organisation), which is one of the next matters on the agenda of the ecosystem. After the *Long-Term Strategy Development for 2020-2027* it is planned to sign a Memorandum between the parties involved in Q1 2020. The Memorandum is planned as an annex and a binding document – the *National Industrial Policy Guidelines*.

11. PROMOTING PRODUCTIVE INVESTMENTS AND EXPORTS

11.1. PROMOTION OF ACCESS TO FINANCE

The purpose of implementation of financial instruments is to reduce market failures and to promote the creation of new economic operators and growth of existing ones, ensuring access to funding for the implementation of prospective and viable business projects to those economic operators, who due to insufficient security, history of economic activity, credit history, net income flow or the amount of current credit obligations were unable to attract funding from participants of the financial market (commercial banks, private investors) for the implementation of business projects in the necessary amount.

The European Regional Development Fund (ERDF) funding for financial instruments intended in the 2014-2020 programming period of EU funds forms 101 million euro. In addition to this funding, the development financial institution "Altum" (ALTUM) should attract indicatively its funding or use the repaid funding of funds (for direct microcrediting, for support to starters of economic activity and mezzanine loans) of 68 million euro, as well as external funding of indicatively 36.15 million euro (for ensuring venture capital and acceleration services) should be attracted.

It is important to ensure continuity of availability of funding to SME also in the new programming period of EU funds after 2020 and state support programmes should continue to be implemented in the form of financial instruments: ensuring loans for starters of business, providing guarantees, as well as fostering the availability of venture capital instruments. The development of guarantee and venture capital instruments should be ensured as a priority, at the same time ensuring mutual complementarity with the activities planned by InvestEU.

LOAN GUARANTEES

Loan guarantee support activities for starting business and development in situations, when own funds of the company are not a sufficient security to attract the necessary funding from commercial banks or the company is classified as too risky, are implemented in the 2014-2020 programming period of EU funds within the scope of *Activity 3.1.1.1 "Loan guarantees" of Specific Objective 3.1.1 "To foster creation and development of SMEs, in particular in manufacturing and in RIS3 priority sectors" of the Operational Programme "Growth and Employment"*.

The programme has been functioning since June 2016 and by 30 June 2019 449 guarantees amounting to 86 million euro were issued, which evidences of constantly high demand for such financial instruments.

PORTFOLIO GUARANTEES

On 12 September 2017 a new state aid programme, portfolio guarantees, was approved. Within it aid in the form of guarantees for the loans issued by credit institutions for investments, financing of working capital as well as financial leasing with a period from 1 to 10 years is available. Banks are able to use a portfolio guarantee for investment and working capital loans and leasing in the amount up to 250 thousand euro. The aid programme is implemented by ALTUM, which in the process of open selection has selected and concluded agreements on portfolio guarantees to promote crediting of small, medium-sized and large economic operators with 3 credit institutions, which are able to grant loans within the scope of available funding with a state guarantee to companies without direct involvement of ALTUM. 7.8 million euro of repaid public funding are available for issuing of the guarantees. The process of selection of credit institutions ended in June 2018, and since Q3 2018 the credit institutions have started issuing loans with a state guarantee. 183 loans with portfolio guarantees for 10.8 million euro, i.e. guarantees for 8.64 million euro, had been issued by 30 June 2019.

PARALLEL LOANS

The *Parallel Loan Programme* is implemented in the 2014-2020 programming period of EU funds within the framework of *activity 3.1.1.2 "Mezzanine loans" of the Specific Objective 3.1.1 "To foster creation and development of SMEs, in particular in manufacturing and in RIS3 priority sectors" of the Operational Programme "Growth and Employment"*, which is planned to be implemented in the form of direct financial instruments.

The availability of parallel loans provides opportunities to receive funding to those economic operators, which are unable to receive funding from commercial banks in the necessary amount for the implementation of viable investment projects due to financial indicators not meeting crediting policies of commercial banks (for example, the ratio of undertaken obligations to net income, inefficient equity, security).

The parallel loan instrument allows to resolve the problem of security and insufficient cash flow, as well as to some extent it resolves situations, when a commercial bank has reached the maximum accepted risk level for the specific customer or transaction and is unable to fund the transaction itself in full. First, using a parallel loan, the bank keeps the first pledge right on the transaction security, thus distributing exposition, banks can improve the security/loan ratio and

reduce estimated losses. Second, ALTUM may postpone part of the principal loan amount to the loan maturity, which is a way of relieving customer's cash flow and supporting higher risk projects. Third, at present, it is possible to create a transaction structure in such a way that a bank loan is repaid before repayment of the parallel loan to ALTUM starts, which allows to consider that the part of the loan from ALTUM is technically subordinated. These opportunities make the use of the product more understandable from the point of view of credit policy of commercial banks.

Furthermore, from the point of view of customers – businesses a parallel loan is a way to reduce participation of the customer, which is rather difficult to accumulate for companies.

The programme has been functioning since July 2016, and 14 parallel loans for 5.7 million euro have been issued by 30 June 2019.

MICROCREDITING AND START-UP LOANS

The *Start-up Loan Programme* is implemented in the 2014-2020 programming period of EU funds within the framework of activity 3.1.1.4 *"Microcrediting and loans-to-start" of the Specific Objective 3.1.1 "To foster creation and development of SMEs, in particular in manufacturing and in RIS3 priority sectors" of the Operational Programme "Growth and Employment"*. Loans to starters are introduced in the form of direct financial instruments, and microcrediting – in the form of direct and indirect financial instruments.

The *Start Loan Programme* is an important type of state aid for companies at an early stage. Already in the 2007-2013 programming period of EU structural funds and the Cohesion Fund the start programme was one of the most popular state aid programmes among new businesses, and many new and currently already popular small and medium-sized enterprises started commercial activity with its help. Overall, 1559 start loans for the total amount of 30.79 million euro were issued in the 2007-2013 programming period of EU structural funds and the Cohesion Fund, 27.74 million euro of which were loan amounts and 3.05 million euro were grants for interest rate subsidies.

Since June 2016 start loans were also provided within the scope of the current programming period for the implementation of viable business projects – for investments and working capital. The loans are issued to economic operators, which are not older than 5 years of their establishment, the maximum loan amount is 150 thousand euro. Start loans are an important instrument for starters of business, ensuring access to funding for the implementation of prospective and viable business projects to those economic operators, who due to insufficient security, history of economic activity, credit history, net income flow or the amount of current credit obligations are unable to attract funding from participants of the financial market (commercial banks, private investors) for the implementation of business projects in the necessary amount.

413 start loans for 9.89 million euro and 118 microloans for 1.5 million euro have been closed by 30 June 2019.

VENTURE CAPITAL INSTRUMENTS

Venture capital instruments are available in the 2014-2020 programming period of EU funds within the framework of activity 3.1.2.1 *"Venture capital" of the Specific Objective 3.1.2 "To increase the number of start-ups" of the Operational Programme "Growth and Employment"*.

SEED, START AND GROWTH CAPITAL FUNDS

Continuing the experience of the 2007-2013 programming period of EU structural funds and the Cohesion Fund and taking into account market development trends, several venture capital instruments are offered, which are introduced through financial intermediaries selected in a public procurement procedure. By 30 June 2019, 6 agreements for a 3.1 million euro have been concluded within the scope of venture capital.

TECHNOLOGY ACCELERATORS

The programme is implemented in the 2014-2020 programming period of EU funds within the framework of activity 3.1.2.2 *"Technology accelerators" of the Specific Objective 3.1.2 "To increase the number of start-ups" of the Operational Programme "Growth and Employment"*.

The programme is intended for innovative start-ups for the creation and development of a business idea, company or product to promote their growth and competitiveness, in particular for technological and industrial projects. Pre-seed funding for the establishment of a company, consultations and development, research, evaluation and approval of a product will be provided in the amount up to 50 thousand euro, and seed funding – to companies, which have successfully passed the pre-seed investment stage, for further growth, for the development of a product and economic activity model – up to 250 thousand euro. Conditions of the programme have been approved, the process of selection of financial intermediaries within the scope of the public procurement procedure has ended, agreement with financial intermediaries have been concluded and the funds have started to function. 3 acceleration funds started the implementation of acceleration programmes in the second half of 2018, as well as the first seed investments in companies have been made. By 30 June 2019, 32 agreements for 2.4 million euro have been concluded.

BUSINESS ANGELS CO-INVESTMENT FUND

The programme is implemented in the 2014-2020 programming period of EU funds is implemented within the framework of activity 3.1.1.3 "Business Angels Co-investment Fund" of the Specific Objective 3.1.1 "To foster creation and development of SMEs, in particular in manufacturing and in RIS3 priority sectors" of the Operational Programme "Growth and Employment".

Initially, it was intended to implement the programme in cooperation with EIF, however, a refusal was received from EIF on 21 November 2016 justifying it by poor development of the network of business angels in Latvia and therefore insufficient demand in the market. In order to promote activities of business angels and provide alternative financial solutions for funding of commercial banks in the market, on 17 March 2016 a cooperation agreement was concluded between ALTUM and the association Latvian Business Angel Network, within the framework of which the funding of ALTUM and business angels is combined providing opportunities to business starters to receive funding or receive it in a larger amount, when there is insufficient co-funding and security for the loan in a commercial bank. Five co-investment agreements on the ALTUM's part of funding amounting to 144.5 thousand euro were concluded within

the scope of the pilot project, which form 4.8% of the ALTUM budget available in the cooperation programme – 3 million euro.

In addition, financially extensive venture capital investments for programmes of EU structural funds are also offered by the **Baltic Innovation Fund (BIF)**. BIF is an innovative investment initiative of the Baltic scale, which was created to increase the availability of private and venture capital funding to companies in Baltic countries. BIF finances and administers venture capital and start capital funds, which make early and growth stage venture capital investments on the Baltic scale into small and medium-sized enterprises, the investments amount from 3 to 15 million euro per company. At present, BIF has 5 active venture capital funds, and 20 venture capital investments amounting to 96.5 million euro are made within them.

An agreement with the Baltic Innovation Fund 2 with a volume of 156 million euro was concluded in 2019. In the next five years BIF2 will invest this funding in the private capital and venture capital funds concentrated in the Baltics countries, thus developing capital investments in small and medium-sized enterprises and fostering growing of the Baltic region.

11.2. SUPPORTING ACCESS TO FOREIGN MARKETS

To achieve Latvia's economic breakthrough described in the National Development Plan and to successfully implement the goals included in the National Industrial Policy Guidelines, the Guidelines for Promotion of Export of the Latvian Goods and Services and Attraction of Foreign Investment for 2013-2019 were approved with decree of the Cabinet of Ministers No. 249 on 17 June 2013 and respectively updated on 14 March 2017.

The guidelines are aimed to promote competitiveness of the economy of Latvia in the open product (goods and services) and capital markets fostering the increase of high and medium-high technology products in Latvian export and focusing on foreign demand-oriented sectors when attracting FDI.

Latvian exporters have access to a wide range of direct services for export support, which include consultations on issues related to export, among them on foreign markets, specific trade requirements and finding potential business partners. Also, informative seminars about export skills and external markets are organised, as well as export and investment projects are identified and promoted.

20 representation offices of the Investment and Development Agency of Latvia (LIAA) are operating in 19 countries (United States, United Arab Emirates, Belarus, Denmark, France, Italy, Japan, Kazakhstan, Russia, China, United Kingdom, Lithuania, Netherlands, Norway, Poland, Singapore, Finland, Ukraine, Germany and Sweden) to solve

economic matters and support to Latvian entrepreneurs. The Latvian of external economic representation offices and connection network ensures the availability of its services to any business and serves as a bridge to the most important foreign markets and for foreign businesses to Latvia.

LIAA provides support to entrepreneurs to implement foreign marketing activities by encouraging their participation in national stands at international exhibitions abroad, as well as by organising trade missions and participation of entrepreneurs in foreign visits of the highest state officials.

LIAA also provides direct export support services for entrepreneurs, which include general consultations, organization of informative seminars on foreign markets and foreign trade issues, as well as preparation of sectoral market reviews, studies and informative reports.

To strengthen and extend economic, industrial, scientific and technical cooperation, as well as create favourable conditions for cooperation between their economic operators, Latvia has concluded bilateral economic agreements with Armenia, United Arab Emirates, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Russia, Kuwait, China, Moldova, Turkmenistan, Tajikistan, Ukraine, Uzbekistan, Turkey. These agreements also provide for an Intergovernmental Commission or a Joint Committee to be established, which ensures supervision of the application of the provisions of these agreements.

agreements regulating bilateral economic cooperation, Their agenda includes bilateral economic cooperation issues of common interest to both at governments and businesses levels in the fields of industry, tourism, transport, pharmacy, agriculture, financial services, communication, vocational training, investment policy, technology and innovation, etc. In 2019 Intergovernmental Commissions meetings with Ukraine was held in Riga, and with Belarus was held in Minsk.

In December 2015, the implementation of the EU funds measure for 2014-2020 Building the International Competitiveness was launched. The aim of this measure is to build the sectoral competitiveness on the international level by supporting businesses and conquering foreign markets, ensuring operation of Latvian Foreign Economic Representative Offices, and developing Latvia's international competitiveness in the priority sectors of tourism. Within this activity entrepreneurs are provided with extensive support to implement external marketing activities and enter foreign markets – support for participation in international exhibitions, conferences, seminars with a stand, trade missions, state visits organised by LIAA, as well as assessment of conformity of production units and products with requirements of the particular target market.

For the fifteenth year in row LIAA in cooperation with MoE organise the Export and Innovation Award. The aim of the award is to acknowledge and honour Latvian entrepreneurs

who have achieved good results in manufacturing of new and exportable products, providing the local market with high quality domestic products, implementing innovations and developing industrial design.

Exporting companies are also supported by Joint Stock Company "Development Financial Institution "Altum"" (ALTUM) enabling exporters to receive insurance (guarantees) of export transactions, thus protecting against foreign buyer's insolvency or lengthy non-payment by selling goods or providing services against deferred payment.

State subsidized export transactions since 2009 to third countries and from the first half of 2017 also to EU countries have exceeded 155 million euros, and the support has been received by 84 entrepreneurs for 273 transactions in total. A number of significant changes have been made to promote the availability of this programme to a wider range of exporters over the last two years: the maximum amount of the export credit guarantee per one buyer has increased from 1 to 2 million euros, requirements to exporters have been simplified, as well as from April 2017 ALTUM has been issuing export credit guarantees for transactions to EU and individual OECD countries, if the company meets the guarantee issuing criteria. Forecasts suggest that until 2023, by supporting up to 150 companies, the guaranteed amount of export transactions might reach up to 30 million euro per year.

11.3. POLICY FOR ATTRACTION OF FOREIGN INVESTMENT

To achieve Latvia's economic breakthrough described in the *National Development Plan* and to successfully implement the goals included into the *National Industrial Policy Guidelines*, in 2013 MoE drafted the *Guidelines for Promotion of Export of the Latvian Goods and Services and Attraction of Foreign Investment for 2013-2019*. These guidelines were amended in March 2017. They described the priorities and activities to attract foreign direct investment (FDI) to export-oriented industries.

