Ministry of Economics
Republic of Latvia

# ECONOMIC DEVELOPMENT OF OF LATVIA

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# OPENING STATEMENT

We would like to deliver *the Report on the Economic Development of Latvia* 2023 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.

In 2023, economic development continued to be affected by the geopolitical situation and uncertainty, high prices and growing loan interest rates. In Q1-Q3 of this year, the gross domestic product (GDP) was 0.6% lower than a year before. The reduction in volumes is seen in producing industries largely due to the deterioration of export capabilities. Meanwhile, there is an increase in construction fostered by investments from European Union (EU) funds and also in many services sectors. In 2023, GDP will remain close to the volumes of 2022, but in 2024, growth could accelerate, and GDP growth could reach at least 2-3%, provided that there are favourable external conditions, as well as ambitious measures are taken to raise investment and promote exports.

The economic policy of the government headed by Evika Siliņa approved by the Saeima on 15 September 2023 aims to achieve sustainable GDP growth by raising productivity, investment, exports, and employment. Targeted state investments in the national economy are planned to implement the economic objective of the government, which together with the investments of the EU funds, including the Latvian Recovery and Resilience Facility (RRF), will make a significant contribution to the Latvian economy, thus contributing to the growth of the Latvian national economy and increase in export volume. In total, 1.6 billion euro will be available in the budget for investment in 2024; this is historically the largest amount of funding. Along with growth opportunities, it also creates a responsibility to invest productively so as not to exert additional pressure on inflation.

The priorities of the Ministry of Economics in the coming years are to increase business competitiveness, resilience of the economy and energy independence, to improve real estate development processes, to promote accessibility of housing, as well as to improve accessibility and quality of human capital.

Already in 2024, we are planning to provide substantial support to increase productivity, digitisation, energy efficiency, export capacity and competitiveness of our entrepreneurs. In 2024, 77.3 million euro will be earmarked to increase the competitiveness of business. They will be channelled towards creating industrial zones, new jobs with high added value, raising high added value investment, transforming the economy, and supporting export capacity.

A new programme worth 6.4 million euro for investment and export promotion measures, and support for start-ups has also been supported within the priority measures of the state budget for 2024. As it is known, start-ups play an important role in the overall innovation ecosystem, as they provide an inflow of innovative business ideas and contribute to a faster shift in the economic paradigm towards the knowledge economy. We need to be more ambitious in ensuring access to finance for faster growth and development of start-ups.

The activity of the Investment Fund (Altum loans with a capital discount for export-capable large projects) also continues. According to the Ministry of Economics, it will make a significant contribution to the national economy of Latvia – the funding of 152.5 million euro available in the programme is expected to create more than 1000 well-paid jobs, ensuring export volume of 207.27 million euro per year and investment in research and development of at least 14 million euro per year. The Cabinet of Ministers has decided on a call in the next round of 70 million euro, which will add to the return by at least half the performance of previous rounds.

Investment in the development of the digital transformation of businesses is one of the priorities for promoting productive business. To achieve these objectives, companies have access to support for digitisation of business processes, improvement of digital skills, development of new products and services, as well as testing and purchasing of technological equipment. The Ministry of Economics is planning to invest 194.15 million euro in digital transformation support programmes. Two European Digital Innovation Hubs have been approved to help entrepreneurs identify their needs in digital transformation. They will provide consultations, mentoring, technological services, first and second digital maturity test, digital development roadmap and report development services.

To ensure the continued availability of funding to small and medium-sized enterprises, state aid programmes in the form of financial instruments continued in the new EU funds programming period 2021-2027, increasing loan amounts and extending the availability of guarantees, including for export transactions to the EU Member States, as well as continuing the availability of venture capital instruments while ensuring complementarity between the planned activities of this programme and *InvestEU.* The EU Cohesion Fund funding of 506 million euro is planned to be channelled into the financial instruments.

In total, by 30 June 2026, the Ministry of Economics expects to invest 657.61 million euro in investments of the Recovery and Resilience Facility, increasing the productivity of businesses, providing support to at least 3500 entrepreneurs and ensuring that private co-financing of at least 500 million euro is raised. By 31 December 2029, the Ministry of Economics expects to invest 948.65 million euro in the EU Structural Funds, providing support to at least 2500 entrepreneurs and ensuring that private co-financing of at least 700 million euro is raised.

19 Latvia's external economic representations abroad continue to work to support Latvian companies in increasing exports. In 2023, three Latvia's external economic representations were established – in Brussels, Geneva and Israel, whose main tasks are to seek cooperation and projects in the field of innovation and technology, as well as to represent Latvia's interests in the European Organization for Nuclear Research. Work is ongoing to expand the legal base, and in 2023 the agreement on economic cooperation between the government of the Republic of Latvia and the government of the Kingdom of Saudi Arabia was signed, providing support to Latvian entrepreneurs in entering new markets.

Entrepreneurs are also offered services of the Enterprise Europe Network – help in searching for international partners, preparing market information, consulting on legislation and business aspects, access to finance, etc. It should be noted that the Investment and Development Agency of Latvia has developed a national platform for business development *business.gov.lv*, which provides information and the possibility to apply for services provided by the agency and for different state aid programmes. Moreover, in the next few years, the platform will also be expanded with services provided to entrepreneurs by other state institutions.

To increase the competitiveness of the national economy by promoting energy independence, in 2024 the state budget expenditure of 35.9 million euro is intended for supporting protected electricity users, for the implementation of the *ELWIND* joint offshore wind energy project. Programmes are currently being implemented to support energy efficiency with the main task to limit an increase in final consumption of primary energy sources and energy and to ensure a reduction in energy consumption. The Ministry of Economics is planning to invest 275 million euro to support energy efficiency in the coming years.

The Ministry of Economics continues to improve real estate development processes, paying particular attention to the quality of construction, reducing bureaucratic barriers and promoting proportionality and transparency of processes. To improve the quality of construction, the technical requirements for structures have been reviewed and updated, and wider availability of standards has been ensured in 2023. In 2024, 16.9 million euro will be provided from the state budget for the implementation of the construction and housing policy to ensure a favourable environment for investments in Latvia and promote access to housing. It should also be noted that the Ministry of Economics has developed support programmes intended for the construction of low-rent housing of 42.9 million euro financed by the European Recovery Fund and for the construction of social housing of 51.7 million euro financed by the European Regional Development Fund.

The Ministry of Economics continues to improve the construction information system, and a convenient platform for efficient management and operational supervision of structures, including residential houses, has been established. Over the last few years, several complex measures have been implemented in cooperation with the construction industry contributing to a significant improvement in the competitiveness of the industry. The implementation of the measures provided in the building information modelling roadmap continues with the main emphasis on the training of industry professionals and the improvement of construction study programmes.

The management of labour issues, access to labour, and skills and lifelong learning policies are of increasing importance in the context of labour ageing. To create a new paradigm of the human capital development policy, the Ministry of Economics is currently developing *the Latvian Human Capital Development Strategy 2024-2027*, the overarching objective of which is to ensure coordinated management of human capital issues by promoting labour supply meeting the needs of the future labour market.

To help entrepreneurs maintain their competitiveness with the labour force expected in the future, the Ministry of Economics encourages reviewing control mechanisms in attracting third-country nationals. The prepared amendments to the laws and regulations will reduce the use of uncontrolled and unaccounted-for "employee rental services", which in turn will contribute to responsible labour migration in these challenging geopolitical circumstances. The Ministry of Economics offers to discuss the development of *the Green Corridor* policy to reduce administrative burden for undertakings and accelerate administrative processes while promoting Latvia's competitiveness in the field of raising investment.

Upskilling and reskilling measures for workers are also important. Digitisation, technological progress and economic transformation will lead to higher demand for highly skilled labour. To adapt labour market demand to the needs of the future labour market, the Ministry of Economics is currently encouraging the introduction of a results-based instrument that will support workers in reskilling from low-value-added to high-value-added jobs, including by supporting workers in upskilling.

A favourable business environment is one of the most important elements for increasing the competitiveness of the national economy. The better business conditions a state is able to create, the higher investments flow into the national economy, subsequently leading to new jobs and better welfare of people. There are several obstacles to business identified by entrepreneurs as disruptive in long-term planning of activities and development, such as frequent and unpredictable changes in the regulatory framework, tax system, sectoral supervision and control measures, deficiencies in tax administration, as well as slow decision-making process of the state administration. Therefore, for further improvement of the business environment, we have envisaged a more effective process of identifying and administering the necessary measures, by developing closer feedback with economic operators and by allowing for continuous follow-up to the progress made in the implementation of the measures. The reduction of bureaucracy is also enshrined in the Declaration of the Intended Activities of the Cabinet of Ministers Headed by Evika Siliņa, with specific tasks also reflected in the government action plan.

The provision of a fair competitive environment is also considered to be an essential element in promoting competitiveness in the country. A pressing topic in the competition policy is to keep supervising that companies do not breach the law and act fairly, as well as fostering equal and non-discriminating competition between public persons (for example, state or local government capital companies) and the private sector. Financial resources of 4.7 million euro are provided in the state budget for 2024 for the implementation of the competition policy. They will be spent on preventing the most significant violations of competition law and promoting fair competition.

To ensure the protection of consumer rights in Latvia and the conformity of the market surveillance system with the requirements of the European single market, as well as that only safe goods and services conforming to certain essential requirements are available on the Latvian market, including in the digital environment, the draft state budget for 2024 envisages financial resources of 5.7 million euro for implementation of consumer rights protection and market supervision measures, as well as conformity assessment and quality assurance.

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!

Viktors Valainis,

Minister of Economics

December 2023

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# ABBREVIATIONS, MEASUREMENT UNITS, AND SYMBOLS

## Abbreviations

| | |
|---|---|
| Altum | Joint Stock Company "Development Finance Institution Altum" |
| RRF | Recovery and Resilience Facility |
| UN | United Nations |
| JSC | Joint Stock Company |
| USA | United States of America |
| FICIL | Foreign Investors Council in Latvia |
| FDI | Foreign Direct Investment |
| BIM | Building Information Modelling |
| BIS | Building Information System |
| AMR | Alert Mechanism Report |
| CSB | Central Statistical Bureau |
| DESI | Digital Economy and Society Index |
| ECB | European Central Bank |
| EDIH | European Digital Innovation Hub |
| EEA | European Economic Area |
| EC | European Commission |
| MoE | Ministry of Economics |
| ERDF | European Regional Development Fund |
| EU | European Union |
| EU-14 | European Union Member States before the enlargement in 2004 |
| EU-27 | European Union Member States after the withdrawal of the United Kingdom on 1 February 2020 |
| EU-28 | European Union Member States and United Kingdom |
| ESF | European Social Fund |
| EUR | *euro* |
| Eurostat | Statistical Office of the European Union |
| MoF | Ministry of Finance |
| GCI | Global Competitiveness Index |
| GWh | Gigawatt-Hour |
| GDP | gross domestic product |
| ICT | information and communication technologies |
| IMI | Internal Market Information System |
| MoES | Ministry of Education and Science |
| CF | Cohesion Fund |
| CC | Competition Council |

| | |
|---|---|
| kWh | Kilowatt-Hour |
| LIAA | Investment and Development Agency of Latvia |

| | |
|---|---|
| MoW | Ministry of Welfare |
| CM | Cabinet of Ministers |
| MIP | Macroeconomic Imbalances Procedure |
| Mtoe | megaton oil equivalent |
| SMM | Small and Medium-Sized Merchants |
| SME | small and medium-sized enterprises |
| MWh | Megawatt-Hour |
| NDP | National Development Plan of Latvia |
| NATO | North Atlantic Treaty Organization |
| NRP | National Reform Programme |
| SEA | State Employment Agency |
| CIS | Commonwealth of Independent States |
| OECD | Organisation for Economic Co-operation and Development |
| OPEC | Organization of the Petroleum Exporting Countries |
| OPEC+ | Countries of the Organization of the Petroleum Exporting Countries (OPEC) and 10 more oil-producing countries |
| R&D | research and development |
| CPI | Consumer Price Index |
| PJ | Petajoule |
| PPS | Purchasing Power Standard |
| CRPC | Consumer Rights Protection Centre |
| RIS3 | National/regional research and innovation strategies for smart specialisation |
| LLC | Limited Liability Company |
| SOLVIT | EU Internal Market Problem Solving System |
| STEM | science, technology, engineering, and mathematics |
| IMF | International Monetary Fund |
| MoJ | Ministry of Justice |
| TRIS | Technical Regulations Information System |
| CIT | Corporate Income Tax |
| ULC | unit labour costs of products |
| MoEPRD | Ministry of Environmental Protection and Regional Development |
| MoA | Ministry of Agriculture |

## Country Abbreviations

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

# PART I. ECONOMIC DEVELOPMENT TRENDS

## 1. ECONOMIC DEVELOPMENT TRENDS – OVERVIEW

**Stable economic growth in Latvia** with rates exceeding the EU average **continued until the COVID-19 pandemic**. From 2013 to 2019, GDP grew by 2.9% per year on average. The COVID-19 pandemic has had a significant impact on economic development on a global scale and also in Latvia. GDP shrank by 3.5% in Latvia in 2020. The extensive government and EU funds support measures, as well as the improvement of the epidemiological situation in 2021, contributed to the recovery of Latvia's economy, and GDP grew by 6.7%.

**After the rapid recovery of the economy from the crisis of the COVID-19 pandemic in 2021, growth in Latvia slowed to 3.4% in 2022.** The economic development in 2022 was significantly influenced by the disruptions in supply chains caused by Russia's invasion of Ukraine, the rise in inflation caused by the cost of energy and food, as well as the decline in global demand. In the first half of 2022, the consequences of the war were not yet felt in full in Latvia. The economy grew 5.8% compared to the first half of 2021. The rise was affected by the low base in early 2021 and the gradual lifting of COVID-19 restrictions. However, in the second half of the year, growth decreased to 1.2%, as the export-import balance deteriorated and the growth rates of private consumption and investments decreased.

Table 1.1

**Latvia: Key figures of economic development**

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023f | 2024f |
|---|---|---|---|---|---|---|---|---|
| Gross domestic product (at current prices, billion euro) | 27.0 | 29.2 | 30.6 | 30.1 | 33.3 | 38.9 | 41.2 | 43.2 |
| *changes as per cent* | | | | | | | | |
| Gross domestic product | 3.3 | 4.0 | 0.6 | -3.5 | 6.7 | 3.4 | 0.1 | 2.1 |
| Private consumption | 2.8 | 3.0 | 0.0 | -4.3 | 7.3 | 6.0 | -1.0 | 2.1 |
| Public consumption | 3.5 | 1.7 | 5.6 | 2.1 | 3.5 | 2.8 | 6.0 | 1.8 |
| Gross fixed capital formation | 11.4 | 11.7 | 1.5 | -2.2 | 7.2 | 0.6 | 5.9 | 4.5 |
| Export | 6.4 | 4.4 | 1.3 | 0.4 | 9.0 | 10.3 | -5.2 | 1.9 |
| Import | 8.5 | 6.3 | 2.2 | -1.1 | 15.1 | 11.1 | -2.6 | 2.4 |
| Consumer prices | 2.9 | 2.5 | 2.8 | 0.2 | 3.3 | 17.3 | 9.0 | 2.2 |
| *as a percentage in relation to the GDP, unless indicated otherwise* | | | | | | | | |
| General government sector balance | -0.3 | -0.7 | -0.5 | -4.5 | -7.2 | -4.6 | -2.8 | -3.0 |
| General government debt | 38.9 | 37.0 | 36.7 | 42.2 | 44.0 | 41.0 | 41.0 | 41.5 |
| Export-import balance | -1.7 | -0.7 | -0.7 | 1.3 | -3.2 | -4.5 | -4.3 | -4.4 |
| Changes in the number of the employed (15-74 years of age, % compared to the previous year) | 0.2 | 1.6 | 0.1 | -1.9 | -3.2 | 2.6 | 0.1 | 0.1 |
| Employment rate | 62.9 | 64.5 | 65.0 | 64.2 | 62.5 | 63.9 | 64.3 | 64.8 |
| Unemployment rate (unemployed, % of the economically active population, 15-74 years of age) | 8.7 | 7.4 | 6.3 | 8.1 | 7.6 | 6.9 | 6.4 | 6.3 |
| Average gross wage changes (% compared to the previous period) | 7.9 | 8.4 | 7.2 | 6.2 | 11.8 | 7.5 | 12.0 | 7.8 |

f – forecast

**In 2023, economic development continued to be affected by the geopolitical situation and uncertainty, high prices and growing bank interest rates.** Compared to the corresponding quarter of the previous year, economic growth stopped in Q1, GDP already decreased by 1.1% in Q2 and 0.7% in Q3. In Q1-Q3 of this year, GDP was 0.6% lower than in the same period a year before. Overall, in 2023, GDP is expected to remain close to the levels of 2022.

