2019 OECD ECONOMIC SURVEY AND

ENVIRONMENTAL PERFORMANCE REVIEW OF LATVIA

Towards strong, inclusive and environmentally sustainable growth

Riga, May 29th 2019

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slideshare
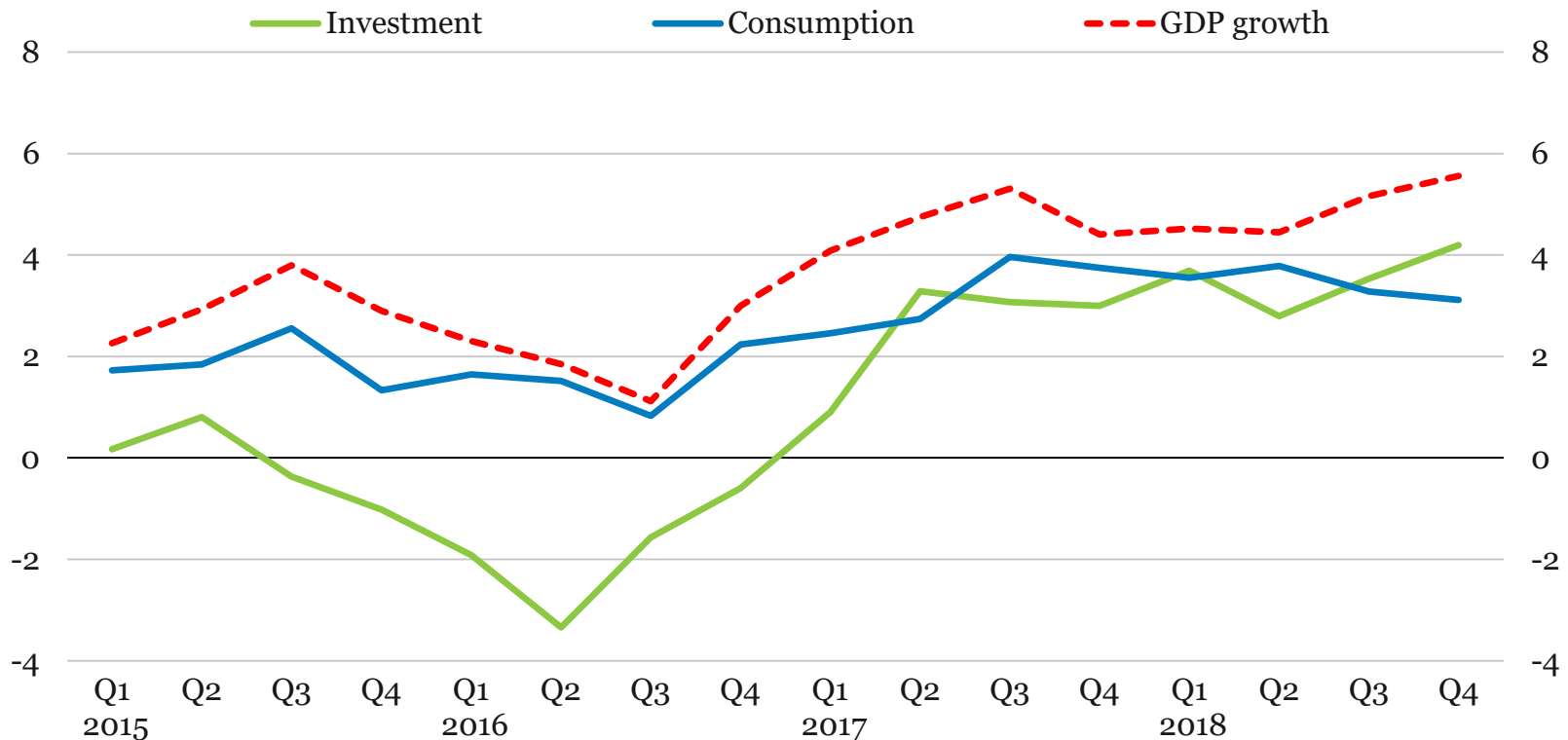
OECD
BETTER POLICIES FOR BETTER LIVES

ECONOMIC GROWTH IS ROBUST

Economic growth is broad-based

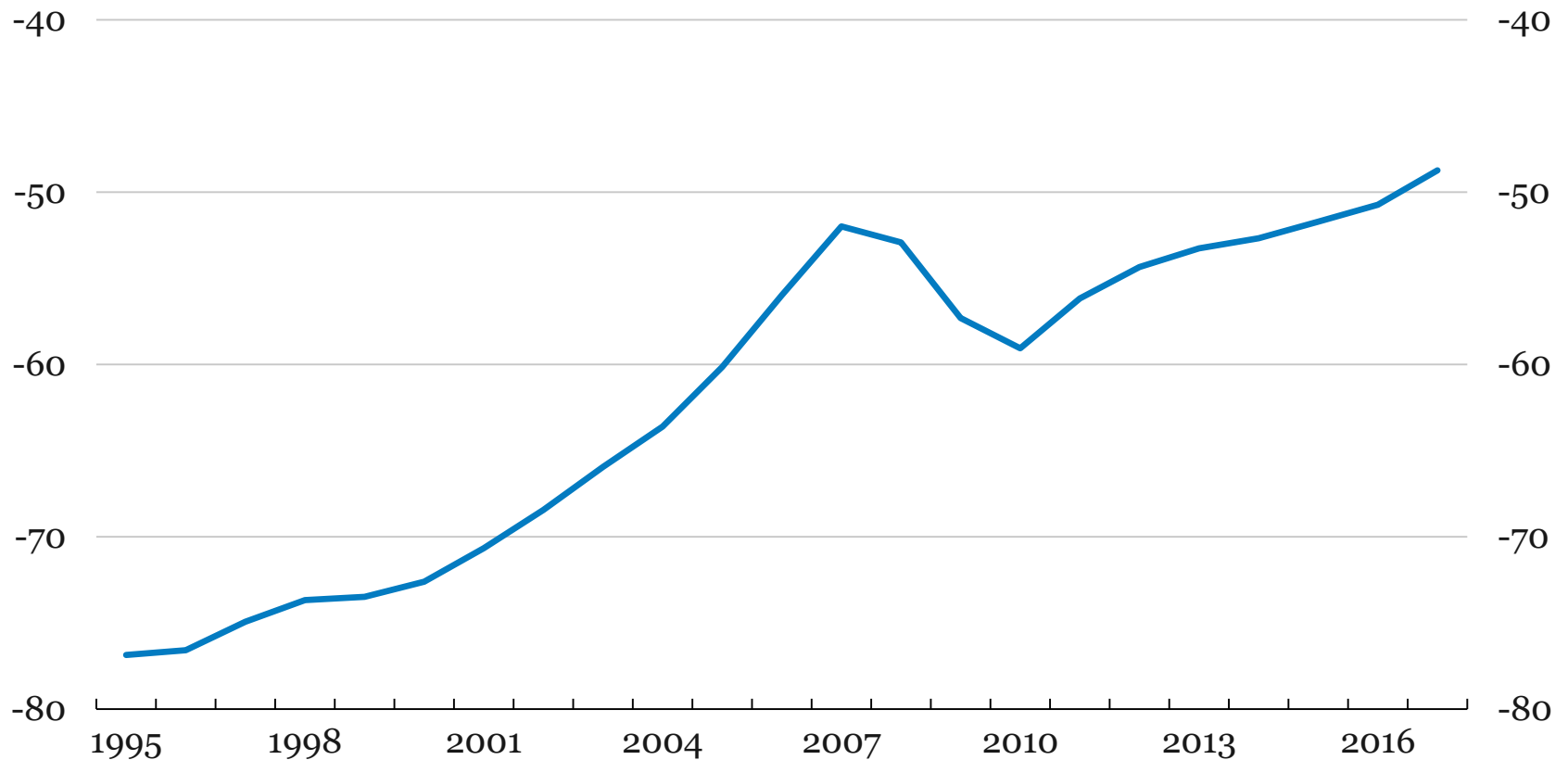GDP and major components, growth and contribution,
% and % points

Note: The chart plots the GDP growth (in %) and the contribution to GDP growth by investment and consumption (in % points).
Source: OECD (2018), OECD Economic Outlook: Statistics and Projections (database).

Income convergence continues

The gap of GDP per capita to the upper half of OECD countries, %

Note: Percentage gap with respect to the weighted average using population weights of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2010 PPPs).
Source: OECD (2019), Economic Policy Reforms 2019: Going for Growth (forthcoming).

The labour market is tight
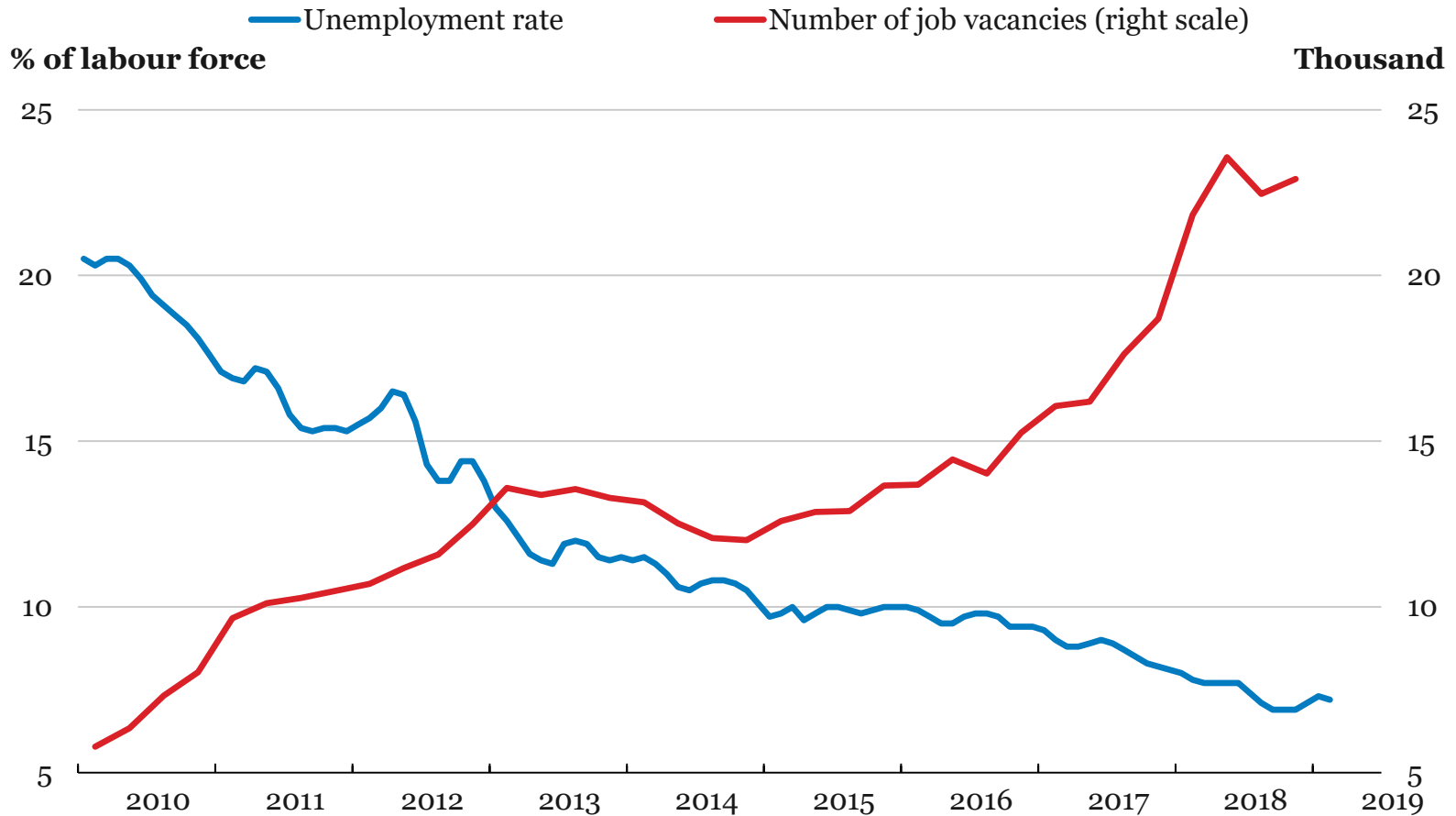
Source: OECD (2019), OECD Economic Outlook: Statistics and Projections (database).

Inflation is moderate despite strong wage growth
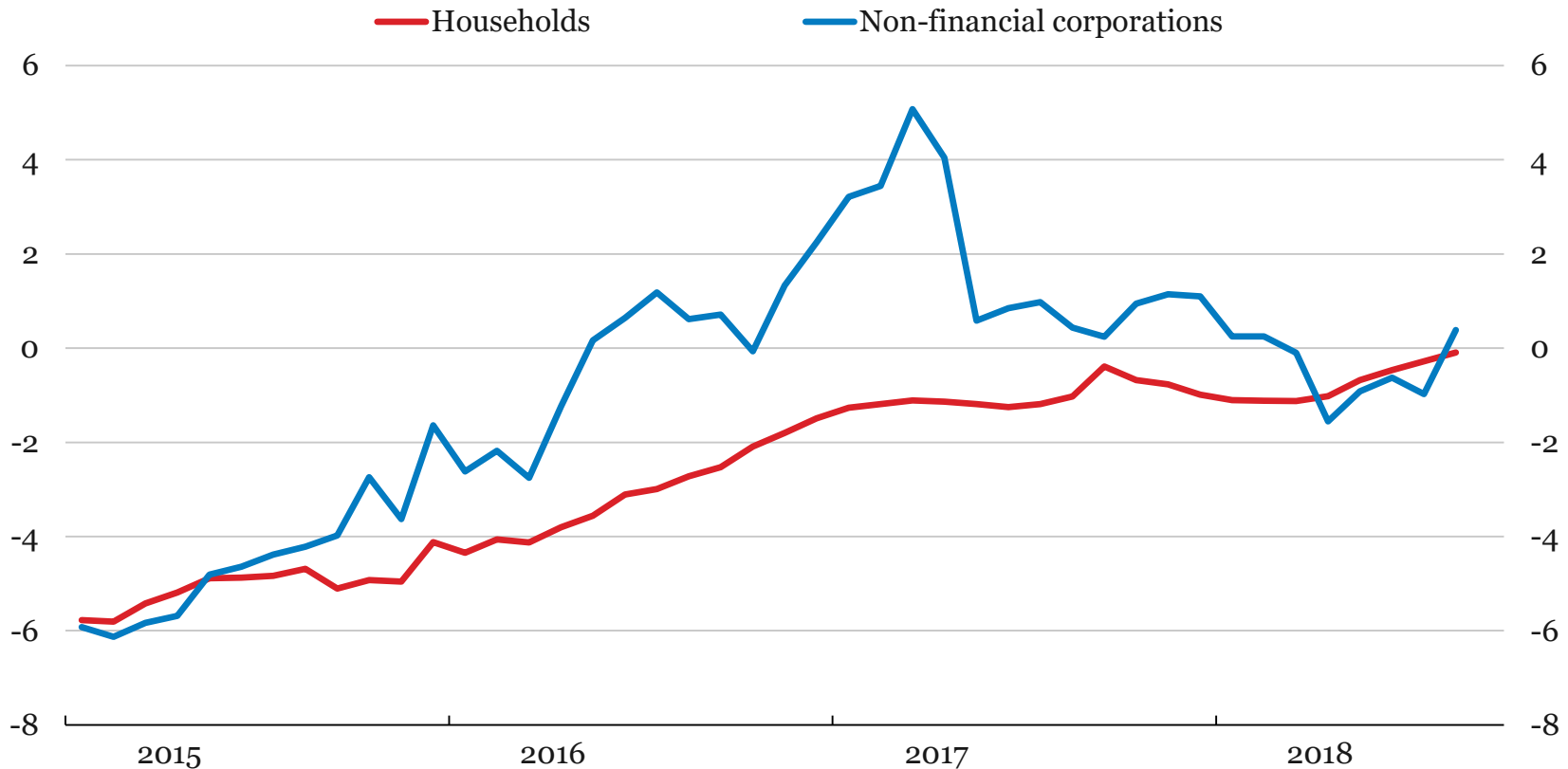
Wage and price inflation, %

Note: Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: Central Statistical Bureau of Latvia; Economic Outlook Database; OECD Productivity Database.

Credit growth remains close to nil

Bank loans to the non-financial private sector,
% change of credit stock

Note: Data are adjusted for one-off effects related to the structural changes in the Latvian banking sector (e.g., due to withdrawal of credit institutions' licences). Source: Financial and Capital Market Commission.