FDI attraction policy is aimed at raising the competitiveness of Latvia as an attractive investment environment, considering the aspects, which are significant for investors: macroeconomic indicators of states, the business environment – simplicity of bureaucratic procedures and the stability of tax policy, availability of an appropriately qualified labour force, market potential, accessibility of the necessary infrastructure, available support instruments and incentives. It is important to attract foreign investment in sectors which ensure changes of the economy structure in favour of external demand oriented¹ sectors, especially in

sectors that are defined as medium-high and high technology sectors².

FDI is an essential precondition for further economic growth of Latvia. It enables Latvian producers not only to use additional financial capital, but also promotes acquisition of different manufacturing and management skills, creation of new jobs, provides an opportunity to use new technologies and preconditions for technology transfer, promotes the state integration in the international trade and involvement of companies in the chains of production sales. The inflow of FDI has a positive effect on and develops also other sectors, for example, medicine, education, infrastructure.

The priority in the process of attraction of foreign investment must be geographically closest neighbouring countries where Latvia is recognized and no extensive additional resources have to be invested for informative activities; also to economically stable and developed countries where the development potential and needs of economy sectors are appropriate for Latvian perspective

¹ External demand-oriented sectors – agriculture, mining, manufacturing, transport and storage, information and communication services.

² Medium-high and high technology sectors – manufacturing of pharmaceutical products, computers, electronic, optical equipment, aircraft and its equipment, and medical instruments, as well as

manufacturing of chemical substances, weapons, electric equipment, mechanisms and working machines, automobiles, ships, railway and other types of transport (excluding aircraft) and repairs and installation of equipment and devices (NACE Rev. 2 20, 25.4, 27, 28, 29, 30 (excluding 30.3), 33)

cooperation opportunities; and countries with globally largest investment outflows – USA, France, Germany, United Kingdom of Northern Ireland and Great Britain, Japan, China, Russia, India.

Attraction and promotion of FDI is broken down into four main processes such as strategy and planning (creation of the national investment policy, setting of goals, investment promotion structure, positioning of competitiveness, targeted analysis of sectors), promotion of interest (marketing and addressing of companies), servicing (project management) and provision of investment services (post-service and improvement, monitoring of services).

A major role in the attraction of foreign investment in Latvia is played by the Investment and Development Agency of Latvia (LIAA). The LIAA's investment attraction strategy is oriented towards qualitative servicing of incoming investment projects and active operation in attracting investment projects through addressing potential investors, as well as ensuring post-servicing of investment projects. The LIAA and economic representations of Latvia abroad provide assistance and necessary information to foreign investors, for example, in relation to the implementation of investment projects in real estate territories/special economic zones and promotion of investments, as well as contact respective authorities at investors' request and help to resolve challenges faced by investors.

Servicing of incoming investment projects in 2018 was quite extensive – 397 requests for investment information were processed. 114 potential visits/meetings of potential foreign investments were arranged in Latvia. Overall, 156 meetings / visits to potential investors were arranged, of which 79 were meetings / visits to potential investors abroad, and 77 were visits to investors in Latvia. In total, work has been carried out with 311 foreign investors, both preparing proactive investment offers for 128 foreign investors and working with 98 potential investment projects, and follow-up activities were carried out for 112 foreign investors.

If all the positive decisions taken in 2018 are implemented completely, it is expected to receive investment of 239 million euro, creating at least 1308 new jobs in total. The foreign investors served by LIAA, who have decided to start or extend their activity in Latvia in 2016-2018, have paid 33.9 million euro in the state budget as taxes administered by SRS.

With LIAA support, in the 9 months of 2019 12 companies made positive decisions to implement investment projects in Latvia. If the investment intentions are implemented completely, it is expected to receive investment of 196.5 million euro, creating 457 new jobs in total.

To improve attraction of investment significant for Latvia, the LIAA is continuing successful implementation of the methodology for attraction of investment – the POLARIS process, aimed at attracting export-oriented investment with high value added. The POLARIS process is based on a coordinated cooperation among the public, private, and academic sectors. The process is focused on eight priority sectors of investment attraction. Within the framework of the POLARIS process, the LIAA performs regular follow-up visits to the existing investors in order to gather information about their needs, obstacles at work, summarises this information and prepares recommendations to the competent ministries directly or with the help of the Coordination Council for Large and Strategically Important Investment Projects.

Work continues on the memorandum of cooperation on the development of international business services centres signed in 2018. Being aware that international business services centres occupy and increasingly bigger role in economic growth of the Central European and Baltic region and that Riga has an unexploited potential for creation of new jobs, the Ministry of Economics, the Riga City Council, the Investment and Development Agency of Latvia, on behalf of the public sector, and the National Alliance of Real Estate Developers, the Association of Commercial Banks of Latvia and the Foreign Investors' Council in Latvia, on behalf of the private sector, by this memorandum have committed to arrange targeted cooperation for the development of the sector, growth and creation of new jobs. An action plan has been developed to implement the goals set in the memorandum.

Until 2019 the most important activities within the scope of the LIAA business strategy in the POLARIS process have been focused on the preparation of more qualitative offers by local governments and strengthening of cooperation mechanisms among the parties involved in the POLARIS process drawing more active attention to investment attraction activities to increase the scope of investment:

1. in manufacturing by increasing the scope of investments in machinery and equipment, as well as intellectual property products;
2. in projects, where non-financial assets provide higher return;
3. by investing in infrastructure objects;
4. by investing in investment projects with increase productivity.

12. ENERGY POLICY

12.1. ENERGY MARKET AND INFRASTRUCTURE

The main priority of the energy policy of Latvia, which is set out in the informative report Long-Term Energy Strategy 2030 – Competitive Energy for the Society (Energy Strategy 2030) approved at the Cabinet meeting of 28 May 2013, is to ensure positive effect of the energy sector on the Latvian national economy at the same time aspiring for security of energy supply, competitiveness and sustainability:

- security of energy supply – access of energy users to stable energy supplies and a developed infrastructure;
- competitiveness – a market-principle based energy sector, which ensures further development of the national economy, its competitiveness in the region and globally;
- sustainable energy – reduced dependence on energy imports, promotion of new, efficient technologies for the use of renewable energy, and energy efficiency improvement measures have been carried out.

The development of both gas and electricity infrastructure, as well as diversification of supply routes and sources is important in Latvia at national and regional level, keeping in mind the importance of reduction of energy dependence. Having identified the scattered network of Latvian energy consumers and the need to promote consumption, at the same time increasing the efficiency of energy production, supply and consumption, in 2019 special attention was devoted to the possibilities of reducing electricity tariffs.

ELECTRICITY MARKET

The full liberalisation of electricity market was completed on 1 January 2015, which means that households, as well as legal electricity users are free to choose the trader by mutually agreeing on the (unregulated) electricity price. According to the electricity trade register of the Public Utilities Commission (hereinafter referred to as the Regulator), 37 traders were registered for sale of electricity as of November 2019.

The Latvian bidding area of electricity exchange *Nord Pool* started its operation on 3 June 2013. Currently, *Nord Pool* bidding areas are opened in all three Baltic States; and electricity trade is carried out in a uniform and consistent manner throughout the Baltic Sea region. Market participants of the *Nord Pool* Latvian open electricity bidding area may submit their quotes for transactions that will take place the following day (day-ahead market) or intraday market. The difference of an intraday electricity market from a day-ahead market is that the price offers are

submitted for transactions that will take place on the current day, after the *Nord Pool* day-ahead electricity trading stock exchange *ELSPOT* trading session results are published. The existence of both markets not only ensures greater liquidity of the Latvian electricity market, but also a more efficient utilisation of network transfer capability, and transparent energy price that the market participants can rely upon. Taking into account considerable shortage of precipitation in the summer season of 2018, the amount of electricity produced at hydro power plants (hereinafter referred to as HPP) reduced both in the Baltic States and Scandinavia causing a considerable increase in prices – from 37.58 EUR/MWh in January 2018 up to 59.05 EUR/MWh in August 2018 in the Latvian bidding area. In the 10 months of 2019, the average electricity price at the *Nord Pool* exchange was 47.10 EUR/MWh (in 2018, the average market price was 49.85 EUR/MWh).

In accordance with the electricity market review data for 2018 by the transmission system operator Augstsprieguma tīkls AS, the Latvian total electricity consumption in 2018, compared to 2017, grew by 1.8% amounting to 7.41 TWh. From this amount, the share of electricity produced by Latvia was 87.7% in 2018. The amount of electricity produced by combined heat and power plants (hereinafter referred to as CHPP) grew by 80.9% in 2018, compared to 2017, which is sequentially consistent with the increase in natural gas consumption in this period of time.

In fulfilment of *Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC*, Latvia has separated the electricity distribution and transmission functions from the electricity trade and production company. As of 1 July 2007, functions of the electricity distribution system operator are performed by Sadales tīkls AS, independent subsidiary of Latvenergo AS (MoE is the holder of capital shares). In Latvia, the regulator has issued 11 licences in total to distribution system operators, of which Sadales tīkls AS provides the service in 99% of the territory of the state.

On 1 January 2012, Augstsprieguma tīkls AS started operating outside the Latvenergo Group as an independent transmission system operator, all capital shares of which are held by MoF. Assets of the transmission system are owned by Latvijas elektriskie tīkli AS, subsidiary of Latvenergo AS, which started its operation on 1 April 2011. Until now, Augstsprieguma tīkls AS rented transmission system assets from Latvijas elektriskie tīkli AS, but on 8 October 2019 CM adopted the decision on supporting Latvijas elektriskie tīkli AS in making a contribution in the form of capital shares in

the share capital of Augstsprieguma tīkls AS, and as a result of that Augstsprieguma tīkls AS will obtain in property transmission system assets – poles, lines, high-voltage substations, related real estates and other. Augstsprieguma tīkls AS is the only transmission system operator in Latvia and is operating in conditions of natural monopoly.

On 10 October 2019, Sadales tīkls AS submitted draft tariffs of electricity transmission services to the Regulator that provide for an average reduction of the transmission service tariff by 5.5% (the reduction of costs in the variable tariff components amounts to 8%). Changes in distributions system tariffs should be approved in accordance with amendments to the *Methodology of calculation of tariffs for services of the electricity distribution system* approved by the Regulator on 30 September 2019. It is planned that changes in tariffs of services of the distribution system might enter into force from 1 January 2020.

One of the most important news in the electricity market is the planned **integration of synchronisation of electricity grid of the Baltic States with the continental European system** (hereinafter referred to as the synchronisation project), work on which started in 2007, when Prime Ministers of the Baltic countries proposed the idea to investigate into such an opportunity. This project is at the top of the EU energy policy agenda, and is set as one of priority projects not only at the level of the Baltic countries, but also at the EU level, because by construction of additional electricity interconnections it improves functioning of the EU's internal energy market and the achievement of goals of the Energy Union. The synchronisation project is part of the total EU integration project, the implementation of which is intended until 2025.

Within the scope of the synchronisation project, energy systems of the Baltic countries will start functioning in a synchronous mode with the network of the continental Europe, at the same time disconnecting from the IPS/UPS (Russian and Belorussian energy system) network. Internal electricity trading of Russia and Belarus, as well as other CIS countries, which jointly with the Baltic countries form BRELL (abbreviation of *Belarus, Russia, Estonia, Latvia, Lithuania*) fluctuations and failures of their power system modes technically affect and strain the electrical transmission network of the Baltic states by limiting their ability to fully implement the EU legal framework in the electricity market, particularly in relation to the calculation and planning of capacity, overload management, and network balancing. Several reports and feasibility studies have been conducted for the synchronisation project to be as successful as possible, identifying all technical and economic considerations, as well as to find the most cost-effective solution. The project aims to reconstruct and build internal infrastructure of each Baltic country, as well as construct a submarine direct current cable between Lithuania and Poland called *Harmony link*.

On 27 May 2019, the agreement on connection of electricity systems to the network of the continental Europe entered into force. In order to continue advancement to the completion of the synchronisation project by 2025, EC in cooperation with the Baltic countries and Poland drafted a roadmap on further implementation of the synchronisation

project from the political point of view. At the meeting of 18 June 2019, CM certified Latvia's commitment to continue the synchronisation project and delegated the Prime Minister Krišjānis Kariņš to sign the political roadmap at the European Council meeting on 20-21 June 2019.

The EC's Connecting Europe Facility (CEF) co-finances 75% of total eligible costs of the project, the remaining funding is provided by transmission system operators of Baltic countries – Elering AA, Augstsprieguma tīkls AA and Litgrid AB. The CEF funding approved for the synchronisation project in January 2019 amounts to 323 million euro. The total costs of measures of the first phase of the synchronisation project of the Baltic countries is 430.39 million euro, of which 75% or 322.79 million euro will be covered from the CEF funding, while other costs will have to be covered by electricity transmission system operators of the Baltic countries. Co-funding of 57.75 million euro was granted to Latvia for costs of the first phase of the synchronisation project.

Another vital matter is **electricity trading with third countries**. After the Astravets nuclear power plant (NPP) starts operating, which is planned for the middle of 2020 (initially – at the end of 2019), Lithuania has decided to unilaterally stop trading electricity with Belarus and continental Russia, which causes concern in Latvia due to potential risks, since only the Lithuanian-Belorussian trading region border (for Lithuania – also the Kaliningrad border) is currently available for imports from third countries. First, this may leave a negative impression in the context of the synchronisation project, because it is important to keep constructive cooperation with Russia and Belarus. Second, the requirements of PTO and General Agreements on Tariffs and Trade (GATT) are being violated. Russia has considered termination of trade as discriminating also in the BRELL Committee, because the principle of the BRELL Committee would not be observed in this way – a decision of one country should not have a negative impact on the economy of any other country. Third, it should be taken into account that part of electricity in shortage in Latvia is also imported from third countries, which, for instance, amounted up to 27% of total consumption in 2018.

Having evaluated several potential scenarios on organisation of further electricity trading with third countries, it has been concluded that the best solution from the technical point of view would be, if direct trade of the Baltic countries with third countries was organised through the Lithuanian-Kaliningrad border and the Latvian-Russian border. Organisation of trade with third countries through the Russian-Latvian border might provide approximately equivalent electricity trading capacity, as there is now through the Belorussian-Lithuanian border. Moreover, the situation relating to restriction of Baltic trade with third countries would not get escalated. Several discussions on this matter have taken place within the scope of meetings of the Committee of Senior Energy Officials on Energy of the Baltic Council of Ministers. Estonia has supported such a solution indicating that it is a tactically correct solution. However, no agreement has been reached with Lithuania on this matter, because Lithuania considers this a political

matter and refuses to support opening of the Latvian-Russian border for electricity trading. Lithuania substantiated such a decision with a position that the Lithuanian population would not have to buy electricity from unsafe power plants. Latvia has explicitly supported Lithuania that NPP should meet the highest safety standards in the world. However, it should be recognised that the decision of Lithuania to stop trading electricity with Belarus will not increase safety of this power plant, and will not promote closing of this power plant, however, this decision will have a negative impact on electricity trading of Baltic countries with third countries.