In 2024, the economy will begin to grow slightly faster. International institutions predict that in 2024 the economy in Latvia's largest export markets will grow and will have a positive impact on the country's export opportunities. As real wages resume to grow, private consumption is also expected to resume growth. The implementation of EU fund programmes will have a positive impact on investment dynamics. The Ministry of Economics (MoE) predicts that GDP growth could reach 2.1% in 2024.

The drop in real income of the population negatively affects household consumption. Private consumption reduced by 1.7% in Q1-Q3 2023.

Public consumption continues to grow largely at the expense of the government deficit so that government priority measures can be financed. Public consumption increased by 6.8% in Q1-Q3 2023.

Investment is growing despite geopolitical uncertainty. Due to the increase in financing of EU funds, investments in gross fixed capital formation were 6.5% higher in Q1-Q3 2023 than in the same period a year before. During the year, investment in dwellings, other buildings and structures increased by 16.2%, investment in machinery and equipment – by 1%, and investment in intellectual property products – by 0.1%.

Net flows of foreign direct investment (FDI) attracted in Latvia continue to increase. The amount of FDI attracted at the end of September 2023 reached 24.5 billion euro (61% of GDP). It increased by 8.8% compared to the end of 2022 mainly due to the increase in investments in professional, scientific and technical activities, as well as financial intermediation, trade and financial services sectors.

The situation in the external environment adversely affects foreign trade. Export volumes of goods and services in Q1-Q3 2023 were 5.8% lower than a year before. Export volumes of goods decreased by 8.1%. The main export goods during this period were wood and wood products, mechanisms and mechanical equipment, as well as electrical appliances and electrical equipment. Service exports continue to recover from the COVID-19 pandemic, up 0.7% in Q1-Q3 compared to a year ago. Exports of air transport services, as well as professional and technical economic activity services and computer services contributed to the increase. Import volumes of goods and services decreased by 2.3% in Q1-Q3 and export-import balance at current prices was -4% of GDP.

In 2022, the current account deficit grew to 4.7% of GDP; it was most significantly affected by the deterioration of the trade balance of goods due to rising energy prices. The level of deficit remained high in 2023 as well. In the nine months of this year, it reached 4.8% of GDP mainly due to the increase in the negative balance of primary income. The current account is expected to improve in the coming years.

Development trends across sectors vary considerably. Rapid growth rates in 2022 were observed in the sectors hit the hardest by COVID-19 pandemic restrictions. Despite rising costs, disruptions in supply chains and high uncertainty, positive growth remained in manufacturing in 2022. A decline was observed in construction due to a rapid increase in costs.

The total value added across sectors decreased by 0.4% in Q1-Q3 2023, compared to the same period in 2022. The reduction in volumes was seen in producing industries largely due to the deterioration of export capabilities. Manufacturing decreased by 6.3%. A drop of 7.9% was recorded in agriculture and forestry largely affected by the decline in crop production due to the unfavourable weather this summer. The decline in volume in the rest of the economy (by 6.6%) was affected by the drop in the electricity, gas, steam and air conditioning supply, as well as mining. The drop in volumes in transportation and storage (by 7.0%) was affected by land transportation and warehousing and support activities for transportation. In Q1-Q3, there was also a drop in volumes in trade – by 5.4% affected by household consumption and shrinking foreign trade.

In Q1-Q3, a decline was observed in construction and many services sectors. The increase in construction during the year was 15.7%. Stable growth rates remained in the sectors hit the hardest by the COVID-19 restrictions – in Q1-Q3 accommodation and food service activities increased by 8.8%, arts, entertainment and recreation – by 12.3%. A stable increase is still observed in the ICT sector – by 4.2% in Q1-Q3.

The COVID-19 pandemic has led to significant changes in the fiscal policy that has been implemented so far. In 2020, *the general escape clause of the Stability and Growth Pact (SGP)* was activated in the EU, enabling EU countries to increase their general government deficits to the extent necessary to mitigate the economic harm caused by the pandemic. Given the Russia-Ukraine war and all the related consequences, the general exception clause of the SGP also remains in force in 2023.

Due to the COVID-19 pandemic, the budget deficit in Latvia increased to 4.5% of GDP or 1.3 billion euro in 2020 and to 7.2% of GDP or 2.4 billion euro in 2021. It slightly reduced in 2022 and was 4.6% of GDP or 1.8 billion euro. The Saeima approved the budget for 2023 with a deficit of 4.2% of GDP or 1.77 billion euro. According to the estimate of the Ministry of Finance (MoF), the general government budget deficit in 2023 was expected to be 2.7% of GDP.

On 1 November 2023, the Cabinet of Ministers (CM) approved the draft law on the state budget for 2024. The state budget for 2024 was prepared taking into account the EU fiscal provisions and provisions of the Fiscal Discipline Law – the general government budget is estimated to be 2.8% of GDP in 2024, 2.3% of GDP in 2025 and 0.9% of GDP in 2026. In 2024, the total general government budget revenue is planned to be 17.8 billion euro, while expenditure – 19.1 billion euro.

Despite the increase in the budget deficit in recent years, the general government debt level in Latvia is one of the lowest in the EU. The outbreak of COVID-19 caused the need to provide considerable amounts of funding to mitigate the impact caused by the COVID-19 crisis. Government debt increased to 44% of GDP or 14.7 billion euro in 2021. Since the nominal GDP increase under high inflation conditions is rapid, then its ratio to GDP in 2022 reduced to 41% but increased to 15.9 billion euro in nominal terms. According to the MoF assessment, government debt is expected to be 39.9% of GDP in 2023. For 2024, it is expected to be 41.0% of GDP. The debt provision of 60% of GDP defined in the Fiscal Discipline Law is expected to be observed in the medium term, and Latvian general government debt will stabilise at a level below 40% of GDP.

The banking sector has been able to remain stable despite the economic turmoil caused by the COVID-19 pandemic and the geopolitical tension. The banking sector is operating with profit. However, the development of lending is still evaluated as weak, in particular lending to businesses. Meanwhile, positive trends are observed in lending to households. Deposit volumes continue to rise.

Inflation is mostly affected by the rise in global prices of energy and food. In December 2022, consumer prices were 20.8% higher than a year before, but the annual average inflation increased to 17.3%. In December, food prices increased by 29.3%, prices of electricity, gas and solid fuel – by 63.9% and prices of fuel – by 17.9%.

In 2023, consumer prices stabilised and were shrinking every month compared to the corresponding month of the previous year – from 21.5% at the beginning of this year to 1.0% in November. The average annual inflation in November was 10.6%. Taking into account the tense geopolitical situation and the base effect of inflation dynamics, total annual average inflation in 2023 is expected to be within 9%.

The main impact on price changes will continue to be linked to the rise in global prices for energy and food, and their downstream impact on prices of industrial goods and services will be observed.

Despite the economic turmoil, the labour market remains stable. The number of employees in Latvia increased by 2.6% in 2022. This was the fastest increase in the number of employees since 2007, partly due to both the recovery of the labour market from the COVID-19 pandemic and the employment of Ukrainian civilians in Latvia. As employment increased, the unemployment rate continued to fall. It decreased by 6.9% in 2022 (compared with 2021 by 0.7 percentage points).

Also in 2023, despite the tense geopolitical situation and the slow-down in economic growth rates, the situation in the labour market did not significantly deteriorate as the demand for the labour force is high. In Q3 2023, compared to the situation a year before, the number of employees aged 15 to 74 declined by 1% or 8.6 thousand. The employment rate increased by 0.1 percentage points – to 64.7%. The unemployment rate in Q3 2023 was 6.5%, down 0.4 percentage points from the respective period a year before. 61.5 thousand people aged 15-74 were looking for a job in Q3 which is 7.4% or 4.9 thousand less than in Q3 2022. Overall, the unemployment rate in 2023 could reduce to an average of 6.4%, while the number could remain close to the level of 2022.

The monthly average gross wage continues to grow; however, its growth rates were lower than the inflation growth rate compared to the corresponding period from Q1 2022 to Q1 2023, causing a deterioration in purchasing capacity. The real wage resumed growth in Q2 and Q3 2023. The net average wage in Q3 2023 (calculated using the employment taxes applicable in the workplace) was 1126 euro or 72.7% of gross wage, and it increased by 11.0% during the year, outpacing the rise in consumption prices. The increase in real net wage, taking account of inflation, was 5.7%.

At the same time, positive pressure on wages will continue to be maintained both by the process of wage convergence closer to the wage level of the economically developed countries of the EU, and by the growing shortage of qualified labour – the narrowing of the labour market, which makes it necessary for entrepreneurs to think more actively not only about how to attract new specialists, but also how to keep the existing ones, including through a review of wage rates.

Further economic development in the medium term depends on the situation in the external environment and progress in reforms. The highest risk to the growth of Latvia is related to global economic development, particularly the geopolitical situation. Further development of the EU's total economic space is similarly important. In the medium term, the 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 funds and the improvements in the business environment. If the war in Ukraine endures, the pace of economic recovery might be slower.

If the advantages of Latvian economic competitiveness are mainly based on technological factors, improvement of production efficiency, and innovation, and to a lesser extent on cheap labour and low resource prices, Latvia's growth rates could potentially reach 4-5% per year in the medium term.

# 2. GLOBAL ECONOMIC DEVELOPMENT

The **global** economy is facing growing challenges. The war started by Russia causes untold suffering and destruction in Ukraine and has significant global consequences. Growth has slowed, high inflation has spread across different countries and product groups and remains persistent. Energy supply shortages can also contribute to further price increases. The rise in interest rates needed to curb inflation increases financial vulnerabilities. The outlook for global trade is not optimistic. The growth rate of global imports of goods and services is decreasing. It is affected by persistent challenges such as declining trade in goods and geopolitical tension. The European Commission (EC) forecasts that global growth will reach 3.1% in 2023[1], while in 2024, with big uncertainty still in place, growth rates are expected to slow down to 2.9%.

Table 2.1

**GDP growth rate**
*changes compared to the previous year, as per cent*

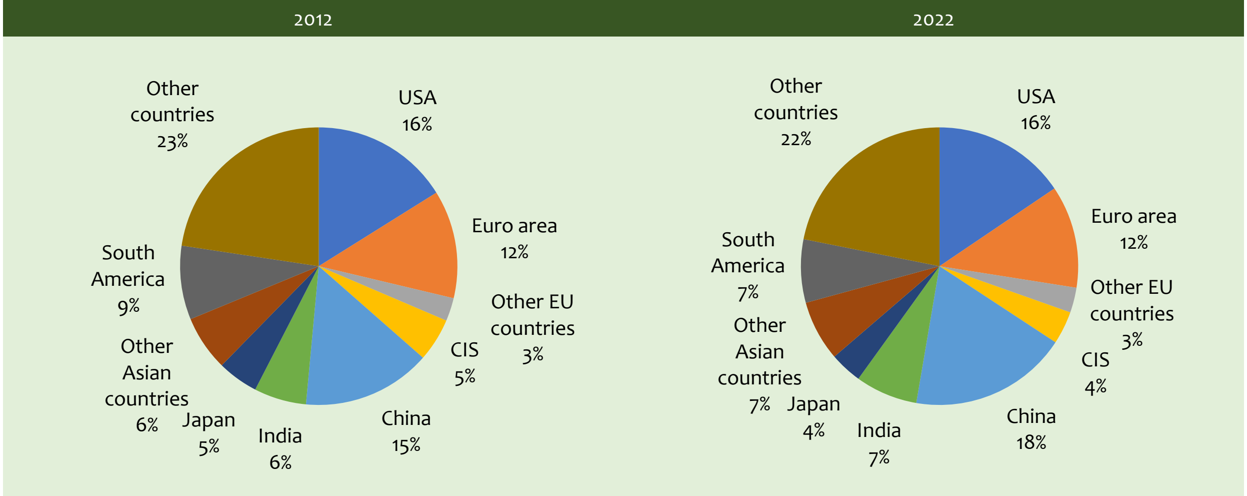
| | 2020 | 2021 | 2022 | 2023p | 2024f |
|---|---|---|---|---|---|
| **World,** including: | **-3.0** | **6.3** | **3.3** | **3.1** | **2.9** |
| USA | -2.2 | 5.8 | 1.9 | 2.4 | 1.4 |
| United Kingdom | -10.4 | 8.7 | 4.3 | 0.6 | 0.5 |
| EU, including: | -5.6 | 6.0 | 3.4 | 0.6 | 1.3 |
| Euro area | -6.1 | 5.9 | 3.4 | 0.6 | 1.2 |
| Japan | -4.2 | 2.2 | 1.0 | 1.9 | 0.8 |
| China | 2.2 | 8.5 | 3.0 | 5.2 | 4.6 |

Source: *EC – European Economic Forecast, Autumn 2023*
f – forecast

Economic growth in the **United States** in 2023 has been remarkably robust despite the steep monetary tightening. This reflects healthy household balance sheets, a resilient labour market and government support for investment. After a strong 2023, when GDP reached 2.4%, the pace of economic activity is forecast to slow to 1.4% in 2024, gradually responding to tight financial conditions and high cost of credit, but to rebound in 2025. Disinflation has been gradually progressing and is expected to continue.

Figure 2.1

**Breakdown of the total global GDP by countries and groups of countries**
*by purchasing capacity parity, share in the global total, as per cent*




Source: International Monetary Fund (IMF)

[1] Unless other source is specified, the data in this chapter is taken from the EC edition European Economic Forecast. Autumn 2023: https://economy-finance.ec.europa.eu/publications/european-economic-forecast-autumn-2023_en.

Despite the strong rebound at the beginning of 2023, China is still affected by the consequences of the pandemic. GDP is expected to grow 5.2% in 2023, while growth rates will slightly slow to 4.6% in 2024. Low confidence among households and private enterprises, amplified by the crisis in the real estate sector, is expected to unwind gradually over the next two years. At the same time, many local governments and state-owned enterprises find themselves financially strained, unable to provide their usual boost to growth through investment spending, while the central authorities focus on maintaining stability. Without implementing a more profound reform agenda, growth is projected to weaken further in 2024 and 2025, undermined by China's structural imbalances, geopolitical uncertainty and weakening demographics, but authorities are likely to support growth to the extent needed to limit the fallout of the slowdown.