Foreign deposits have been wound down amid efforts to fight money laundering

Share of foreign deposits in the Latvian banking sector ,
% of total deposits
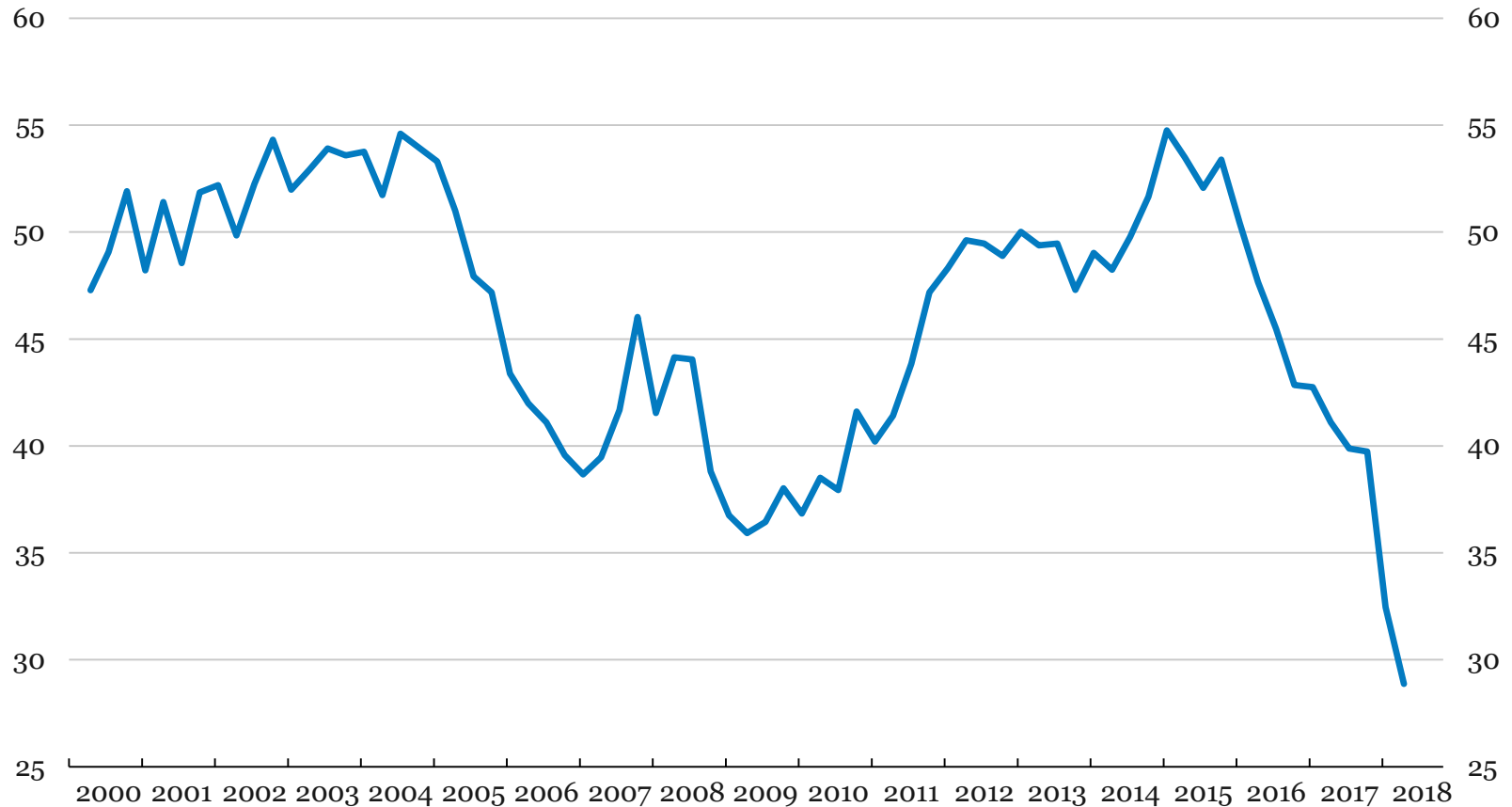
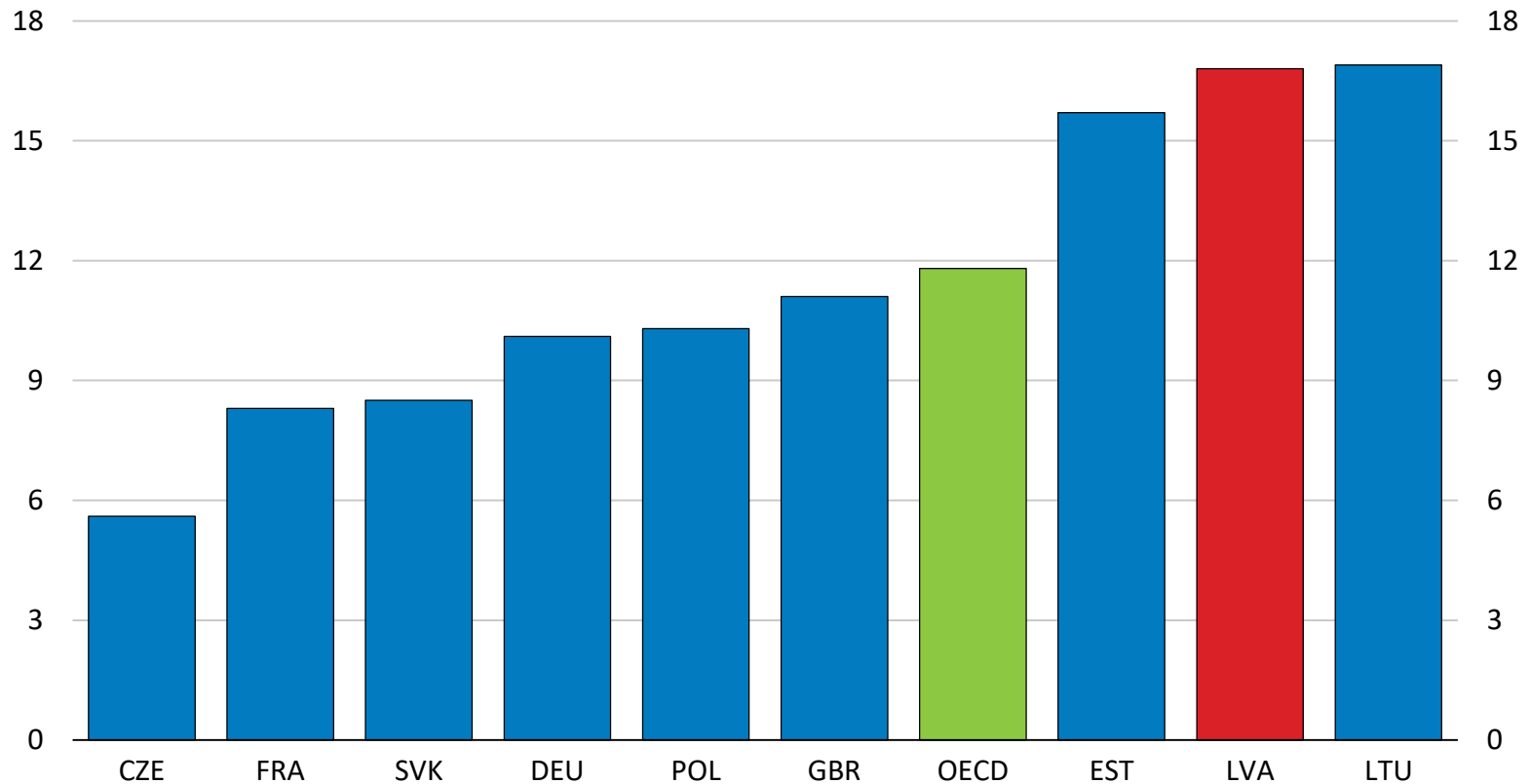Source: Financial and Capital Market Commission.

CHALLENGES REMAIN

Poverty is high

Share of population with disposable income below the poverty line, %

Note: The poverty threshold is 50% of median household disposable income. Household income is adjusted to take into account household size.
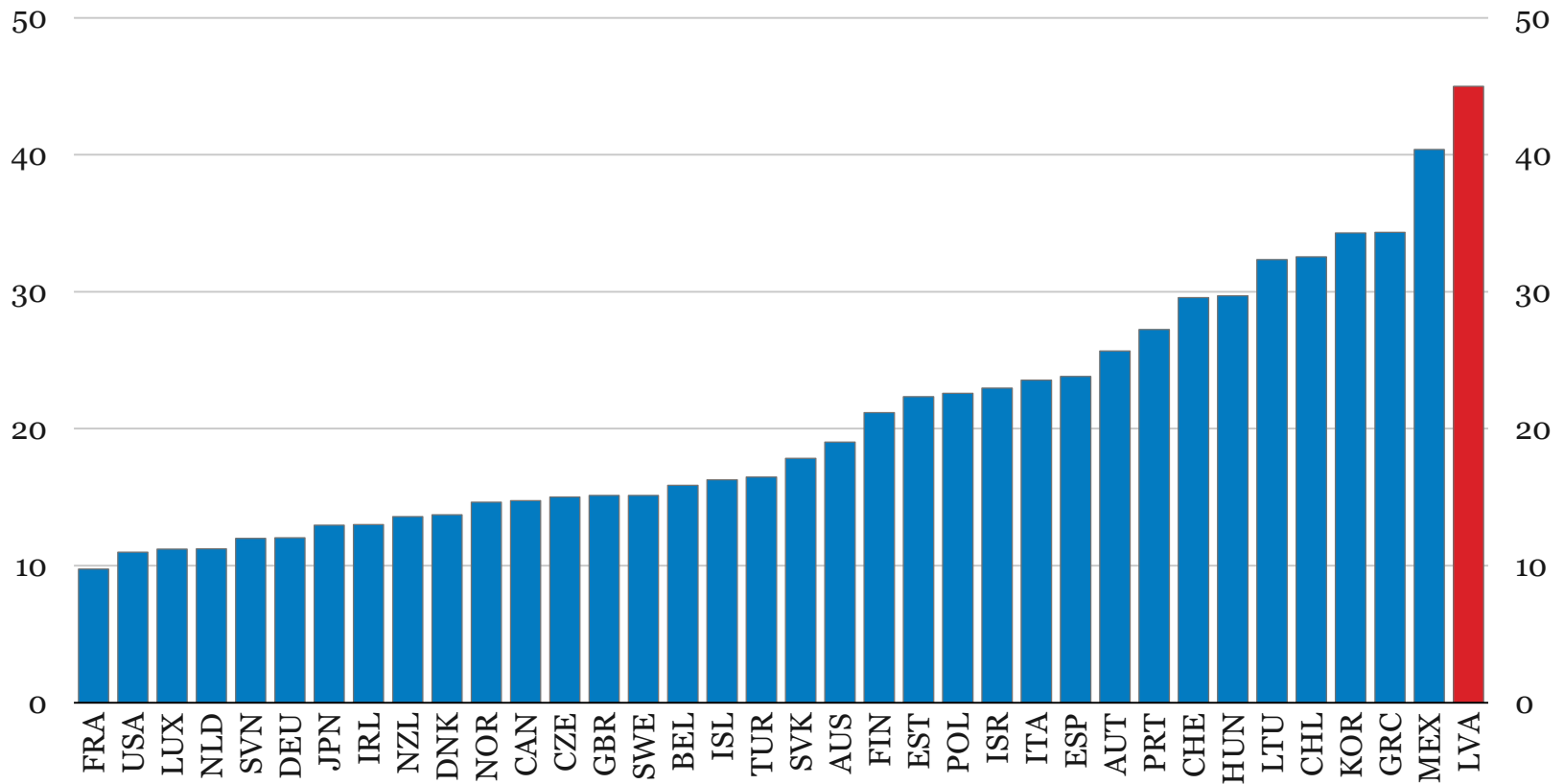OECD average is the unweighted average of available countries.
Source: OECD Income Distribution database (IDD).

Very high out-of-pocket expenditure results in unequal access to healthcare

Share of households' out-of-pocket expenditure in health care,
% of total current expenditure on health care, 2017 or latest available year
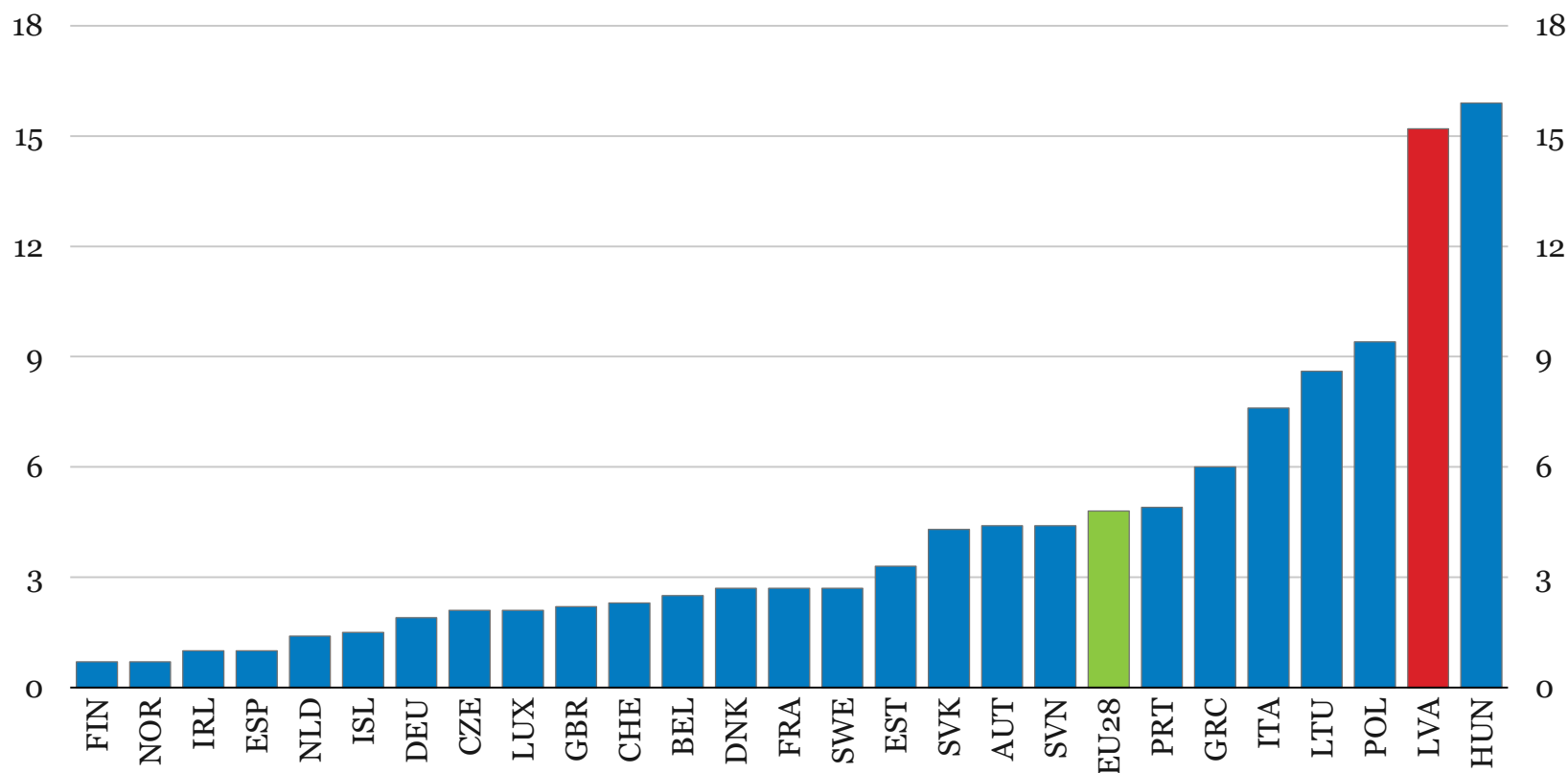

Source: OECD Health Statistics Database

Many households live in substandard housing

Severe housing deprivation rate,
%, 2017 or latest available year

Note: Severe housing deprivation rate is defined as the percentage of population living in the dwelling which is considered as overcrowded, while also exhibiting at least one of the housing deprivation measures (leaking roof, no bath/shower and no indoor toilet, or a dwelling considered too dark).
Source: EU statistics on income and living conditions (EU-SILC).

Regional inequalities are high

Gini index of inequality of GDP per capita,
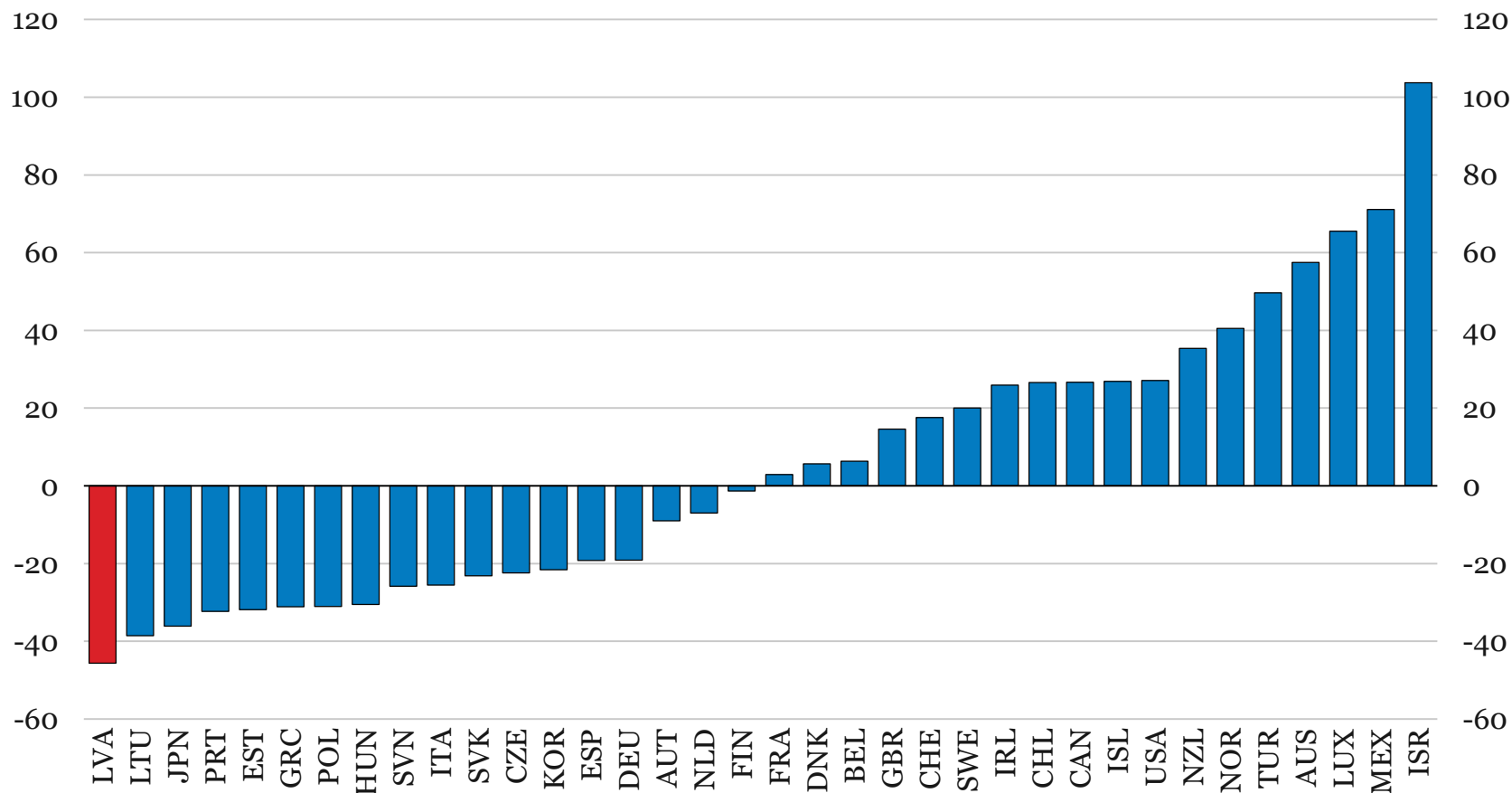Scale from 0 "perfect equality" to 1 "perfect inequality", latest year available
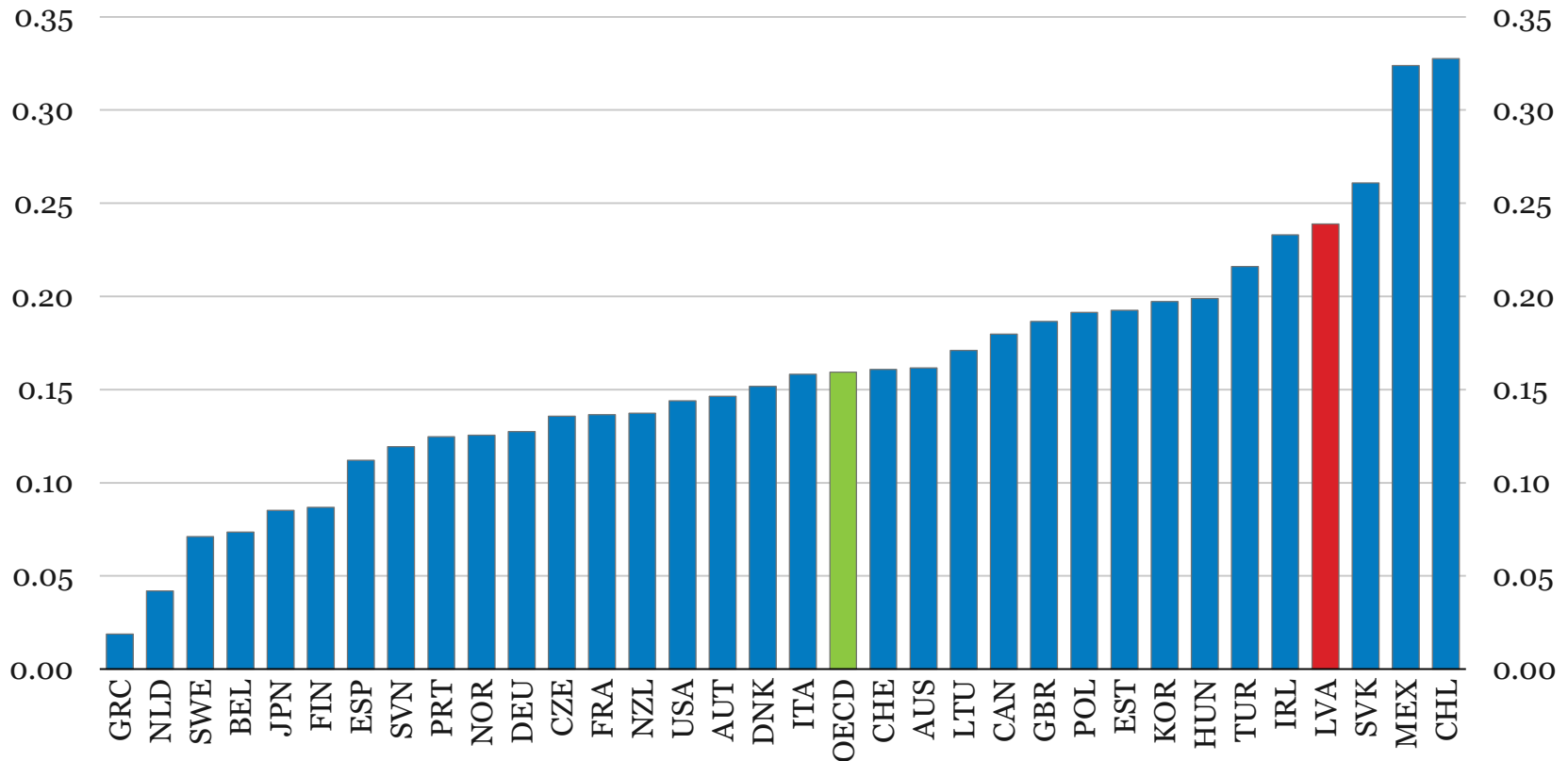
Note: Inequality across TL3 regions
Source: OECD (2016), OECD Regions at a Glance 2016