On 13 August 2019, in order to reduce risks of potential electricity capacity flow reduction or negative tariff fluctuations in Latvia in a timely manner, CM has taken a decision – when Lithuania stops trading electricity with Belarus, to move trading of electricity to the Latvian-Russian border. At the same time, the Latvian electricity transmission system operator in cooperation with the Estonian transmission system operator should develop a methodology for implementation of the electricity transmission infrastructure tariff for trading with third countries, as well as should draft a new methodology for determining trading capacities for the Latvian-Russian electricity trading border.

Efficient **electricity transmission interconnections** are one of the most important preconditions for optimal functioning of the electricity market. The Latvian electricity market, just like the energy market of the Baltics, is currently connected to the common European energy market with two sea cables connecting the Estonian and Finnish power systems – Estlink I, with the transmission capacity of 350 MW, and the Estlink II, with the transmission capacity of 650 MW. Transmission capacity of both interconnection links is sufficient for aligning electricity prices in the *Nord Pool* Estonian and Finnish bidding areas. Although these interconnections improve the situation in ensuring the integration of Estonian and Finnish power systems and liquidity of the Estonian and Finnish bidding areas, they do not reduce the risk of overload in the Latvian-Estonian cross-section, which, although of a highly seasonal nature, is characterized by a negative impact on the dynamics of electricity prices in the *Nord Pool* Latvian and Lithuanian bidding areas. In addition, the load on Estlink II in the direction from Finland to Estonia could lead to additional load on the Latvian-Estonian cross-section, thus increasing the risk of overload or line outage. In order to improve the interconnection capacity, Lithuanian-Polish interconnection LitPol Link stage 1 with transmission capacity of 500 MW started its operation at the end of 2015. In addition, the Lithuanian-Swedish interconnection NordBalt with transmission capacity of 700 MW was established.

Part of the NordBalt project is the 330kV transmission line project Kurzemes loks implemented in the western region of Latvia, which started in 2010 and has been implemented in 3 stages (construction of a 330 kV cable between Riga TEC-1 substation and Imanta substation in 2013, construction of Grobiņa-Ventspils electricity transmission line in 2014 and Ventspils-Tume-Imanta 330 kV electricity transmission line)

creating, in total, a 330 km long 330 kV electricity transmission line, which increases the availability of capacity and power supply safety in Kurzeme. Also, with commissioning of Kurzemes loks in November 2019, the Latvian energy system will provide a potential for the renewable energy sources generation connection to the network at least in the amount of 800MW. The costs of the third stage of Kurzemes loks amounting to 55.089 million euro were covered by CEF.

In the coming years, one of planned priorities is also the development of electricity transmission infrastructure, which will promote closer integration of Latvia in the electricity market of the Latvian integration region, as well as will strengthen operational efficiency and interoperability of infrastructure.

Construction of the third Estonian-Latvian interconnection is also strategically important, which will allow eliminating the existing transmission network overload and increasing the available transmission capacity of the Latvian-Estonian interconnection. Within the projects, there are intents to construct a 176 km long 330 kV high-voltage electricity transmission line from Riga TEC-2 330 kV substation to the Estonian-Latvian border. In January 2019, a construction of the interconnection started at the Estonian border, and at the end of 2019, works were started at the section from Saulkrasti to Riga. Presently, 257 poles of 527 poles planned in the line have their foundations built, 166 poles have been mounted, of which 126 poles have been already lifted, laying of wires has been completed for 67 poles. It is planned to launch the connection of the said interconnection by 2020. Total costs of the third Estonian-Latvian interconnection are approximately 172.7 million euro. The total planned costs in the territory of Latvia are approximately 102 million euro. In November 2014, EU co-funding of 65% was granted for the construction of the third Estonian-Latvian interconnection from CEF funds.

The Riga TEC-2-Riga HPP electricity transmission line is also a technical important project. The network reinforcement should be commissioned until 2020, when the third Estonian-Latvian interconnection is commissioned, because the Riga TEC-2- Riga HPP project is an important reinforcement for the Latvian internal network to ensure full functionality of the third Estonian-Latvian interconnection not only in normal, but, in particular, in emergency and repair modes. At a regional scale, this network reinforcement is important for increasing the throughput capacity of the Baltic region in the Northern-Southern direction.

In order to implement the requirements defined in *Regulation (EU) No 347/2013 of the European Parliament and of the Council of 17 April 2013 on guidelines for trans-European energy infrastructure and repealing Decision No 1364/2006/EC and amending Regulations (EC) No 713/2009, (EC) No 714/2009 and (EC)* (hereinafter referred to as Regulation No 347/2013), EC, using the delegated acts procedure, the **EU's lists of Projects of Common Interest (PCI) are adopted**. Regulation No 347/2013 provides that the products included in the list of PCI not only may qualify for the support of the EU co-funding, but also benefit from fast

and efficient authorization procedures, while respecting the environmental assessment and protection standards. In Q3 2019, EC included the third Estonian-Latvian interconnection, the Riga TEC-2-Riga HPP electricity transmission line and the synchronisation project in the list of PCI, and the first two were awarded the status of projects of national interest by an order of the Cabinet of Ministers.

Continuation of the synchronisation project by starting the second phase of the project has an important priority in the coming years. At the meeting of the Committee of Senior Energy of the Baltic Council of Ministers of 29 August 2019, Augstsprieguma tīkls AS informed that at that moment transmission system operators of the Baltic countries and Poland and EC were discussing co-funding for the second phase of the project, considering that EC informed that the CEF funding would reduce. Presently, the investments into the second phase are expected to be ~1.2 billion euro, where the share of Poland is 535 million euro, the share of Lithuania – 458 million euro, the share of Latvia – 99.5 million euro and the share of Estonia – 104 million euro. The CEF-2020 call, which is the last call in the *CEF Programme 2016-2020*, allocated just 500 million euro for all infrastructure projects important for the EU (including gas, smart network and CO₂-free transport projects). It is very important for Latvia to defend its position about the amount of CEF budget in the next support period 2021-2027 not only in the context of the synchronisation project, but also for cross-border cooperation projects in the field of renewable energy sources to create favourable conditions for an increase in internal generation volumes.

Since 2015, when the electricity market has fully opened, a certain group of electricity users has access to the **vulnerable user trading service** to fulfil the recommendations included in EU laws and regulation with regard to reducing the risk of poverty for vulnerable energy users. Vulnerable user (about 150,000-160,000 families/persons) is a poor or a low-income family (person), a large family or a family (person), which takes care of a disabled child, or a person with disability group I, which uses electricity in their household for their own needs (final consumption). Under the current legal regulation, the vulnerable user trading service can be received only by those vulnerable users, who have concluded an electricity trade agreement with a service provider (since 2015 – Latvenergo AS).

In July 2019, the Saeima adopted in the second reading amendments to the *Electricity Market Law*, which provide for changes in the current principle of provision of the service, namely, the service can be provided by any electricity trader, and compliance with the status of a vulnerable user will be checked by the vulnerable user data information system (VUIS), the controller of which is the State Construction Control Bureau. With regard to VUIS – each electricity trader providing the service will have a link to VUIS so that after data exchange it allocates once a month a reduction for an electricity bill for those of its customers, which qualify for the status of a vulnerable user. The service is funded from the funds allocated for this purpose in the state budget funds. The described service provision

regulations are currently being drafted by MoE, and they are expected to enter into force in the second half of 2020.

NATURAL GAS MARKET

Since April 2017 the natural gas market has been fully liberalised, which is mainly related to the purpose of creating an effectively functioning and integrated EU energy market, ensuring high flexibility of the system, competition among companies, competitive prices, as well as strengthening energy security. In order to promote the development of competition and independence of operators of the transmission and distribution system, and at the same time observing the amendments to the *Energy Law* adopted on 11 February 2016, the historical natural gas monopoly Latvijas Gāze AS had to separate its natural gas transmission and storage infrastructure from the natural gas trading and distribution functions, namely legally separated natural gas transmission and storage system operator Conexus Baltic Grid AS and distribution system operator GASO AS were created. A gradual opening of the market is planned for household users, namely, they reserve the right not to use the opportunity of becoming a market participant to freely choose a natural gas trader. By using the right not to become a market participant, in 2019 household users retained the user status and the possibility to buy natural gas according to the tariffs set by the regulator, rather than the market price.

The total natural gas consumption in 2018 was 1422 million m³. Since 2007, natural gas consumption has shrank by 278 million m³. The drop in natural gas consumption was also accompanied by the drop in the volume of imported natural gas, which may be largely linked to the use of alternative fuel resources and taking energy efficiency measures. Despite the drop in its share, natural gas still occupies an important role in the Latvia's total structure of consumption of energy sources. Most of natural gas is used for generation of electricity and heat in boiler houses and cogeneration stations. However, in 2018, natural gas consumption increased compared to 2017. Of course, it should also be taken into account that natural gas consumption is always seasonal in nature, because, for instance, the demand for natural gas in 2018 is explained by comparatively low outdoor temperatures in months of the heating season. An uncharacteristically high natural gas consumption was also observed in summer 2018. The major consumers of natural gas in 2018 were the CHPPs of Latvenergo AS and heating companies. Approximately 65% of the natural gas used in Latvia is consumed in Riga region.

However, it should be recognised that the Latvian natural gas supply system is still not connected to the EU's single natural gas supply system. In order to implement the agreement of Prime Ministers of the Baltic countries and Finland of 5 December 2014 for the purposes of creating a single regional natural gas market from 2020, as well as in order to harmonise the implementation of network codes, it is necessary to set uniform rules for functioning of the regional natural gas market. The regional natural gas market will create access to new gas trading platforms and

routes, improve market liquidity, diversify gas supplies, as well as promote transparency of tariffs. This might become the only single market region of such a type in the EU.

Considerable progress has been achieved in the implementation of this goal, which is also certified by the *Memorandum of Understanding on commitment to create a regional gas market until 2020* signed by Finnish, Estonian and Latvian transmission system operators in October 2018, as well as the *Compensation Agreement between Conexus Baltic Grid AS, Estonian electricity and natural gas transmission system operator Elering AS and Finnish natural gas transmission system operator Gasum Oy* signed on 14 February 2019, which will introduce a single gas transmission tariff zone in Finland, Estonia and Latvia by 2020. The single natural gas market is expected to start functioning with two balancing zones – the combined Latvian and Estonian balancing zone and Finland. It is important to emphasise that Finland will join the regional natural gas market not earlier than 2022, when the Estonian-Finnish natural gas interconnection *Balticconnector* will be completed. At the same time, parallel

work is ongoing on a single IT platform, which will simplify operations of every natural gas trader in the single market zone.

On 17 September 2019, CM supported amendments to the *Energy Law*, which prevents obstacles in the creation of a regional natural gas market and operation of Latvia in a single input-output tariff system with Finland and Estonia. Amendments to the Energy Law were supported in the Saeima on 17 October 2019.

Further diversification of supplies of natural gas, as well the creation of a highly liquid and integrated regional natural gas market in Latvia and in the entire Baltic region are considered to be one of the most important future priorities on the natural gas market. It is important to emphasise the need to continue work on provision of safe and accessible infrastructure, which corresponds to market conditions. In order to improve security of natural gas supplies in the Baltic region and to create an effective market, there are plans to implement several projects (see box 12.1).

Box 12.1

Projects for Improvement of Security of Natural Gas Supplies and Creation of an Effective Market in the Baltic Region

Interconnection of the Lithuanian-Polish natural gas supply systems (GIPL)

The purpose of GIPL is to connect Lithuanian and Polish natural gas transmission systems, ensuring connection of Baltic Eastern part natural gas transmission systems to the Central European natural gas transmission network. GIPL plays an important role in strengthening energy security of the region, because isolation of natural gas transmission systems of the Baltic countries will be prevented enabling to access the single EU natural gas market. GIPL also provides for ensuring alternative natural gas supply routes and access to new gas trading platforms. In the long term, the GIPL project might potentially increase the use of the Inčukalns underground gas storage facility and create other cooperation opportunities for the Baltic countries and Poland. The GIPL interconnection will cover 357 km in the territory of Poland and 165 km in the territory of Lithuania. Transmitted capacities PL-LT will be 2.4 billion m³/year and LT-PL 1.9 billion m³/year. The implementation of the GIPL project is an important stage in the achievement of EU energy policy goals – creation of a single energy market at EU level, as well as creation of the Energy Union. Taking into account the role of GIPL in the region, it is important that the project is implemented by the end of 2021.

Estonian-Finnish interconnection *Balticconnector*

The construction of this interconnection will allow to connect the Finnish natural gas transmission system with the natural gas transmission system of the Baltic countries. It will consist of a land pipeline section, a submarine pipeline section and two compressor stations. The planned input and output capacity of *Balticconnector* will be 79 GWh per day.

Latvian-Lithuanian interconnection modernisation project

At present, the flows in two directions in the Latvian-Lithuanian interconnection. Last year, Conexus Baltic Grid AS in cooperation with the Lithuanian natural gas transmission system operator AB Amber Grid presented the results of a study, which was conducted using EU funding. The study included the cost-benefit analysis for the interconnection capacity project. The study identifies optimum interconnection capacities, taking into account other gas interconnection projects implemented in the region (*Balticconnector* and GIPL) and potential gas flows. At the Lithuanian side, it is planned to modernise the Kiemenai gas measuring station and the Panevezys compressor station, while at the Latvian side, it is planned to modernise high-pressure pipelines to be able to increase working pressure of the system to 50 bar. By making respective investments, the interconnection capacity would increase up approximately 130 GWh/d in the Latvian direction and to 119 GWh/d in the Lithuanian direction. The planned investments are 10.3 million euro, of which 4.7 million euro would be attributable to the territory of Lithuania. Regulators are also raising EU co-funding. If financial and other aspects resolve as planned, the project might be fully implemented by 2023.

Modernisation of the Inčukalns underground gas storage facility (UGSF)

Latvia has the only natural gas storage facility and an important strategic site in the entire Baltic region – the Inčukalns underground gas storage facility (UGSF), which is managed by the natural gas storage operator Conexus Baltic Grid AS ensuring regional gas supply stability and strengthening energy security of the region, as well as providing market players with an opportunity to store natural gas in a strategically advantageous place. This modern main natural gas transmission system connects the Latvian natural gas market with Lithuania, Estonia and Russia. The total volume of UGSF is 4.3 billion m³, including the active natural gas volume of approximately 2.3 billion m³, thus fully securing natural gas demand even in the coldest winter months. The Inčukalns UGSF modernisation project is included in the list of projects of common interest, and in early 2019 the European Commission allocated 50% co-funding for it (the total project investments amount to 88 million euro) from CEF funding. The implementation of this project intends to improve technical infrastructure of UGSF, operational flexibility of the storage facility and safety of operation of equipment.

Box 12.1 continued

Information about the spare capacity of the transmission system and Inčukalns UGSF available on the market is publicly available on the website of Conexus Baltic Grid AS and is updated on a regular basis. In order to ensure uninterrupted operation and proper technical condition of the natural gas transmission system and storage facility, Conexus Baltic Grid AS is obliged to control the quality of gas entered into and discharged from the system, to keep relevant records and balance the natural gas transmission system, while the market participants wishing to transport natural gas are obliged to ensure the compliance of the natural gas, biogas, and gas produced from biomass, as well as liquefied natural gas converted to its gaseous form, to be entered into the transmission system with the natural gas quality characteristics established by CM, as well as obliged to comply with the established operating modes and natural gas transportation schedule.