Table 2.2

**Main macroeconomic indicators of the EU member states**
*as per cent*

| | Real GDP | | | Inflation | | | Unemployment rate | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2022 | 2023f | 2024f | 2022 | 2023f | 2024f | 2022 | 2023f | 2024f |
| **EU** | **3.4** | **0.6** | **1.3** | **9.2** | **6.5** | **3.5** | **6.2** | **6.0** | **6.0** |
| Austria | 4.8 | -0.5 | 1.0 | 8.6 | 7.7 | 4.1 | 4.8 | 5.3 | 5.4 |
| Belgium | 3.0 | 1.4 | 1.4 | 10.3 | 2.4 | 4.2 | 5.6 | 5.6 | 5.6 |
| Bulgaria | 3.9 | 2.0 | 1.8 | 13.0 | 8.8 | 4.0 | 4.3 | 4.2 | 4.2 |
| Czech Republic | 2.4 | -0.4 | 1.4 | 14.8 | 12.2 | 3.2 | 2.2 | 2.4 | 2.5 |
| Denmark | 2.7 | 1.2 | 1.4 | 8.5 | 3.6 | 2.4 | 4.5 | 4.6 | 5.2 |
| France | 2.5 | 1.0 | 1.2 | 5.9 | 5.8 | 3.0 | 7.3 | 7.2 | 7.4 |
| Greece | 5.6 | 2.4 | 2.3 | 9.3 | 4.3 | 2.8 | 12.5 | 11.4 | 10.7 |
| Croatia | 6.3 | 2.6 | 2.5 | 10.7 | 8.1 | 2.4 | 7.0 | 6.5 | 6.2 |
| Estonia | -0.5 | -2.6 | 1.9 | 19.4 | 9.4 | 3.5 | 5.6 | 7.0 | 6.9 |
| Italy | 3.7 | 0.7 | 0.9 | 8.7 | 6.1 | 2.7 | 8.1 | 7.6 | 7.4 |
| Ireland | 9.4 | -0.9 | 3.0 | 8.1 | 5.3 | 2.7 | 4.5 | 4.2 | 4.2 |
| Cyprus | 5.1 | 2.2 | 2.6 | 8.1 | 4.1 | 3.0 | 6.8 | 6.4 | 6.1 |
| Latvia | 3.4 | -0.2 | 2.4 | 17.2 | 9.6 | 3.2 | 6.9 | 6.8 | 6.6 |
| Lithuania | 2.4 | -0.4 | 2.5 | 18.9 | 8.8 | 2.9 | 6.0 | 6.8 | 6.7 |
| Luxembourg | 1.4 | -0.6 | 1.4 | 8.2 | 3.2 | 3.0 | 4.6 | 5.5 | 5.9 |
| Malta | 6.9 | 4.0 | 4.0 | 6.1 | 5.7 | 3.3 | 2.9 | 2.7 | 2.7 |
| Netherlands | 4.3 | 0.6 | 1.1 | 11.6 | 4.6 | 3.7 | 3.5 | 3.6 | 3.9 |
| Poland | 5.3 | 0.4 | 2.7 | 13.2 | 11.1 | 6.2 | 2.9 | 3.0 | 2.8 |
| Portugal | 6.8 | 2.2 | 1.3 | 8.1 | 5.5 | 3.2 | 6.0 | 6.5 | 6.5 |
| Romania | 4.6 | 2.2 | 3.1 | 12.0 | 9.8 | 5.9 | 5.6 | 5.4 | 5.2 |
| Slovakia | 1.8 | 1.3 | 1.7 | 12.1 | 10.8 | 5.2 | 6.1 | 5.7 | 5.4 |
| Slovenia | 2.5 | 1.3 | 2.0 | 9.3 | 7.5 | 3.9 | 4.0 | 3.6 | 3.7 |
| Finland | 1.6 | 0.1 | 0.8 | 7.2 | 4.4 | 1.9 | 6.8 | 7.2 | 7.3 |
| Spain | 5.8 | 2.4 | 1.7 | 8.3 | 3.6 | 3.4 | 12.9 | 12.1 | 11.6 |
| Hungary | 4.6 | -0.7 | 2.4 | 15.3 | 17.2 | 5.2 | 3.6 | 4.1 | 4.2 |
| Germany | 1.8 | -0.3 | 0.8 | 8.7 | 6.2 | 3.1 | 3.1 | 3.1 | 3.2 |
| Sweden | 2.8 | -0.5 | -0.2 | 8.1 | 5.7 | 1.8 | 7.5 | 7.6 | 8.5 |
| United Kingdom | 4.3 | 0.6 | 0.5 | 7.9 | 7.3 | 3.6 | 3.7 | 4.3 | 4.7 |

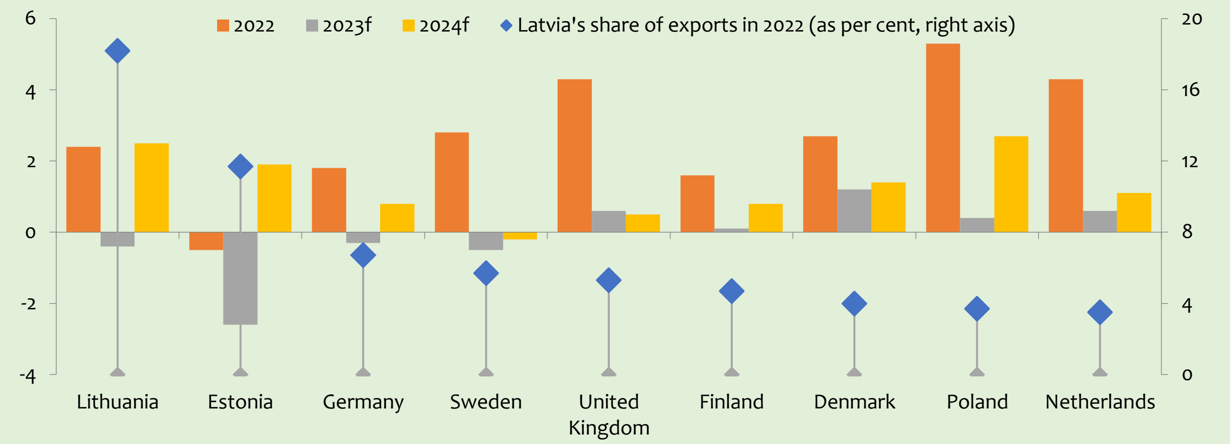
Source: *EC – European Economic Forecast. Autumn 2023*
f – forecast

After a very strong first half of 2023, economic activity in Japan is expected to moderate in the remainder of the year amid persistently elevated inflation and soft global demand. GDP is expected to reach 1.9% in 2023 and decline to 0.8% in 2024. Yet, an economic slowdown is expected in 2025, reflecting both a cyclical downturn and structural bottlenecks. Average annual consumer inflation is set to remain above the central bank target of 2%, reflecting rising wage pressure.

**India** is forecast to be one of the fastest-growing economies among the G20 countries with GDP growth rates reaching 6.6% in 2023. Growth will continue in 2024, while GDP will slightly reduce to 6.1%.

Figure 2.2

**Economic development of the main partner countries of Latvia**
*annual real GDP growth, as per cent*




Source: CSB, EC – European Economic Forecast, Autumn 2023
f – forecast

The **euro area** economy is expected to grow 0.6% in 2023, while growth rates will increase to 1.2% in 2024.

Economic activity in **Germany** is expected to decline by 0.3% in 2023. A loss in purchasing power due to high inflation and the tightening of financing conditions are weighing on consumption and investment. Moreover, foreign demand has evolved less favourably than previously assumed, resulting in a worsened trade outlook. However, going forward, domestic demand is set to pick up driven by a real wage increase. Together with recovering foreign demand this is expected to support a pick-up in GDP growth to 0.8% in 2024. Public finances are entering a path of fiscal consolidation with gradually decreasing government deficits and debt-to-GDP ratios, also supported by less-costly-than-anticipated measures to mitigate the impact of high energy prices.

The **Swedish** economy is projected to contract by 0.5% in 2023 and broadly stabilise in 2024 with the economy still declining by 0.2%. Tightened financial conditions and high energy prices hit the Swedish economy, in particular the household and construction sectors, reflecting high debt and overvalued real estate prices. A cooling labour market is expected to contribute to a drag on domestic demand. Inflation is expected to fall appreciably in 2024 but to rise back to slightly above 2% in 2025. The general government balance is expected to show a small deficit in 2023 and a somewhat larger deficit in the subsequent two years.

The **United Kingdom** economy is expected to see subdued growth in 2023 and 2024, as the impact of high interest rates and tighter fiscal policy offsets gains to households from lower energy prices. GDP is forecast to increase by 0.6% in 2023 and by 0.5% in 2024. A modest pick-up is projected into 2025 with growth rising closer to potential as the drag from the ongoing monetary and fiscal policy tightening fades.

The economic growth rate in **CIS countries** will reach 2.5% in 2023 and will slightly slow down to 2.2% in 2024. **Russia**'s economy is set to rebound in 2023 on the back of stronger-than-earlier expected domestic demand underpinned by fiscal stimulus. In 2023, GDP growth is expected to reach 2.0%. Nevertheless, reflecting tight monetary policy, growth is projected to ease again to 1.6% in 2024 due to weakening domestic demand (household spending), production bottlenecks, especially labour shortages, and a deteriorating economy's growth potential. The government budget is expected to remain in a deficit and public debt is forecast to slightly increase.

Despite the profound challenges posed by Russia's war of aggression. **Ukraine**'s economy has shown remarkable resilience in 2023. thanks to exceptional harvests. government stimulus underpinned by the unwavering support of international partners. as well as to the authorities' commitment to ensure macrofinancial stability. Growth is forecast to reach 4.8% in 2023 and 3.7% in 2024. with private consumption and public investments as key growth drivers. After declining swiftly in 2023. annual inflation is projected to decrease. supported by an easing of constraints on production and a tight monetary policy. The fiscal deficit is expected to remain elevated in 2024 driven by high defence expenditures. However. higher nominal GDP growth should increase revenues in 2025 and contribute to a narrowing of the deficit. Public debt is forecast to increase steadily in the coming years.

In the last two years, Baltic States have been experiencing the fastest rates of increase in prices, especially food and energy prices, among EU Member States.

Lithuania's GDP is expected to decrease by 0.4% in 2023 due to high inflation weighing on private consumption and weak global demand. In 2024, GDP is projected to pick up to 2.5%. as input costs and consumer prices subside and investment and private consumption drive growth. Inflation is to slow down to 8.8% in 2023 on the back of a strong decline in energy prices before decelerating further in 2024 and 2025 to below 3%. In 2023 and 2024, the general government deficit is projected to increase to 1.6% and 2.3% of GDP, respectively, mainly due to increases in social spending and public wages.

GDP growth is expected to contract in 2023 by 2.6% amid weakness in private consumption, sharply falling investment, downbeat demand from Estonia's main trading partners, and the depletion of accumulated inventories. Growth is projected to turn positive in 2024 and more robustly so in 2025 as real incomes rise as the trade outlook improves. GDP is expected to reach 1.9% in 2024. Despite the planned VAT increase as of 1 January 2024, inflation is projected to keep decelerating and to stand around 2% in 2025. The government deficit is expected to rise in 2025 on the back of a cut in personal income taxation.

# 3. GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND

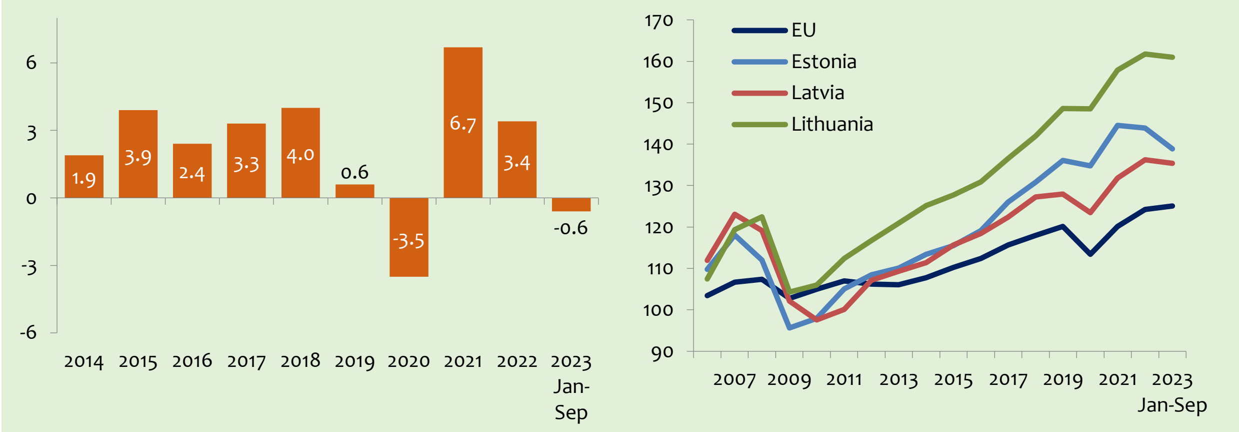
## 3.1. DYNAMICS AND STRUCTURE

From 2014 to 2019, GDP grew by 2.7% per year on average. In 2014, slower GDP growth was influenced by trends in the external environment – slower growth in the EU, weaker economic situation in Russia. Even though the geopolitical situation in the region was tense, the Latvian economy grew more rapidly in 2015 due to the rapid increase in private consumption and export volumes. Growth was weaker in 2016 due to the drop in investments and delayed implementation of the EU's new structural funds programme.

Figure 3.1

**Gross domestic product**

*changes compared to the corresponding period of the previous year, as per cent* | *2005 = 100*

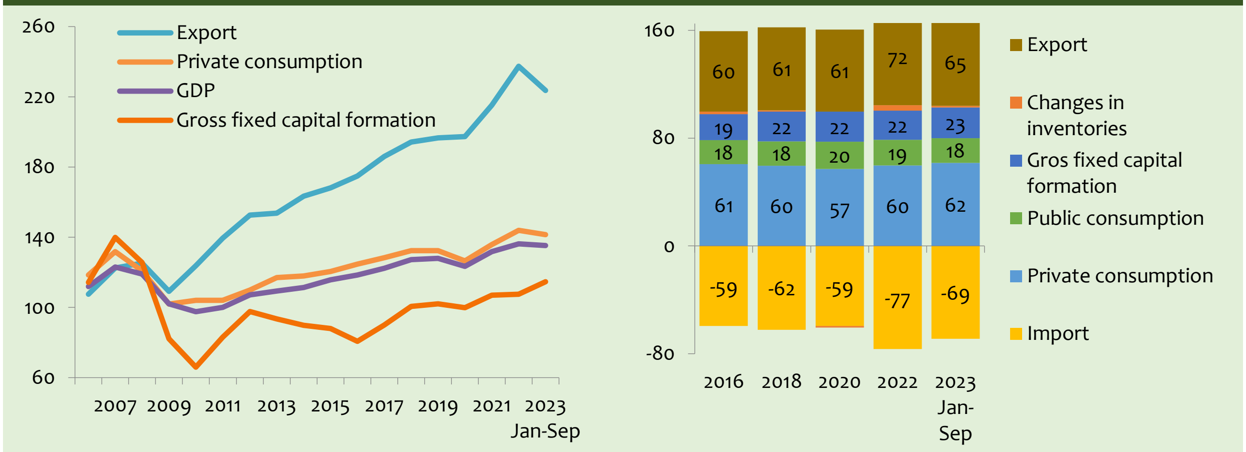



Growth became more rapid in 2017-2018 fostered by the improvement of the situation in the EU, the commencement of a new structural funds programme, increase in wages and employment. In this period, exports, investments, private and public consumption were growing stably. The deceleration of economic development in 2019 was underpinned by both internal factors (the investments from EU funds have reached their maximum, developments in the financial sector, changes in port management), and external factors (revision of global trade relations, *Brexit,* slower growth in the EU countries).

Figure 3.2

**Gross domestic product by expenditure components**

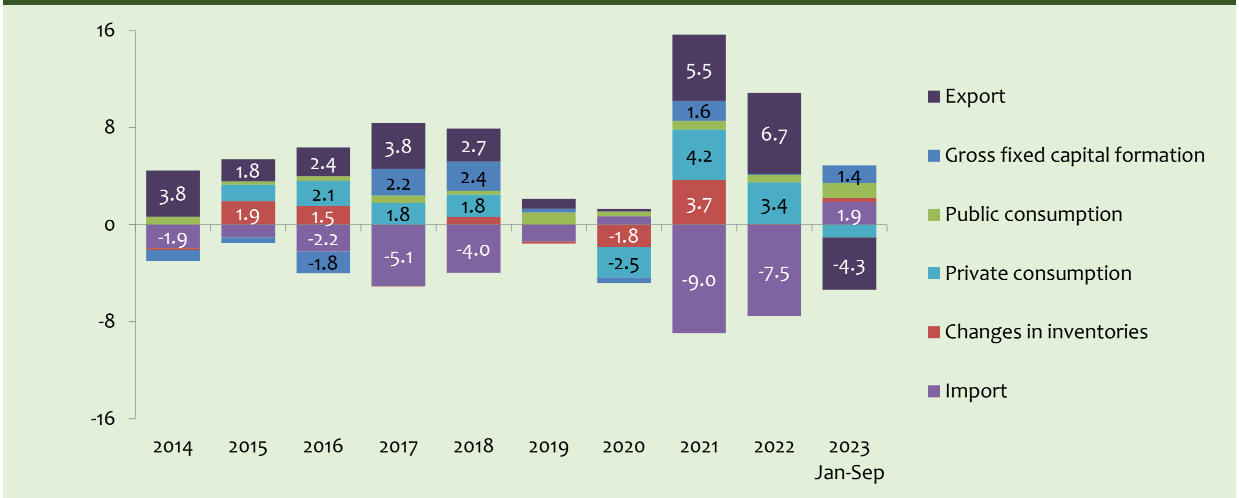
*2005 = 100, seasonally adjusted data* | *as per cent of GDP at current prices*



Economic development in 2020 was mainly dependent on the negative effects of the COVID-19 crisis. In 2020, GDP fell by 3.5%. It was the only GDP decline since the financial crisis. The fall in private consumption, which was affected by rising unemployment and shrinking incomes, had the biggest impact on the GDP reduction. Economic development in 2021 was still affected by the COVID-19 pandemic and measures to restrict it, but rapid growth was observed in the economy in the middle of the year largely due to the base effect, and in 2021 GDP increased by a total of 6.7%. The biggest impact was from the increase in exports fostered by the favourable atmosphere in Latvia's largest export markets and growing private consumption mainly secured by the base effect.