Latvia faces demographic challenges

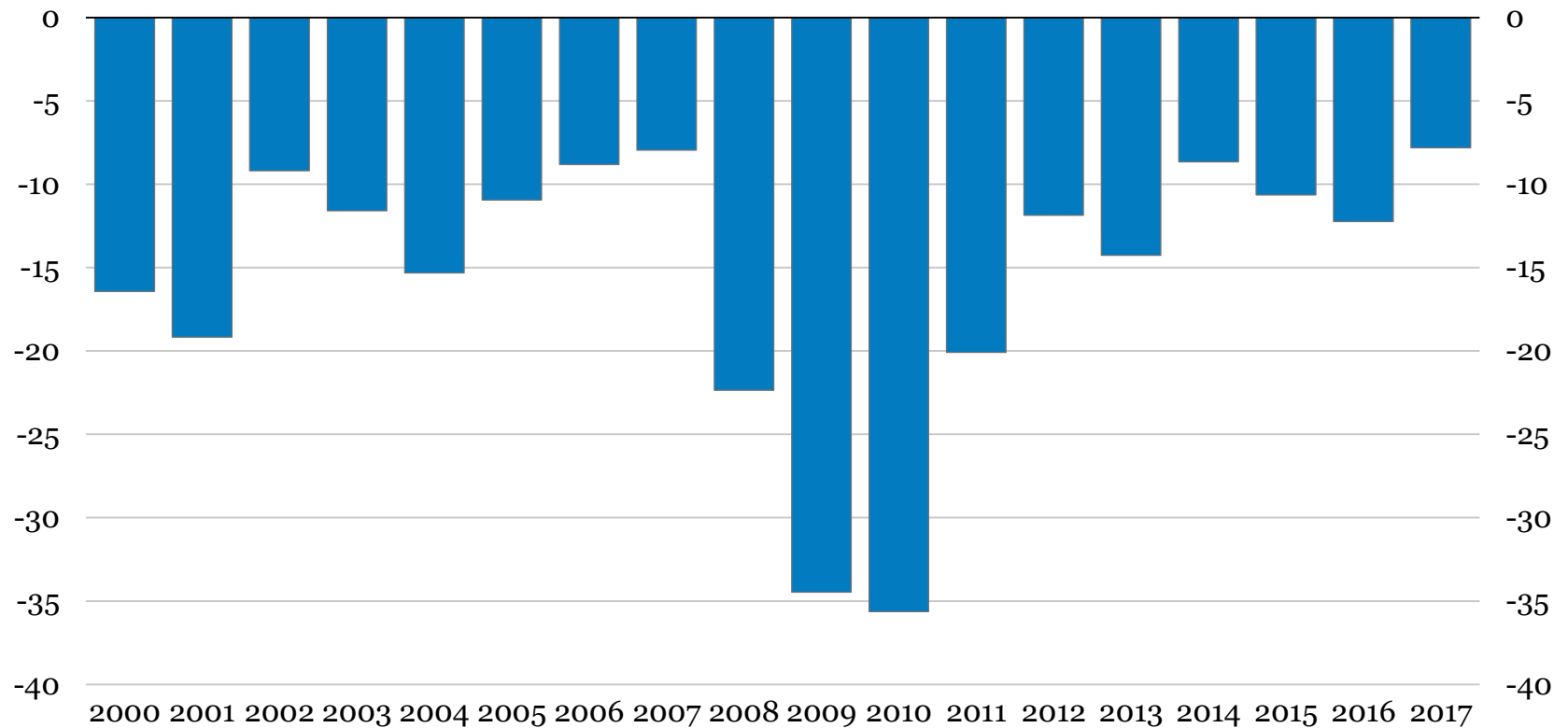Change in population aged 15-64, 2000-2050, %

Outmigration remains substantial

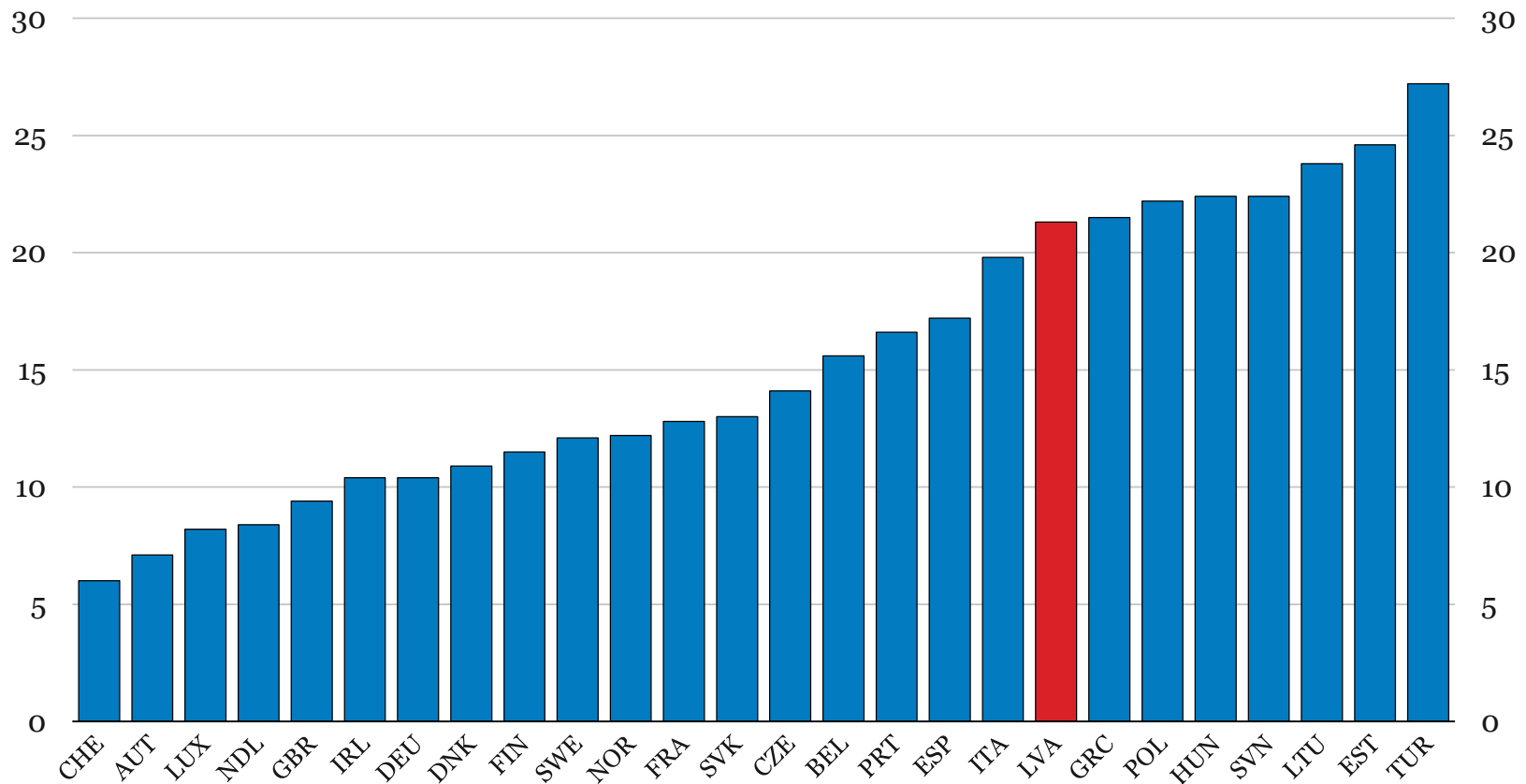Net immigration, thousands

Source: Central Statistical Bureau of Latvia.

The large shadow economy weighs on productivity and wellbeing

Estimated size of shadow economy, % of GDP

Source: Schneider, F. (2017) "Implausible Large Differences in the Sizes of Underground Economies in Highly Developed European Countries? A Comparison of Different Estimation Methods" CESifo Working Paper No. 6522, Munich.

Trust in national institutions is low

Shares of nationals trusting their government and judiciary, %, 2017
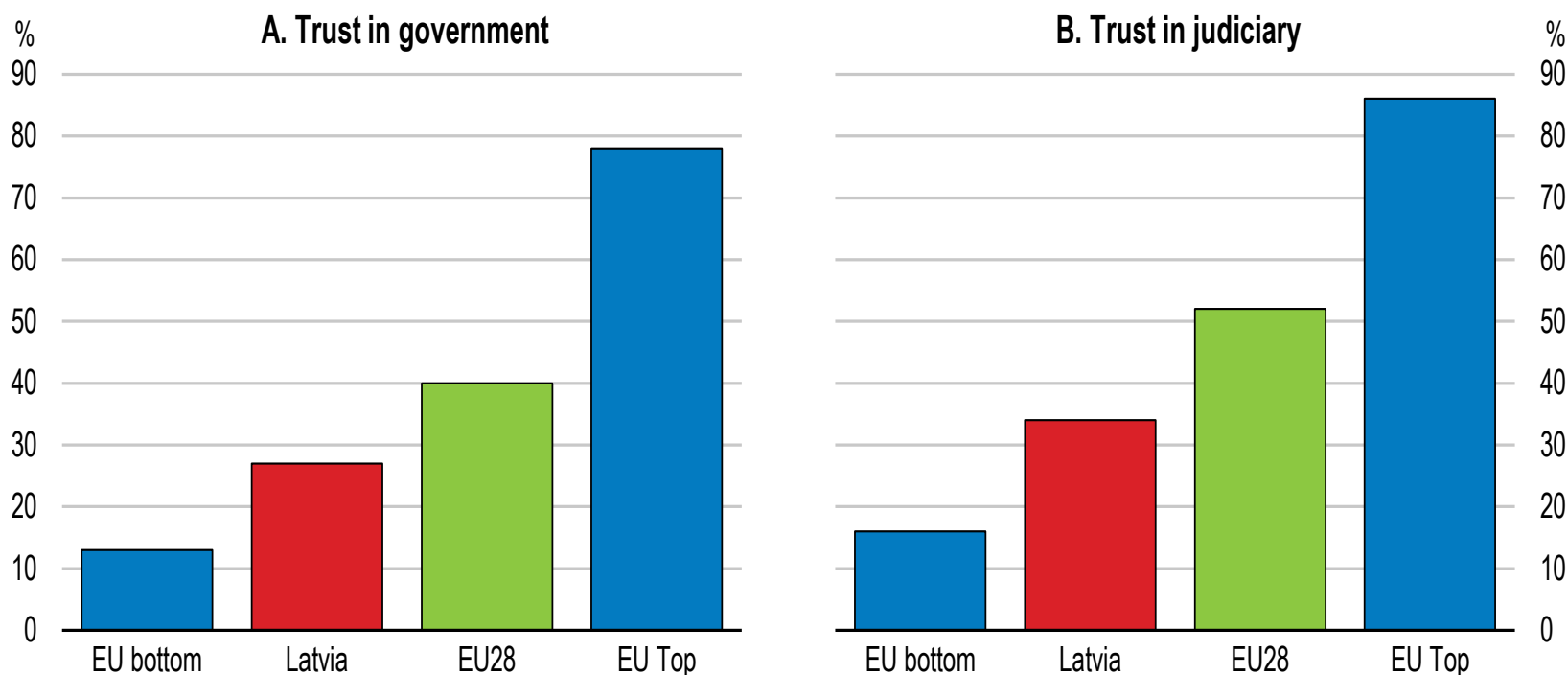
Note: Some 28,501 EU citizens were interviewed face-to-face and were asked whether they trust the national government and the national legal system. Shares reported in panel A are shares of nationals responding they tend to trust their government. Shares reported in panel B are shares of nationals responding they tend to trust their legal system.
Source: European Union (2017), Special Eurobarometer 461 "Designing Europe's future".

Car traffic increased substantially, due to inadequate public transportation services

Principal means of going to work, Riga
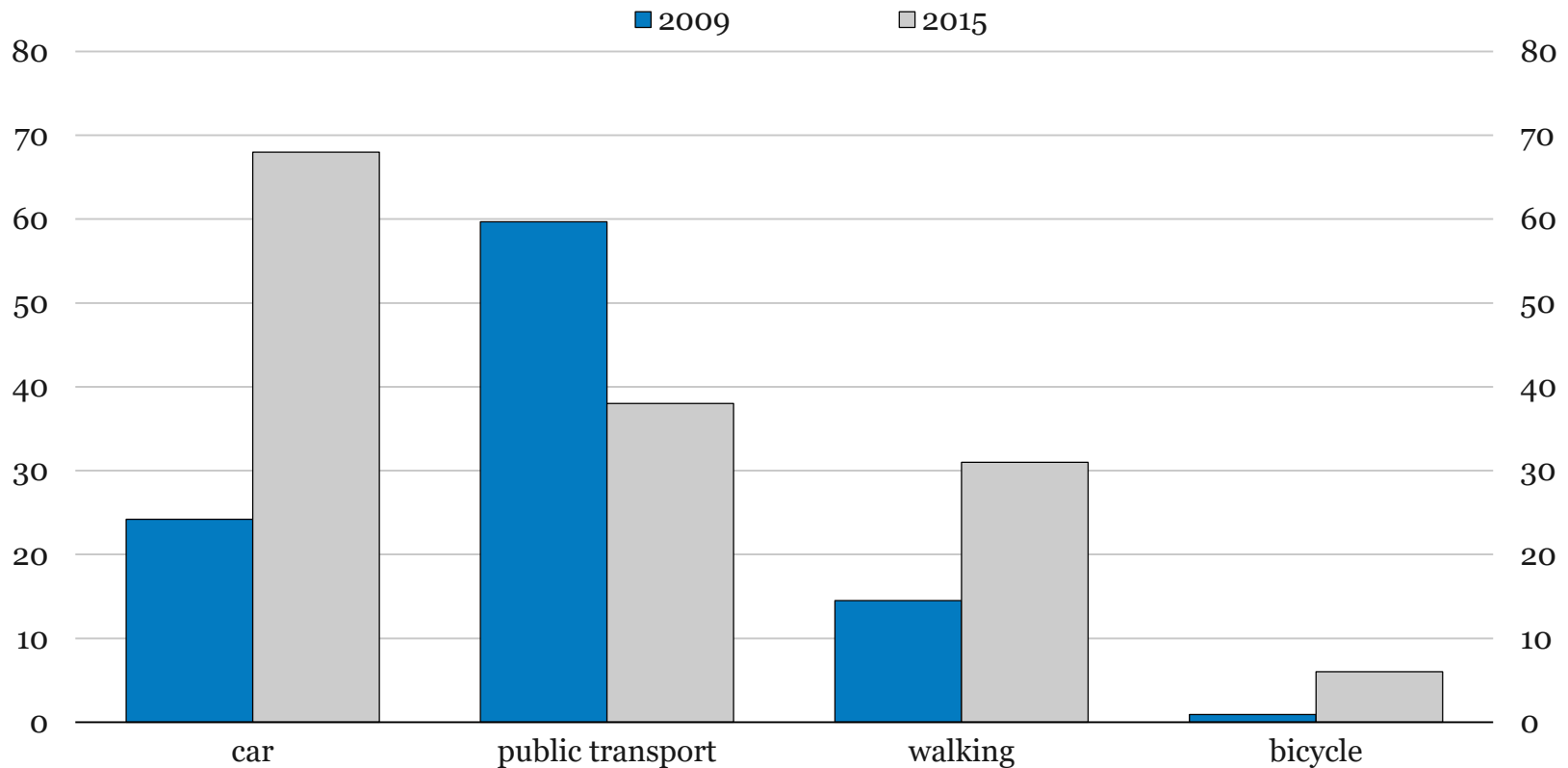
Note: Respondents were given the option to mention more than one means of transport for going to work (shares may rise to over 100%).
Source: Eurostat.

Policies for improving well-being and inclusiveness

- Strengthening social protection
  - ➢ Increase the guaranteed minimum income and consider tapering its withdrawal further.

- Increasing access to healthcare
  - ➢ Increase spending on healthcare to reduce out-of-pocket payments.
  - ➢ Ensure that all residents have access to the full healthcare package as envisaged.

- Improving housing conditions
  - ➢ Provide more public funding for affordable rental and social housing

- Increasing the size of municipalities by merging local administrations.

- Reducing the shadow economy and bolstering the rule of law
  - ➢ Continue the engagement of social partners in the fight against informality through sectoral agreements.
  - ➢ Ensure the accountability of judges, including by extending the deadlines for dealing with disciplinary cases.
  - ➢ Ensure continued commitment at the highest level of the government to swiftly implement the government action plan, strengthening the anti-money laundering and counter-terrorist financing framework.