Skulte liquefied natural gas terminal (Skulte LNG terminal)

The Skulte LNG terminal is a floating regasification unit created in waters of the Skulte Port 2.5 km from the seashore, with a 34 km gas pipeline connection with Inčukalns UGSF. This project will strengthen the security of energy supply of Latvia allowing to diversify sources and routes of supply of energy sources, as well as create new jobs. This will also provide an opportunity not only to Latvia, but also to the entire region to reduce dependence on the dominating natural gas supplier, increase integration of the Baltic gas market and promote competition in the sector, which might have a positive impact on prices of natural gas in the long term, taking into account wider market supply. In addition, it should be indicated that the factors of closeness of the Inčukalns UGSF makes the project privileged compared to other potential and existing LNG terminals in the region. The project would also leave a positive impact on sustainable and stable use of the asset of strategic importance – Inčukalns UGSF, at the same time strengthening energy independence of the country. Thus, from the point of view of the energy policy, the total impact on the country and the national economy are *prima facie* evaluated as positive.

A strength of the LNG terminal is its ability to compete in free market conditions on conditions equivalent to those of other market participants. Within the scope of implementation of this project it is also necessary to take into account an important fact that this is a private investment project, and it is not planned to create state aid mechanisms.

The national and regional gas supply projects listed in Box 12.1 are included in the fourth list of Projects of Common Interest.

The natural gas market will also be significantly affected by the project for synchronisation of electric networks of the Baltic countries with the network of continental Europe, because connection to the European network envisages that Latvian electricity producers will have to provide generating capacities themselves, and natural gas will play an important role in guaranteeing stable energy supplies.

Cyber security is one of challenges in the natural gas sector that are growing year on year. For example, Conexus Baltic Grid AS carries out a risk assessment on a regular basis paying special attention to constant exchange of information with respective supervisory authorities, as well as equipment and software in supervision of natural gas transmission and storage processes. In 2018, Conexus Baltic

Grid JSC started several projects for improvement of cyber security management processes.

It should be indicated that in March 2019, the NATO Energy Security Centre of Excellence organised training for protection of infrastructure sites of strategic importance in crisis situations in Vilnius. One of the most important matters, which were updated during the training, are natural gas solidarity mechanisms, application of crisis communication procedures, evaluation of preventive emergency action plans of countries, mainly focusing on their implementation at regional level. This training largely emphasised the important role of cooperation between employees of the energy sector, policy makers and decision makers, identifying risks and areas where capacity needs to be improved.

12.2. PROMOTING ENERGY EFFICIENCY

The Latvian government has set¹ energy efficiency targets to be reached by 2020:

- total indicative national energy efficiency target— the primary energy savings in 2020 — 0.670 Mtoe (28 PJ), which correspond to the total primary energy consumption of not more than 225 PJ in 2020;
- annual saving of 1.5% for energy supplied to end consumers – final energy savings in 2020 — 0.213 Mtoe

(8.9 PJ) and the final energy saving cumulated from 2014 to 2020 – 0.85 Mtoe (9897 GWh);

- annual renovation of 3% of the state-owned building area (maximum estimates – 678.5 thousand m²).

The main task of implementation of energy efficiency improvement measures is to limit an increase in final consumption of primary energy. In accordance with the indicative energy efficiency target achievement trajectory,

¹ Energy Sector Development Guidelines 2016-2020 <http://polsis.mk.gov.lv/documents/5499>

the Latvia's total primary energy consumption in 2018 should not exceed 216 PJ. The actual primary energy consumption in 2018 was 197 PJ, therefore Latvia has met the target. Final energy savings in end consumers are obtained through financial support programmes for energy efficiency of residential public and industrial buildings and

public lighting. The measures taken by the obligated parties of the energy efficiency obligation scheme and the measures stated in mandatory energy audits and introduced by companies have also made a contribution to achievement of energy efficiency targets (see Box 12.2).

Box 12.2

Energy efficiency of Enterprises in Latvia

Energy efficiency of enterprises is one of foundations of increase in EU competitiveness, therefore, since 2015 all large companies of the EU are obliged to conduct regular energy audits.

The *Energy Efficiency Law* provides that large companies and companies with electricity consumption above 500 MWh should conduct an energy audit or introduce a certified energy management system, as well as implement energy efficiency measures with the highest energy savings or economic pay-off.

By November 2019, approximately 833 Latvian companies have conducted an energy audit, or have introduced a certified energy management system according to ISO 50 001.

As a result of audits companies have received recommendations for increasing of heat insulation of buildings, installation of more energy efficient lighting and production equipment and transport.

Effective use of energy will allow companies to save costs, as well as will help Latvia to reach its energy efficiency targets.

From 2014-2017¹, the cumulative final energy saving obtained as a result of implementation of energy improvement measures until 2020 is 5227 GWh or 53% of the mandatory cumulative target (9896 GWh). In order to ensure the fulfilment of the cumulative final consumption target, an assessment of the accrued energy saving was carried out in 2019 based on up-to-date information on promotion and regulatory measures adopted by state and local governments, which improve energy efficiency.

Taking into account that from 1 January 2020 maintenance of the energy efficiency monitoring system is transferred to the State Construction Control Bureau, it is expected that collection, summarising, serving of information and

calculations will improve within the scope of the monitoring system.

In 2018, EU Member States agreed that they should reach an increase of energy efficiency by 32.5% by 2030. Therefore, each Member State should contribute to reaching of this target, as well as implement the horizontal principle "energy efficiency first" in its development planning. This principle is included in the *National Energy and Climate Plan*.

In 2014-2020 EU funds programming period, support to energy efficiency measures is provided through several programmes supervised by the Ministry of Economics (see Box 12.3).

Box 12.3

Support Programmes for Improvement of Energy Efficiency (Conditions as at November 2019)

Energy efficiency programme for multi-apartment buildings:

- 618 projects requesting ERDF funding of 142 million euro were submitted to the Development financing institution Altum;
- 243 positive decisions on granting of grants were taken;
- the implementation of 141 projects has completed, 100 projects are being implemented, incl. at the construction stage;
- 26 Altum loans for 4.3 million euro were issued;
- 134 guarantees for 22.8 million euro were granted.

Average indicators of projects:

- the average energy consumption reduction in homes - 47%;
- the annual average energy consumption for a renewed house - 54.9 kWh/ m².

Annual energy saving in submitted projects:

- annual consumed heating energy reduction- 38.09 MWh/ m²;
- annual CO₂ reduction - 228.55 thousand tons.

¹ Report of 2019 on advancement towards the fulfilment of state energy efficiency targets for 2020 in 2017 in accordance with the requirement of Article 24(1) and Part 1 of Annex XIV of Directive 2012/27/EU https://em.gov.lv/lv/nozares_politika/energoefektivitate_un_siltumapgade/zinojumi_eiro_pas_komisijai/

[lv/lv/nozares_politika/energoefektivitate_un_siltumapgade/zinojumi_eiro_pas_komisijai/](https://em.gov.lv/lv/nozares_politika/energoefektivitate_un_siltumapgade/zinojumi_eiro_pas_komisijai/)

Box 12.3 continued**Energy efficiency programme for public buildings:**

- 123 project applications requesting ERDF funding of 96.4 million euro were received;
- the implementation of 15 projects requesting ERDF funding of 6 million euro has been completed;
- the total area of state-owned buildings, which will be renewed within projects – 115,162 m²;
- the annual average energy consumption of the buildings after a year of implementation of the project – 110 kWh/ m².

Energy efficiency programme for production buildings:

- 46 agreements for Cohesion Fund funding of 12.05 million euro were concluded;
- the implementation of 20 projects for Cohesion Fund funding of 5.47 million euro has been completed.

The following indicators will be achieved within the framework of approved projects:

- annual energy savings – 107.2 GWh;
- installed capacity of renewable energy sources (heating boilers + solar collectors) – 9.5 MW;
- annual CO₂ reduction – 12.3 thousand tons.

Energy efficiency programme for the district heating systems:

- 102 agreements for Cohesion Fund funding of 50.22 million euro were concluded;
- the implementation of 15 projects for Cohesion Fund funding of 2.1 million euro has been completed.

The following indicators will be achieved within the framework of approved projects:

- additional installed capacity of renewable energy sources – 9.31 MW;
- reconstructed production capacity – 225.83 MW;
- reconstructed heating networks – 59.8 km;
- annual reduction in heating energy losses in reconstructed heating networks – 46.58 GWh;
- annual CO₂ reduction – 162.57 thousand tons.

12.3. ENERGY FROM RENEWABLE SOURCES

The *National Reform Programme of Latvia for the Implementation of the “Europe 2020” Strategy* (see Section 8.1) sets national goals: In 2020, the share of renewable energy in gross final consumption should be 40%, this share should be 10% of the final energy consumption in the transport sector.

The share of renewable energy in gross final energy consumption has grown from 37.16% in 2016 to 39% in 2017. In the transport sector the share of renewable energy in the gross final energy consumption has decreased from 2.76% in 2016 to 2.54% in 2017. However, due to changes in regulatory enactments, which intend to enshrine admixture of biofuel to diesel, starting from 2018, it might be approximately 4% (see Box 12.4).

Box 12.4**Renewable Energy in Transport**

A binding 32% RES share target for 2030 is set at the EU level, which should be reached by all countries, making their contribution, and national targets cannot be smaller than for year 2020. In the transport sector, in 2030 Latvia along with other EU Member States should ensure the share of RES of 14%, however, there is a possibility that a lower target will be set, if the use of biofuel produced from food and animal feedstuffs is limited. At the same time, sub-targets for modern biofuels and biomethane have been set in the transport sector envisaging that their share should be 0.2% of the final consumption of transport in 2022 and increase to 3.5% in 2030.

In order to promote an increase in consumption of different alternative fuels, including renewable energy, in the transport sector, amendments to the Law On Pollution entered into force on 6 March 2018, which oblige fuel suppliers to reduce the life cycle greenhouse gas emission per one supplied transport energy unit by 2020 by 6% compared to the level of 2010. On 25 September 2018, Cabinet Regulations No.597 “Procedure of calculation and reporting of the amount of transport energy life cycle greenhouse gas emissions and its reduction” were adopted.

The *Draft Law on Transport Energy* is drafted in order to promote the use of alternative fuels in transport and the development of alternative fuel infrastructure by strengthening supervision of the transport energy market and promoting public awareness of available and usable transport energy types, as well as foster sustainable economic development and limit climate change.

Fuel wood (firewood, fuel chips, pellets, etc.) is the most popular renewable energy source used in Latvia (hereinafter referred to as RES). Its share in RES consumption in 2018 was 80.9 per cent.

The consumption of biogas keeps growing (gas from waste landfills, sewerage sludge gas, other biogas) – its consumption increased by 16.2 % over five years reaching 3.6 PJ in 2018.

In 2018, Latvia produced 6,725 GWh of electricity, and the amount of electricity produced from RES reduced by 35.9 % in comparison with 2017. Last year, hydro power plants (HPP) produced 2,432 GWh, but wind power plants – 122 GWh. The decrease in electricity production in 2018 was most affected by low output of HPPs, which is explained by untypically dry and long summer period with low levels of water in water bodies and low inflow of water to Daugava.

In 2018, cogeneration plants produced 4,17 TWh of electricity, 22.6 % of which was produced from RES (biogas and biomass cogeneration plants). Electricity produced at biomass cogeneration plants increased from 319 to 570 GWh and at biogas cogeneration plants – from 350 to 374 GWh over five years.

Support to generation of electricity using RES in Latvia is provided in the form of a mandatory electricity procurement or as a payment for the electrical capacity installed at power plant. Starting from 1 January 2018, the costs raising from capacity payments to cogeneration power plants are attributed to end consumers in proportion to their system connection parameters, while the costs for electricity purchased within the scope of mandatory electricity procurement are distributed in proportion to the electricity end consumption.

The Ministry of Economics is constantly reviewing and searching for solutions for the improvement of the existing support mechanism, and its policy has been aimed at the reduction of the mandatory procurement component

(hereinafter referred to as MPC) for end users of electricity. In the period from 2014 to 2017, MPC was kept at the level of 26.79 EUR/MWh, while from 1 July 2018 it has reduced to 22.68 EUR/MWh¹. In order to promote competitiveness of energy-intensive manufacturing companies at export markets, from 2017 particular industry companies are entitled to reduced participation in the MPC payment².

In order to strengthen control of mandatory procurement, amendments to regulatory enactments of the industry have been made providing that the power plants, which were granted the right to sell produced electricity within the scope of the mandatory procurement (hereinafter referred to as MP power plants), should further submit annual reports on operation of their MP power plant in the created IT system ensuring more rational opportunities for data analysis. The amendments provide that the public energy trader performs one-time inspection of all MP power plants, involving also the State Labour Inspectorate, the State Environmental Service and involving other competent persons. At the end of 2018, 122 inspections were completed identifying several risks and violations, for which warnings have been made. Tax payment checks have been carried out and warnings to 61 debtors have been sent (53 of these undertakings have fulfilled their liabilities towards the state after these warnings having paid delayed taxes for the total amount of 1.454 million euro). The rights for MP have been withdrawn from six MP power plants, thus reducing the total amount of MP liabilities.

The Ministry of Economics has been gradually promoting the development of self-consumption of electricity by improving the NET accounting system created on 1 January 2014, which is now offered to households for production of electricity for their own needs from RES, for example, using solar panels or wind turbines for this purpose. The NET system enables to transfer excessive electricity produced to the power grid and use it, when necessary.

12.4. REDUCING GREENHOUSE GAS EMISSIONS

Climate has changed faster over the last decades in the history of instrument meteorological observations, and it is expected that the temperature will increase even more drastically in the 21st century having a bigger effect on the society in general and different sectors and national economy sectors.

Individual policies in national economy sectors are implemented to reduce greenhouse gas emissions (hereinafter referred to as GHG) in Latvia – promotion of use

of renewable energy sources, improvement of energy efficiency, promotion of electrical mobility, measures to reduce the use of fossil fuels, extraction and use of biogas, etc.