Figure 3.3

**Contribution of expenditure components to Gross domestic product changes**
*as percentage points*




After the rapid recovery of the economy from the crisis of the COVID-19 pandemic in 2021, growth in Latvia slowed to 3.4% in 2022. The economic development in 2022 was significantly influenced by the disruptions in supply chains caused by Russia's invasion of Ukraine, the rise in inflation caused by the cost of energy and food, as well as the decline in global demand. There was rapid growth in the first half of the year when the consequences of the war were not yet felt. The rise in exports and private consumption had the biggest effect underpinned by the low base in early 2021 and the gradual lifting of COVID-19 restrictions. However, in the second half of the year, growth decreased, as the export-import balance deteriorated, and the growth rates of private consumption and investments decreased. In 2022, government consumption continued to increase yet more moderately than in the previous year.

In 2023, economic development continues to be affected by the geopolitical situation and uncertainty, high prices and growing bank interest rates. GDP was 0.6% lower in Q1-Q3 2023 than a year before. The biggest impact came from the decline in exports and private consumption. The unfavourable external environment affected the Latvian export market, while the decreasing real income of the population negatively affected household consumption. In contrast, the biggest increasing impact came from investment growth, with the most rapid investment increases in housing, buildings and structures underpinned by the growth of the construction sector. Government consumption also rose sharply.

In 2014-2022, comparing the Baltic States, faster growth was observed in Lithuania and Estonia, by 3.3% and 3% per year on average, while Latvia showed growth of 2.5%.

Table 3.1

**Gross domestic product by expenditure components**
*changes compared to the corresponding period of the previous year, as per cent*

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 Jan-Sep |
|---|---|---|---|---|---|---|---|---|---|---|
| **GDP** | **1.9** | **3.9** | **2.4** | **3.3** | **4.0** | **0.6** | **-3.5** | **6.7** | **3.4** | **-0.6** |
| Private consumption | 0.5 | 2.5 | 3.5 | 2.8 | 3.0 | 0.1 | -4.2 | 7.3 | 6.0 | -1.7 |
| Public consumption | 3.8 | 1.5 | 2.1 | 3.5 | 1.7 | 5.6 | 2.1 | 3.5 | 2.8 | 6.8 |
| Gross fixed capital formation | -3.9 | -2.0 | -8.2 | 11.4 | 11.7 | 1.5 | -2.2 | 7.2 | 0.6 | 6.5 |
| Export | 6.3 | 3.0 | 4.0 | 6.4 | 4.4 | 1.3 | 0.4 | 9.0 | 10.3 | -5.8 |
| Import | 3.0 | 1.6 | 3.6 | 8.5 | 6.3 | 2.2 | -1.1 | 15.1 | 11.1 | -2.3 |

## 3.2. CONSUMPTION

The increase in **private consumption** volumes, as well as overall economic growth, has been moderate since 2014. From 2014 to 2019, private consumption increased by an average of 2.1% annually. The increase was fostered by growth in wages, but the rise in employment was slow. In 2020, private consumption declined sharply due to the restrictions caused by the COVID-19 pandemic. As economics recovered, a rapid increase in private consumption was observed in 2021 fostered by both the reduction of COVID-19 restrictions and the increase in average wages and government support measures.

Although there was a significant increase in consumer prices, in 2022 private consumption continued to grow very rapidly. The increase was driven by the increase in average wages, the reduction in unemployment and the complete cancellation of the COVID-19 containment restrictions.

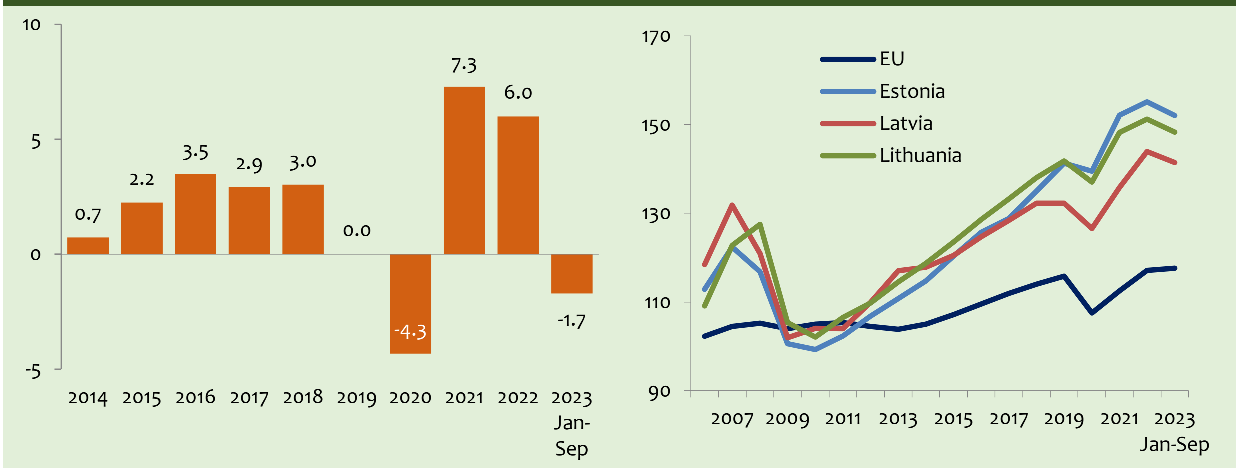
In 2023, household consumption is affected by the high level of prices. Price growth rates outpaced wage growth, negatively impacting the purchasing power of the population in the first half of 2023. Despite the base effect of lifting COVID-19 restrictions and improving the situation in the labour market, household consumption contracted equally rapidly in Q1 and Q2, while the decline was slightly more moderate in Q3. Overall, private consumption decreased by 1.7% in Q1-Q3 2023 compared to the corresponding period of 2022.

Since 2014, Latvia has been having the slowest increase in private consumption in comparison with other Baltic countries.

Figure 3.4

**Private consumption**
*changes compared to the corresponding period of the previous year, as per cent*

**Public consumption in the Baltic countries and in the EU**
*2005 = 100*




In the structure of household consumption, most of the expenditure is on housing, expenditure on food is the second largest consumption group, while transport expenditure is the third priority. Within 10 years, the share of expenditure related to food, housing, transport, communications and education has decreased in the structure of household consumption expenditure, while the share of expenditure related to alcoholic beverages and tobacco, clothing and footwear, housing equipment (furniture, household appliances and cleaning), health, recreation and culture, as well as restaurants, cafés and hotels has increased.

As the economy continued recovering from the COVID-19 crisis and as inflation was rising in 2022, compared to the previous year, expenditure increased in all main consumption groups, except expenditure on housing and food. Rising food and energy prices spurred households to save, with spending on food down 0.5%, while housing-related expenditure (rent, maintenance and repair of housing, water supply, electricity, gas and solid fuel) was down 7.5%. The decrease was also influenced by warmer weather at the beginning of the heating season. Increased expenditure on recreation and culture (by 29.6%) and restaurants and hotels (by 51.2%) had the biggest increasing impact fostered by the lifting of COVID-19 containment restrictions. The increase in expenditure on clothing and footwear (by 17.1%) and alcoholic beverages and tobacco (by 9.7%) also had a significant impact. A more moderate increase was in expenditure on transport and health.

In 2022, compared to 2012, household consumption expenditure increased in all groups of consumption expenditure. But spending on recreation and culture, food, transport, clothing and footwear was the biggest consumer expenditure, which also led to an increase in overall costs.

**Consumer sentiment** generally improved between 2010 and 2019, despite being negative. The most optimistic sentiment level over the past five years had been reached in July 2019, when the rate was -1.8 points. Such an improvement in the sentiment has been largely fostered by rapid economic growth in recent years. Latvian consumers were generally more optimistic, and consumer confidence has been higher than the EU average since mid-2011. The confidence level was more pessimistic in 2017-2018 when Latvia's indicator slipped below the EU average. Pessimistic trends were again dominating after improving in 2019.

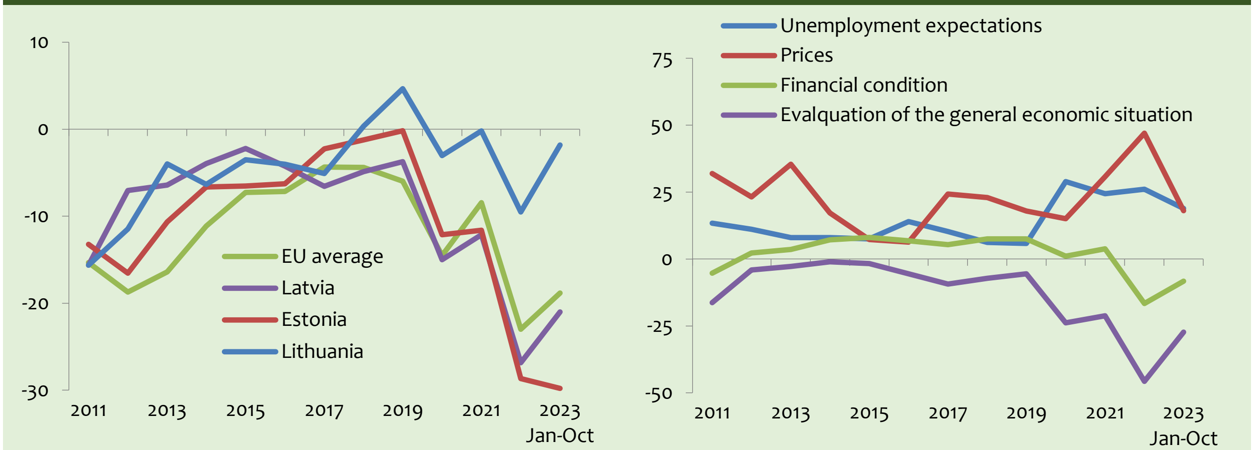
As a result of the COVID-19 pandemic, the consumer confidence indicator experienced a sharp decrease in 2020. Following the announcement of the emergency in the country, the lowest level of the indicator was reached in April and May 2020. As the epidemiological situation improved and restrictions eased, in 2021, consumer sentiment broadly improved, but in the second half of the year, optimism was tempered by growing uncertainty and concerns about the development of the spread of COVID-19, as well as price growth trends.

Figure 3.5

**Consumer confidence indicator***

*response balance, seasonally adjusted data*

Consumer confidence in the Baltic countries and in the EU | Consumer evaluation for the upcoming 12 months




* Consumer confidence indicator is calculated as the average of response balance to 4 questions – about the financial situation, the general economic situation, unemployment assessment and savings in the next 12 months.

Russia's invasion of Ukraine has severely impacted consumer confidence in 2022, and this trend was exacerbated by inflation. The confidence indicator fell to its lowest level in the last decade.

Consumer sentiment is beginning to recover in 2023. The consumer confidence indicator improves as inflation pressure eases and wages rise. In January-October 2023, this trend has been observed in all key items of the confidence indicator: assessment of the financial situation, assessment of the general economic situation, inflation expectations and unemployment expectations. It was only in June that the planned increase in electricity distribution tariffs damaged consumer sentiment, with a positive trend continuing in the coming months. In October, the consumers' future assessment deteriorated slightly.

Consumers' assessment of the financial situation of the family in the future has largely stabilised since 2012 and was generally positive during the year. Optimism has been growing on average since mid-2017, continuing until April 2020. While overall the financial prospects of families were viewed positively in 2020 and 2021, this indicator deteriorated in those years. However, in 2022, following Russia's invasion of Ukraine, a sharp decline followed. Although the indicator has improved in the 10 months of 2023, the average indicator for the year is still negative.

The assessment of the overall situation in the country, which has tended to improve since 2010, is essentially similar to the assessment of the financial situation of the family. A rapid increase has been observed until 2012, and in 2012 consumer confidence stabilised at the same time sticking to the ascending trend. The emergency announced in early 2020 drastically reduced consumer optimism. It continued to ease throughout the year and into 2021 as well. A particularly sharp decline was experienced in 2022. The indicator has overcome the negative trend and is starting to improve in 2023. It should be noted that the prospects of the country's economic situation are evaluated much more critically than the future of the financial condition of the family.

Unemployment expectations of consumers have been generally falling since 2010, although fluctuations were observed and stuck to the descending trend. However, since 2016 these expectations resumed growth reaching the highest level (24.3

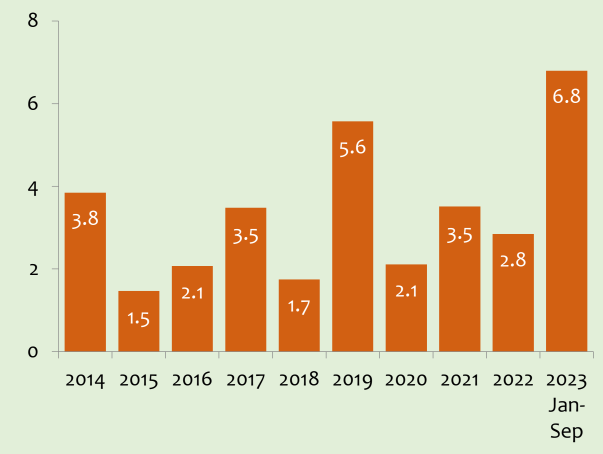
points) by the end of 2016. Since the middle of 2017, unemployment expectations have been generally declining, which is largely related also to the overall decline in the unemployment rate and an increase in employment. Unfortunately, in 2020, unemployment expectations of consumers grew rapidly, reaching 63.1 points, the highest level in the last ten years, in April. Consumers then regained confidence in their job prospects, and unemployment expectations have had a downward trend since 2021.

Inflation expectations were rising sharply until April 2011. Since the middle of 2011, inflation expectations have been cyclical and this was the consumers' way of responding to different changes, however, they have been generally declining. Since the middle of 2013, the drop has been very rapid reaching the level of -2.3 points in September 2016, the lowest since 2011. At the end of 2016, inflation expectations started to pick up again, a trend that persisted until mid-2017. Since the end of 2017, inflation expectations have moderately reduced, largely under the influence of a slower rise in prices and high inflation in the previous years. The COVID-19 pandemic did not significantly influence inflation expectations in 2020. Consumer concerns about price increases rose significantly in 2021, further boosted by Russia's invasion of Ukraine in 2022, and the highest rate of inflation expectations was reached in May and June. In 2023, as price growth reduces, the inflation expectations indicator is also shrinking, except for June, affected by the planned increase in electricity distribution tariffs.

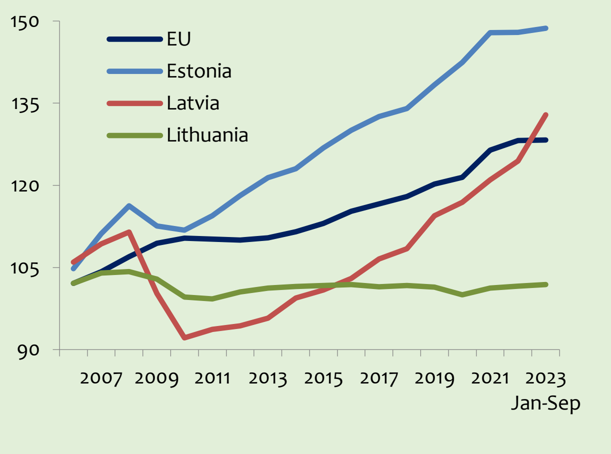
The volume of **public consumption** or public services has grown at the fastest pace since 2014 as budget revenues increased. Overall, from 2014 to 2022, public consumption was growing by an average of 3% per year.

Figure 3.6

**Public consumption**
*changes compared to the corresponding period of the previous year, as per cent*




**Changes in public consumption in the Baltic countries and in the EU**
*2005 = 100*




Budget expenditure has been growing rapidly in recent years to increase public defence capacity to provide financing for the national defence of 2% of GDP, setting the target at 2.4% of GDP in 2024, and planning to gradually increase it to 3% of GDP by 2027. To promote a sustainable and balanced country's economic development, deferred CIT for enterprise profits was introduced, the tax burden of the labour force was reduced and an increase of funding for defence, health, education, energy and road maintenance was primarily ensured within the scope of the state budget possibilities.