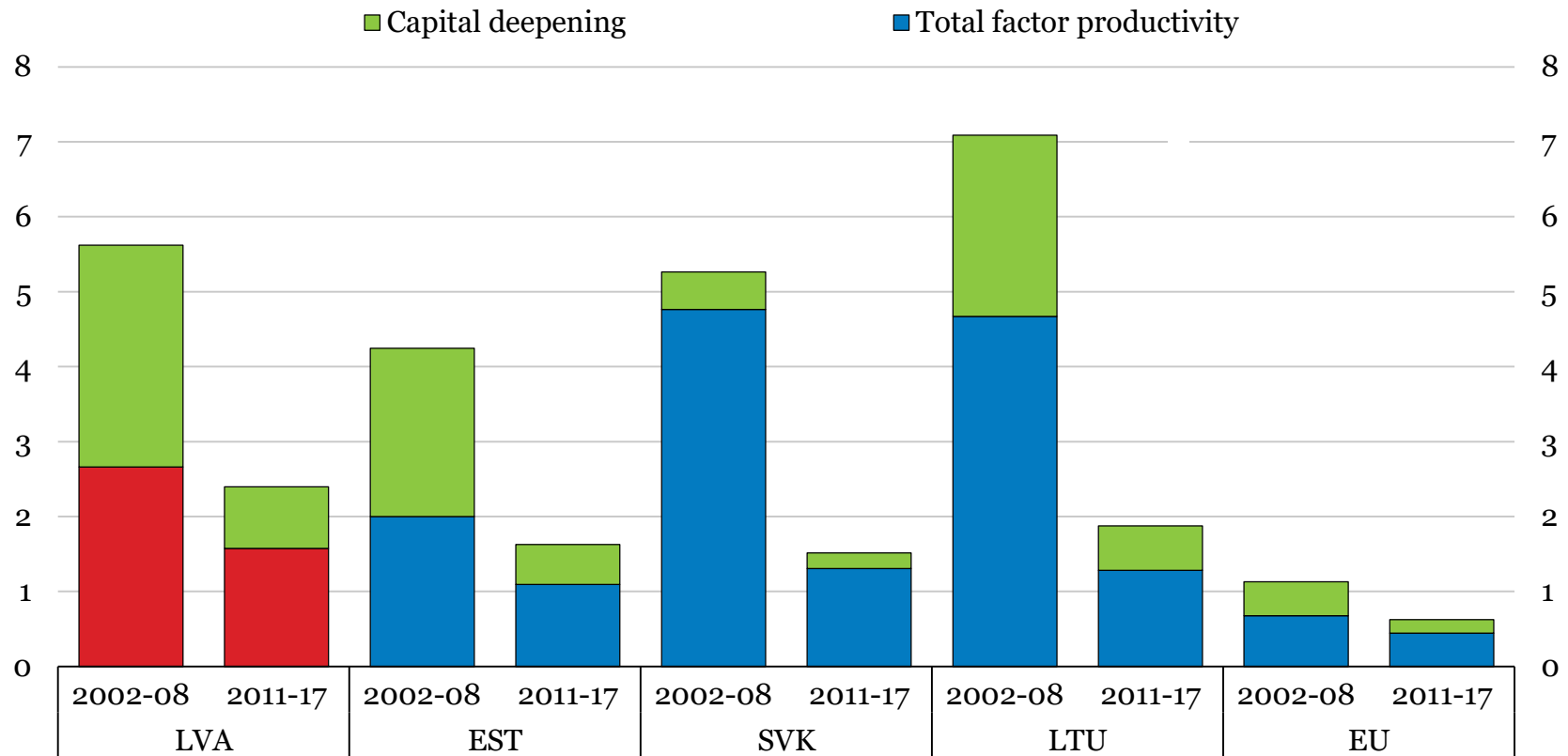More recommendations in the 2019 Economic Survey of Latvia

STRONGER PRODUCTIVITY GROWTH IS NEEDED FOR FAST INCOME CONVERGENCE

Productivity growth has slowed down

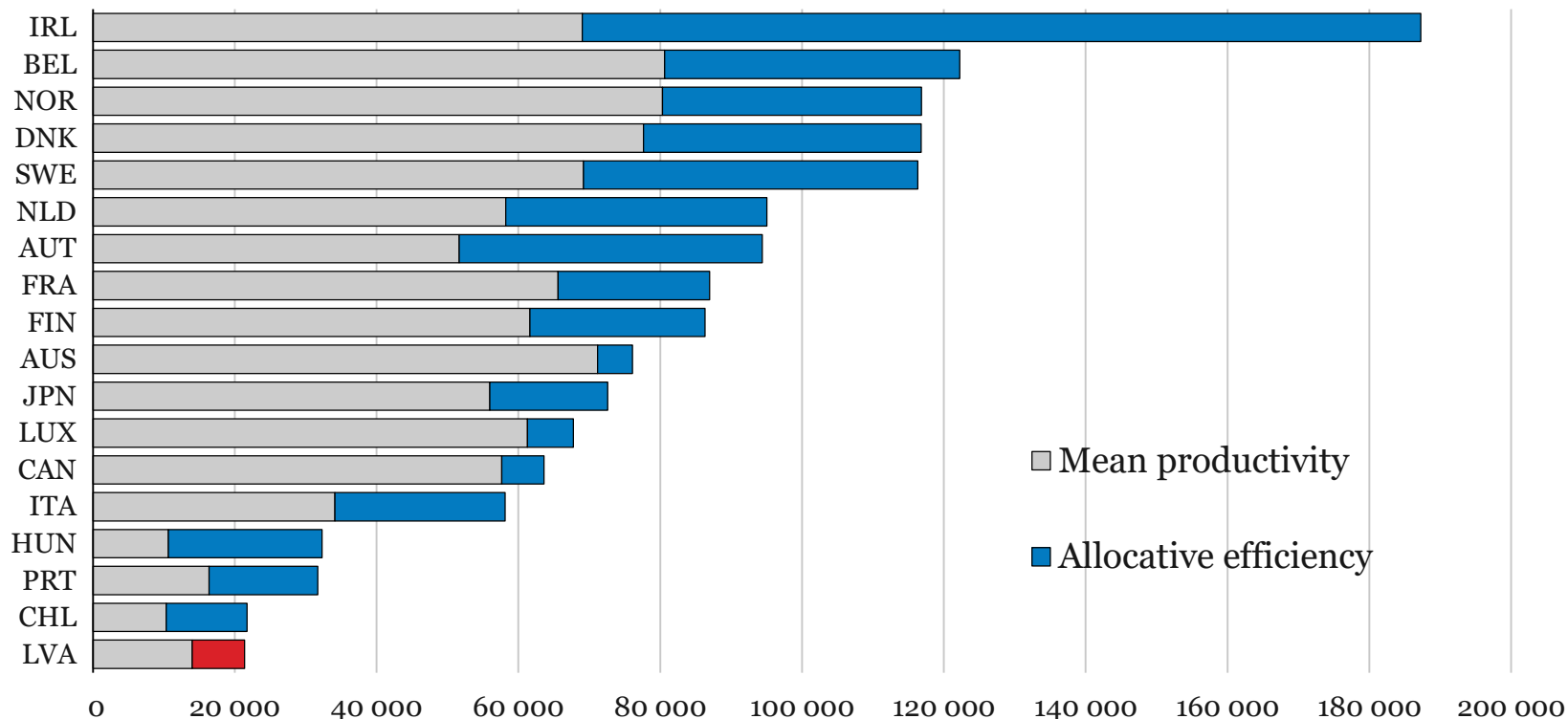Average annual growth in labour productivity, %

Source: OECD (2019) Going for Growth 2019 Edition.

Productivity is held back by weak innovation and inefficient resource allocation

The labour productivity of the manufacturing sector, 2005 PPP USD

Note: Mean productivity is the average productivity of firms in the manufacturing sector. Allocative efficiency captures to what extent more productive firms are larger, indicating the extent to which resources are allocated to more productive firms, allowing them to grow. Data refer to 2011 and are converted to USD using the 2005 Purchasing Power Parity.

Source: Latvia data are from Benkovskis, K., O. Tkacevs and N. Yashiro (2019), "The role of resource allocation in Latvia's productivity", OECD Economics Department Working Papers, OECD Publishing, Paris, forthcoming.. The Ireland data are from: Papa, J., Rehill, L., and O'Connor, B., "Patterns of Firm Level Productivity in Ireland", OECD Productivity Working Papers, 2018-15, OECD Publishing, Paris. Other countries' data are from Berlingieri, G., et al. (2017), "The Multiprod project: A comprehensive overview", OECD Science, Technology and Industry Working Papers, No. 2017/04, OECD Publishing, Paris.

Latvian firms lag behind in digitalisation

Enterprises using specific digital technologies,
### % of enterprises, 2017 or latest available year
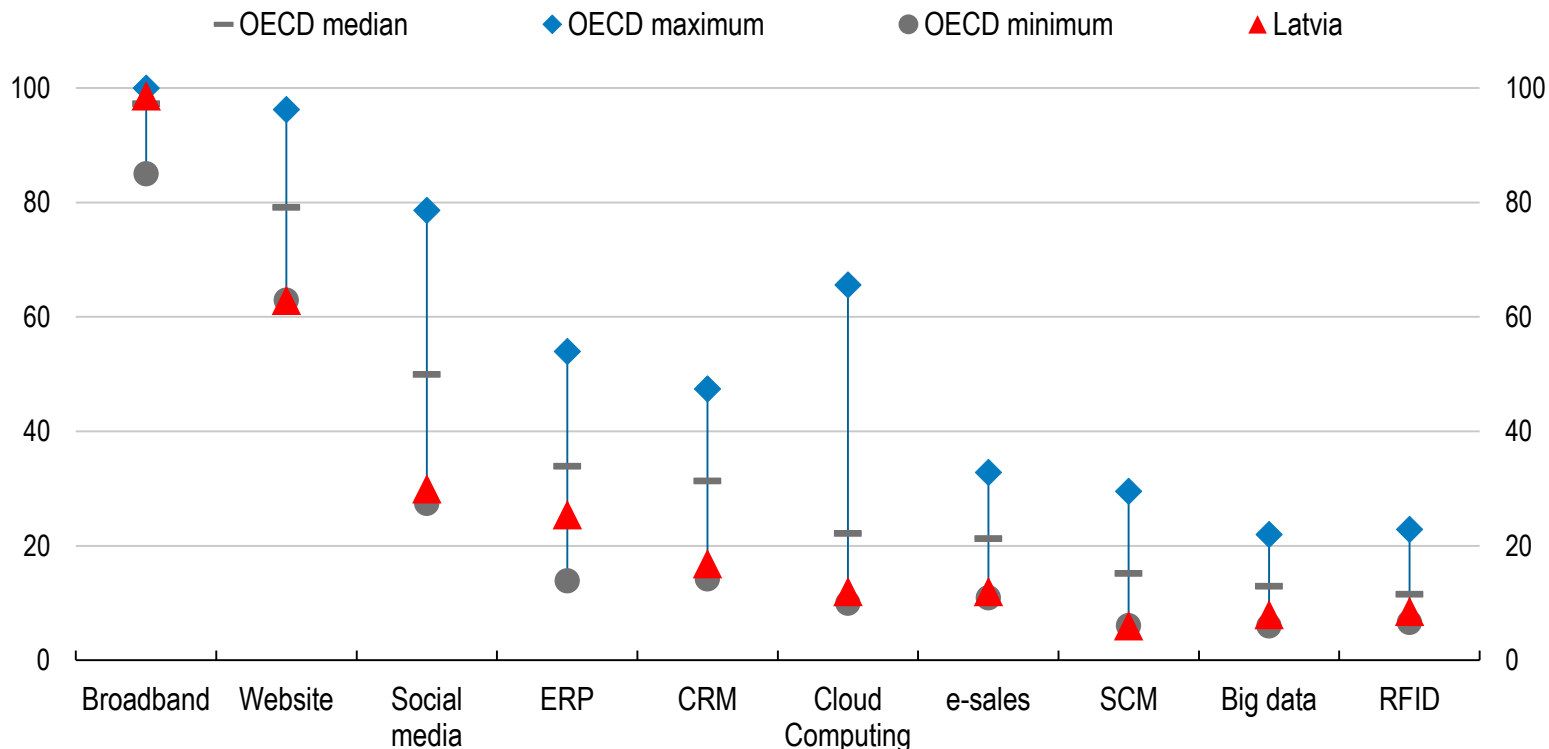
Note: Data cover 26 OECD countries and correspond to the share of businesses with ten or more employees with broadband connection (fixed or mobile); with a website or home page; using social media; using Enterprise Resource Planning (ERP) software; using Customer Relationships Management (CRM) software; purchasing cloud computing services; receiving orders over computer networks; sharing electronically information with suppliers and customers (SCM); using Radio Frequency Identification (RFID) technology; and having performed big data analysis (2018 data).
Source: OECD ICT Access and Usage by Businesses Database and Eurostat.

Weak debt recovery holds back lending

Average debt recovery rate, cents per a dollar of credit, 2018
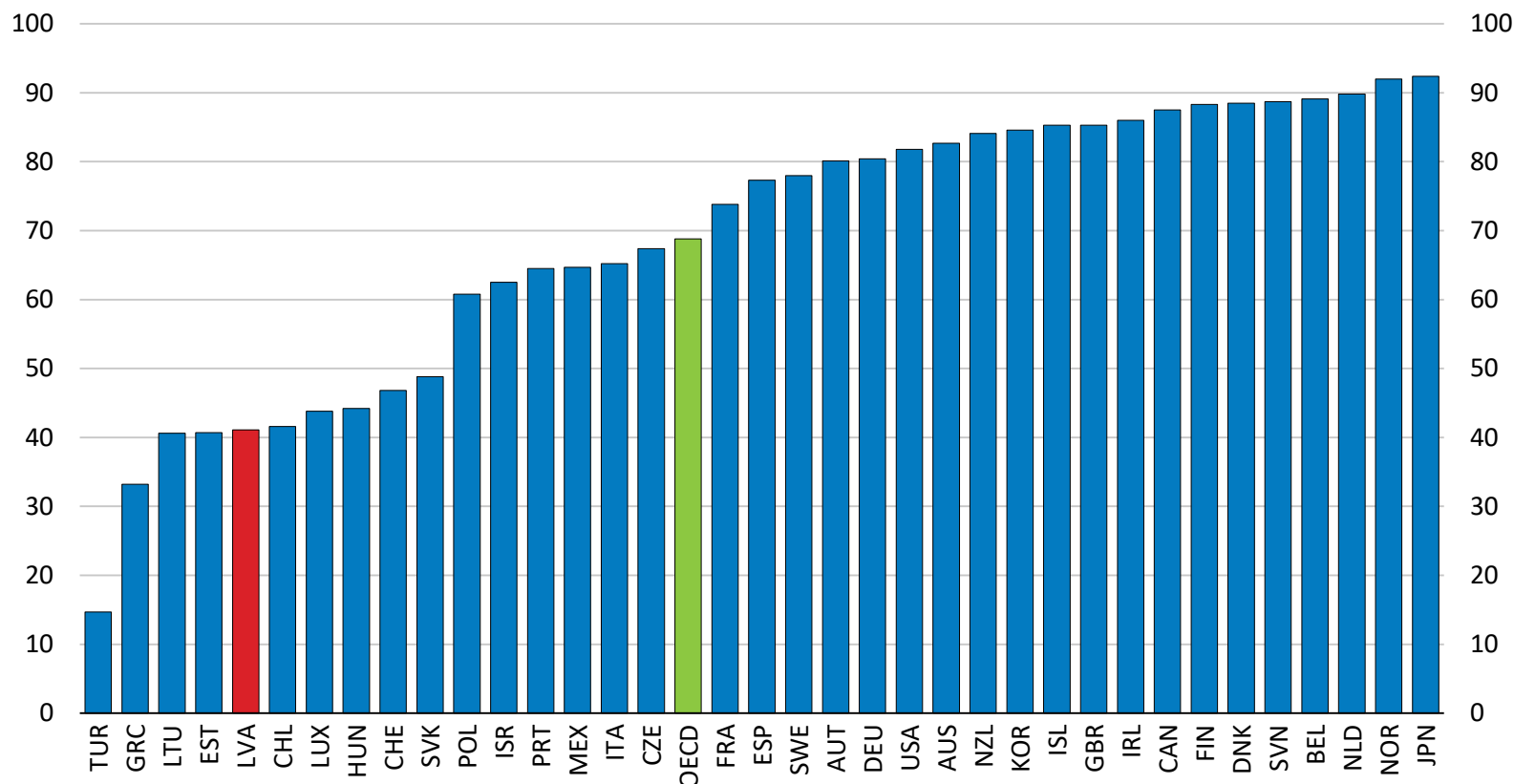
Note: The recovery rate is calculated based on the time, cost and outcomes of insolvency proceedings and is recorded as cents on the dollar recovered by secured creditors. The calculation takes into account whether the business emerges from the proceedings as a going concern or the assets are sold piecemeal. The costs of the proceedings are deducted. The value lost as a result of the time the money remains tied up in insolvency proceedings is also deducted. The recovery rate is the present value of the remaining proceeds.
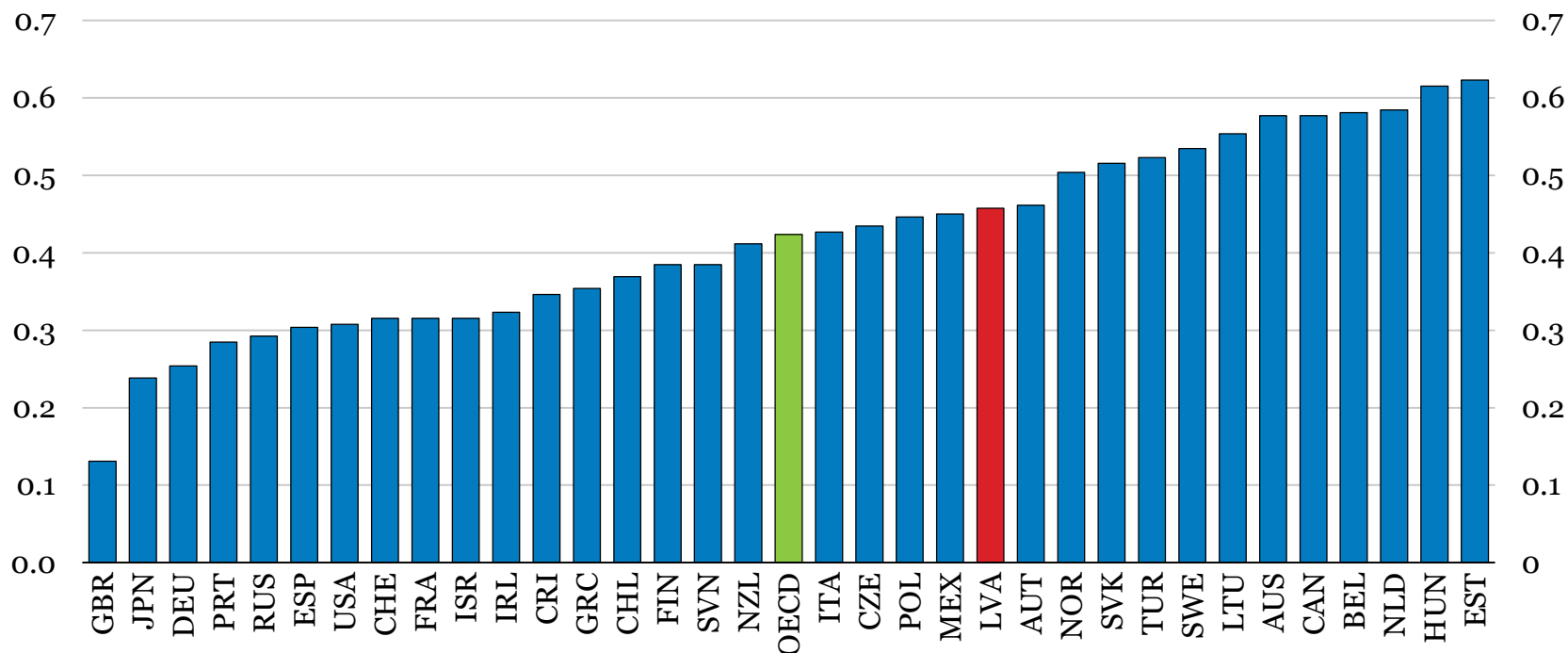Source: World Bank, Doing Business 2019 database.