According to the GHG inventory of 2019 for years 1990-2017³ (hereinafter referred to as GHG inventory of 2019) and the approximate GHG inventory for 2018⁴ Latvia's total GHG emissions from 1990 to 2017 and until 2018 reduced by 56.9% and 55.1%, respectively, while in the period from

¹ From 1 January 2019, the average value of the mandatory procurement and capacity component remains at the same level – 22.68 EUR/MWh <https://www.sprk.gov.lv/content/tarifi-1>

² Information about aid granted to companies is published on the website of the Ministry of Economics https://www.em.gov.lv/lv/nozares_politika/

[atjaunojama_energija_un_kogeneracija/atbalsts_energoietilpigiem_apstrades_rupniecibas_uznemumiem/](https://www.em.gov.lv/lv/nozares_politika/atjaunojama_energija_un_kogeneracija/atbalsts_energoietilpigiem_apstrades_rupniecibas_uznemumiem/)

³ <https://unfccc.int/documents/194812>

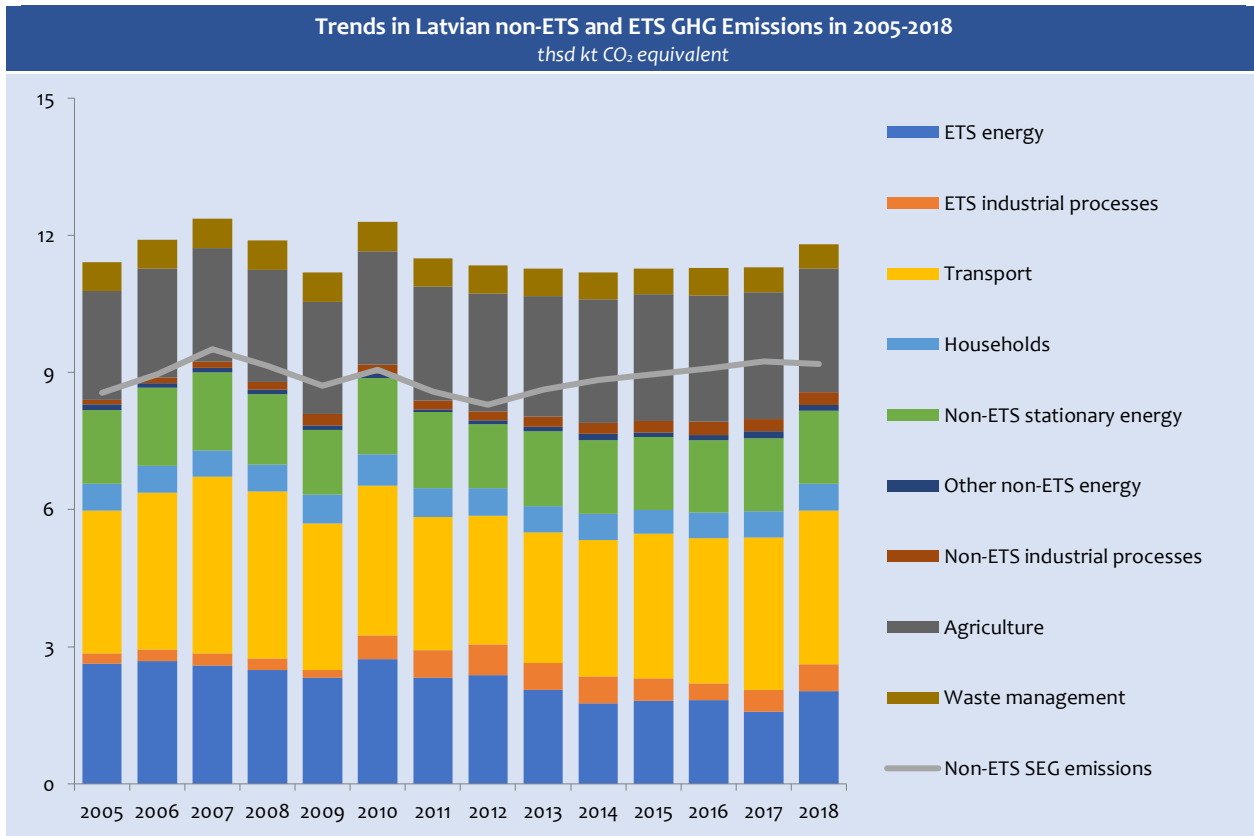
⁴ https://cdr.eionet.europa.eu/lv/eu/mmr/arto8_proxy/envxta4zg

2005 to 2017 and in 2018 Latvia's total GHG emissions by 0.7% and increased by 3.4%, respectively. Latvia's total GHG emissions in 2017 amounted to 11,325.3 kt CO₂ eqv. but approximate GHG emissions in 2018 – 11,800.2 kt CO₂ eqv.

In 2017, GHG emissions from non-ETS activities dominated in the Latvia's total GHG emissions – 81.9 %¹. The

approximate share of GHG emissions of non-ETS activities in Latvia's total GHG emissions in 2018 is smaller – 77.8%. GHG emissions generated by Latvian ETS operators amounted to 2049.8 kt CO₂ eqv. in 2017, and already 2612.6 kt CO₂ eqv. in 2018, or 18.1% or 22.1%, respectively, of Latvia's total GHG emissions.

Figure 12.2



The GHG emissions dynamics of non-ETS activities evidences of an increase in emissions – 8.09% increase in 2005-2017 and an increase by 7.38% in 2005-2018. Overall, until 2018 Latvia was within the annual targets set for non-ETS activities in Decision 406/2009/EC². Latvian ETS operators had reduced their GHG emissions by 28.19% before 2017 and by only 8.47% before 2018, in comparison with 2005, thus significantly lagging behind the Latvian national ETS GHG emissions reduction target for 2020 – minus 21% compared to the volume of 2005.

In 2017, the energy sector was the largest source of GHG emissions, creating 64% of Latvia's total GHG emissions. Most of emissions from fuel combustion are generated by the transport sector – 46.2%. Emissions of the energy sector

reduced by 62.5% in 2017 in comparison with 1990, and by 10.3 percent in comparison with 2005.

Agriculture is the second largest emissions sector in the Latvian GHG inventory, which generated 24.6% of Latvia's total GHG emissions in 2017. Non-ETS emissions from waste management constituted 4.7% of the total GHG emissions in 2016.

Latvia has drafted the National Energy and Climate Plan 2021-2030³, which sets the main action policies and measures for the fulfilment of GHG emissions reduction targets, as well as in other dimensions of the energy union, which also affect the volume of GHG emissions – ensuring of

¹ The non-ETS activities subject to Decision 406/2009/EC, the calculation of GHG emissions has been carried out using the formula defined by the European Commission – total GHG emissions minus amount of CO₂ emissions verified by EU ETS operators minus local aviation CO₂ emissions
² Decision No 406/2009/EC of the European Parliament and of the Council of 23 April 2009 on the effort of Member States to reduce their greenhouse gas emissions to meet the Community's greenhouse gas emission reduction commitments up to 2020

³ It is to be approved in December 2019, the plan has been drafted in accordance with Regulation (EU) 2018/1999 of the European Parliament and of the Council of 11 December 2018 on the Governance of the Energy Union and Climate Action, amending Regulations (EC) No 663/2009 and (EC) No 715/2009 of the European Parliament and of the Council, Directives 94/22/EC, 98/70/EC, 2009/31/EC, 2009/73/EC, 2010/31/EU, 2012/27/EU and 2013/30/EU of the European Parliament and of the Council, Council Directives 2009/119/EC and (EU) 2015/652 and repealing Regulation (EU) No 525/2013 of the European Parliament and of the Council

the share of renewable energy sources and fulfilment of energy efficiency improvement targets.

At the same time, MoEPRD is drafting the *Low-Carbon Development Strategy of Latvia 2050*, the Ministry of Transport is working on the implementation of alternative

fuel infrastructure to determine the most effective measures, which would, among other things, ensure also a reduction in GHG emissions from transport activities, while the Ministry of Agriculture has drafted the *Bioeconomy Strategy of Latvia 2030*.

Box 12.5

Reducing GHG Emissions in Latvia

Taking into account Latvia's participation in the EU, Latvia's political goals in terms of climate are connected with the EU climate policy goals, as well as the international climate policy – the UN Framework Convention on Climate Change and its Kyoto Protocol and the Paris Agreement.

A common EU GHG emission reduction target has been set within the EU, and it is broken down into two parts – the activities included in EU Emissions Trading System (hereinafter referred to as EU ETS) and the activities not included in EU Emissions Trading System (hereinafter referred to as non-ETS). Common targets set by the EU:

- EU ETS operators should jointly reduce the amount of GHG emissions by 21% until 2020 and by 43% by 2030 (in comparison with the amount of GHG emissions of EU ETS operators in 2005).
- the total amount of non-ETS GHG emission within the EU should reduce by 10 % by 2020 and by 30% by 2030 (in comparison with the amount of GHG emissions of non-ETS operators in 2005).

The organisation of fulfilment of the **EU-ETS target** is responsibility of the European Commission. ETS operation conditions have been approved for the fulfilment of this target and responsibility of operators has been set with EU regulations. Measures for reduction of the amount of GHG emissions of ETS operators are set in a harmonised way in the *Emissions Trading System Directive*. The development and implementation of ETS measures is ensured by the EC jointly with EU Member States. The Latvia's largest energy and industrial companies are also EU ETS operators.

Non-ETS GHG emissions reduction target fulfilment liabilities are shared by all EU Member States, incl. Latvia. For the period from 2013 to 2020 the target of each EU Member State and its fulfilment conditions are expressed with the so called *Decision 406/2009/EC*, and for the period from 2021 to 2030 – with *Regulation 2018/841*. In the period from 2013 to 2020 Latvia is allowed to increase the amount of Latvia's non-ETS GHG emissions by no more than 17%. In the period from 2021 to 2030 Latvia should reduce GHG emissions from non-ETS activities by 6% in comparison with 2005. The total target of the period is broken down into annual binding targets.

13. CONSTRUCTION POLICY

The construction sector has been experiencing rapid growth in recent years (see Chapter 4.5), which is largely based on sustainable development principles. Companies in the construction industry make considerable investments to increase their productivity, strengthening of social guarantees of employees and promotion of social protection, as well as implementation of innovative technologies.

A regulation meeting clear and modern requirements are of big importance in the construction process.

A new *Construction Law* entered into force on 1 October 2014, the purpose of which was to create a contemporary and modern legal regulation for the construction process, as well as to foster opportunities of society to cooperate in decision-making, ensuring balanced protection of the initiator of construction and protection of public interests.

At the same time, regulations of the Cabinet of Ministers related to the new construction regulation were approved,

which have considerably changed the procedure of construction, making a special emphasis on the process of organisation of construction works and responsibility of the involved. Several significant improvements have been made in the normative regulation of the construction process in recent years, paying considerable attention to the reduction of administrative burden. In 2017, the process of making changes to the construction project was facilitated in the *Construction Law*, those cases, when construction concept documentation is not necessary, were supplemented in the *Construction regulations for buildings*, in 2018 and 2019 special regulations were amended to ensure a transition to the electronic construction procedure.

A range of amendments to the *Construction Law* have been prepared to continue improving the regulation (see Box 13.1).

Box 13.1

Planned improvements in the normative regulation of construction

The responsible commission of the Saeima has completed the review of the draft law “Amendments to the Construction Law” (197/Lp13) before the 3rd reading. The draft law provides for the transfer of the regulation on administrative violations in construction, which is included in the *Latvian Administrative Violations Code* to the *Construction Law*. **New administrative penalties** are envisaged in addition to currently existing administrative penalties:

- for inappropriate construction products and their use;
- for provision of construction services without registration in the register of construction merchants;
- for failure to issue technical rules, permits or coordination or refusals within the deadlines and in the way provided for by regulatory enactments.

The draft law “Amendments to the Construction Law” (VSS-764; TA-1759), which has been submitted for review to CM, provides for the following changes in the **regulation on specialists**:

- construction technicians keep their previously obtained rights to conduct engineering research, manage construction works and carry out construction supervision without time restrictions;
- persons with college education keep their previously obtained rights to conduct engineering research without time restrictions;
- the rights to independent practice are clearly defined for the craftsmen registered in the Latvian Chamber of Crafts, if they carry out or manage construction craftsmanship works;
- rights to independent practice are envisaged for conservators (masters and old masters) in the speciality relating to conservation of construction joinery articles or construction art objects;
- rights to independent practice can also be obtained by the persons, who have received education in an engineering study programme related to construction;
- the main use of the building can be changed during designing and construction works;
- it is clearly defined that a general partnership and a limited partnership are entitled to provide construction services without registration in the register of construction merchants, if all its members are construction merchants.

The draft law “Amendments to the Construction Law” (VSS-698; TA-1973), which has been reviewed by MoSS, provides for the following changes in the **allocation of responsibilities**:

- clearly differentiated responsibility of each participant of the construction process:
 - the initiator of construction involves a construction specialist or construction merchant meeting regulatory enactments for development and implementation of construction design documentation (with the exception of the cases specified in special construction regulations), as well as provides them with information on the requirements of the intended user of the building;
 - the performer of construction designing ensures compliance of construction design documentation and the solutions included in it with the requirements of the construction initiator and regulatory enactments, as well as compliance of construction design documentation and the solutions included into it with the requirements set in applicable standards and mutual compliance of information included into it;

Box 13.1 continued

- the performer of construction works ensures compliance of the building or its part built as a result of construction works with construction design documentation and the solutions included into it, as well as is responsible for the quality of construction works and use of proper construction products and their integration technologies (to the extent construction design documentation does not directly indicate the construction product or its integration technology);
- the performer of construction works ensures compliance of the building or its part built as a result of construction works with construction design documentation and the solutions included into it, as well as is responsible for the quality of construction works and use of proper construction products and their integration technologies (to the extent construction design documentation does not directly indicate the construction product or its integration technology);
- the performer of construction supervision ensures representation of legitimate interests of the construction initiator in the process of construction works, including supervision of the entire process of construction works and control of any stage specified in the construction supervision plan in accordance with general construction regulations and the concluded contract;
- the performer of construction examination is responsible for the content of the construction examination opinions and validity of the conclusions included into it within the scope of the construction examination task;
- the construction board is not responsible for the quality of construction design documentation and its competence (in relation to construction principles and technical requirements) is verification and control of the architectonic quality principle, requirements of local government territory planning and requirements to the location of the building under regulatory enactments;
- the State Construction Control Bureau (SCCB) will control construction works of public buildings of third group (if the construction works require a construction permit) and will perform functions of the construction board with regard to construction of buildings in inland sea waters, the territorial sea and exclusive economic zone of the Republic of Latvia. SCCB will not control new buildings or reconstruction of existing buildings in local governments, where the contract price of the contract on public construction works is 1.5 million euro or more;
- the application of the tacit consent principle is intended with regard to state or local government institutions, as well as with regard to owners of engineering networks and roads;
- disputing and appealing will not stop the effect of specific decisions (acceptance of an explanatory note for preservation of a building, decision on coordination of preservation works during construction works, note on fulfilment of conditions for starting construction works, decision or note on change of participants of the construction process or construction specialists). In other cases, appealing of a decision favourable for the construction initiator by itself will not stop its effect;
- it is indicated that an outdoor improvement element is not a structure.

On 20 March 2018, the Cabinet of Ministers approved new regulations No.169 "Rules of Evaluation of Competence of Construction Specialists and Supervision of Independent Practice", which considerably improve the regulation in the area of **certification of construction specialists**. They provide criteria for practical work experience requirements to candidates for a certificate of a construction specialist, update the procedure of maintenance of an independent practice, clarify the criteria for warning, suspension and annulment of the sphere of effect of the certificate, set the requirement for the construction specialist to maintain in force the existing agreement with the National standardization institution on subscription of necessary Latvian national standards, which are necessary for the fulfilment of daily duties. From 2019, the National standardization institution Latvijas Standarts SIA has been providing construction specialists with access to standards in a reading room of standards without an additional fee, authorised online reading in 24/7 regime on www.lvs.lv from any internet connection and any device: computer, smartphone, tablet. In 2019, nine new delegation agreements on evaluation of competence of construction specialists and supervision of independent practice were concluded with non-governmental organisations representing construction specialists and one delegation agreement was concluded with an economic operator, as well as new pricelist of paid services of construction specialists have entered into force, within the scope of which supervision of independent practice is ensured.