The government support measures to mitigate the negative effects of the COVID-19 crisis are largely funded at the expense of increasing the state budget deficit maintained a positive increase in public consumption in 2020 and 2021. In 2022 and Q1-Q3 2023, support measures implemented by the state to compensate for the rapid increase in energy prices for households and enterprises contributed to the increase in public consumption.

Since 2014, Latvia has been having the most rapid increase in public consumption in comparison with other Baltic countries.

# 3.3. INVESTMENT

Investment activities in the Latvian economy have been very volatile in recent years, significantly affected by changes in the geopolitical situation, availability of financing and production resources, as well as other external and internal factors.

In the last three years (2020-2022), expenditure on total fixed capital formation increased by an annual average of 1.8%, much more moderate than before the COVID-19 pandemic in 2017-2019, when growth averaged 8.1% per year.

In 2020, investment activities declined significantly due to the COVID-19 pandemic. Sensing the uncertainty about the possibility of combatting the pandemic soon, in 2020, expenditure on fixed capital formation fell by 2.2%, and this was the worst indicator in the Baltic States. However, as the economy stabilised after the shock caused by the COVID-19 pandemic, investment volumes increased by 7.2% in 2021.

Figure 3.7

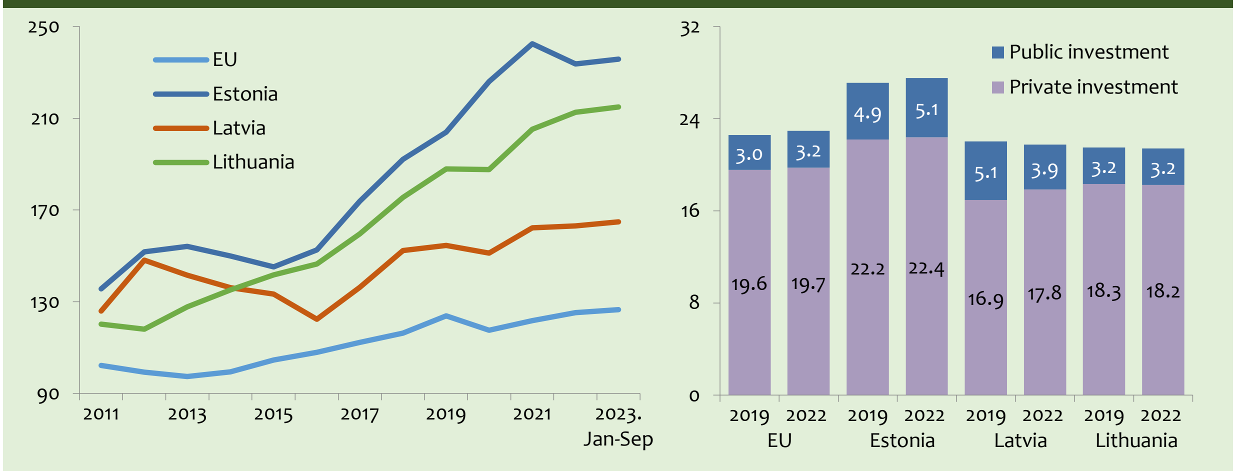
**Changes in investment amounts in the EU countries**
*changes as per cent*


The war in Ukraine exacerbated the situation and increased uncertainty, and this reflected in the dynamics of investment activities. In 2022, investment increased by only 0.6% and amounted to 21.7% of GDP. Investment activity was limited by the increase in construction prices and delays in the absorption of EU-funded programmes.

Figure 3.8

**Increase in Investments in the Baltic Countries and in the EU**
*2010 = 100*

**Investment level in the Baltic countries and in the EU**
*as per cent of GDP*



Overall, from 2020 to 2022, investment in the national economy of Latvia amounted to 22.2% of GDP, same as the average indicator before the pandemic, but still a lower level than before the global financial crisis.

Following three years of a moderate increase investment activities in 2023 are growing. In January-September of this year, expenditure on fixed capital formation was 6.5% higher than a year ago.

The high uncertainty associated with the geopolitical situation and the further development of the global economy, uncertainty about the course of the Russian war in Ukraine, weak lending, as well as the deterioration of financing conditions due to the monetary policy implemented by the European Central Bank (ECB) have reduced the incentive of the private sector to invest.

Private investment in Latvia has remained at low levels for a long time. It has been growing by 4.1% per year on average in the last three years (2020-2022), almost 2 percentage points slower than before the COVID-19 pandemic (2017-2019). Measures to combat the COVID-19 pandemic limited overall economic activity and discouraged previously planned investments. In 2020, the private sector investment volume fell by 5.2%, compared to the previous year. However, in 2021 and 2022 the volume of private investment grew by 9.1% every year. Positive, but more moderate dynamics remained also in 2023 – in the first half of the year, the volume of private investment (at constant prices) was 6.6% higher than a year ago.

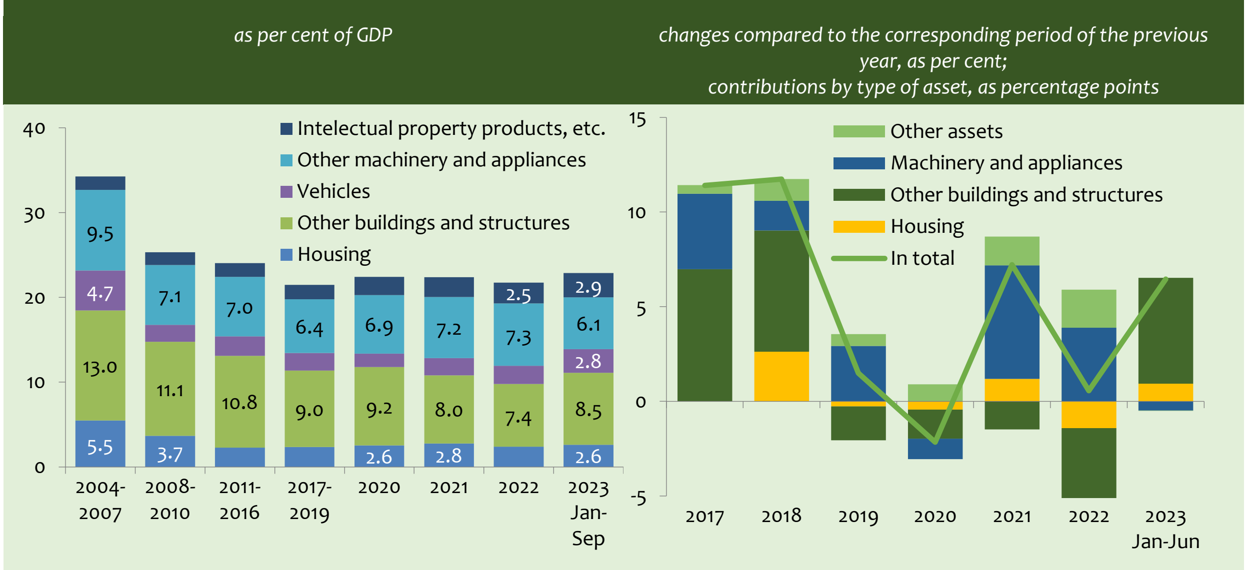
Although since 2021 private investment growth rates have been rising, their level is still lower than before the global financial crisis and also lower than in most EU countries, including Lithuania and Estonia. This is largely affected by weak lending, which has been very low for a long time.

According to the data of the Bank of Latvia, the balance of loans to non-financial corporations and households in 2022 accounted for 29% of GDP, which is well below the level before the global financial crisis and one of the lowest in the EU. Compared to 2021, it shrank by 2.5 percentage points. In the first half of 2023, the balance of loans issued to non-financial corporations fell by 3.4%, but to households – increased by 1.1%, and the domestic credit portfolio (without credits to the government) continued to shrink, reaching 27.2% of GDP in June 2023. The reduction of the credit-to-GDP ratio was affected not only by moderate lending dynamics but also by nominal GDP growth (denominator effect).

Analysts of the Bank of Latvia note that while lending dynamics remain positive for households to purchase housing, they are becoming more moderate. However, uncertainty and rising risks negatively affect lending conditions and demand in other lending segments. Both bank risk appetite and entrepreneurs' willingness to borrow, especially for investment purposes, are declining.

Figure 3.9

**Investment by type of asset**




Public investment in Latvia is at a comparatively high level. It amounts to almost 1/5 of total investments in the Latvian national economy, and their dynamics are largely related to the cyclicity of absorption of EU structural funds. From 2017 to 2019, public investments were growing by an average of 16.4% per year. Although we had to experience the COVID-19 crisis, public investment increased by 8% in 2020. It increased by only 1.8% in 2021, but the volume of public investment (at constant prices) shrank in 2022 and was 26.2% lower than a year before. In the first half of 2023, compared to the corresponding period of the year before, state budget expenditure on total fixed capital formation (at constant prices) fell by 26.4%.

Investments in construction assets constitute the largest part of the total investment. These mainly are investments in buildings and structures, which accounted for 36.7% of the expenditure on gross fixed capital formation in the last three years (2020-2022). Negative dynamics have been observed in investments in construction assets since 2019. In 2019, compared to 2018, investment in these assets fell by 3.7%, largely affected by the end of the EU structural funds absorption cycle. Due to the crisis caused by the COVID-19 pandemic, in 2020, investments in construction assets (at constant prices) decreased by 3.8%, but in 2021 they were 0.5% lower than a year before. In 2022, investments in these assets also continued to shrink by 11.1%, including investments in engineering structures and buildings reduced by 11%, and investments in housing – by 11.4%, being largely influenced by the appreciation of construction costs. In January-September 2023, investment activities in construction assets increased rapidly (by 16%) underpinned by the increase in investment in engineering structures and buildings by 17.6% and an increase in investment in housing by 10.8%. Rapid investment dynamics are partially explained by the low base effect.

Investments into machinery and appliances react sensibly to shocks, their recovery after the crisis is slower than in other assets. This is mainly due to weak lending, relatively high private debt and unfavourable market conditions, as well as low capacity utilisation. In 2020-2022, investments into machinery and appliances did not exceed 41% of total investments. However, it should be noted that their dynamics were more rapid than in other assets. The impact of the crisis caused by the COVID-19 pandemic on investment in manufacturing machinery and equipment was relatively small. In 2020, investment in these assets fell by 2.8% driven mainly by the lower than a year ago investment in vehicles (by 26.7%). By contrast, in 2021 and 2022, 15.8% and 9.4% more, respectively, were invested in machinery and appliances than a year before. The increase in investment was largely underpinned by investments in vehicles, as well as in information and communication technology equipment, which is necessary for remote work. In January-September 2023, investments in machinery and appliances reduced slightly and were 0.1% lower than a year ago.

Investments in intellectual property assets have accounted for around 10% of total investment in the last three years (2020-2022). They are characterised by stability in the years of economic recession, and growing dynamics are generally observed. They were particularly rapid in 2020-2022. Since 2020, investments in these assets increased 1.5 times, and their levels are higher than before the COVID-19 pandemic. In January-September 2023, 0.2% more than a year ago was invested in intellectual property products and accounted for 2.8% of GDP.

Table 3.2

**Gross capital formation**
*annual average*

| | 1995–2007 | 2008–2010 | 2011–2019 | 2020 | 2021 | 2022 | 2023 Jan-Sep |
|---|---|---|---|---|---|---|---|
| | | | | *real growth* | | | |
| **GDP** | **7.4** | **-7.5** | **3.1** | **-3.5** | **6.7** | **3.4** | **-0.6** |
| Gross capital formation | 18.1 | -25.3 | 6.0 | -10.0 | 24.9 | 0.8 | -5.1 |
| – gross fixed capital formation | 18.4 | -22.2 | 5.0 | -2.2 | 7.2 | 0.6 | 6.5 |
| | | | | *as per cent of GDP* | | | |
| Gross capital formation | 27.9 | 27.0 | 23.7 | 21.4 | 25.0 | 26.1 | 24.1 |
| – gross fixed capital formation | 25.2 | 25.1 | 22.3 | 22.4 | 22.4 | 21.7 | 22.9 |
| – changes in inventories | 2.6 | 1.8 | 1.3 | -1.0 | 2.6 | 4.4 | 1.2 |

Investments in Latvia's economic sectors are unsustainable, and their volatility is affected by both the cyclicity of the absorption of EU structural funds and the adjustment of private sector investment plans in line with changes in market conditions.

In the last five years (2015-2019) before the COVID-19 crisis the intensity of investment was moderate. Investment volumes increased more rapidly in services sectors – by an average of 3.5% annually, with the largest contribution from extensive investment in real estate activities, public administration, as well as administrative and support service activities. In commodity producing sectors, investments increased slowly – by an average of 0.1% annually. Overall, the investment intensity in the services sectors has been close to historical indicators since 2011, while in the manufacturing sectors it remains at a lower level.

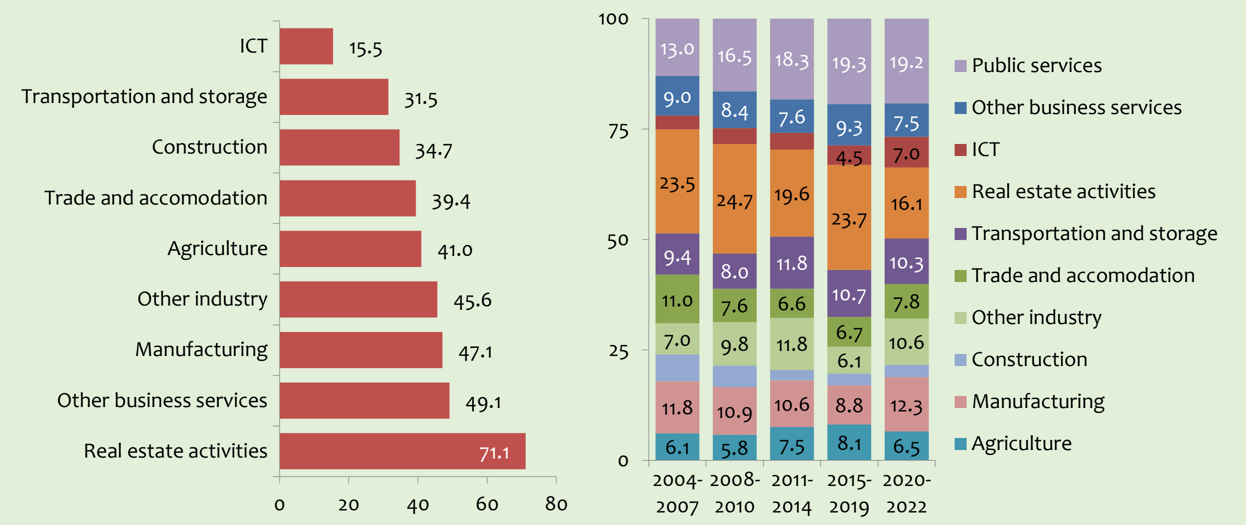
The crisis caused by the COVID-19 pandemic has affected the services sectors the most. In 2020, expenditure on fixed capital formation in the services sectors was 9.7% lower than a year ago. 18.2% more than in 2019 was invested in the commodity producing sectors, mainly due to the large volume of capital investment in the energy and communal services sectors. In 2021, investments in commodity producing and services sectors increased by almost 10.7% and 9.7%, respectively, exceeding the level of the previous year. Investments in commodity producing sectors continued to grow rapidly (by 12.1%) also in 2022, while investments in the services sectors were 5.1% lower than a year before. It should be noted that, despite the generally unfavourable conditions, investment activity in some sectors in the last three years (2020-2022) has been rather high. There was a significant increase in investment volumes in sectors like manufacturing, energy, transportation and storage. Extensive investments were made in education, health, as well as information and communication.

According to provisional data, in January-September 2023, overall capital investment in tangible assets (at current prices) in sectors of the Latvian economy increased by almost 31.9%, including by 44.2% in the commodity producing sectors and by 26.3% in the services sectors, thus the commodity producing sectors were growing at a faster rate. The largest increase in capital investment was recorded in manufacturing, trade, transportation and storage, as well as in real estate activities. It accounts for almost half of the total capital investment in January-September of this year.