The efficiency of insolvency procedures could improve further

OECD insolvency regime indicator, 2016

Note: A higher value corresponds to an insolvency regime that is most likely to delay the initiation of and increase the length of insolvency proceedings. Composite indicator based on 13 components: time to discharge; exemption of assets; early warning mechanisms; pre-insolvency regimes; special insolvency procedures for SMEs; creditor ability to initiate restructuring; availability and length of a stay on assets; possibility and priority of new financing; possibility to 'cram-down' on dissenting creditors and dismissal of management during restructuring; degree of involvement of courts; distinction between honest and fraudulent entrepreneurs and the rights of employees.
Source: Adalet McGowan, M., D. Andrews and V. Millot (2017), "Insolvency Regimes, Zombie Firms and Capital Reallocation", OECD Economics Department Working Papers, No. 1399

Regulatory settings are overall competition friendly, but public ownership is relatively high

OECD 2018 Product Market Regulation indicator and selected components,
Index scale of 0-6 from least to most restrictive (provisional)

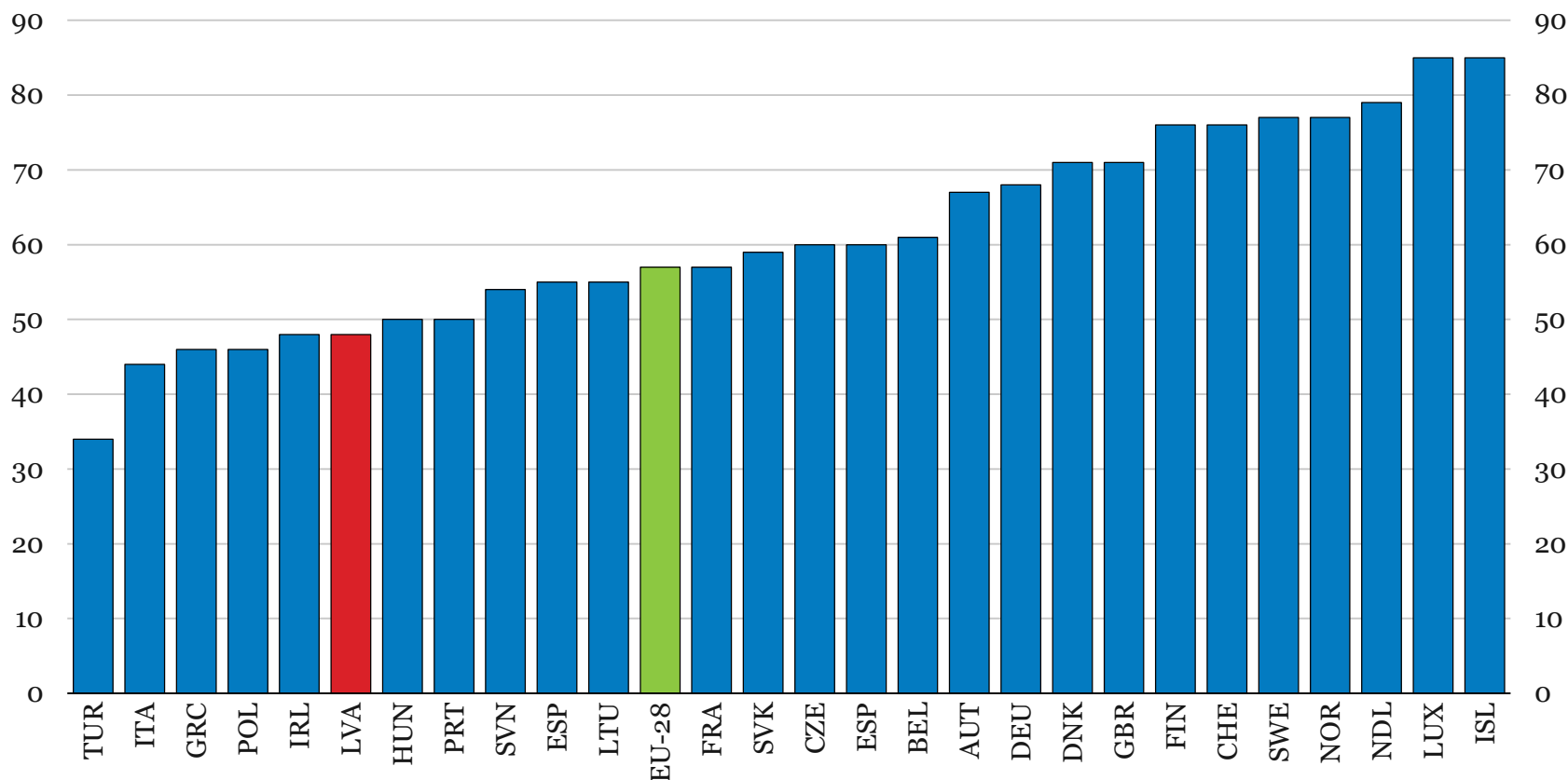— OECD median   ◆ OECD maximum   ● OECD minimum   ▲ Latvia
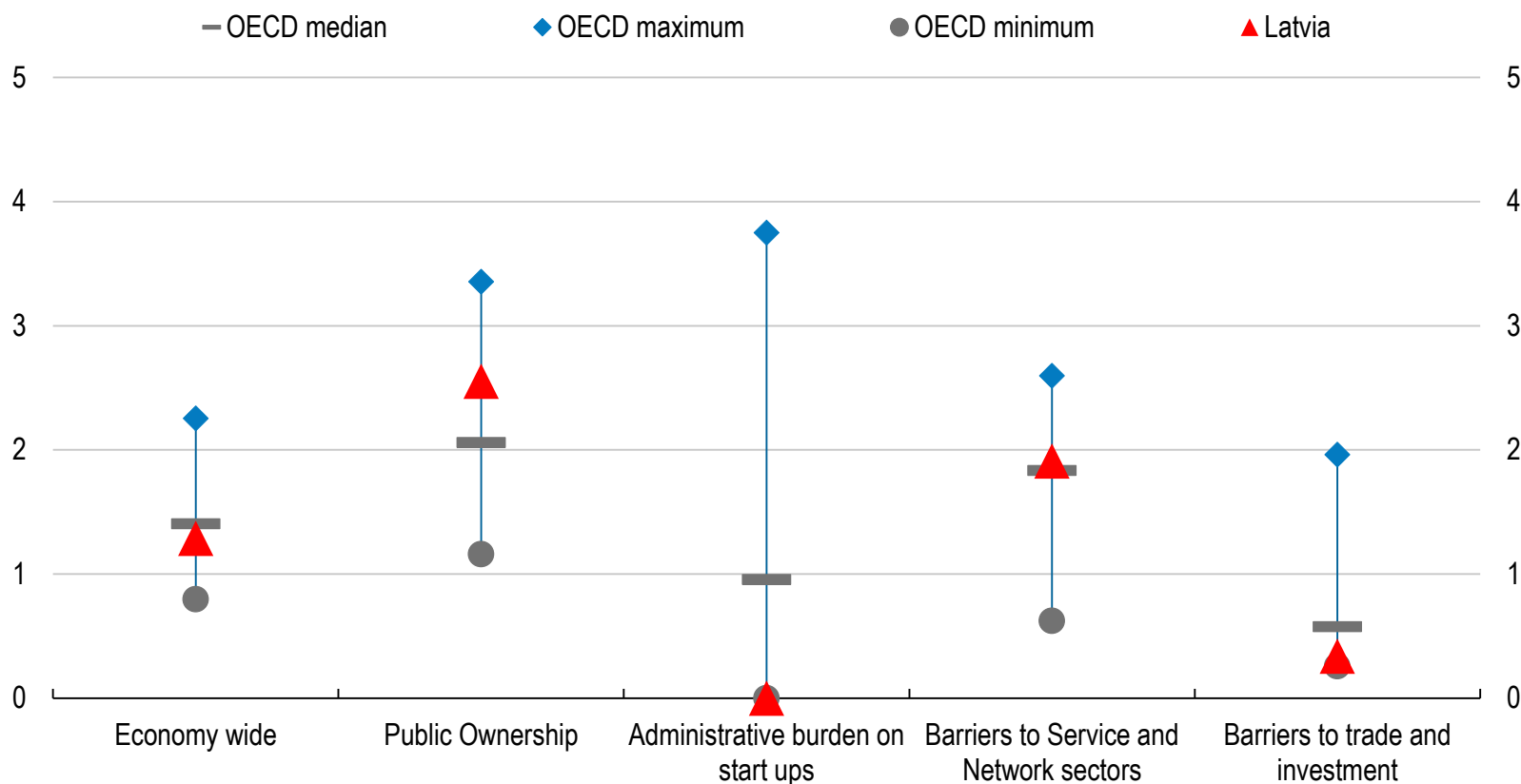
Source: Preliminary OECD 2018 PMR database.

About a half of Latvians lack basic digital skills

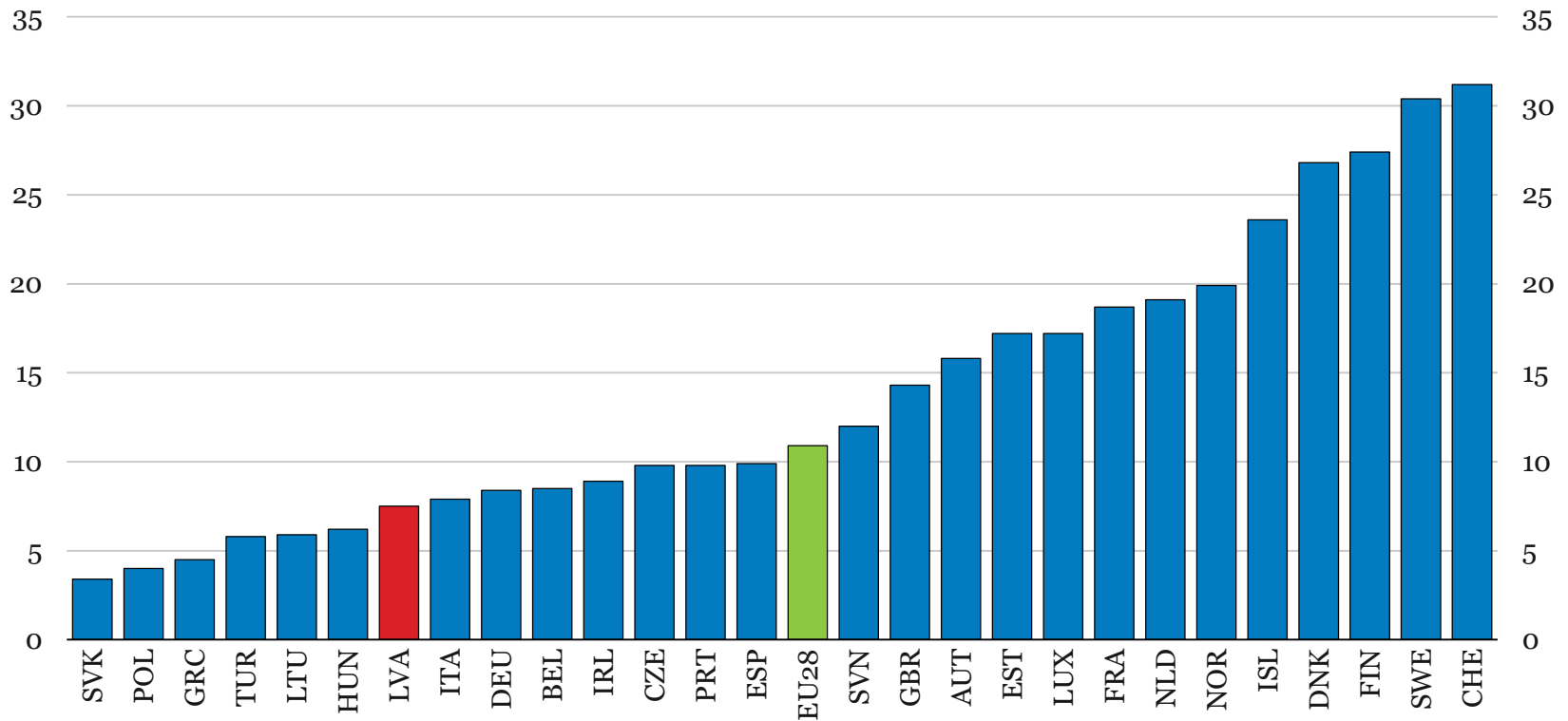The share of individuals with at least basic digital skills, %, 2017

Source: Eurostat.

Participation in adult learning is low

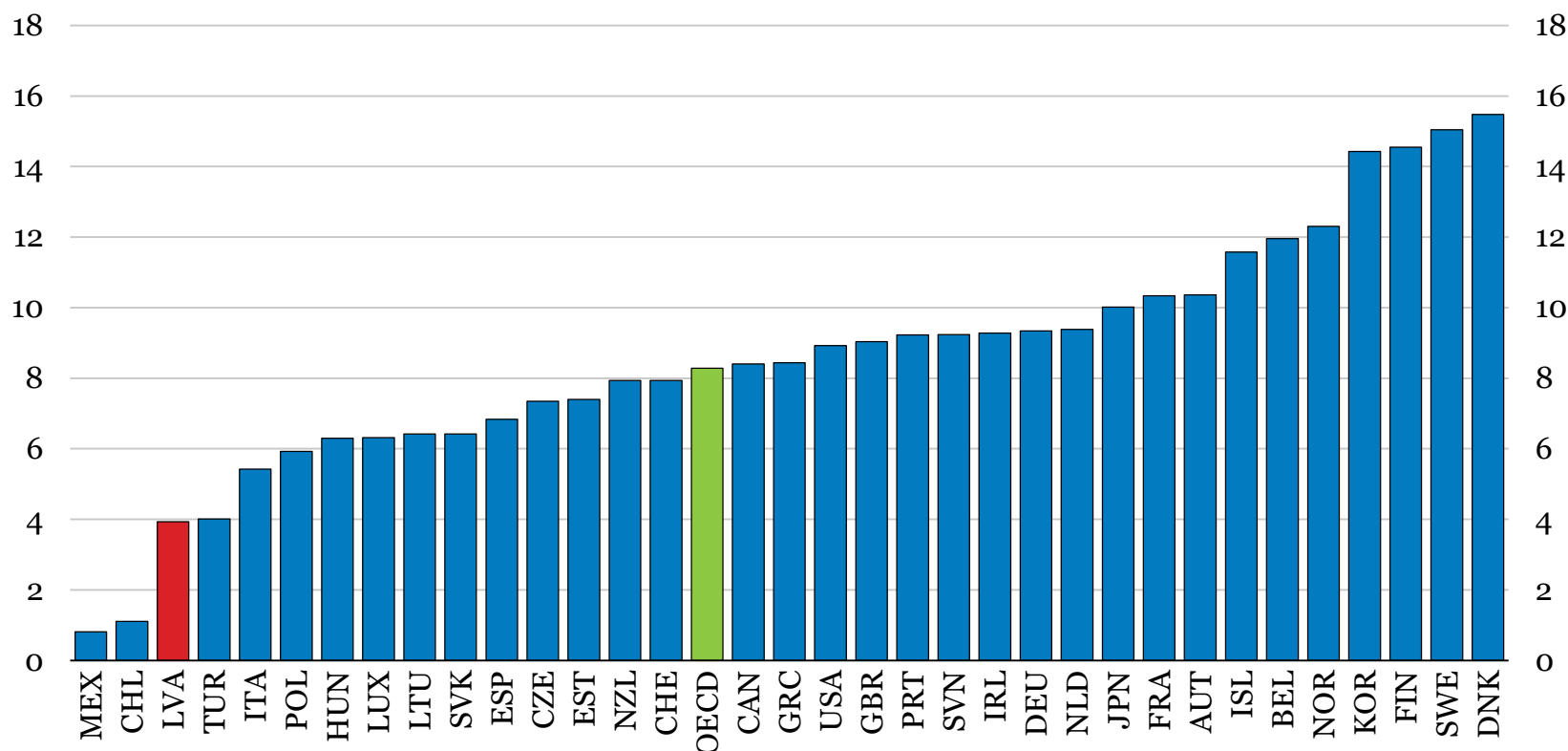Share of working-age population participating in education and training, %, 2017

Source: Eurostat.

The research workforce is small, limiting the innovation capabilities of Latvian firms

Share of researchers in total employment,
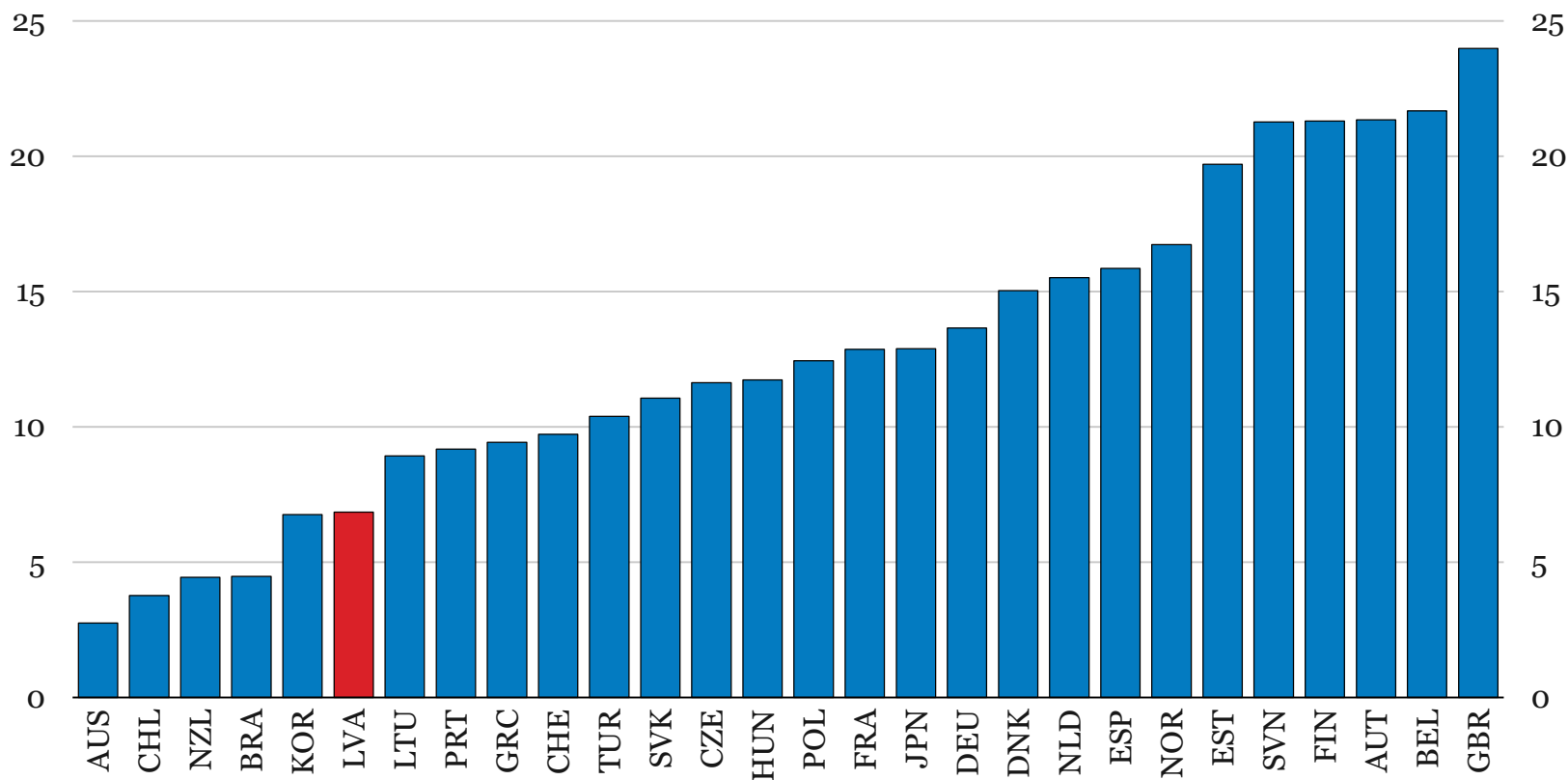per thousand of total employed, 2017 or latest available year

Technology transfer to SMEs is limited

Share of SMEs collaborating on innovation with research institutions,
% of innovating SMEs, 2014-16

Source: OECD Science, Technology and Industry Scoreboard 2017.

Policies for stronger productivity growth

- Improving the allocation of capital
  - ➢ Improve the quality and speed of judgement through training and specialisation of judicial staff.
  - ➢ Allow creditors to initiate restructuring and introduce early warning mechanisms of financial distress.

- Enhancing competition
  - ➢ Develop more detailed guidelines and apply them more rigorously for the review of the rationale for state ownership.
  - ➢ Strengthen the authority of the Competition Council to intervene against anti-competitive behaviour by state-owned and municipal enterprises.

- Strengthening skills
  - ➢ Promote joint training offers involving several firms.
  - ➢ Implement as early as possible the planned financial support for firms providing training to employees with stronger financing for the low skilled.