A cooperation *Memorandum to reduce shadow economy in the construction sector, as well as for improvement of the sector and promotion of development* between responsible members of the Cabinet of Ministers and representatives of the construction sector (hereinafter referred to as the *Memorandum*) was signed on 31 May 2016. The most important areas, on resolution of which the parties agreed by signing the *Memorandum*, is the need to take controlled measures to increase production volumes, especially for export, reduce shadow economy, increase competitiveness, as well as improve security and quality in construction. The most important task set in the *Memorandum* is to conclude a *General Agreement on minimum wage levels in construction professions* (hereinafter referred to as the *General Agreement*). The *General Agreement* entered into force on 3 November 2019. It provides for a considerable increase in minimum wages in the construction sector **envisaging the minimum gross wage of 780 euro in construction**.

By fulfilling the tasks included in the *Memorandum*, electronic registration of working hours in construction was introduced in 2017. This is applicable not only to public procurements, but also to construction of new structures of the third group or any construction works costing 1 mln euro or more. The introduction of electronic registration of working hours of workers employed on a construction site will provide objective information to controlling authorities on the hours worked on the construction site by workers. On 13 June 2019 amendments to the Law On Taxes and Duties

entered into force intending to provide that from 2020 electronic registration of working time applies to all the sites starting from 350 thousand euro or more. In combination with the *General Agreement on minimum wage rates for persons employed in groups of professions in construction* it becomes the most effective tool for combatting shadow economy;

In 2017, the Latvian Construction Council¹ (created under MoE and including delegated representatives of 15 non-governmental organisations representing the construction sector, as well as responsible ministries and the Latvian Association of Local and Regional Governments) approved the *Construction Sector Development Strategy 2017-2024* (hereinafter referred to as the Strategy), which combines interests and needs of the sector and public administration, as well as sets goals and priority measures of the sector for balanced development of the sector. The main task of the strategy is to determine a uniform policy for sustainable and competitive development of the Latvian construction sector. In August 2019, the Latvian Construction Council updated the measures included in the Strategy in accordance with the actual situation in the sector.

In order to achieve the development vision of the Latvian construction sector, the Latvian Construction Council has defined strategic development goals for the sector:

- to reduce bureaucracy in construction regulation, reducing by 50% the total process period and digitalising solutions, thus ensuring more effective construction process;
- to triple productivity of the sector to reach the average indicator of TOP 10 EU Member States;
- to increase turnover of the construction sector from current 1.5 billion euro per year to up to 3 billion euro per year;
- to improve the system of education and professional qualification of construction specialists achieving that highly qualified specialists are available in each construction profession;
- to improve the quality of construction services at the same time creating a single system of quality management.

Significant improvements have been reached in recent years in the area of **digitalisation of the construction sector**.

The *Construction Information System (CIS) development project* started in 2017, which ensures electronic coordination of construction concepts, improvement of supervision of construction works and use of buildings, as well as a number of improvements in management of data of construction merchants and construction specialists. There have already been 130 meetings of the work group involving 1848 participants, representing

88 institutions/organisations and businesses within the scope of the CIS development project.

Since 1 July 2018, the functionality of electronic coordination and acceptance of construction proposal and construction concept documentation has been ensured, which provides the possibility to coordinate the entire construction concept from the application to the commencement of construction works electronically, considerably reducing the deadlines ensuring reception of different coordinations in parallel. Since 1 October 2019, the functionality of control of construction works and commissioning of building has been ensured electronically. An electronic process will also allow to track the stage of the concept, thus making the process transparent.

Since the beginning of the CIS development project in 2017 the number of CIS users has doubled and exceeds 20 thousand, as well as the number of created construction cases has considerably grown – from 22 thousand in 2017, reaching 92 thousand in 2019.

When developing CIS, special attention is devoted to proper training of all user groups. Overall, over 4000 system users have been trained on the newly developed functionality, and the trainings are still ongoing. Training materials, video recordings and manuals on system use can be studied on the SCCB website: www.bvkb.gov.lv, as well as on the portal www.bis.gov.lv.

At the same time, the Saeima has prepared amendments to the *Construction Law*, which envisages a transition to the electronic construction process from 1 January 2020.

The implementation of the *Construction Information Modelling (CIM)* in Latvia is essential to increase productivity of companies in the construction sector on a local and international scale, as well as to increase quality of construction, shorten the time of implementation of construction and to reduce the costs of life cycle of buildings. CIM consists of modern and transparent construction processes aimed at quality and more efficient use of public funding in construction procurements.

CIM is a process, in which a digital three-dimensional structure is created with added information about its elements, therefore, all the parties involved, including the contracting authority, the designer and the construction merchant, will be able to see from the very beginning of development of the construction project, what the final result will be, this will allow to notice and pay attention to errors in the project before construction starts, to calculate the necessary amount of construction materials more accurately, which may result in a reduction of total costs of construction materials and the amount of waste during construction, which makes CIM one of the most efficient tools for the development of environmentally friendly and sustainable construction. CIM models may also be used in management and maintenance, as well as supervision of use of structures, because the information available in the CIM

¹ The **Latvian Construction Council** is an advisory organisation, the purpose of activity of which is to make proposals for draft laws and regulations and draft policy planning documents, as well as draft EU

international laws and regulations affecting the construction sector according to community's interests. The **Latvian Construction Council** also provides feedback to participants of the construction process.

model simplifies performance of these activities, as well as reduces their costs considerably.

A work group was created in 2019 representing national regulatory authorities, capital companies, education institutions, non-governmental organisations of the construction sector for the development of a CIM roadmap. The CIM roadmap is a document describing CIM implementation goals, the most essential benefits and priority tasks. The roadmap has been developed to promote common understanding of the goals to be reached and necessary tasks for implementation of CIM, as well as

promotion of public leadership and political support in the implementation of CIM in Latvia.

The CIM roadmap lays down main action lines necessary for its successful implementation in the construction sector – development of standards, guidelines and regulatory requirements to increase competence of new and existing construction specialists in work with digital tools, identification and demonstration of examples and good practices. Non-governmental organisations, education and state institutions have expressed their support to the measures included in the CIM roadmap.

14. HOUSING POLICY

The Latvia's current housing facilities are considerably outdated, which increases their maintenance costs, and if income of households does not increase, its renewal prospects become even more remote. 44% of all the multi-apartment buildings in Latvia were built before 1940, and 51% of all the Latvia's residential facilities were built in 1941 to 1992, while the share of new multi-apartment residential houses built after 1993 is only 4%¹. 2.9 million m² of living spaces were built in 2010 – 2016. At present, the rebuilding rate of multi-apartment residential housing in Latvia is very slow, only 0.2% of the total number of apartments are built during a year (0.77 mln m²).

In 2019, the Ministry of Economics has focused on due diligence of the technical condition of serial multi-apartment houses built in Soviet times to follow up the technical condition of the residential housing and offer technical solutions for restoration of load-bearing structures and other elements of buildings. Guided by the conclusions and proposals made by specialists, the need to improve the requirements of regulatory enactments with regard to maintenance of buildings will be evaluated. The choice of this year was to study large panel series 464 multi-apartment residential houses which were built on a mass scale, because experts have indicated that buildings of this series might potentially have higher risks for load-bearing structures.

Taking into account growing housing costs, the low level of income and purchasing capacity of the population is the main reason for housing availability problems in Riga and other regions. Lack of affordable and qualitative housing is one of the reasons delaying internal mobility of the state, and this causes other negative effects – lower opportunity to involve job seekers and unemployed in the labour market, delayed national economy growth and profound depopulation. The development of the market of rental apartments is stagnating – there are economic, administrative and regulatory obstacles, which delay attraction of investments into construction of low cost rental apartments – high fees, long procedure of resolution of rent disputes and lack of long-term funding (for 30 years or more) for projects. OECD indicates in its research that a successfully functioning housing market promotes mobility, which respectively ensures effective distribution of human resources and jobs throughout the labour market.²

The main directions for resolution of the situation are:

- promotion of the affordability of rental housing;
- drafting of a legal framework on residential tenancy;

- improvement of a housing support programme for acquisition of housing.

AFFORDABILITY OF RENTAL HOUSING

At present, investments of the private sector in construction of rental houses on market conditions are insufficient. Available crediting periods are considerably shorter than the lifetime of buildings, which increases costs of residential premises. Construction of multi-apartment houses considerably lags Estonia and Lithuania in terms of private investments. 1726 apartments in multi-apartment buildings were built in Latvia in 2017, while almost three times more or 4220 apartments were built in Estonia and 5270 apartments were built in Lithuania. Compared to other OECD member states, the share of commissioned apartments proportionately to the total residential housing has been one of the lowest in Latvia for a long time. Only 0.2% of apartments in all residential housing were commissioned in 2015. To compare, this indicator was 0.6% in Lithuania and Estonia.

It should be pointed out that at present, the private sector is not interested to invest in construction of rental housing, because, taking into account high construction costs and the investment pay-off period expected by the developer, the rent in newly constructed housing exceeds the average rent payment level in the local government and payment capacity of the population living in regions. It is clearly demonstrated by the statistics on residential areas constructed, because from 2010 to Q3 2019 78.8% of all housing areas and 96.8% of multi-apartment housing areas were built in Riga and Riga Metropolitan area.

In accordance with Eurostat data, in 2018, only 7.5% of the population rented an apartment in accordance with market value, while most of the population (69.3%) own housing without mortgage liabilities.

The OECD *Economic Survey on Latvia* shows that welfare of the population in Latvia in comparison with the OECD's average indicator is one of the lowest exactly in income, healthcare and housing categories. There is also high share of population in Latvia, whose net income is below the poverty threshold, leading to a situation that many households with low income are insufficiently provided with housing.³

In other EU Member States, for example, in the Netherlands, France, United Kingdom and Spain, the share of public investments in promotion of the availability of housing exceeds 1% of GDP. About 6 mln EUR (~0.02% of GDP) per

¹ State Cadastral Information System

² D.Andrews, A.Caldera Sanchez, A.Johansson. OECD Economics Department Working Papers No. 836 "Housing Markets and Structural Policies in OECD countries", (2011)

³ OECD survey on Latvia (2017) <http://www.oecd.org/economy/surveys/Latvia-2017-OECD-economic-survey-overview.pdf>

year are invested in promotion of availability of housing in Latvia.

In order to develop and introduce efficient support for housing affordability, it is necessary to objectively and qualitatively evaluate support mechanisms of other countries, and on 21 May 2019 the Latvian Government decided to start a bilateral project with OECD on housing affordability in Latvia, during which by March 2020 OECD will develop a project, within the scope of which it will define persons and households, which need support in ensuring housing affordability, as well develop proposals for an effective set of support tools to ensure housing affordability in Latvia by taking over and adapting best practices from other countries, the project aims to develop a proposal for a support mechanism also for purchasing of housing.

In order to develop *Regulations on loans for construction, renewal, reconstruction of rental housing or acquisition of newly built, renewed or reconstructed rental housing*, which would promote the availability of rental housing in Latvia, the Law On Assistance In Solving Apartment Matters should be amended to include in the law a delegation for the development of such CM regulations. The Ministry of Economics has drafted necessary amendments, and on 5 May 2019 CM supported the draft law. On 20 June 2019 the Saeima supported these amendments in the first reading.

DRAFTING OF A LEGAL FRAMEWORK ON RESIDENTIAL TENANCY

The currently existing residential tenancy regulation is outdated, it has been in force since 1993. Currently, residential housing is not being constructed for the purposes of renting. This is related to the lessor's risks, which arise from the regulation currently in force. These risks, at the same time taking into account that a tenant may be removed from living spaces only based on legal action, increase the costs of construction of rental housing for potential developers so much (increasing also the potential rent) that it is not profitable to build rental housing right now. Therefore, the priority of the Ministry of Economics is to draft a new legal framework for residential tenancy, the purpose of which was to promote construction of rental housing and the affordability of housing, ensuring a fair balance between interests of lessors and tenants.

The draft law "Law on Residential Tenancy" would require to register all tenancy agreements in the land register for the purposes of ensuring acquisition of information about concluded tenancy agreements, which can be used to resolve disputes between tenants and lessors, and also to fight shadow economy, as well as provides that a tenancy agreement will be binding for the acquirer of the living space, if it is registered in the land register.

To provide better protection of the interests of tenants, the draft law stipulates that the lessor will be able to increase the rent only when the tenancy agreement sets out the principles and procedures for raising the rent, for example,

linking the raise with the average annual inflation, planned expenditures, or periodically raising the rent. Similarly, the law envisages the principle that members of the family will no longer enjoy permanent right to use the living space and are not severally liable for the obligations arising from the tenancy agreement.

To reduce shadow economy the new draft law "Law on Residential Tenancy" demands all tenancy agreements to be registered in the Land Register, thus ensuring publicly available and reliable information on concluded transactions that will protect both tenants and new owners of real estate. It is important to emphasize that registration of a tenancy agreement in the Land Register will be free of charge, thus avoiding any additional costs to the lessor or tenant. Simultaneously, registration of a tenancy agreement in the Land Register will allow to eliminate fictitious rental agreements as well as to protect honest tenants in the event of a change of lessor.

Compared to the current law, significant changes are intended regarding the term of the tenancy agreement – from now on, the tenancy agreement can no longer be concluded for an indefinite period. Namely, the tenancy agreement will be entered into only for a finite period of time, and, upon expiry of the term, the tenant will be obliged to vacate the living space, unless a new tenancy agreement is concluded with the tenant. In the context of the term of the agreement, it should be noted that, as before, a tenant, without giving a reason, will be able to terminate the agreement by notifying the lessor in advance. The lessor will still be able to withdraw from the agreement only in cases and within the time limits provided for in the law.

Taking into account the significant differences between the new regulation and the current law, the draft law provides for a transitional regulation. Tenancy agreements that were concluded prior to the entry into force of the new law will have to be registered in Land Register within 5 years from the entry into force of the said law.

Viewing and discussion of the draft law continued in the Public Administration and Local Government Commission of the Saeima also in 2019. The Ministry of Economics keeps improving the offered draft law together with parties involved sticking to the initially set goals.

At the same time, for the purposes of drafting the draft law "Law on Rental of Living Spaces" amendments related to the new draft law are made to the *Civil Procedure Law*, which will considerably accelerate resolution of disputes between the tenant and the lessor and reduce the costs involved, intending to set the procedure of unconditional forced fulfilment of liabilities in the amendments, when the tenancy agreement is over, or when there is a rent debt and tenancy rights are registered in the land register, as well as if real estate, in which living spaces are rented, is alienated during the effective period of the tenancy agreement, but tenancy rights are not registered in the land register. At the same time, such a solution will significantly reduce the risks for potential investors to invest in the construction of new rental housing.