Figure 3.10

**Gross capital investments by sectors**
*January-September 2023 changes compared to the corresponding period of the previous year, as per cent**

**Gross fixed capital formation by sectors**
*as per cent*




* Calculated using quarterly data, at current prices.

Surveys carried out by the European Investment Bank (EIB) in 2023 show that in the field of investment Latvian entrepreneurs mark the shortage of skilled personnel and uncertainty regarding the future as the most significant long-term barriers to investment. These are also the two most frequently mentioned obstacles in EU Member States. Investments are also limited by the high costs of energy sources and shortcomings in business regulation. The negative impact of the rise in energy prices caused by Russian military aggression may increase if the development or outlet prospects of the Latvian economy, its individual sectors or enterprises weaken.

The dynamics of investment will also be further affected by the uncertainty in the international environment. EU funding, which is an important incentive for increasing investment levels, will have a positive impact. Several projects to be funded under the Recovery and Resilience Facility (RRF) will make a significant contribution to increasing investment activities. Increasing the loan portfolio, which has been low for a long time, also plays an important role. However, it should be noted that, in the coming years, investments will be significantly constrained both by the rise in costs and by lending becoming more expensive as the ECB implements restrictive monetary policy.

## 3.4. EXPORTS AND IMPORTS

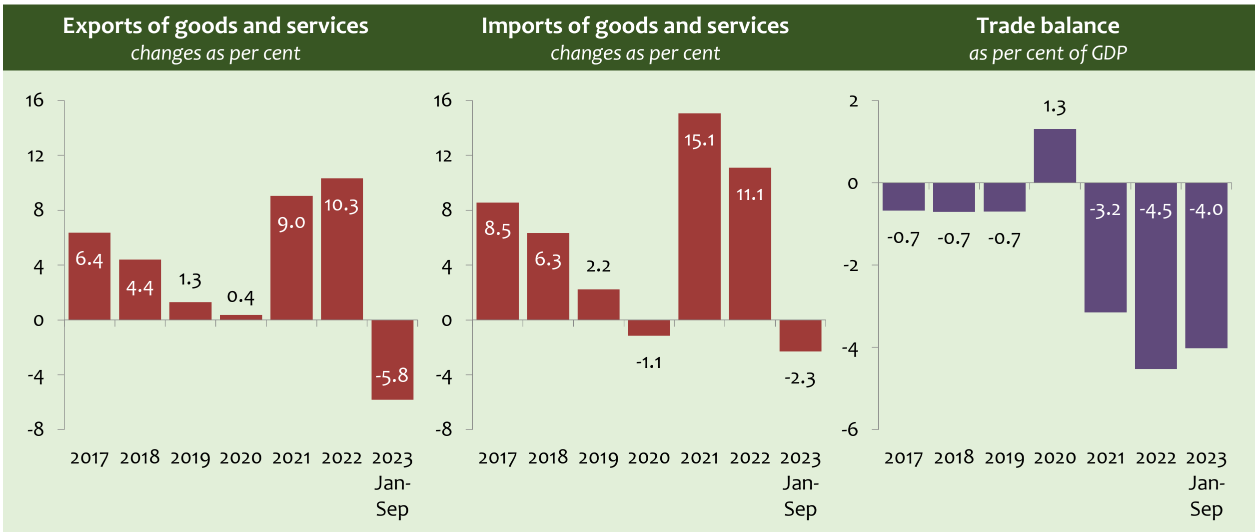
Export usually is one of the main factors of economic growth, and its dynamics are closely related to the competitiveness of Latvian companies in foreign markets, as well as external demand and rates of development of economies of trade partner countries.

In 2014-2018, the development of exports was fostered by economic growth in EU countries and stable demand in other partner countries. In 2019, as the economic growth rates of partner countries declined, the development of exports was more moderate.

2020 and 2021 will be marked in history as the time of crisis caused by COVID-19, which affected all economic indicators in all countries around the world, also in Latvia. As exports are directly dependent on external demand, this crisis had a significant impact on export volumes. In early 2020, export volumes increased, while in March a sharp decline in rates following the beginning of the pandemic was observed. In Q2 2020, export volumes were already significantly lower than a year before. In the second half of 2020, as external demand increased, exports started to grow moderately. In Q1 2021, export volumes were like a year ago, while in Q2 2021, as the external demand had grown rapidly and partially due to the base effect, export volumes increased significantly. Rapid growth continued also in the second half of the year.

In 2022, despite active hostilities taking place near the country's eastern border, the rapid growth of exports continued. Like in the previous year, it was largely driven by strong external demand. It should be noted that export prices increased significantly in 2022, especially to EU countries – the main trading partner countries of Latvia.

Figure 3.11




A different picture is observed in 2023, namely, in Q1 export volumes were like those a year ago, in Q2 exports were 4.5% lower than a year ago, but in Q3 exports reduced considerably – by 11.8%. Export prices in Q1-Q3 2023 also reduced significantly – by 9.9%.

As usual, the most important export markets for Latvia are EU countries, including its neighbours – Lithuania and Estonia. Exports to CIS countries, including Russia, keep getting smaller. It should be noted that Russian military aggression in Ukraine has a negative impact on the volume of trade deals with both Russia and Belarus. This is partly compensated by the increase in export volumes to other CIS countries, unfortunately also in an unfair way – bypassing sanctions imposed by EU and Latvia. It should be noted that the increase in trade volumes with CIS countries, except Russia and Belarus, is relatively small. In January-October 2023, the decrease in the value of trade volumes to Russia and Belarus is tenfold higher than the increase in value to other CIS countries.

Exports to other countries, to which the United Kingdom belongs since the first half of 2020, make up an increasingly higher share in the total export structure. In recent years, exports to other countries have been twice as high as exports to CIS countries.

The main factors of the development of imports of Latvian goods and services are increases in production volumes in manufacturing and income available to households. Import volumes are growing considerably, as internal demand is growing. In 2020, as internal demand dropped considerably, import volumes slightly reduced. In 2021, disparate trends were observed. In particular, in early 2021, a moderate increase in imports was observed. However, starting from Q2 2021, because of the significant increase in demand and the base effect, imports of goods and services were significantly higher than a year ago. Similar trends still existed in 2022.

The development of imports in 2023 was similar to that of exports: in Q1 export volumes were 4.8% higher than a year ago, in Q2 they shrank slightly, but in Q3 the decline was already considerable – by 8.3%. Like export prices, import prices also reduced by 12.3% in Q1-Q3 2023.

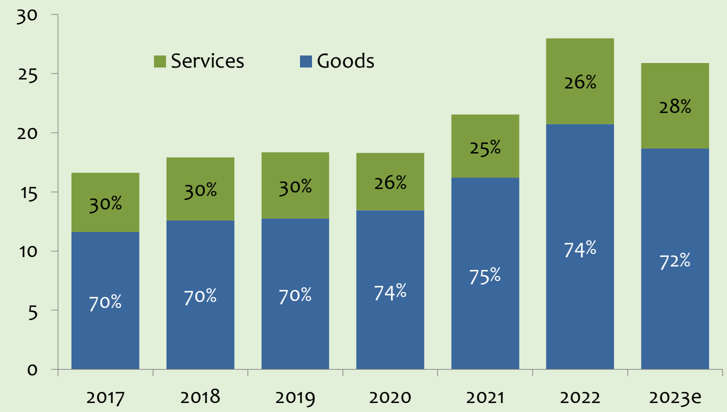
In 2020, when import volumes were declining more rapidly than export volumes under the influence of COVID-19, the export-import balance reached historically the highest positive level. As the rapid increase in trade volumes resumed in 2021-2022, the export-import balance deteriorated considerably. Similar trends still existed in 2023.

## EXPORTS

More than two-thirds of Latvian exports are composed of exports of goods. Until 2019, this proportion has not significantly changed. It should be noted that from 2020 to early 2022, when the possibilities of exporting services were considerably restricted due to the COVID-19 crisis, the export structure changed in favour of exports of goods. However, starting from Q2 2022, as exports of services were growing more rapidly than exports of goods, the export structure slowly changed in favour of exports of services.

Figure 3.12

**Exports of goods and services**
*billion euro and percentage*




e – evaluation by the MoE

Latvia's exports of goods in 2017-2018 developed dynamically. In 2019, exports of goods increased more moderately due to falling external demand.

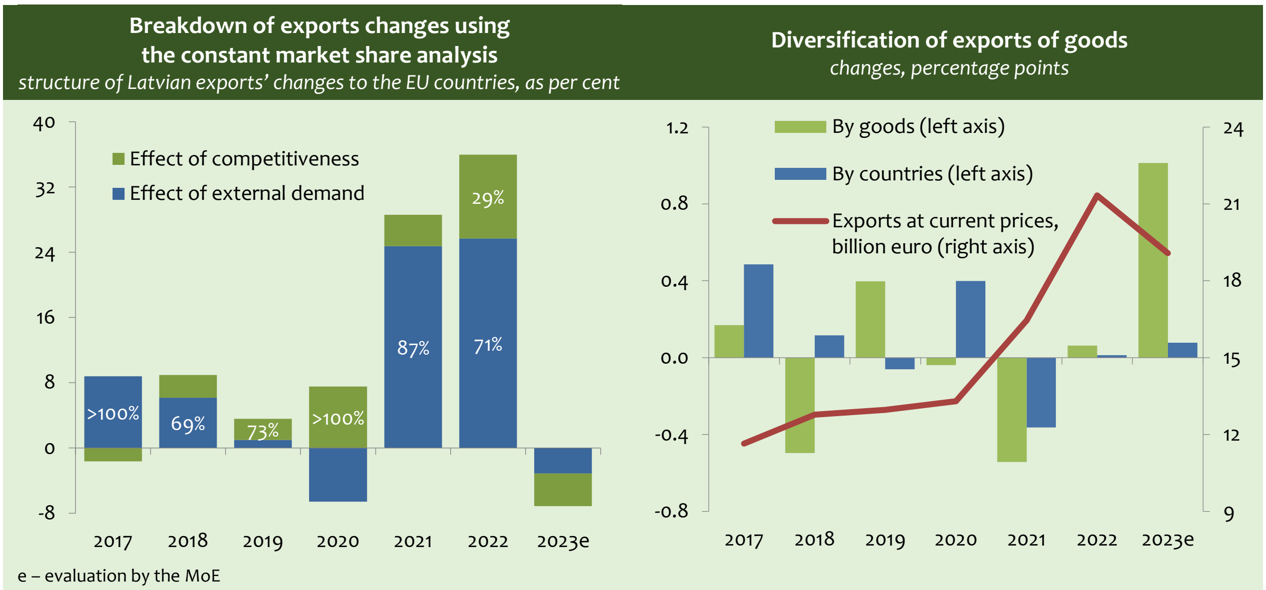
The first half of 2020 was not favourable to exports of goods or the overall economic development. Export volumes during the crisis were lower than a year ago under the influence of COVID-19. However, rapid growth in exports of goods in the second half of the year, particularly in the last quarter of the year, allowed the year to be concluded with very good growth. In 2021 and 2022, exports continued to develop dynamically. In Q1-Q3 2023, exports of goods have decreased by 8.1% due to limited external demand.

In 2017-2018, the development of exports of goods was positively influenced by changes in export prices. At current prices, exports increased on average by around 10% annually. Export prices declined slightly in 2019 as external demand declined. Similar trends were also observed in 2020. Starting from Q2 2021, the export unit value has been showing rapid growth. During 2021 and in 2022, it was 13.9% and 19.7% higher than a year before, respectively. In Q1 2023, export prices continued to grow, albeit at a slower rate. In Q2 it was 5% lower and in Q3 9.8% lower than a year before. Overall, in January-September 2023, the reduction in export prices was most significantly affected by the drop in prices of agricultural products, wood and wood products, mining products, as well as chemical industry products.

Figure 3.13


In 2017-2018, the increase in exports of goods was driven by external demand, with a low or even negative role of competitiveness in export growth. In 2019, however, Latvia's exports to EU countries were driven by a more rapid increase in the competitiveness of Latvian companies. With external demand shrinking rapidly in 2020, the negative export development was partly compensated by the ability of entrepreneurs to compete in external markets. 2021-2022 were marked by a considerable increase in external demand, which largely drove the increase in exports. Negative export growth in 2023 is equally affected by competitiveness and the external demand effect.

Figure 3.14




As major groups of goods such as wood and wood products and agricultural and food products are growing more rapidly, the diversification rate of export goods is deteriorating, while faster development of relatively smaller export groups improves this indicator. The diversification indicator has been volatile year on year in the last five years. For example, in 2018, when exports of wood and wood products grew considerably in response to the United Kingdom's anticipation of withdrawal from the EU, and this had a negative effect on the diversification indicator for goods. The indicator improved in 2019 when this effect subsided. In 2021, as the value of the largest groups of export goods was growing rapidly because of the influence of COVID-19, the diversification indicator deteriorated. In 2023, as export values of the largest groups of export goods – wood products and mineral products – decrease, the diversification indicator of export products is growing.

A similar process is observed in the diversification of exports of goods by country. This indicator increases when new export markets are entered, and the indicator deteriorates when exports to major partner countries increase more rapidly. The diversification of goods by country has not changed significantly in the last two years.

In 2022, exports of goods to the EU countries at current prices increased rapidly – by 34.7%. A large part of the increase was due to the growth of exports groups of mineral products, and wood and its products. By contrast, exports of iron and steel reduced. In January-October 2023, exports to the EU countries reduced similarly to total exports. This drop was mainly due to the decline in the value of exports of mineral products, wood and its products, as well as iron and steel. Meanwhile, the value of exports of electrical appliances and equipment increased during this period.

Table 3.3

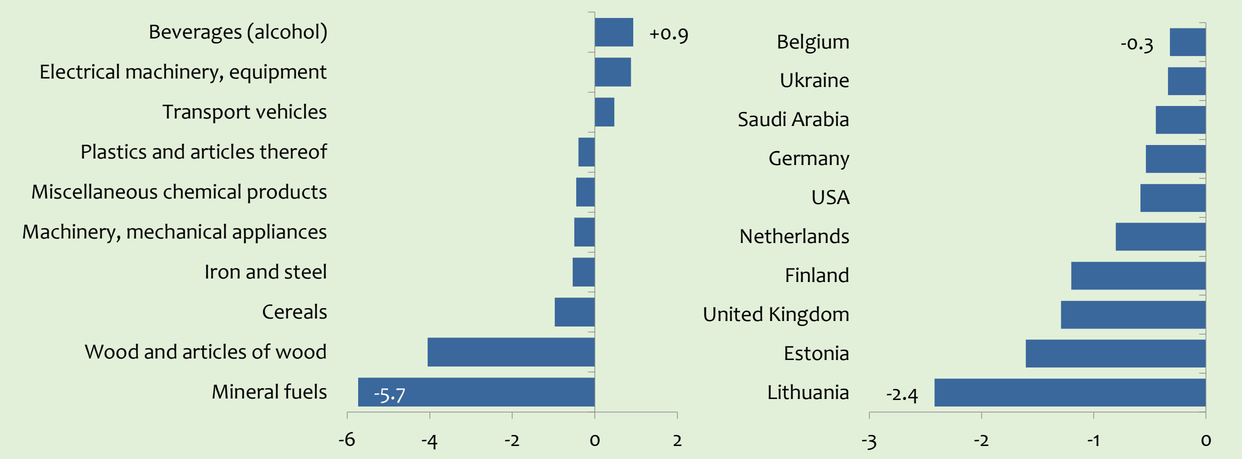
**Exports of goods**
*as per cent, at current prices*

| | 2022 | | | 2023 Jan-Oct | | |
|---|---|---|---|---|---|---|
| | structure | changes | contribution to the changes | structure | changes | contribution to the changes |
| **Total** | **100** | **29.7** | **29.7** | **100** | **-10.7** | **-10.7** |
| Agricultural and food products | 19.9 | 40.9 | 7.5 | 22.0 | 3.6 | 0.7 |
| Mineral products | 12.8 | 162.5 | 10.3 | 8.1 | -43.9 | -5.6 |
| Chemical industry products | 11.3 | 20.3 | 2.5 | 11.8 | -8.2 | -0.9 |
| Light industry products | 2.9 | 15.6 | 0.5 | 3.6 | 12.9 | 0.4 |
| Wood and articles of wood | 17.2 | 16.8 | 3.2 | 15.3 | -22.9 | -4.1 |
| Metal and articles of metal | 6.9 | -10.9 | -1.1 | 6.6 | -16.9 | -1.2 |
| Machinery, mechanical and electrical appliances | 14.3 | 13.4 | 2.2 | 16.1 | 2.7 | 0.4 |
| Transport vehicles | 4.6 | 29.2 | 1.4 | 6.1 | 17.0 | 0.8 |
| Other goods | 10.2 | 32.9 | 3.3 | 10.4 | -10.3 | -1.1 |

In 2022, exports of goods to the EU countries at current prices increased by 8.2%. The value of exports of beverages, pharmaceutical products, different plants, rubber and its products increased more rapidly. On the other hand, exports of electrical appliances and equipment and plastics to CIS countries reduced. In January-October 2023, exports to CIS countries continued to increase – by 3.4%. The growth was fully secured by the increase in the value of exports of beverages. It should be noted that the total value of exports to CIS countries, without exports of beverages, decreased significantly – by 9.7%. The value of machinery and appliances exported to CIS countries decreased considerably during this period.