- Strengthening innovation and knowledge transfer
  - ➢ Promote sharing of resources of universities and research institutions.
  - ➢ Improve wages, working conditions and career prospects for researchers in public institutions and provide stronger incentives to collaborate with industry.
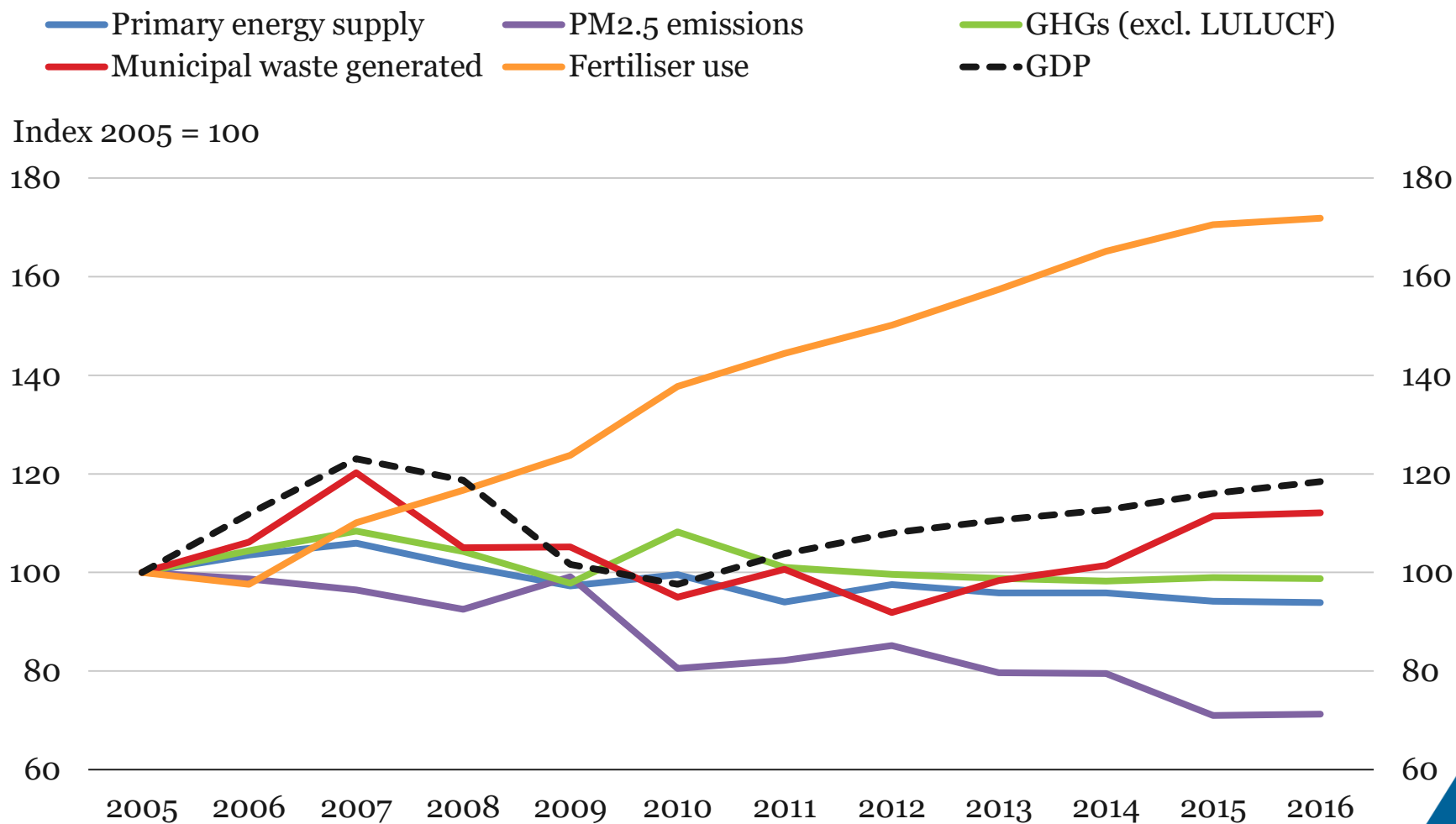
More recommendations in the 2019 Economic Survey of Latvia

ENVIRONMENTAL PERFORMANCE HAS IMPROVED BUT MORE WORK IS NEEDED TO GREEN THE ECONOMY

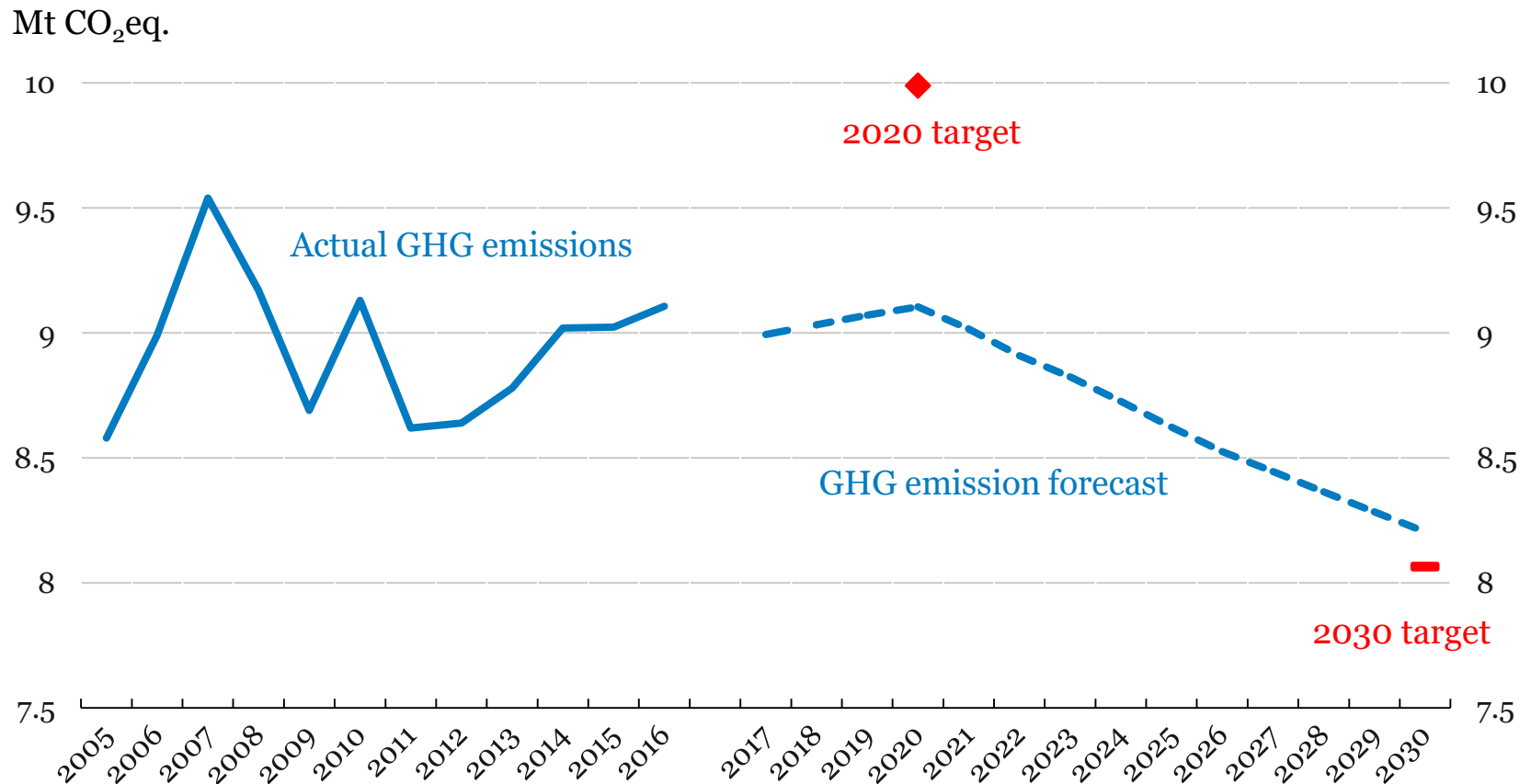# GHGs, PM$_{2.5}$ and energy supply have been decoupled from GDP growth, but not waste and fertilisers

Source: IEA (2019), *World Energy Statistics and Balances* (database); OECD (2018), *OECD National Accounts Statistics* (database); OECD (2018), *OECD Environment Statistics* (database).

The 2020 climate target is easy to meet but not the 2030 target

GHG emissions outside the EU Emission trading system
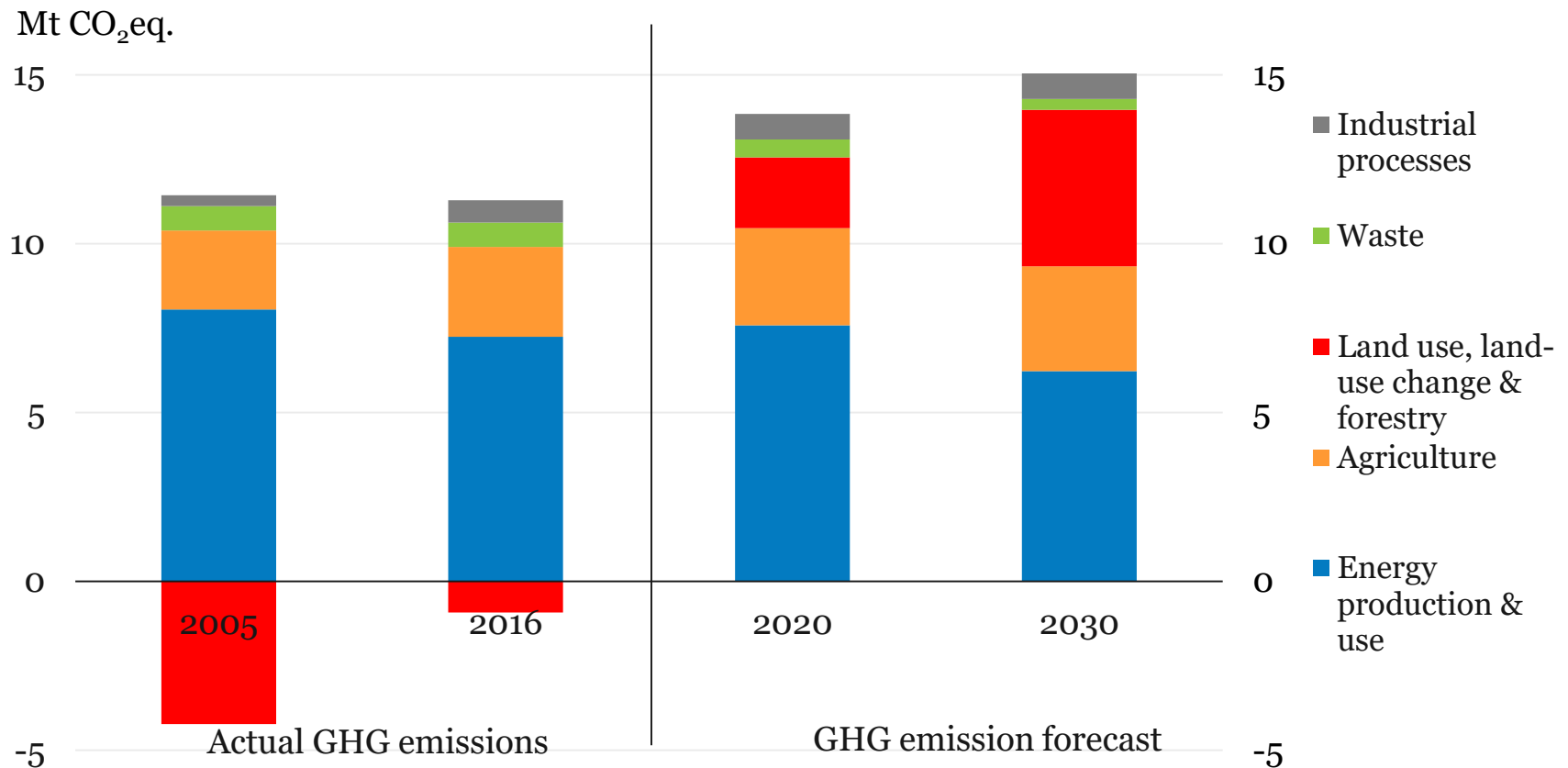(transport, agriculture, waste and small industrial and commercial facilities)

Mt CO_2eq.

Actual GHG emissions

2020 target

GHG emission forecast

2030 target

GHG emissions from agriculture, land use and forestry are rising

GHG emissions and removal by main sector
(actual emissions and projections)

Mt CO_2eq.

Actual GHG emissions

GHG emission forecast

Legend:
- Industrial processes
- Waste
- Land use, land-use change & forestry
- Agriculture
- Energy production & use

Source: UNFCCC (2018), *Greenhouse gas emissions data* (database); MEPRD and LVGMC (2019), "National projections of greenhouse gas emissions and removals", submitted to the European Commission pursuant Commission Implementing Regulation (EU) No 749/2014 of 30 June 2014.
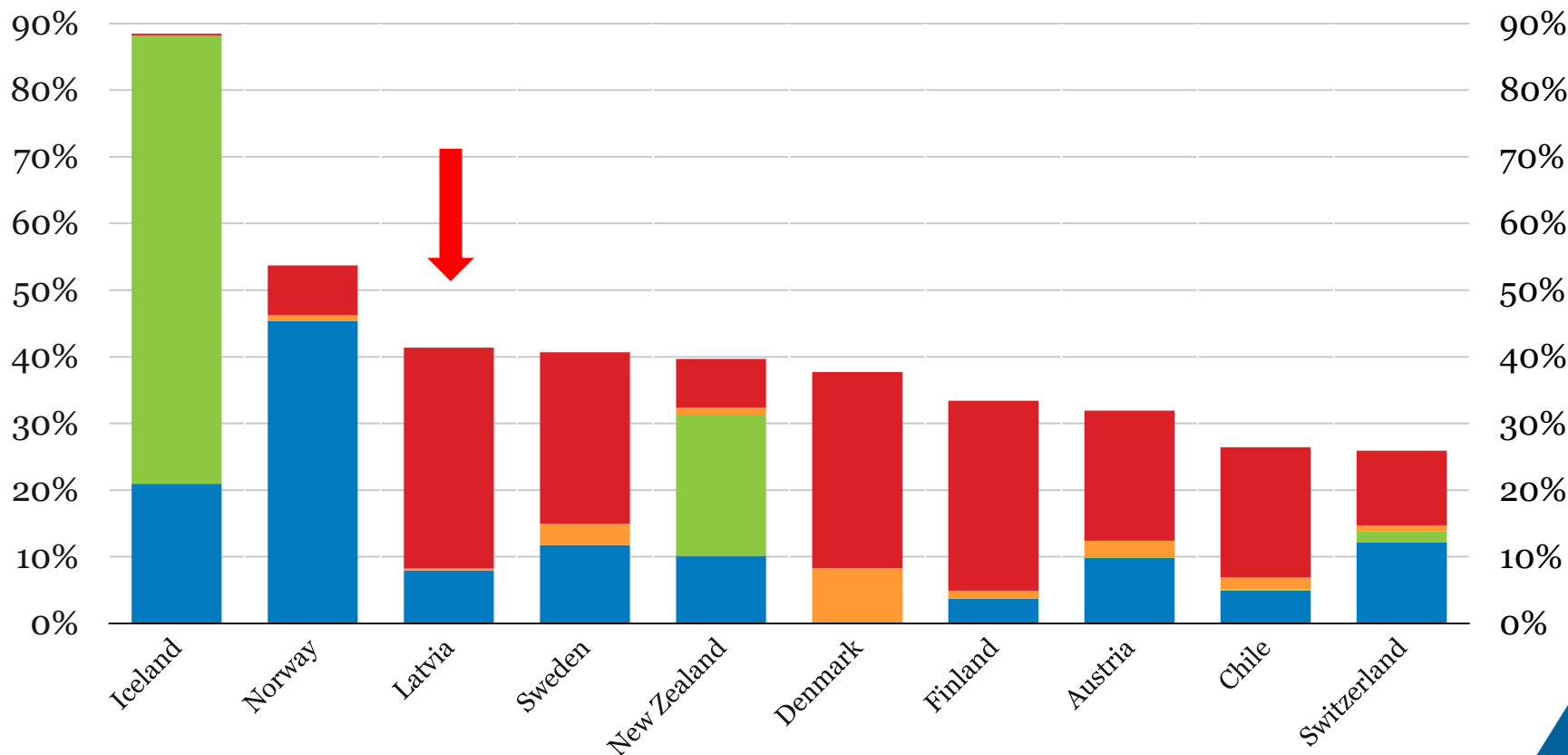
Latvia is among the OECD leaders in the use of renewables

Proportion of renewables in primary energy supply in 2017,
top 10 OECD countries

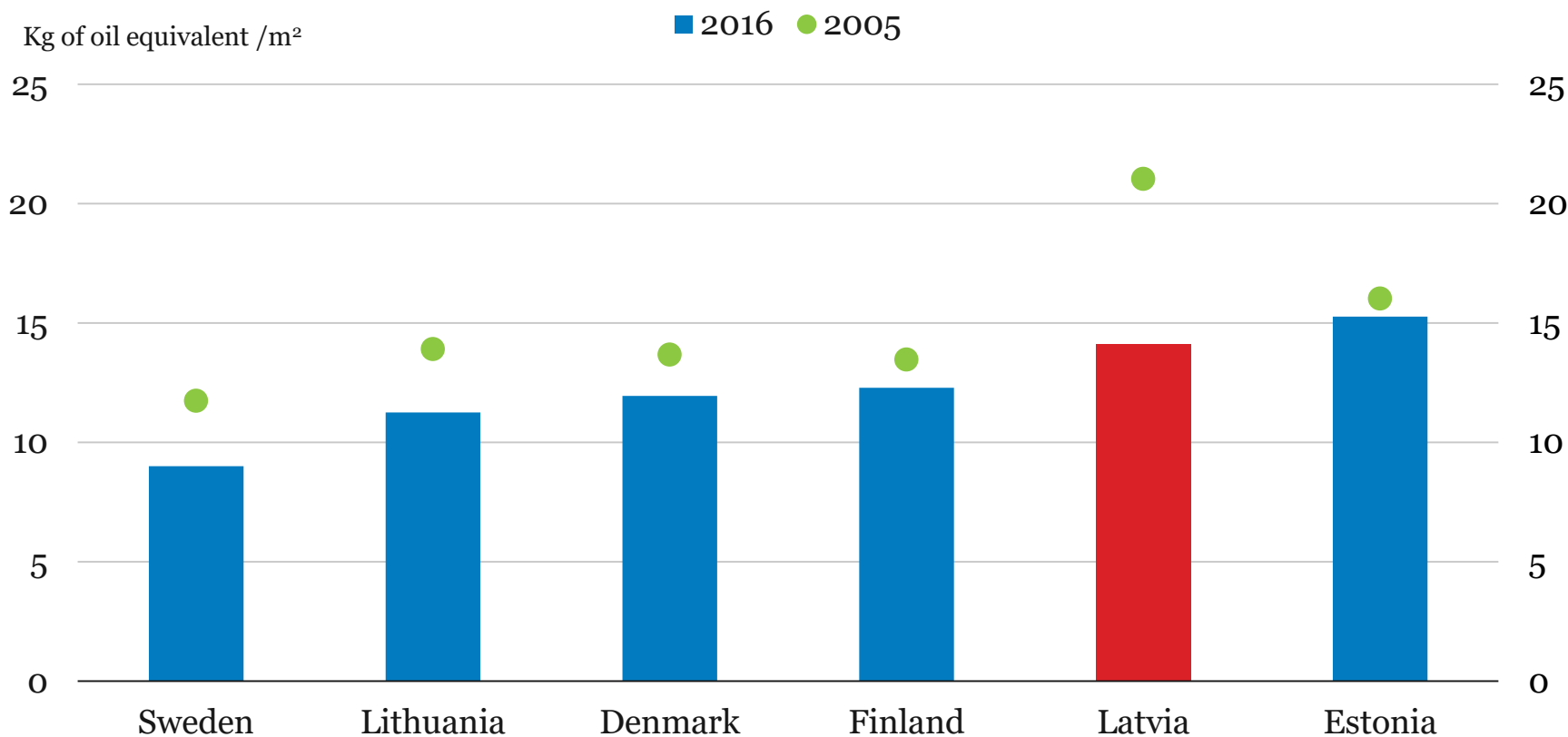■ Hydro   ■ Geothermal   ■ Solar/wind/other   ■ Biofuels and waste

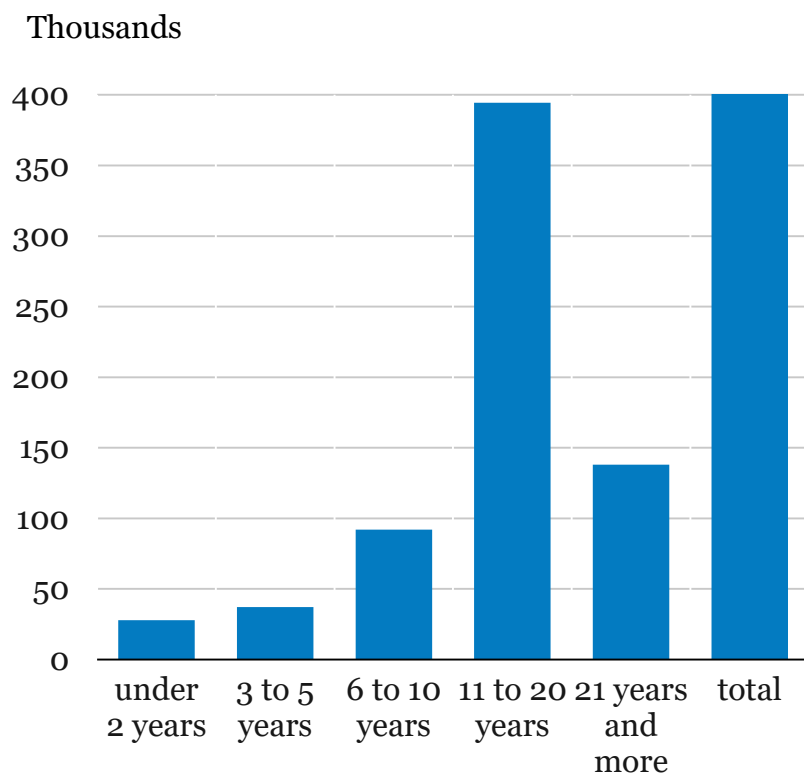% of Total primary energy supply

Source: IEA (2019), *World Energy Statistics and Balances* (database).