HOUSING ACQUISITION SUPPORT PROGRAMME

In order to simplify the possibility for families with children to secure the first instalment for the loan for acquisition or construction of housing, in accordance with CM Regulations No.95 of 20 February 2018 "Regulations Regarding the State Assistance in Purchase or Construction of Residential Space" Joint Stock Company "Altum Development Financial Institution" issues sureties to persons, who live together with and care for at least one minor child.

The housing acquisition support programme has been highly appreciated by the population so far helping families with children to secure the first instalment for the loan for acquisition or construction of housing. Since 2014 the programme has helped more than 12.7 thsd families with 18.3 thsd children to get housing of appropriate size.

The programme was extended in 2018 providing that not only families with children, but also persons younger than 35 and having higher or vocational education will have the possibility to get a guarantee for the first instalment for the loan for acquisition or construction of housing. More than 1500 guarantees have been granted to young specialists by now. It was also defined that the guarantee for families with children will be available to persons, who live together with and care for a child, who has not reached the age of 24, thus extending this group of the population, which can receive support from the programme.

At present, the Ministry of Economics is forwarding amendments to the housing acquisition support

programme, which will increase the amount of guarantee available for families with four or more children, enable receiving of the guarantee if the family is expecting another child, as well as to improve existing conditions of the programme.

The draft regulation would provide that:

- the borrower no longer needs to declare or register his/her residence address in Latvia, as well as it is not necessary to prove the legal status of the dependent child in Latvia;
- the person, who has one or more children and is pregnant may also qualify for the guarantee;
- the amount of the guarantee for families with four or more children has increased to 30% of the loan;
- the possibility to qualify for the guarantee repeatedly has been envisaged provided that the previously granted guarantee liabilities are over.

The cancellation of the restriction with regard to registered place of residence in Latvia would promote re-emigration, because it is hard for the persons wishing to return to Latvia and receive help in acquisition or construction of a residential housing to fulfil the requirement with regard to declaration of a place of residence in Latvia. Until now the use of the programme by such families was restricted, because based on the current conditions it is impossible to qualify for a housing guarantee within the scope of the programme without being declared in Latvia.

15. TOURISM POLICY

Tourism policy in Latvia is designed to promote the development of domestic and international tourism, increasing the competitiveness of the tourism industry and export of tourism services.

The statistical indicators of tourism summarised by CSB evidence that development trends of this industry in Latvia are positive. This is certified by annual indicators and also their evaluation in a longer period of time (see box 15.1).

Box 15.1

Tourism Development Indicators in Latvia

The tourism sector in Latvia forms 4.3% of GDP. Its export volumes amount to 4.5% of the total Latvian exports. Together with related industries the tourism industry provides 8.9% of jobs in Latvia.

In 2018, the number of border crossings by foreign travellers has increased by 54% in comparison with 2010, and their number has doubled since 2005. In 2018, foreign travellers crossed the Latvian border 7.8 million times, which is by 0.6% more than in the previous year. In 2018 foreign travellers spent 751.9 mln euro – by 3.7 million euro more than in 2017. In 2018, Latvia was visited by 1.9 million overnight travellers, and they spent 516.7 mln euro, which is by 3.2% less than in 2017. 51.9% of foreign travellers, who visited Latvia for tourism purposes, came for recreation, 30.9% – visited friends or relatives, but 17.2% came on a business trip.

2.8 mln of travellers used accommodation services in Latvia in 2018, incl. 1.9 mln were foreign travellers, which is by 8.2% more than in 2017. More than half of all the foreign guests came from Russia, Germany, Lithuania, Estonia and Finland. Most of foreign guests visited Riga – 77.1%, Jūrmala – 8.5%, Liepāja – 1.8%, Sigulda Municipality – 1.6%, and Daugavpils – 1.4%.

Data on bed occupancy rate evidence of a growing hotel occupancy trend, although the number of rooms increases year on year. Significant seasonal fluctuations are still being observed. The highest rate of hotel room occupancy in 2018 was in July, in the hotels of Latvia in general – 69.4%, and in August in Riga – 80.2 per cent.

Growing trends are also observed in 2019. In the first half of 2019, Latvian travel accommodations served 1.24 mln guests, which is by 1.2% more than in the first half of 2018. Compared to the corresponding period of the last year, the number of nights spent by guests has increased by 3% and has reached 2.4 mln.

In 2018, Latvian tour operators served 478.5 thsd travellers, of which 128.4 thsd travelled to Latvia, 335.3 thsd travelled outside Latvia, while 14.9 thsd used services of tour operators within Latvia.

On 1 July 2014, a medium-term tourism policy planning document *Latvian Tourism Development Guidelines 2014-2020* was adopted, where MICE tourism (meetings, incentives, conferences, and exhibitions), wellness tourism, nature tourism, culture tourism, and creative industries were established as the strategic forms of tourism. Sustainable development of Latvian tourism, promoting increase in the competitiveness of tourism services in foreign markets, has been set as the objective of the tourism policy development. The policy results and performance indicators to be achieved are:

- an increase in the number of foreign overnight travellers;
- an increase in the average occupancy (bed occupancy rate) of accommodation establishments outside the busy summer season (September-May);
- an increase in the daily average expenditure of a foreign overnight traveller;
- an increase in the total annual expenditure of foreign overnight travellers.

Main lines of action:

- to ensure the recognition of the Latvian tourism offer in the target markets, especially through modern means of communication;
- to promote the improvement of the quality of tourism products, also by ensuring a better regulatory framework of the industry and support both to the tourism businesses and product consumers;
- to promote the development of competitive tourism products, supporting the development of new, innovative tourism products with higher value added, by developing an infrastructure for the growth of tourism, promoting the formation of regional tourism clusters and inclusion of the Latvian tourism product into the common tourism offer of the Baltic Sea Region.

In order to foster further positive changes in these indicators, the *Latvian Tourism Development Marketing Strategy 2018-2023* has been developed, as well as several ambitious marketing activities and advertising campaigns are implemented for promoting international competitiveness of the tourism sector.

Latvian tourism challenges are also related to the promotion of local tourism and cooperation among providers of tourism services and organisations to ensure the development of a qualitative supply, in particular in Latvian regions. At the end of 2018, work started on new tourism policy initiatives for 2021-2027, starting a public opinion study for the development of *Action Plan for Development of Export Capable Tourism Products in Latvia*, by studying existing support instruments and developing proposals for the tourism sector within the scope of *BRANDtour*, a project of the *Interreg Europe programme*, getting an evaluation of existing support instruments and making proposals for the development of the tourism policy. It is intended to use the action plan as a basis for the development of Latvian tourism guidelines for the next period, as well as for the development of effective political instruments to promote the development of the tourism sector to enter regional, national and international markets and innovation processes, to increase the number of SMEs offering new tourism products in business and event tourism, as well as in health/welfare sectors.

According to the conclusions included in the Interim Evaluation for 2014-2016 the Implementation of Latvian Tourism Development Guidelines 2014-2020 significant changes in trends are observed in the tourism sector, and therefore several action lines are set on the basis of which it is planned to draw up the planning document and the development plan for the next period (2021-2027).

In light of the foregoing, the Ministry of Economics is planning to continue to develop such action lines as:

- creation of new tourism products;
- promotion of local tourism;
- analysis of impact of the cooperation economy on the tourism industry;
- development of business and health tourism;
- creation of tourism clusters.

Furthermore, in order to ensure higher protection of travellers in case of insolvency of the tour operator and to improve the existing system of functioning of tourism agents and tourism operators in Latvia, from 1 July 2018 Latvia has introduced mandatory licencing of tourism agents and tourism operators by the Consumer Rights Protection Centre (see Chapter 17). Of approximately 300 undertakings known today, 51 applications for registration and receiving a licence were received from providers of tourism services in 2018 (44 licences were issued). On 1 July 2018, CM "Regulations on the Procedure of Preparation and Provision of Complex and Related Tourism Service and Rights and Duties of Providers of Complex and Related Tourism Services and Travellers".

The work on separately implementable measures to promote export of medical tourism has started. In order to promote

export capacity of tourism, MoE in cooperation with the Ministry of Health and the medical industry worked on the "Health Care Services Exports Development Plan 2019-2023", the fulfilment of which will ensure the development of health tourism and an increase in export of medicine.

In order to strengthen visibility of Latvia as a travel destination, promote the development of sustainable tourism and inflow of valuable tourists, marketing campaigns in target markets, visits of journalists and tour operators to Latvia are organised, participation in travel exhibitions and other events in the tourism industry in target markets is ensured, the availability of information about the supply of Latvian tourism is ensured, including in the digital environment, in several languages.

By implementing marketing activities, the biggest challenge are new marketing communication tools, in particular, in the digital environment. In 2016, LIAA has been implementing the project "Promotion of international competitiveness of Latvia in tourism" by performing marketing activities in foreign countries and providing support to tourism industry representatives for participation in exhibitions and conferences in foreign countries.

In 2018, the LIAA Tourism Department started working on a satisfaction study on the diversity, quality and other factors of the Latvian tourism supply. When implementing the study "Domestic travel habits of the population of large Latvian cities", the purpose is to learn domestic travel habits of the population of large Latvian cities, motivators in decision-making and destination selection principles.

Measures for promotion of local tourism and development of products are also implemented. Every year, trainings for representatives of the tourism industry on the development of products, quality of services and other topical issues are organised, tourism conferences and a new tourism product competition are organised. In 2018, a local tourism promotion campaign devoted to the centennial anniversary of Latvia was implemented. Its purpose was to invite the Latvian population to see less known, special, unordinary tourism places in Latvia and to share experiences with other interested persons.

In 2019, the total amount of funding (state budget funds, ERDF co-funding, as well as funding for the implementation of the project European Destination of Excellence(EDEN)) for tourism marketing is 2.58 mln euro.

As to tourism marketing activities and LIAA's activities in the current planning period, marketing activities will continue to be implemented in target markets, organising more extensive activities in priority target markets – Russia, Germany, Lithuania, Estonia, Finland, Sweden and Norway, making an emphasis on specialised tourism events for industry representatives. Education of tourism businesses and information of the population about the Latvian tourism supply will continue to promote local tourism.

16. COMPETITION POLICY

Free and fair competition stimulates the development of businesses, allows consumers to get diverse goods of higher quality for competitive prices. Competition has become the foundation for the general economic competitiveness increase, promotion of efficiency of operations and innovation of businesses, as well as public welfare.

Moreover, the goal of the competition policy is to protect free and fair competition, promote its development in all national economy areas among market players, create new and innovative products, as well as to prevent different anti-competitive practices, incl. unjustified involvement of public administrative bodies in business.

The Competition Council of Latvia (the CC), which is supervised by the Ministry of Economics of Latvia, is responsible for the implementation of the competition policy. The CC investigates and prevents infringements of the competition law, controls market concentration,

supervises that state and municipal regulatory enactments do not create unjustified obstacles for free and fair competition, and educates the society, thereby promoting its understanding about the competition law and contributing to intolerance towards competition distortions. In order to strengthen the application of the competition law, the CC cooperates not only with other national level law enforcement institutions, but also with international level organisations and foreign competition supervisors.

For market supervision to be effective, the CC has the right to prioritise its activities to prevent above all severe violations of the competition law. In case of signs of smaller potential violations, the CC uses alternative methods, incl. the public administration principle "Consult first" allowing to preventively improve the competition environment in national economy sectors.

Box 16.1

International Cooperation

In 2019, the CC has been included in the international Global Competition Review (GCR) for the fifth time, where world's leading competition authorities are evaluated. The CC received the high three-star evaluation with an ascending or growth-oriented trend. The Lithuanian competition authority received a three-star without ascending growth, while the Estonian competition authority is not included in the review at all.

The GCR review including 37 world's leading competition authorities emphasises that the CC has the smallest budget of all the evaluated authorities, however, according to the surveyed independent lawyers "Latvian competition authority is the most active and the most competent competition authority compared to other Baltic countries".

Similarly, in 2019, the CC received the highest award in the Competition Advocacy Contest 2018-2019 organised by World Bank group and the International Competition Network (ICN) for the proposal made by the authority to open the market for control of technical condition of vehicles to free competition. The purpose of the contest is to highlight attempts of competition authorities, state and non-governmental organisations and the private sector in promoting healthy competition in different markets. The CC and its market research in the field of state technical inspection of vehicles has been recognised as one of two winners in the nomination "Promoting competition as a tool to the fight against corruption and for an equal playing field among public and private players".

In 2018, after the implementation of sector inquiry into the market of state technical inspection of vehicle, the CC made a conclusion that the state has been unjustifiably restricted possibilities of the private sector to provide one of components of technical inspection – control of technical condition of vehicles. In order to eliminate the unjustified monopoly of the state on this market, the CC proposed to offer the implementation of the technical condition control service to private businesses.

PROHIBITED AGREEMENTS

In conditions of free competition, market players are prohibited to perform actions, which may reduce or completely exclude mutual competition. One of the severest violations of the competition law is a prohibited agreement on prices, market distribution, conditions of participation in procurements, etc. Practices of the authority prove that prohibited agreements among competitors or cartels in public procurements become an increasingly more widespread violation of the competition law.

On 12 April 2019, the CC revealed a prohibited agreement implemented by six tenderers and supported by the contracting authority in two public procurement procedures of municipal public transport company SIA Rīgas satiksme

on delivery of nanotechnology chemicals. A 2.4 million euro fine in total has been imposed on the contracting authority SIA Rīgas satiksme and the tenderer SIA Sava arhitektūra for deliberate distortion of competition. Other five cartel members – SIA RS Baltic, SIA Alchimica-Latvia, SIA UKT Serviss, SIA Vialeks and SIA HRM – have been liquidated, therefore no fine has been imposed on them.

In both public procurement procedures for the total contract amount of more than 800 thousand euro, tenderers coordinated participation conditions and documentation to be submitted, as well as agreed on the planned winner of the procedure. Having evaluated mutual communication among case participants, the CC concluded that all the tenderers were aware of their involvement in prohibited activities and their nature of competition imitation.

The information obtained by the competition authority also evidences that the official of the contracting authority SIA Rīgas satiksme, who was responsible for purchasing the specific product, was actively involved in preparation and coordination of tenders and preliminary determining of the winner. The involvement of SIA Rīgas satiksme as the contracting authority in promotion of the cartel is also confirmed by the fact that tenderers were informed about participation in the public procurement procedures even before they have been announced.

Market players, including also organizers of public procurements, should implement effective competition compliance programme in order to train all employees of the company, who are involved in decision-making. If an employee guided by intentional or unintentional goals violates the competition law, this is a subject of joint responsibility of the company.

The process of case investigation provides that prior to making a decision the authority sends Statement of Objections where the authority informs involved parties of its preliminary view by summarising evidences of the authority. At this stage of the investigation, case participants can express their opinion on the obtained evidences. Taking into account that significant public finances have been involved in the respective implementation of the violation, the CC made the information about the sent Statement of Objections public for the first time. Additional benefits from such an action are promotion of transparency of activities of the authority and an additional preventive factor for other possible infringers of the competition law.