Figure 3.15

**Groups of goods and countries with most effect on changes in exports**
*contribution to changes in January-October 2023, percentage points*

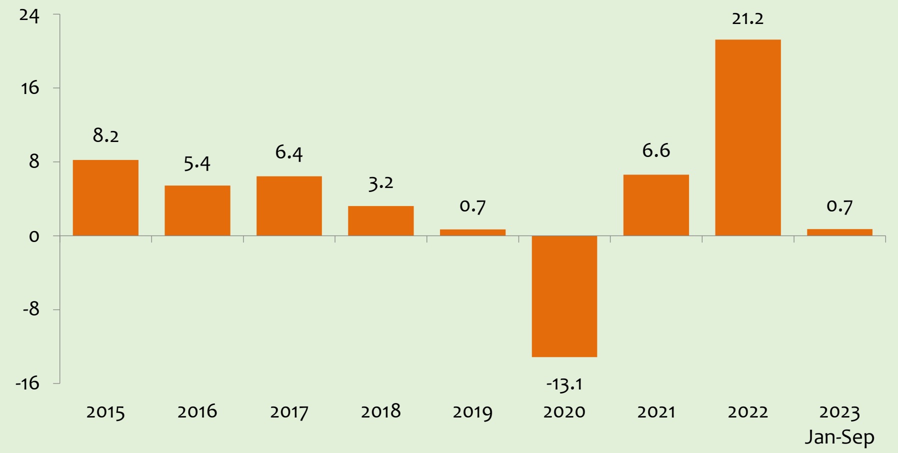


In 2022, exports of goods to other countries, excluding EU and CIS countries, at current prices grew by 24.2%. This was considerably influenced by the increase in exports of cereals and unspecified goods to Ukraine. In January-October 2023, exports to other countries decreased by 14.4%. This was considerably influenced by the decrease in exports of wood and wood products to the United Kingdom.

In 2015-2016, exports of services grew considerably more rapidly than exports of goods, thus compensating for the impact of the negative goods export balance. In 2017, export rates of goods and services were similar. However, in 2019-2020, growth in the exports of services was slightly lower than in the exports of goods.

Figure 3.16

**Exports of services**
*changes as per cent*




It should be noted that in 2020, the growth of exports of services was greatly impacted by restrictions imposed on travelling, food services activities, and other service activities due to the COVID-19 pandemic. In 2020, overall exports of services decreased considerably. The most rapid drop was observed from Q2 2020 to Q1 2021. Since Q2 2021, exports of services have resumed growth at a comparatively rapid pace due to the base effect. Rapid growth rates of exports of services were also preserved in 2022. In Q1-Q3, the increase in the value of exports of services exceeded 20% driving the most rapid growth in exports of services since 1996.

Table 3.4

**Exports of services**
*as per cent, at current prices*

| | 2022 | | | January-September 2023 | | |
|---|---|---|---|---|---|---|
| | structure | changes | contribution to the changes | structure | changes | contribution to the changes |
| **Total** | **100** | **36.0** | **36.0** | **100** | **7.5** | **7.5** |
| Transport services, including: | 32.2 | 46.0 | 13.8 | 31.4 | 6.2 | 2.0 |
| – sea transport | 3.2 | 19.9 | 0.7 | 2.2 | -27.3 | -0.9 |
| – air transport | 9.3 | 169.1 | 7.9 | 11.6 | 44.4 | 3.8 |
| – rail transport | 2.2 | 4.0 | 0.1 | 1.7 | -16.8 | -0.4 |
| – road transport | 16.3 | 28.2 | 4.9 | 14.4 | -4.7 | -0.8 |
| – other transport services | 1.3 | 10.2 | 0.2 | 1.4 | 17.4 | 0.2 |
| Travel | 14.5 | 65.6 | 7.8 | 16.7 | 18.3 | 2.8 |
| Other services, including: | 53.3 | 24.8 | 14.4 | 51.9 | 5.1 | 2.7 |
| – construction services | 4.5 | -11.8 | -0.8 | 4.5 | 8.6 | 0.4 |
| – financial and insurance services | 3.0 | 15.0 | 0.5 | 2.5 | -19.7 | -0.7 |
| – ICT services | 17.2 | 29.2 | 5.3 | 16.6 | 5.5 | 0.9 |
| – other business services | 27.4 | 32.6 | 9.2 | 27.2 | 7.8 | 2.1 |
| – other services | 1.2 | 19.2 | 0.3 | 1.1 | -3.1 | 0.0 |

Similarly to exports of goods, growth in exports of services reduced every quarter in 2023. Positive growth in exports of services was observed in the first half of the year, but in Q3 exports of services reduced by 4%.

Until 2019, about 40% of the exports of services usually consisted of income from transport services. The last few years have not been successful for the export of transport services. In 2019, the exports of services were similar to the previous year. In 2020, exports of services provided by all modes of transport declined significantly under the influence of COVID-19. The value of road transport export services declined moderately. In 2021, the development of exports of transport services was similar to the general trends in exports of services. In 2022, exports of services by all modes of transport increased. Transport by air and road transport grew most significantly, while transport by sea and rail was growing more moderately.

In Q1-Q3 2023, the increase in exports of transport services was underpinned by a significant increase in the value of export of air transport, while exports of other types of transport services declined.

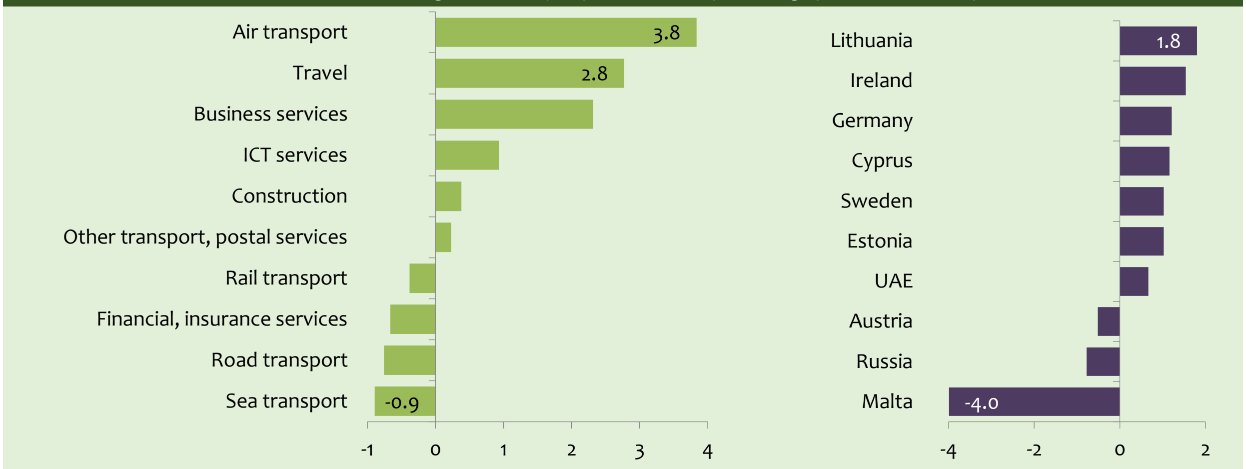
In 2021, income from foreign tourists fell slightly due to the COVID-19 crisis, while in 2022 it increased rapidly. In Q1-Q3 2023, income from foreign tourists continues to increase forming a big contribution to the total development of exports of services. Exports of economic activity services, ICT and construction services during this period increased as well.

Until 2018, slightly less than 60% of total exports of Latvian services were related to EU countries; in 2020 and 2021, this share rose significantly – by 66%. In Q1-Q3 2023, exports of services to EU countries were slightly lower.

Exports of services to EU countries grew at a slightly faster pace in Q1-Q3 2022 than total exports of services – by 7.8%. The value of exports of travel was growing more rapidly, but of transport services more moderately during this period.

Figure 3.17

**Services items and countries with most effect on changes in Latvian exports**
*contribution to the changes in January-September 2023, percentage points, at current prices*




## IMPORTS

In 2017-2020, the growth of imports of Latvian goods and services followed a downward trend – from 8.5% to -1.1%. Weak import growth in 2019-2020 was due to low domestic demand due to the COVID-19 pandemic. However, demand began to grow rapidly in 2021, with import growth rates at their fastest pace in recent years. Import volumes exceeded the level of the previous year by 11.1% also in 2022. Imports of both goods and services were growing rapidly. In Q1-Q3 2023, imports of services continued to grow – by 6.7%, but imports of goods reduced by 4% driving the total reduction in imports by 2.3%.

In 2022, the increase in imports of goods was affected by growth in imports of almost all main groups of goods. The value of imports of mineral products, land transport, electrical appliances and equipment, as well as machinery and appliances increased at a faster pace. The decline in imports of goods in January-October 2023 was significantly affected by the drop in the value of imports of mineral products (partially the base effect). Imports of wood and wood products, iron and steel reduced more moderately. The reduction was partially compensated by the increase in the value of imports of land transport, aircraft and their parts, as well as beverages.

In 2022, imports from EU countries at current prices increased faster than total imports of goods – by 44.8%. In January-October 2023, imports of goods from EU countries decreased by 8.8%. Similarly to total imports, the reduction was underpinned by the drop in the import value of mineral products.

Figure 3.18


Imports from Russia and Belarus traditionally accounted for about 98% of imports from CIS countries, they reached even 99% in 2021. On the other hand, as extensive Russia's hostilities in Ukraine began, due to the various restrictive measures introduced by the EU and Latvia, imports from these countries accounted for 95% in 2022 and 85% in January-October 2023.

Table 3.5

**Imports of goods**
*as per cent, at current prices*

| | 2022 | | | January-October 2023 | | |
|---|---|---|---|---|---|---|
| | structure | changes | contribution to the changes | structure | changes | contribution to the changes |
| **Total** | **100** | **35.7** | **35.7** | **100** | **-11.7** | **-11.7** |
| Agricultural and food products | 15.2 | 35.7 | 5.4 | 19.1 | 12.2 | 1.8 |
| Mineral products | 20.9 | 194.6 | 18.8 | 11.8 | -50.4 | -10.6 |
| Chemical industry products | 14.7 | 21.5 | 3.5 | 15.2 | -10.9 | -1.6 |
| Light industry products | 3.9 | 21.0 | 0.9 | 4.6 | 3.8 | 0.2 |
| Wood and articles of wood | 3.4 | -4.1 | -0.2 | 2.6 | -37.6 | -1.4 |
| Metal and articles of metal | 6.8 | -2.4 | -0.2 | 6.5 | -19.3 | -1.4 |
| Machinery, mechanical and electrical appliances | 17.3 | 16.4 | 3.3 | 19.3 | -1.2 | -0.2 |
| Transport vehicles | 9.9 | 23.0 | 2.5 | 12.5 | 21.8 | 2.0 |
| Other goods | 7.8 | 18.6 | 1.7 | 8.3 | -5.6 | -0.4 |

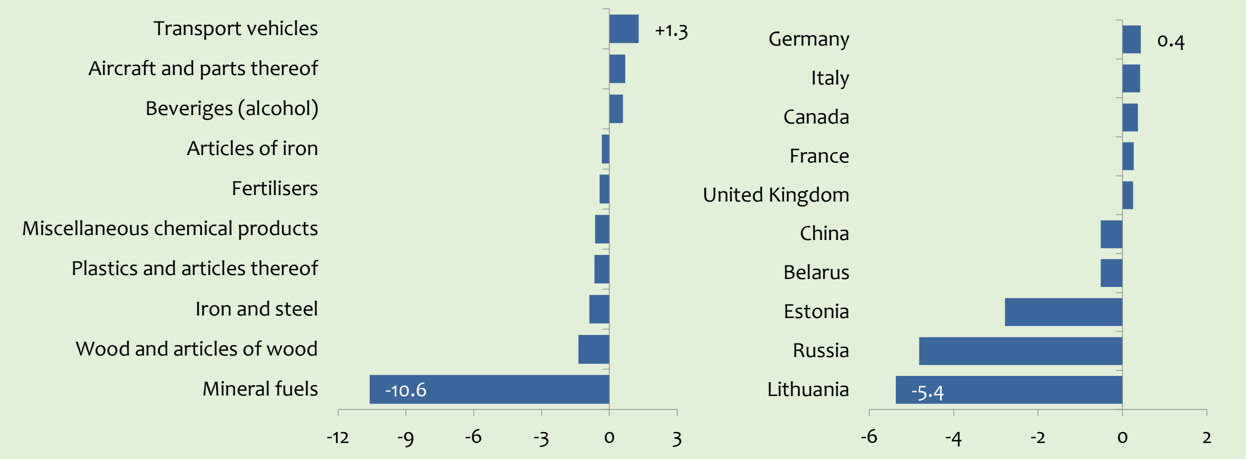
Imports from CIS countries at current prices decreased by 1.6% in 2022. This was mainly fostered by the decline in imports of iron and steel, wood and wood products, as well as fertilisers. The value of imports of mineral products increased significantly. Imports of mineral products in 2022 accounted for almost half of all Latvian imports from CIS countries.

In January-October 2023, as sanctions were stepped up, imports of goods from CIS countries decreased by 60%. Half of the entire increase was fostered by the drop in the value of imports of mineral products amounting to more than half a billion euro. Imports of wood and wood products, iron and steel, as well as fertiliser continued to decline significantly.

In the group of other countries, except the EU and the CIS countries, imports in 2022 grew rapidly by 21.4% significantly affected by imports of aircraft and its parts from Canada. Imports of goods from other countries continued to grow (by 2.9%) also in January-October 2023. This was positively affected by increases in imports of aircraft and its parts, mineral products and vehicles.

Figure 3.19

**Groups of goods and countries with most effect on changes in imports**
*contribution to changes in January-October 2023, percentage points*



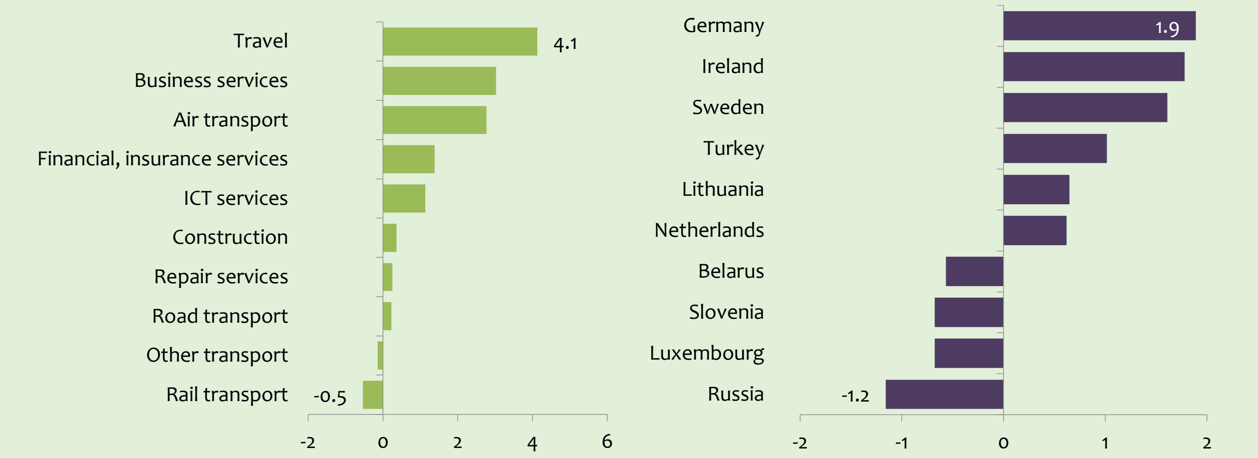

In the structure of imports of goods in terms of their end use, imports of capital goods increased until 2019. However, in 2021-2022, their share shrank slightly under the influence of the COVID-19 crisis. The share of intermediate goods in total imports reduced until 2019, mainly due to the reduction in the import value of fuel. In 2022, as fuel imports increased, the share of imports of intermediate goods was growing more rapidly, while a different picture was observed in Q1-Q3 2023. In January-September 2023 the share of imports of consumer goods, as well as capital goods increased at the expense of intermediate goods.