Houses still consume much energy

Heat consumption per square metre,
selected Northern European countries
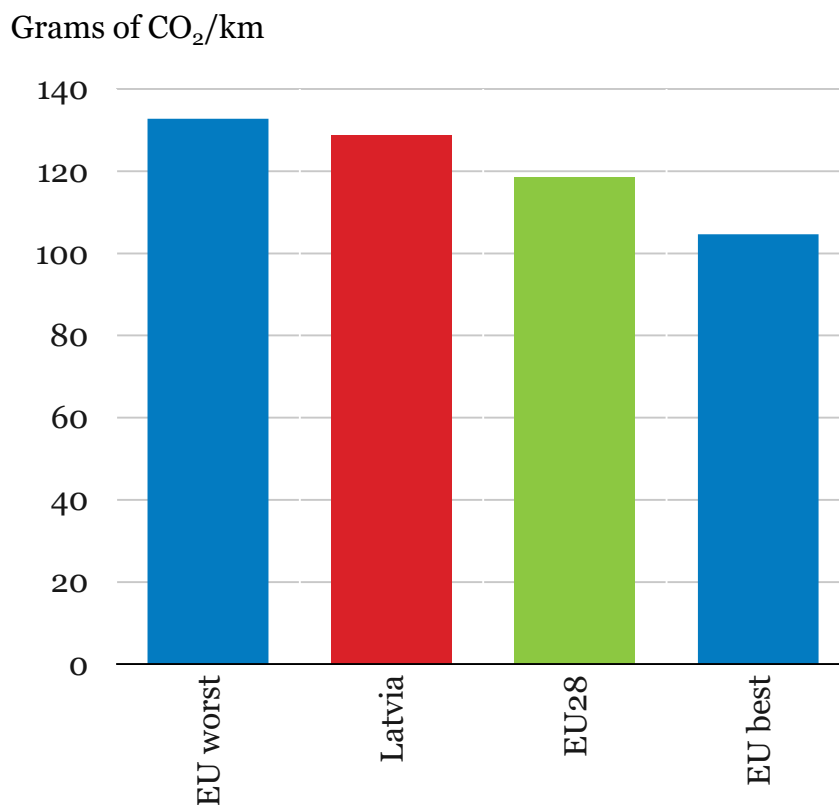
Kg of oil equivalent /m²

■ 2016 ● 2005

The vehicle fleet is old and carbon intensive

Number of cars by age, 2017

Thousands

Average CO2 emissions per km of new cars, 2017

Grams of CO_2/km

Source: Central Statistical Bureau of Latvia (2018), *Transport in Latvia 2018*; Eurostat (2019), Average carbon dioxide emissions per km from new passenger cars" (grams of CO_2 per km) (database).

Quality of roads and railways is among the poorest in the Baltic Region

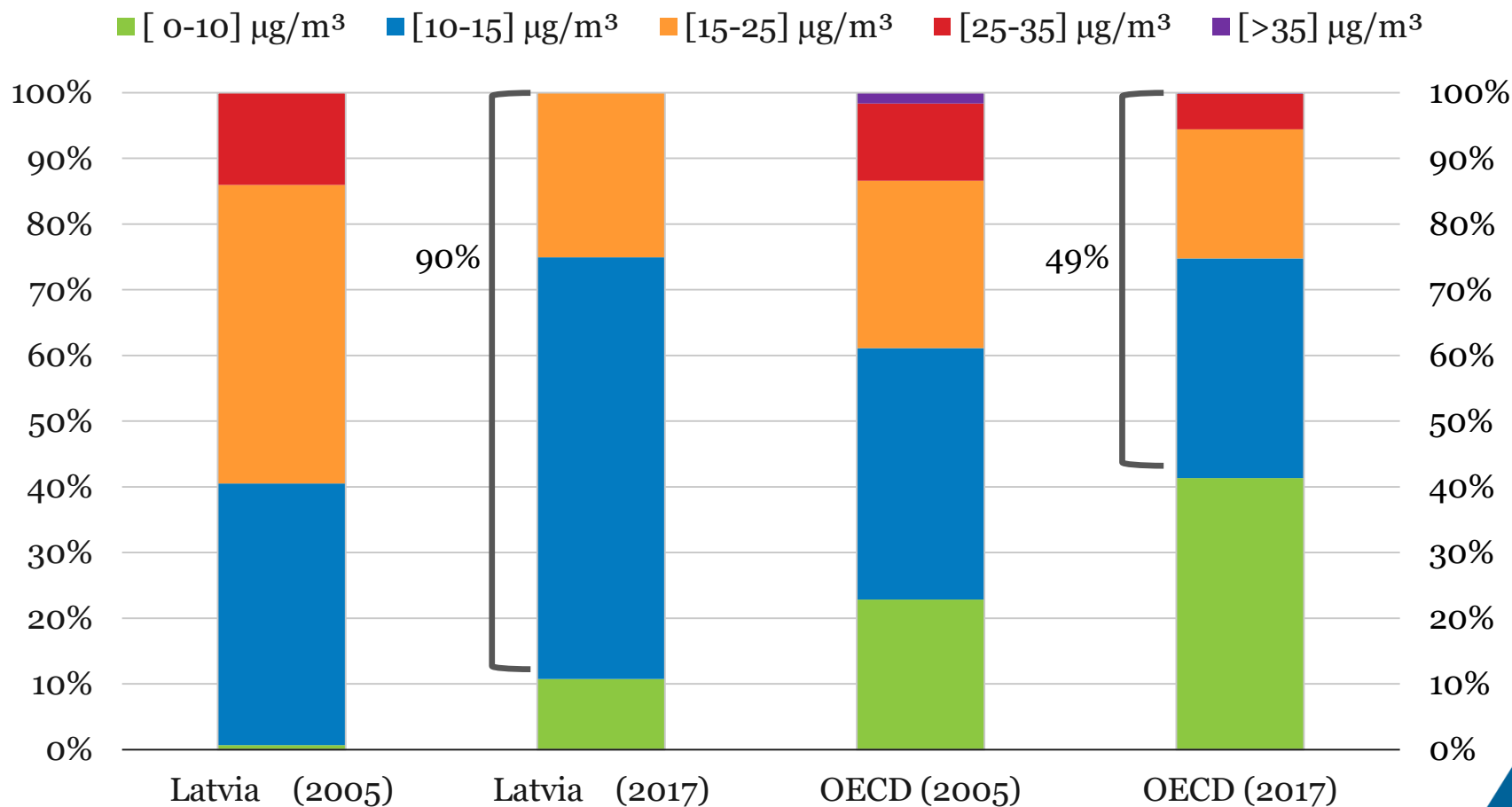Perceived quality of transport infrastructure,
Baltic Region, 2018

Roads

Score 0-6

Railways

Score 0-100
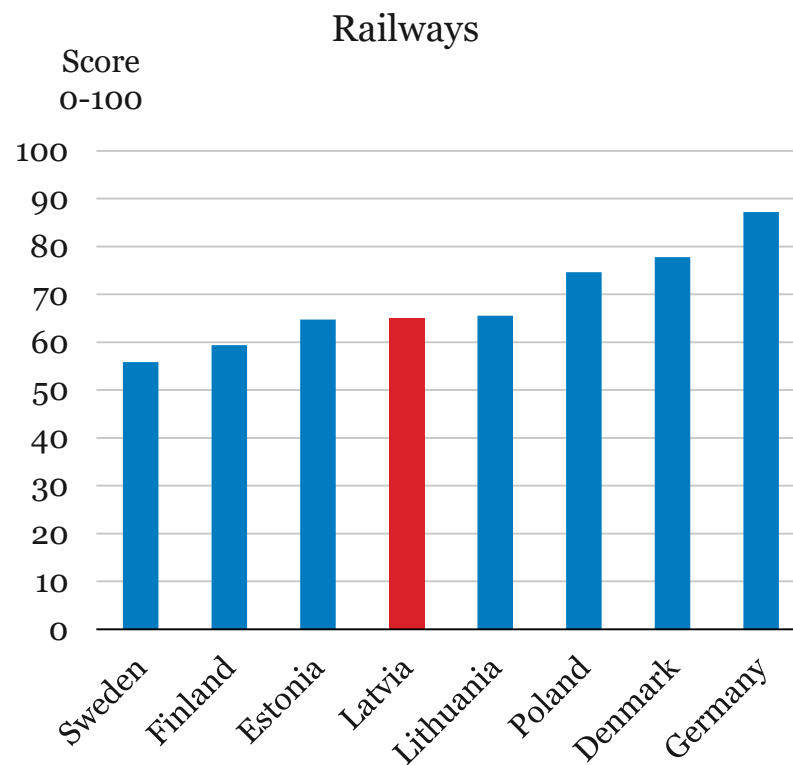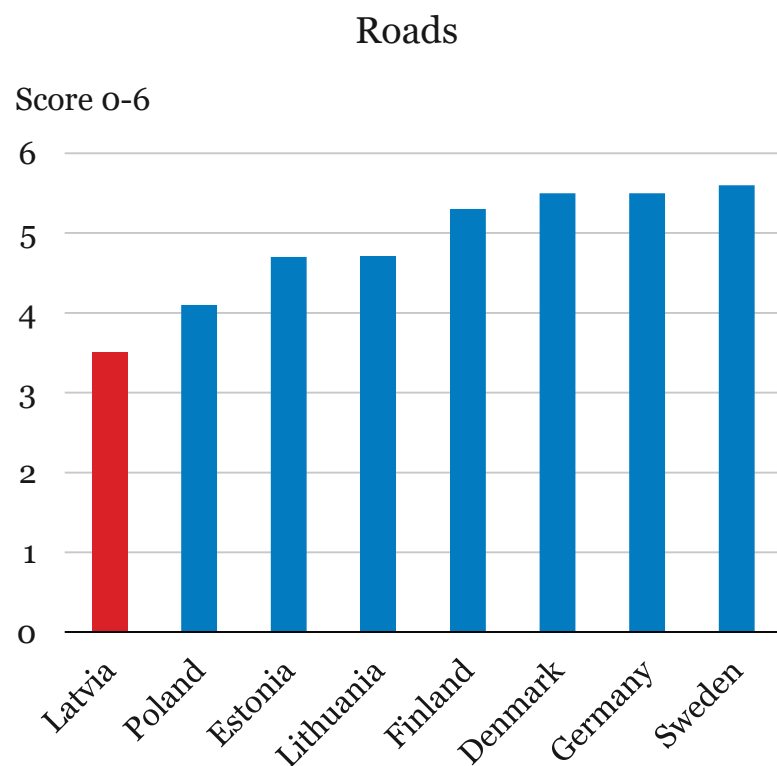
Source: WEF (2018), *The Global Competitiveness Report 2018.*

Most of Latvia's population is exposed to high $PM_{2.5}$ concentrations

Population exposed to $PM_{2.5}$, shares (%) by concentration levels

Legend: ■ [0-10] µg/m³ ■ [10-15] µg/m³ ■ [15-25] µg/m³ ■ [25-35] µg/m³ ■ [>35] µg/m³

90%

49%

Latvia (2005)   Latvia (2017)   OECD (2005)   OECD (2017)

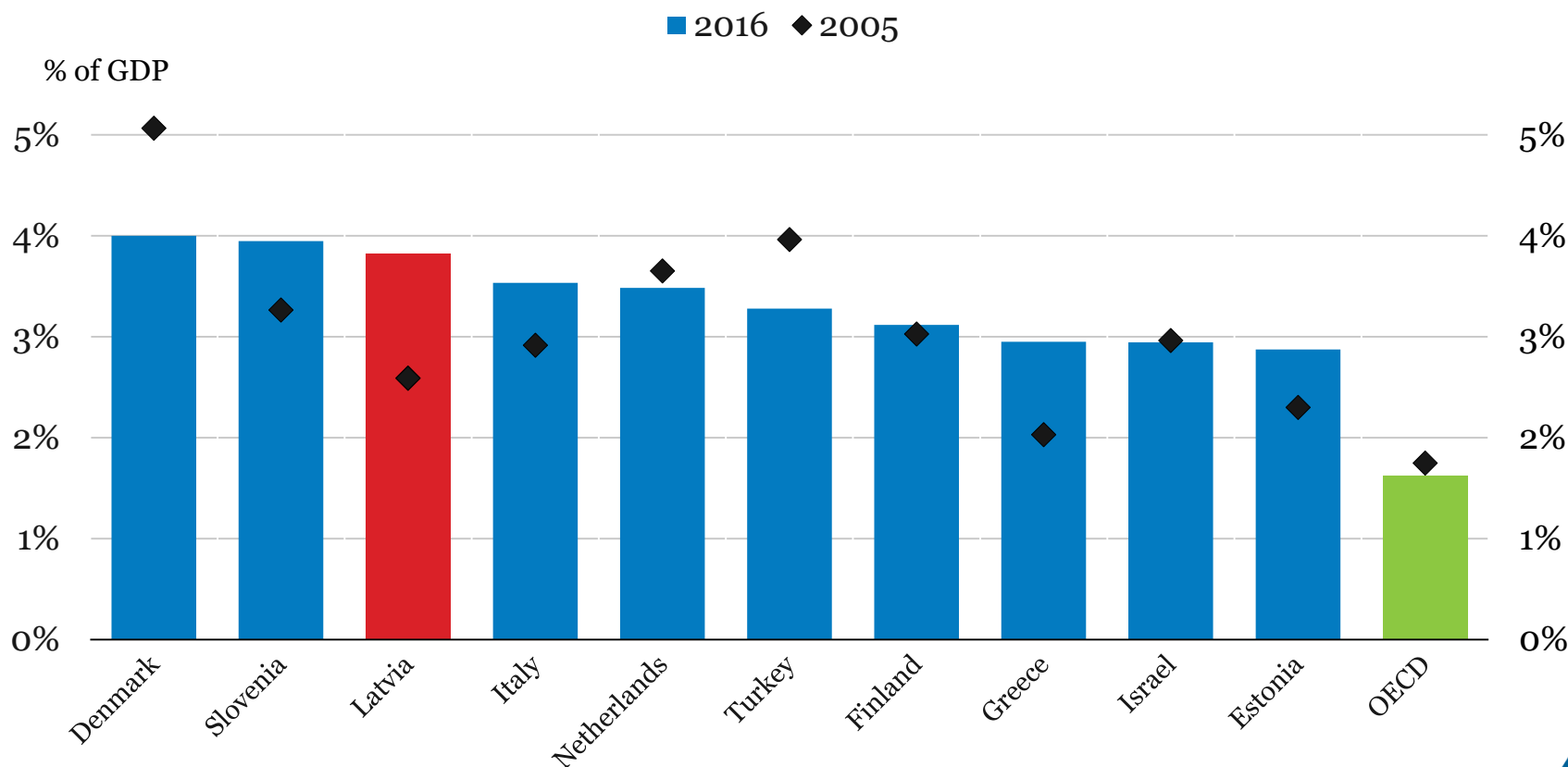*Source:* OECD (2019), *OECD Environment Statistics* (database).

Green taxes generate high revenue but their effectiveness is limited

Revenue of environmentally related taxes,
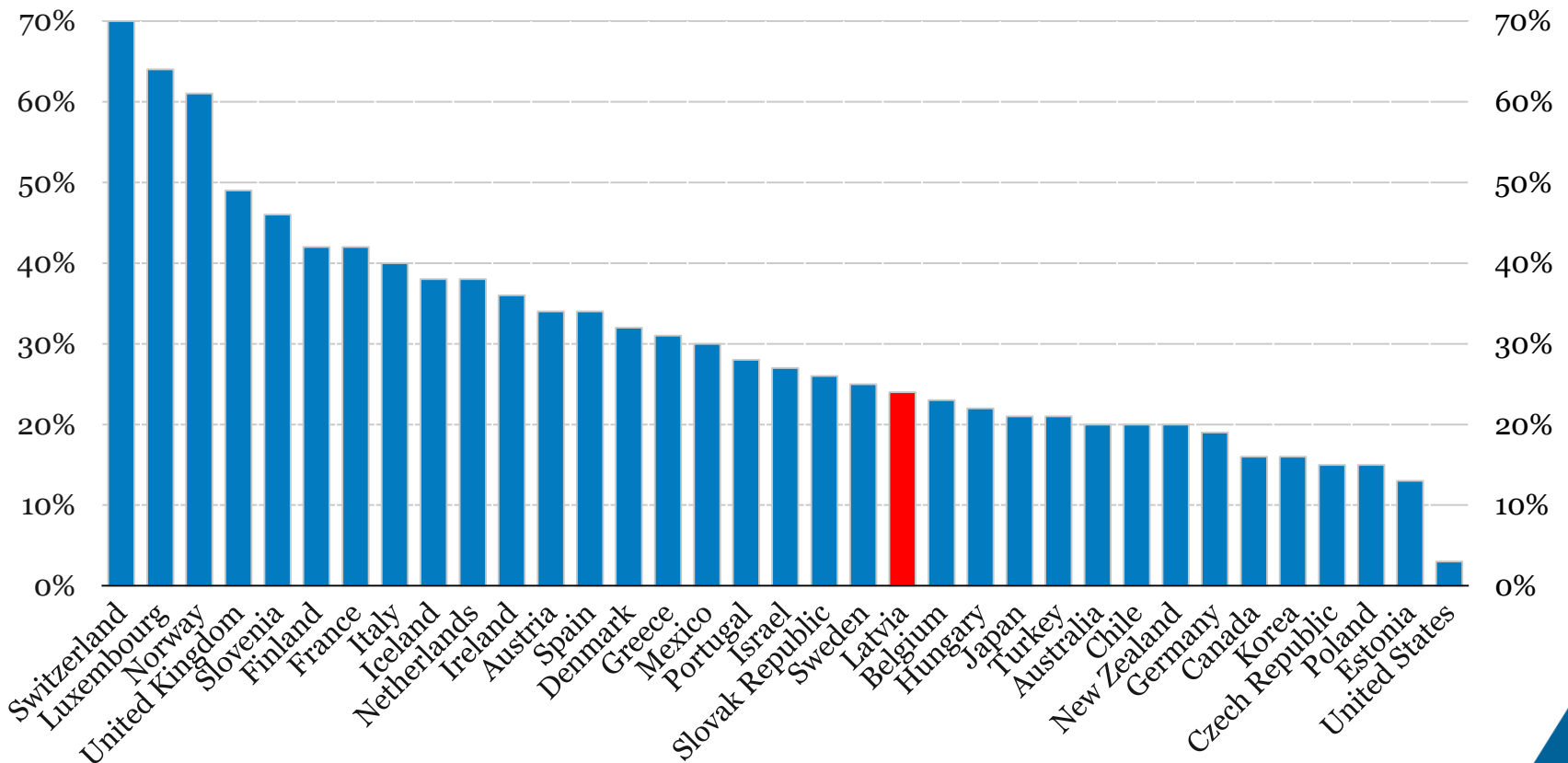% of GDP, top 10 OECD countries

Source: OECD (2019), OECD Environment Statistics (database).