In addition to the decision taken, by which the cartel has been identified, in case of less significant violations having signs of potential prohibited agreements the CC made five warnings to 12 persons in the nine months of 2019. The authority issues the warnings without initiating a formal case investigation and without imposing a fine, allowing to effectively implement the "Consult first" principle. This method allows the CC to save resources, and, at the same time, is rather effective and preventive in the improvement of the competition environment, because none of the parties involved in the warning processes up to now has repeatedly fallen under the radar of the CC for similar actions.

ABUSE OF DOMINANT POSITION

Dominant companies have a special responsibility – to prevent such actions in their activities, which may cause unjustified harm to customers, cooperation partners or other parties involved.

In 2016, the CC applied a 4026.53 euro fine and imposed SIA Rēzeknes autoosta legal obligations for abuse of the dominant position by asking an excessive fee from carriers for entering the Rēzekne Bus Station. In 2017, the litigation, which was favourable for the CC, completed.

In 2019, the CC supervised the fulfilment of those legal obligations, and while doing this the competition authority

sent an information request to the company. Taking into account that SIA Rēzeknes autoosta did not provide the information requested by the CC within the initially requested or the extended deadline, thus delaying the work of the authority for three months, the CC imposed a 838 euro fine on the company. The decision taken by the authority has entered into force.

The changes in waste management planned by the Riga City Local Government should be emphasised as one of the most important topics in 2019. The local government had planned to implement a public-private partnership entrusting management of waste in the entire territory of the capital to one market player for 20 years. Before the conclusion of the concession agreement with the selected private partner, the waste management service in Riga was ensured by four market players.

Since the CC foresaw considerable threats to competition, in July, shortly after the conclusion of the concession agreement, the CC initiated a case investigation on potential abuse of the dominant position under the Article 102 of the Treaty on the Functioning of the European Union (the TFEU). The case investigation by the CC may last up to two years, therefore the authority, for the first time, decided to exercise the opportunities provided by TFEU and imposed interim measures – a measure allowing to stop negative consequences for competition until the authority takes the final decision.

The litigation on the imposed interim measures concluded favourably for the CC. Meanwhile, the authority continues the investigation for alleged infringement of the Article 102 of the TFEU in activities of the Riga City Local Government and its company SIA Getliņi EKO.

MERGERS

Merger control is required to prevent a considerable reduction in competition as a result of merger of companies. When larger companies reach the criteria defined in the Competition Law, they should notify the CC and receive its approval for the planned merger transactions. The authority may take three types of decisions: approval, approval with binding conditions or prohibition.

In 2015, the CC allowed the Estonian company MM Grupp OÜ to purchase a provider of news agency services SIA LETA. Prior to submission of the merger notification, the Estonian company owned competitors of SIA LETA – SIA BNS-Latvija and SIA Mediju Monitorings. If the deal is struck, the only two news agencies in Latvia would merge and the monopoly would be created. Therefore, MM Group OÜ structurally separated SIA BNS-Latvija and SIA Mediju Monitorings by selling the companies to a third person – Estonian company AMP Investeeringud OÜ. At the same time, during the review of merger notification, MM Grupp OÜ did not inform the CC about the fact that it took over from the companies to be alienated to SIA LETA the most important resource, namely, most of employees of the separated companies. In 2019, the CC took a decision that having stated that during the review of merger notification the Estonian company had not

provided the authority with vital information on takeover of employees on a large scale from the separated companies.

A violation of merger conditions by not informing about changes in the circumstances and facts of the merger deal, denied the authority the opportunity to make objective considerations about preservation of the market structure in the market of new agency services in Latvia. In accordance with the merger regulation, MM Grupp OÜ implemented the merger contrary to the allowing decision taken by the CC in 2015 for purchasing SIA LETA, and for that a fine of 32 200 euro was imposed on the Estonian company.

SECTOR INQUIRIES

The CC supervises different markets to identify potential competition restrictions and propose potential changes, incl. in the regulatory framework. The authority carries out market inquiries both in the context of the previously defined priorities and reactively, based on news on the market.

In 2019, the CC completed inquiry of mandatory insurance of civil liability of owners of land vehicles (OCTA) concluding that the amplitude of the average increase and the volume of the OCTA varies among companies, however, not all companies after price increase in 2017 had it justified by the economic situation and individual OCTA financial indicators. The CC stated as a feature not characteristic for markets functioning in competitive conditions that competitors in the OCTA market have free access to individual commercial information, which provides benefits and explanations to insurance companies rather than consumers on trends in the OCTA market. This makes the OCTA system too transparent, allows insurance companies to monitor the market and respectively adapt to actions of competitors.

Among the most important factors promoting market transparency identified by the CC was the OCTA information system, which is used by insurance companies in daily work, including in determining OCTA offers. OCTA price calculators should also be emphasised, which serve for convenience of consumer and should generally be supported, however, at the same time, they create a high risk that with uncontrolled and automated access to individual data insurance companies and brokers obtain information about offers of competitors, including trends in prices, which create risks of adaptation and coordination of actions.

In order to reduce further possible increase in OCTA market, including due to digital economy, the CC proposed responsible authorities to make significant corrections. The authority has prepared proposals to the Ministry of Finance, the Financial and Capital Market Commission and the Motor Insurers' Bureau.

In 2019, the CC completed sector inquiry into the market of mobility of bank customers (private persons), the purpose of which was to learn the most important factors affecting mobility of bank customers and to evaluate their impact on

the customer's willingness to change the provider of services.

In order to get more objective and deep insight into consumer habits relating to banking services, the CC conducted a consumer survey. The survey results allowed the CC to conclude that most of Latvian consumers consider change of a bank an expensive, complex and time-consuming procedure and therefore do not search for offers that are more attractive in terms of price and quality.

The respondents indicated that, when considering the change of a bank, the most serious obstacles for them seem to be existence of loans, switching costs, special offers made by banks, physical availability of branches and ATMs, as well as time to prepare necessary documents. The CC has confirmed that bank customers who do not have long-term liabilities with a bank are more mobile. At the same time, it should be emphasised that when analysing standard bank loan agreements the CC did not state any direct conditions hindering mobility of customers.

Since low mobility of customers does not promote competition among banks for new customers, the CC prepared several proposals for the parties involved, incl. for the Financial and Capital Market Commission, in order to promote the development of competition on the market.

In 2019, the CC also completed inquiry into following markets: additional layouts of goods in special places in retail shops, incl. updating the Guidelines for the Application of the Unfair Commercial Practice Prohibition Law, services for change of individual water consumptions meters, etc.

SUPERVISION OF ACTIONS AND EDUCATION OF PUBLIC ADMINISTRATIVE BODIES

After at least four-year long discussions, on 28 March 2019, the Saeima supported amendments to the Competition Law, which will provide the CC with more effective powers to turn against competition distortions caused by public administrative bodies – the state, local governments and capital companies belonging to them.

The public opinion studies and practice of the CC evidence that the competition distortions caused by public administrative bodies are one of the most important competition problems in Latvia. Until now, in such cases the CC could only provide opinions in the form of recommendations urging public administrative bodies to change their practices. The amendments to the Competition Law will allow the CC, if its attempts fail, to initiate a case investigation, to impose a fine and to impose legal obligations on the capital companies owned by public administrative bodies.

The amendments to the law enter into force on 1 January 2020. To allow the stakeholders to prepare for the new regulation more successfully, in summer 2019 the CC published the Competition Neutrality Evaluation Guidelines.

Since the Section 88 of the State Administration Structure Law requests public administrative bodies to re-evaluate

their participation in a capital company or to evaluate competitive conditions on the market before establishing a new capital company, the CC has prepared an informative material on preconditions for participation of a public administrative body in a capital company and its evaluation.

Similarly, in the second half of 2019, the CC implements educational activities relating to the new Competition Law – workshops for public administrative bodies and non-governmental organisations representing them, participates in different discussions, etc.

17. CONSUMER RIGHTS PROTECTION AND MARKET SURVEILLANCE

Consumers are the largest driver of the economy. Today the range of fundamental rights of consumers is rather extensive: the right to secure own needs, the right to safe goods and services, the right to be informed, the right to choose, the right to resolution of disputes, etc. In order to ensure their observation, it is important to ensure the implementation of the consumer rights protection policy in different directions. When shaping the consumer protection policy, all the necessary measures to protect rights and economic interests of consumers should be taken. Consumer rights protection requirements should be taken into account, when defining and implementing other policy directions.

The modern consumer policy includes: protection of rights by law, help in quick and effective resolution of disputes with traders, guarantee of safety of any goods purchased in the single market, alignment of consumer rights with economic and social changes, in particular in the area of digital technologies, energy, financial services, as well as provide consumers with the possibility to choose on the basis of clear, accurate and consistent information.

Taking into account the rapid dynamics under the influence of rapid development of globalisation, digitalisation and technologies, also the consumer rights protection policy is made flexible to respond to the situation dynamically. The policy is implemented in such a way to foster more complete use of the potential of e-commerce to create a favourable and safe environment for consumers.

Therefore, one of important aspects is information of consumers and businessmen on consumer rights protection matters through different informative campaigns, by preparing advertising videos and distributing other materials. In line with our dynamic daily life, the development of e-commerce and rapid development of information technologies, it is important to emphasise the right of consumers to be informed and educated, because it is important for consumers to take sound decisions in this fast daily life.

Consumer rights protection system in Latvia is constantly being developed to ensure effective market surveillance and consumer rights protection. The Ministry of Economics is working to improve and develop the existing framework and

ensure a high level of consumer rights protection. There is also active cooperation in shaping of the international consumer protection policy and good practices of other countries are used for protection of consumers.

In 2019, the Ministry of Economics made an important step to put in order the area of organisation of trade of tickets and organisation of events promoting the culture of fair commercial practices. For several years, concerts have been cancelled in the area of trade of tickets and organisation of events, but the consumers, who suffered from this, have not been repaid money for purchased tickets. The Ministry of Economics, the Consumer Rights Protection Centre and the Latvian Event Producers' Association agreed on cooperation between public administration and the industry, which was enshrined in the memorandum of cooperation in the industry to ensure fair commercial practices.

Along with the Moneyval evaluation of Latvia with a number of measures to be performed, work in the field of anti-money laundering and countering the financing of terrorism was also very important in 2019, where the Ministry of Economics in cooperation with the Consumer Rights Protection Centre continued to improve the regulatory framework to ensure that anti-money laundering and countering the financing and proliferation of terrorism are ensured when providing consumer loan and debt recovery services.

The Consumer Rights Protection Centre, a body subordinated to the Ministry of Economics, is responsible for protection of consumer rights. Every year, CRPC sets priorities for its operations and in 2019 continues enforcement of the already initiated principle "Consult first", strengthening of the mechanism of extrajudicial resolution of consumer disputes, strict supervision of consumer rights in the field of finances and provision of aid using modern communication methods (see box 17.1).

At the beginning of 2019, CRPC received an award for the "Consult first" initiative in the nomination "Supervision policy leader in achieving compliance in 2018".

Box 17.1**Activities of the Consumer Rights Protection Centre in 2019**

The following priority axes are set for **market surveillance** in 2019: improvement of safety and compliance of goods and services in fields such as construction products, electrical appliances, machinery, explosive equipment, toys and goods safe for children, radio and telecommunication terminal units, recreation services, as well as observation of the procedure of indication of prices in places of provision of services. A project for inspection of dangerous equipment – surveillance of elevators, cargo cranes and hoists intended for people – is also implemented. Supervision projects in state metrological supervision are implemented in priority areas like non-automatic weighing instruments and breath alcohol testers, as well as control of pre-packaged products in companies.

In the 10 months of 2019, 862 market supervision inspections, 57 metrological supervision inspections were carried out in companies, where measuring instruments are used, and in companies distributing measuring instruments. 37 inspections were carried out in metrological supervision of pre-packaged products and 76 inspections – in supervision of dangerous equipment.

In 2019, CRPC started to implement priority projects in 7 areas in the field of **surveillance of consumer rights**. Surveillance cases were mainly started in the field of e-commerce, financial services and travel. 165 cases were started in 2019. Decisions on violations of collective interests of consumers have been taken in 12 cases, voluntary actions have been carried out in 16 cases. In 150 cases, examination of cases has been terminated, because no violation was stated, was prevented or was insignificant.

Taking into account the CRPC function to act as a supervisory authority to supervise the regulation for anti-money laundering and countering the financing of terrorism in the field of non-bank crediting and debt recovery, CRPC has been actively working in work groups, participated in development of regulatory enactments, drafted different explanatory materials and organised trainings for subjects being supervised, as well as performed supervisory activities, which resulted in improved levels of observation and understanding of regulatory enactments in the fields supervised by CRPC.

In 2019, licencing and registration of providers of complex and related travel services in the Database of Tour Operators and Agents continued. 297 licences have been in force as at 30 September 2019. In order to resolve current matters related to licencing and registration, CRPC met industry representatives and institutions involved, as well as is drafting informative materials for economic operators and consumers. Report forms have been developed and proposals for submission of the reports in electronic form have been provided while developing a reporting system for providers of travel services is developed for CRPC to supervise the size of security. Economic operators in the industry have also been supervised in terms of licencing of economic operators and for the marker players, who did not receive a licence.

Observing the “Consult first” principle and the good practices being implemented so far, in 2019, CRPC has approved 5 guidelines and has drafted an informative material relating to prohibition of consumer crediting ads. In 2019, CRPC developed and transferred for use to consumers a tool for comparing costs of accounts, which is available at konti.ptac.gov.lv.

In the field of **examination of consumer complaints and provision of consultations**, CRPC provided consumers, legal entities and institutions with 29,233 consultations in the ten months of 2019. The number of provided consultations has slightly increased compared to the 10 months of 2018. When asking for advice, consumers most often inquired about issues related to their rights, if a product of low quality is purchased or a service of low quality is received. Most of the questions are about actions in the cases, when shoes, electrical appliances, mobile phones, as well as other goods not meeting provisions of the agreement are purchased, or also about problems with airline, travel, distance contract and electronic communication services. Consumers also wanted to receive consultations on the matters, examination of which is not in competence of CRPC, for example, the quality of residential house administration services, medical services and other.

3444 consumer complaints were received in the 10 months of 2019 showing an increase by 16% in comparison with the 10 months of 2018. Consumers most frequently complained about products which did not meet provisions of the agreement and services which did not meet provisions of the agreement. Consumers most frequently complained about footwear and electrical appliances which did not meet provisions of the agreement. In the area of services, many complaints were received about airline services (1048 complaints). Many complaints also concern electronic communications and travel services, as well as concerts that have not happened and have been cancelled.

In the field of **informing consumers**, in the 10 months of 2019 CRPC has prepared 89 press releases, as well as has organised and got involved in several campaigns. In order to attract attention of society and promote financial literacy, CRPC implemented an informative educational campaign “See through the debt!” on responsible borrowing urging the population to critically evaluate their creditworthiness and motivated to plan their private budget in the long-term. Within this campaign, CRPC developed educational materials summarising information on crediting tools and their fitness for satisfaction of various needs, when necessary, as well as developed a map of advises to borrowers, who have faced problems in repayment of debts.

In 2019, CRPC got involved in the “Know before you go” campaign of the European Consumer Centre informing consumers about safe car hire all over Europe, and the “React to recalls” campaign implemented in OECD countries, which informed about the importance of recalls of dangerous goods.