Only a quarter of CO_2 emissions is priced at a sufficient level

Proportion of emissions priced at or above EUR 30 per tonne of CO_2

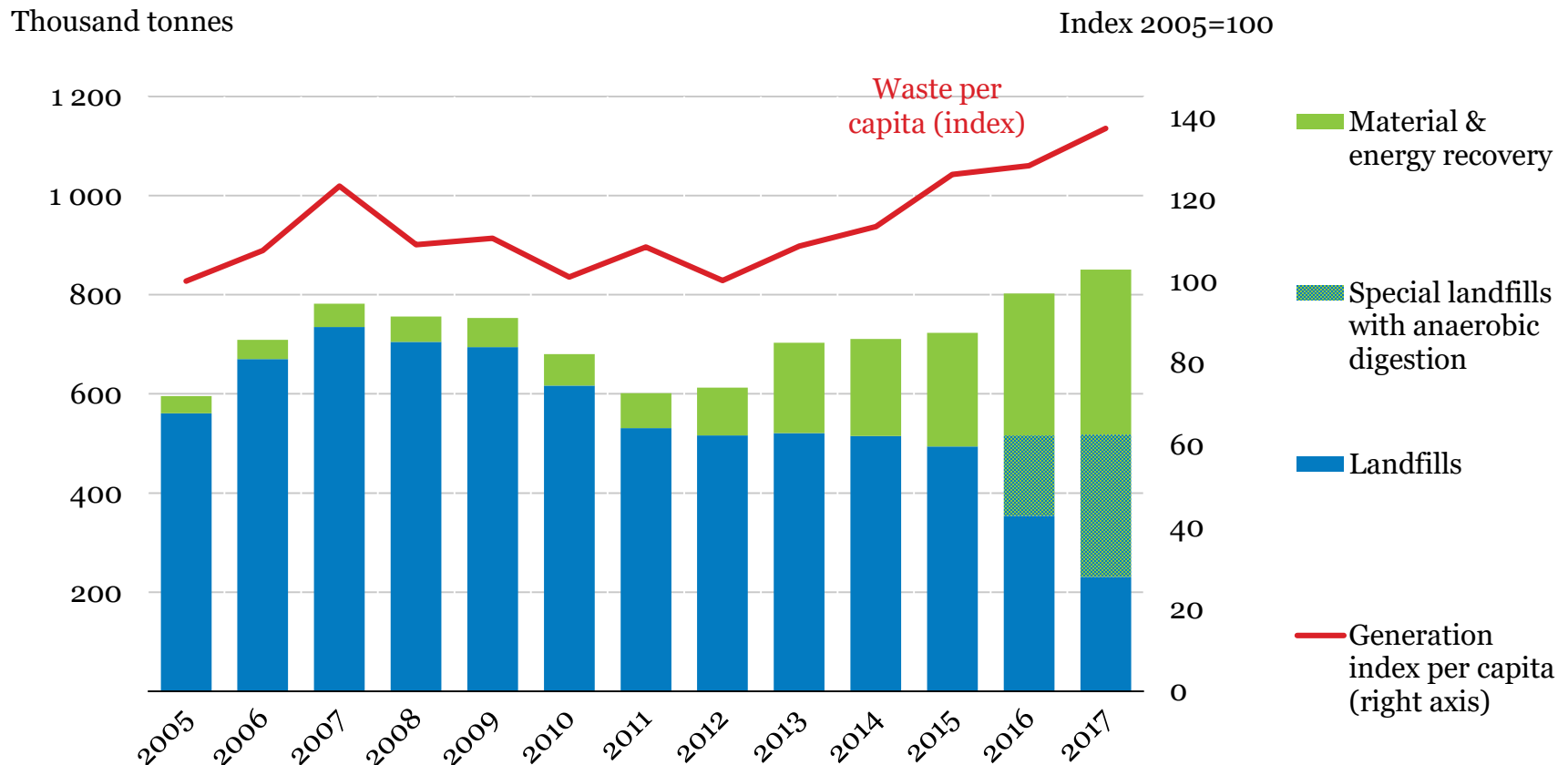Source: OECD (2018), *Effective Carbon Rates 2018*.

Policies for a low-carbon, greener economy

- Mitigating climate change and air pollution
  - ➢ Develop a climate mitigation plan with expected sectoral contributions to GHG emission mitigation and gradually stricter targets.
  - ➢ Improve the knowledge on mitigation options in agriculture and forestry.
  - ➢ Improve air quality monitoring and control measures, especially in the Riga metropolitan area.

- Greening the system of taxes, charges and subsidies
  - ➢ Reduce tax exemptions and discounts.
  - ➢ Raise tax rates on energy, CO_2 emissions and air pollutants, and close the petrol/diesel tax gap.
  - ➢ Revise vehicle taxation to account for air pollutants in addition to CO_2 emissions.
  - ➢ Extend road charges to cars and link them to emission standards and distance travelled.

- Investing in low-carbon infrastructure and eco-innovation
  - ➢ Reduce dependence on EU funds; streamline support mechanisms for business investment.
  - ➢ Continue to improve residential energy efficiency and extend heat metering.
  - ➢ Establish an integrated public transport system linking Riga to surrounding municipalities; extend the charging facility network for electric vehicles.
  - ➢ Further increase environmental R&D funding; strengthen measures to stimulate demand for cleaner products, technology and services.

More recommendations in the 2019 Environmental Performance Review of Latvia

Municipal waste is growing and mostly landfilled, although recovery is improving

Municipal waste generation and disposal

Thousand tonnes

Index 2005=100

Waste per capita (index)

- Material & energy recovery
- Special landfills with anaerobic digestion
- Landfills
- Generation index per capita (right axis)
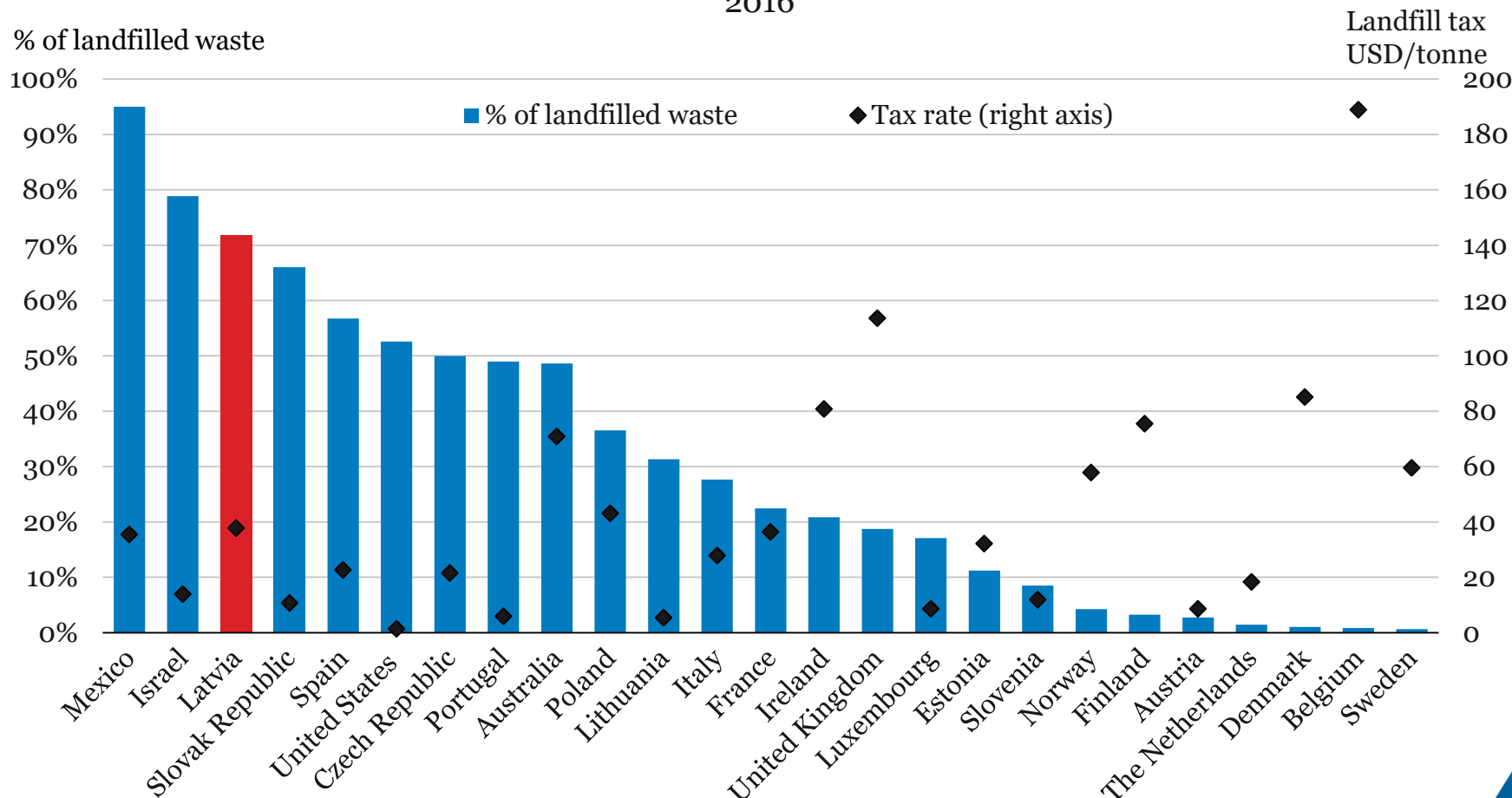
Low landfill taxes encourage landfilling

Percentage of landfilled municipal waste and landfill tax rates, 2016

Note: Subnational data (local taxes) are used for: Mexico (Mexico City), Spain (Catalonia), United States (California), Australia (Western Australia) and Belgium (Flanders).
Source: OECD (2019), *OECD Environment Statistics* (database); CEWEP (2017), *Landfill Taxes and Bans Overview.*

Policies for waste management and circular economy

- Review waste-related taxation in line with the waste hierarchy.

- Improve the transparency of extended producer responsibility systems, and encourage investment in high-value domestic recycling.

- Fully integrate the objectives of closing material loops and waste prevention into innovation and procurement policies.

- Improve waste governance by deepening co-operation across ministries, cascading national waste targets at local level, and using synergies within the Baltic Sea region.

- Set up an integrated information system that covers all waste and materials management steps and treatment routes.
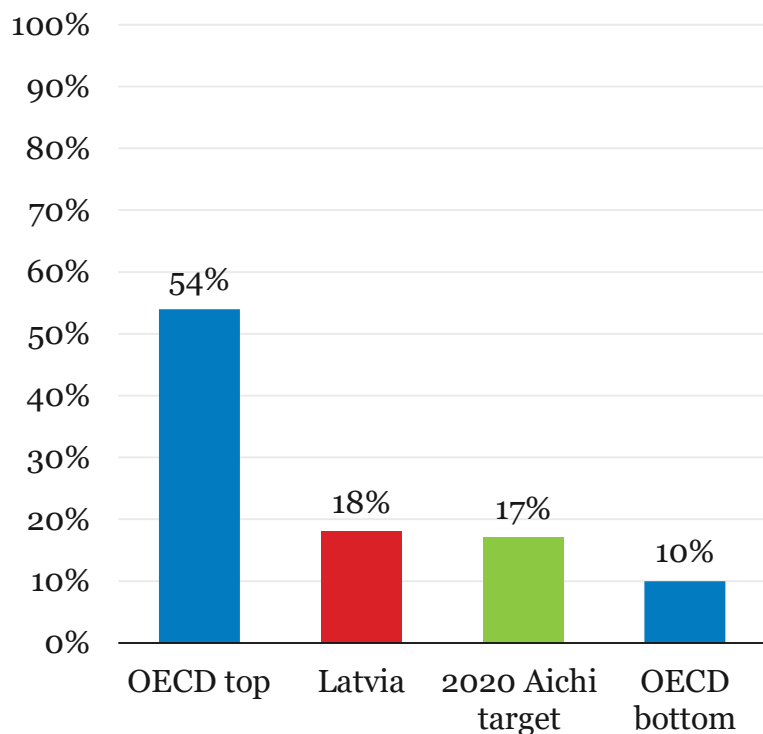
More recommendations in the 2019 Environmental Performance Review of Latvia
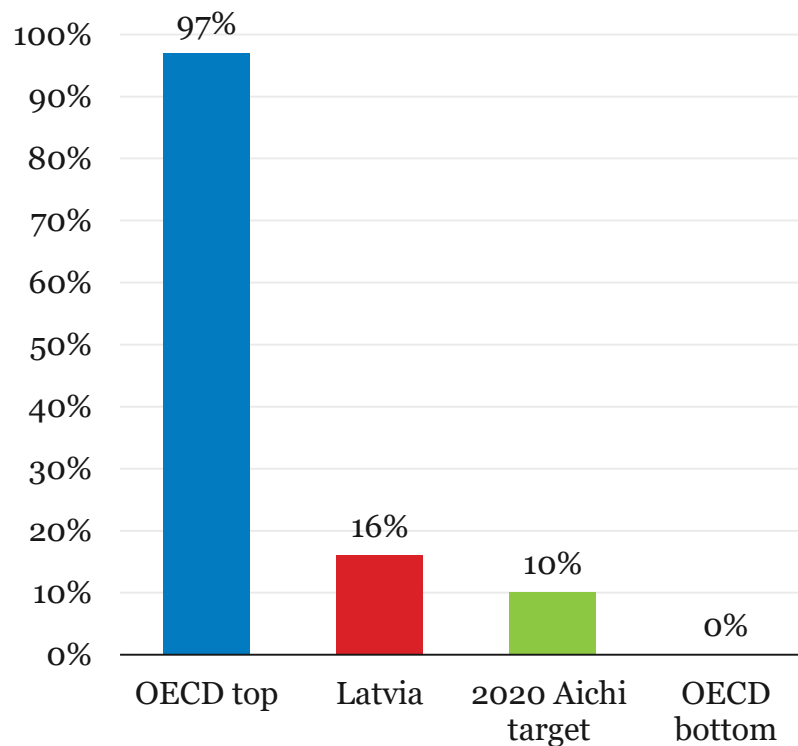
Latvia has exceeded the 2020 Aichi targets on protected natural areas

Protected areas,
2018

Terrestrial areas: % of total land area

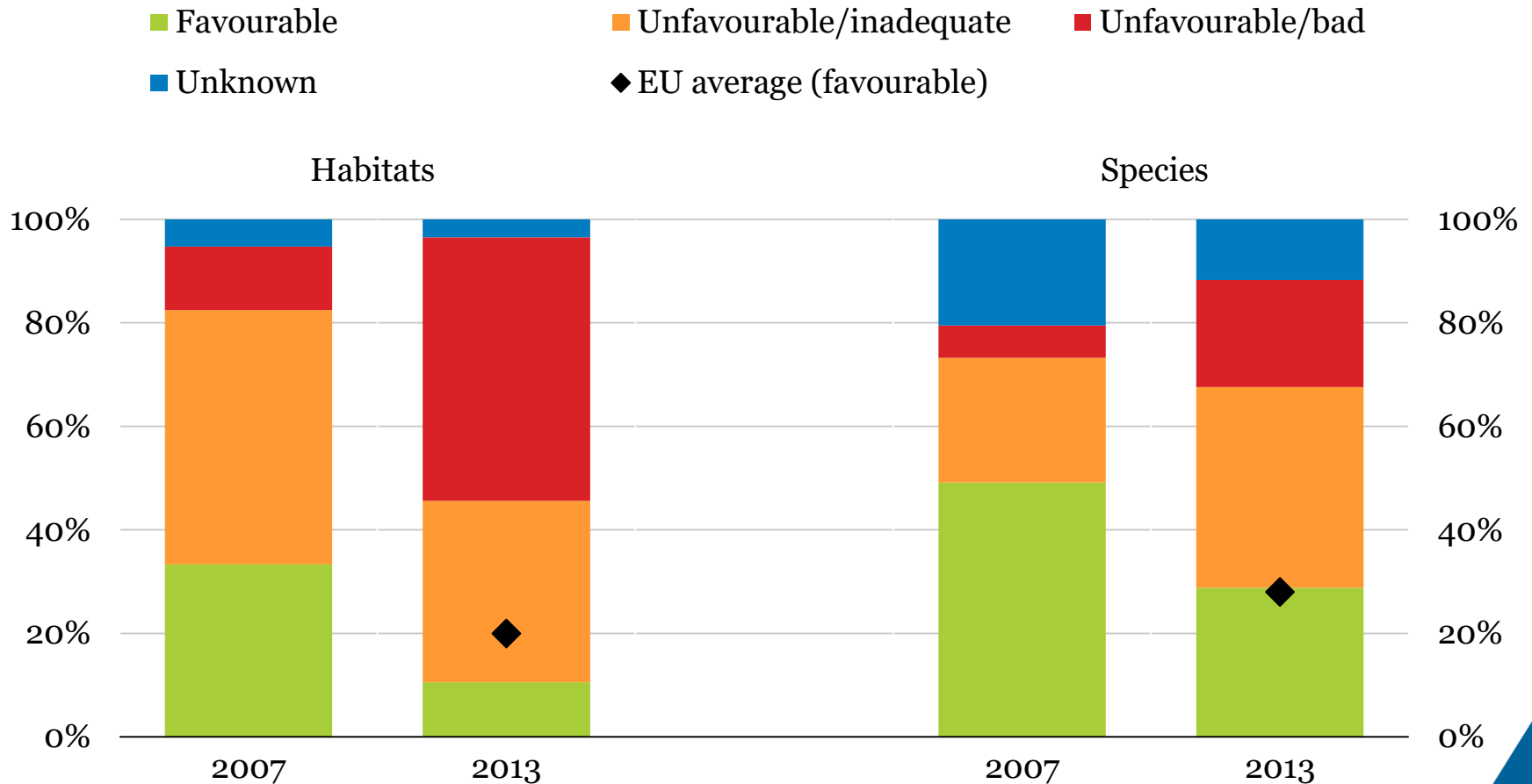

Marine areas: % of Exclusive economic zone

Source: OECD (2018), *OECD Environment Statistics* (database).

The conservation status of many habitats and species is poor and declining

Conservation status of habitats and species,
% by category

■ Favourable   ■ Unfavourable/inadequate   ■ Unfavourable/bad

■ Unknown   ◆ EU average (favourable)

Habitats — 2007, 2013 | Species — 2007, 2013

Policies for biodiversity conservation and sustainable use

- Develop a national biodiversity strategy, supported by adequate human and financial resources for implementation.

- Assess the economic value of biodiversity and ecosystem services and the cost associated with their loss.

- Develop management plans of protected areas.

- Develop a strategic policy framework for green infrastructure and improve wildlife corridors to reduce habitat fragmentation.

- Extend the use of economic and voluntary instruments for biodiversity management, especially for the sustainable use of forests.

- Further untie payments to farmers from production; promote organic farming to achieve the national 2030 target.

More recommendations in the 2019 Environmental Performance Review of Latvia

For more information

http://www.oecd.org/economy/latvia-economic-snapshot/
http://oe.cd/epr-latvia