In 2021, the growth of **imports of services** was rapid – by 17%. This was partially affected by the base effect. Slightly more rapid growth continued also in 2022. Imports of services related to brokering increased significantly. Imports of travel and transport services, in particular air transport, were growing rapidly. In January-September 2023, imports of services continued to increase – by 6.7%. Like a year ago, growth in imports of services was fostered by imports of brokering services, travel and air transport.

About two-thirds of all services are provided to Latvia by EU countries. The share of imports of services from the EU countries was 57% in 2019 and 65% in Q1-Q3 2023. Moreover, the value of services imported from Russia kept declining.

Figure 3.20

**Services items and countries with most effect on changes in Latvian imports**
*contribution to changes in January-September 2023, percentage points*



# 4. CONTRIBUTION OF SECTORS

## 4.1. DYNAMICS AND STRUCTURE

In 2009-2010, as labour costs reduced, the competitiveness of Latvian producers improved, which served as a basis for an increase in export volumes and also the development of tradable sectors (agriculture, forestry and fishing, industry, as well as transport services). The structure of the economy has changed. In 2010, the share of these sectors reached 33.1% of total value added, but in 2022 – 31.9%. In 2022, compared to 2010, the share of agriculture, forestry and fishing, manufacturing, construction, business services and public services increased, the share of transport, trade and accommodation reduced, while the share of other industry remained unchanged. The analysis of economic structures from another perspective shows that in 2022 producing sectors (agriculture, forestry and fishing, industry, and construction) accounted for 30.2%, but services sectors – for 69.8% of total value added. Compared to 2010, the share of producing sectors has increased everywhere, except other industry, where it remained unchanged.

Since 2011, GDP has been growing by an average of 2.8% per year.

Table 4.1

**Structure of the economy**
*by value added, as per cent*

| | 2000 | 2008 | 2010 | 2016 | 2020 | 2022 | 2023 Jan-Sep |
|---|---|---|---|---|---|---|---|
| Agriculture, forestry and fishing | 5.0 | 3.3 | 4.6 | 3.7 | 4.6 | 5.7 | 5.3 |
| Manufacturing | 15.2 | 10.7 | 13.3 | 11.6 | 12.7 | 14.7 | 13.4 |
| Other industry | 4.2 | 3.3 | 4.8 | 4.3 | 3.4 | 4.8 | 4.4 |
| Construction | 7.0 | 10.2 | 4.9 | 5.3 | 6.4 | 5.0 | 5.6 |
| Trade, accommodation and food service activities | 15.6 | 16.0 | 17.7 | 16.6 | 16.2 | 15.4 | 14.9 |
| Transportation and storage | 11.9 | 9.2 | 10.4 | 9.1 | 6.7 | 6.8 | 6.2 |
| Other business services | 23.8 | 30.3 | 28.2 | 33.2 | 32.0 | 31.3 | 33.6 |
| Public services | 17.3 | 17.0 | 16.1 | 16.2 | 18.0 | 16.3 | 16.5 |
| **Total** | **100** | **100** | **100** | **100** | **100** | **100** | **100** |

Growth was comparatively rapid in 2014-2018. In 2014, slower growth was underpinned by the geopolitical situation that affected the drop in volumes in the industry. In 2015, the increase in private consumption and exports fostered a rapid increase in volumes of producing and services sectors. Comparatively weaker growth in 2016 was caused by the drop in volumes in the construction sector due to a decline in investments and delayed implementation of the new programme of structural funds. The improvement of the situation in the external environment and the intensification of absorption of EU structural funds contributed to the acceleration of growth in 2017-2018, with the largest growth secured by the main export sector – manufacturing, as well as construction.

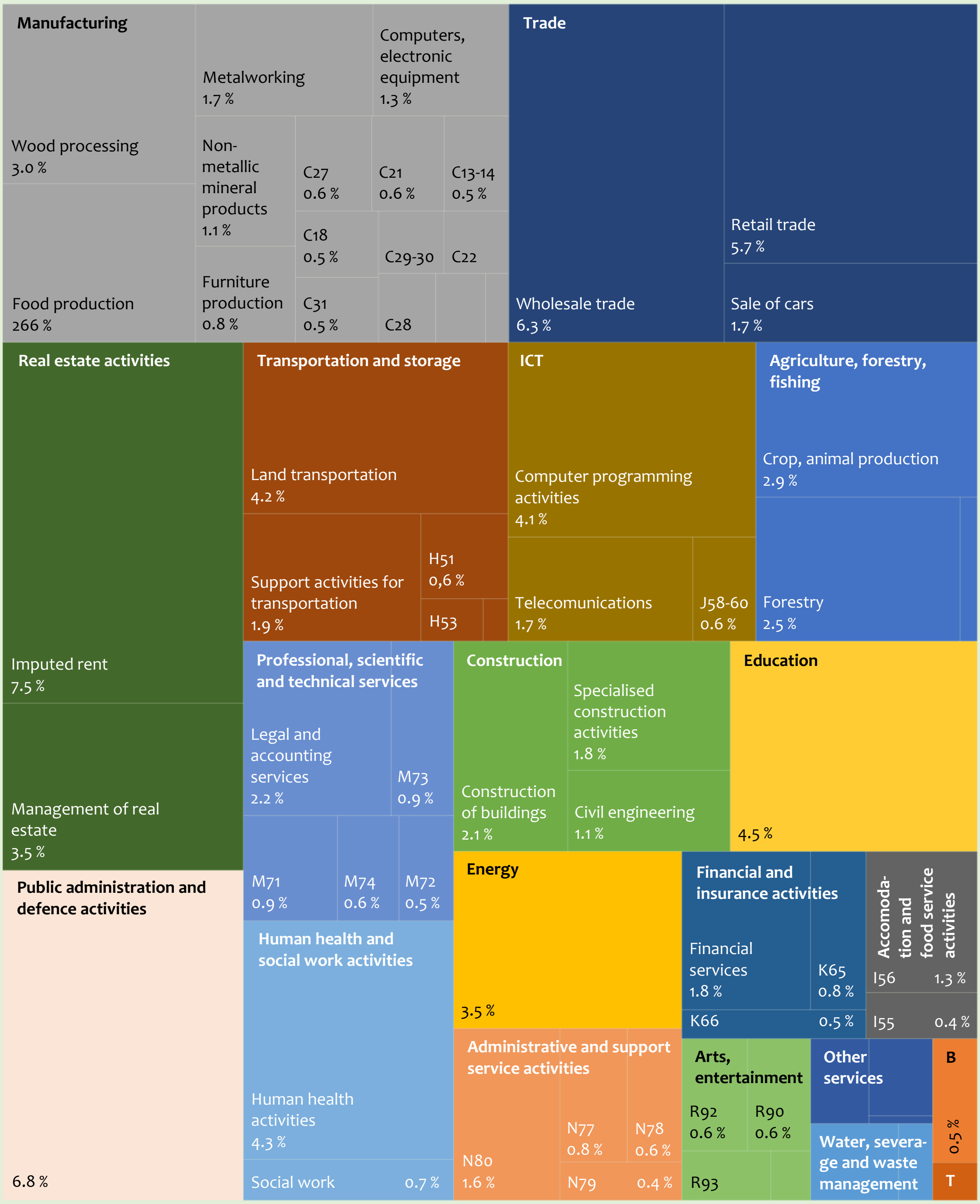
In 2019, growth was very moderate, which was influenced by weak growth in the EU and thus slower export growth rates, as well as weak private consumption. The increase in volumes of agriculture, forestry and fishing had the biggest impact on growth, but the volumes of services decreased, with negative developments in the financial sector having the biggest impact.

The COVID-19 pandemic, which in Latvia started in March 2020, had a significant impact on economic development. The biggest drop in volumes was recorded in construction, trade, transport and business services as they were affected by the restrictions introduced. However, volumes increased significantly in electricity, gas, steam and air conditioning supply, as consumption of these energy sources increased in the context of the COVID-19 pandemic.

In 2021, very rapid growth was observed in the economy. At the beginning of the year, the COVID-19 pandemic continued to affect sectors with high levels of social contact, while sectors more focused on the export of goods lived through the second wave of the COVID-19 crisis considerably more successfully. As extensive government and EU funds support measures were taken and the epidemiological situation improved, economic activity in the most affected sectors gradually recovered. At the same time, several sectors have already significantly exceeded pre-pandemic levels, such as part of manufacturing sub-sectors, health, information and communication, etc.

Figure 4.1

**Value added structure**
*2022, as per cent**




B – Mining and quarrying; C13-14 – Light industry; C18 – Polygraphy; C21 – Manufacture of pharmaceutical products; C27 – Manufacture of electrical equipment; C28 – Manufacture of machinery; C29-30 – Manufacture of motor vehicles and equipment; C31 – Manufacture of furniture; H51 – Air transport; H53 – Postal and courier activities; I55 – Accommodation; I56 – Food services; J58-60 – Publishing, video, TV programme production; K65 – Insurance; K66 – Financial services; M71 – Architectural and engineering activities; M72 – Scientific R&D; M73 – Advertising and market research; M74 – Other professional, scientific and technical activities; N77 – Rentals and leasing; N78 – Employment activities; N79 – Travel agencies; N80 – Security services; R90 – Creative, arts and entertainment; R92 – Gambling and betting; R93 – Sports and entertainment; T – Activities of households as employers

* – MoE assessment

In 2022, the Latvian economy continued to recover, yet economic development was significantly influenced by the disruptions in supply chains caused by Russia's invasion of Ukraine, the rise in inflation caused by the rising costs of energy and food, as well as the decline in global demand. Rapid growth rates were preserved in the sectors hit the hardest by COVID-19 pandemic restrictions. Despite rising costs, disruptions in supply chains and high uncertainty, positive growth remained in manufacturing in 2022. A decline was observed in construction due to a rapid increase in costs.

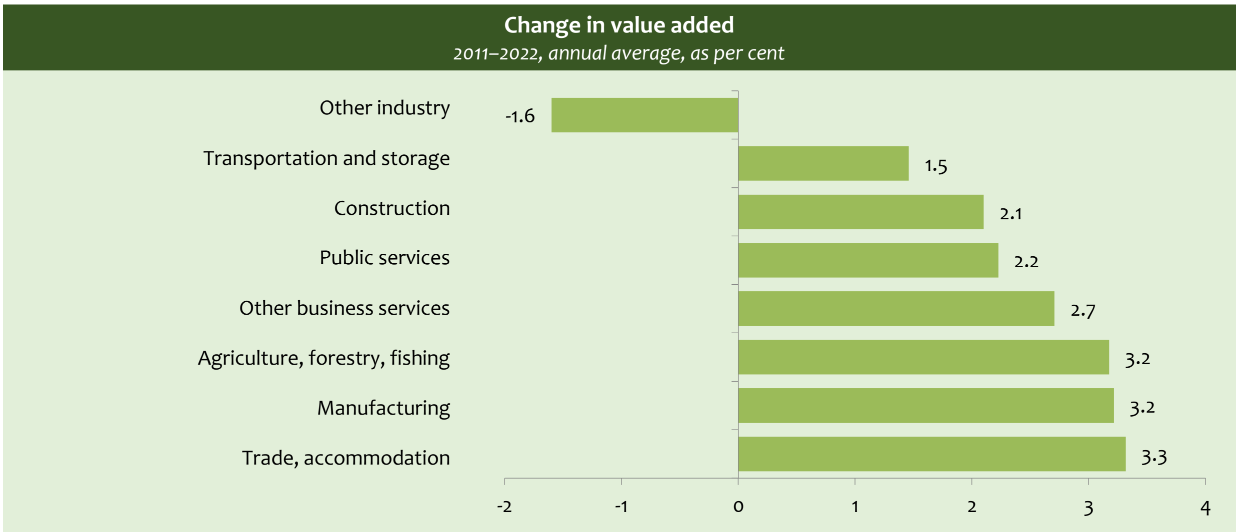
In 2023, economic development continues to be affected by the geopolitical situation and uncertainty, high prices and growing bank interest rates. Volumes declined in all tradable sectors largely due to the deterioration of export capabilities and the drop in private consumption. Overall, GDP was 0.6% lower in Q1-Q3 2023 than a year before.

Table 4.2

**Development trends of sectors**
*compared to the corresponding period of the previous year, changes as per cent*

| | 2019 | 2020 | 2021 | 2022 | 2023 Jan-Sep |
|---|---|---|---|---|---|
| **Gross domestic product** | **0.6** | **-3.5** | **6.7** | **3.4** | **-0.6** |
| Agriculture, forestry and fishing | 20.0 | -0.4 | 1.1 | 7.3 | -7.9 |
| Mining and quarrying | -8.6 | 6.2 | -5.0 | -0.4 | -21.0 |
| Manufacturing | 0.9 | 0.1 | 10.3 | 2.7 | -6.3 |
| Food industry | -0.7 | -1.7 | 1.3 | 1.3 | 2.3 |
| Light industry | -2.6 | -9.5 | 11.8 | 5.1 | -6.3 |
| Wood processing | 0.0 | 4.5 | 3.7 | -1.0 | -10.4 |
| Paper industry and publishing | 5.7 | 4.7 | 14.0 | -2.7 | -25.5 |
| Chemical industry | 3.9 | -1.8 | 14.8 | 4.1 | -9.2 |
| Manufacture of other non-metallic mineral products | -2.1 | -1.4 | 4.4 | 5.4 | -18.9 |
| Metalworking | 13.5 | -5.6 | 5.8 | 16.1 | -8.8 |
| Manufacture of electrical and optical equipment | 11.3 | 12.1 | 5.7 | 3.5 | 18.8 |
| Manufacture of machinery and equipment | -1.9 | -2.7 | 24.1 | -12.3 | 2.9 |
| Manufacture of transport vehicles | -7.7 | -15.3 | 17.7 | 19.5 | -16.7 |
| Other industries | 2.8 | -14.2 | 11.8 | 3.8 | -2.1 |
| Electricity, gas, steam and air conditioning supply | -10.4 | 30.4 | 29.3 | -14.0 | -5.9 |
| Construction | 1.3 | -5.9 | -13.6 | -8.8 | 15.7 |
| Construction of buildings | 11.4 | -8.1 | -16.1 | -9.8 | 26.8 |
| Civil structures | -11.5 | -7.4 | -15.3 | -13.1 | 2.5 |
| Trade | 2.2 | -4.2 | 19.8 | -6.1 | -5.4 |
| Retail trade | -2.0 | -0.3 | 16.7 | 4.3 | -2.8 |
| Transportation and storage | -2.1 | -18.6 | 6.6 | 3.0 | -7.0 |
| Transport of freight by railway | -15.8 | -42.3 | -9.5 | -2.1 | -30.2 |
| Freights transhipped in ports | -5.7 | -27.9 | -7.2 | 15.2 | -16.4 |
| Transport of freight by road | -3.8 | 2.6 | 7.8 | -0.8 | 3.0 |
| Accommodation and food service activities | -4.9 | -31.4 | -4.1 | 57.3 | 8.8 |
| Information and communication | 3.6 | 0.6 | 12.6 | 12.6 | 4.2 |
| Financial and insurance activities | -9.9 | 0.6 | 16.0 | -6.0 | -4.9 |
| Real estate activities | -1.0 | -1.9 | 5.8 | 1.6 | 4.2 |
| Other business services | -0.6 | -2.0 | 5.2 | 17.4 | 0.9 |
| Public administration and defence; compulsory social security | 0.2 | 2.8 | 0.5 | 3.7 | 5.8 |
| Education | -4.4 | 1.1 | -0.8 | 4.1 | 8.8 |
| Human health and social work activities | 4.8 | -3.4 | 6.1 | 1.0 | -2.8 |
| Arts, entertainment and recreation | 1.9 | -33.5 | 2.8 | 29.4 | 12.3 |

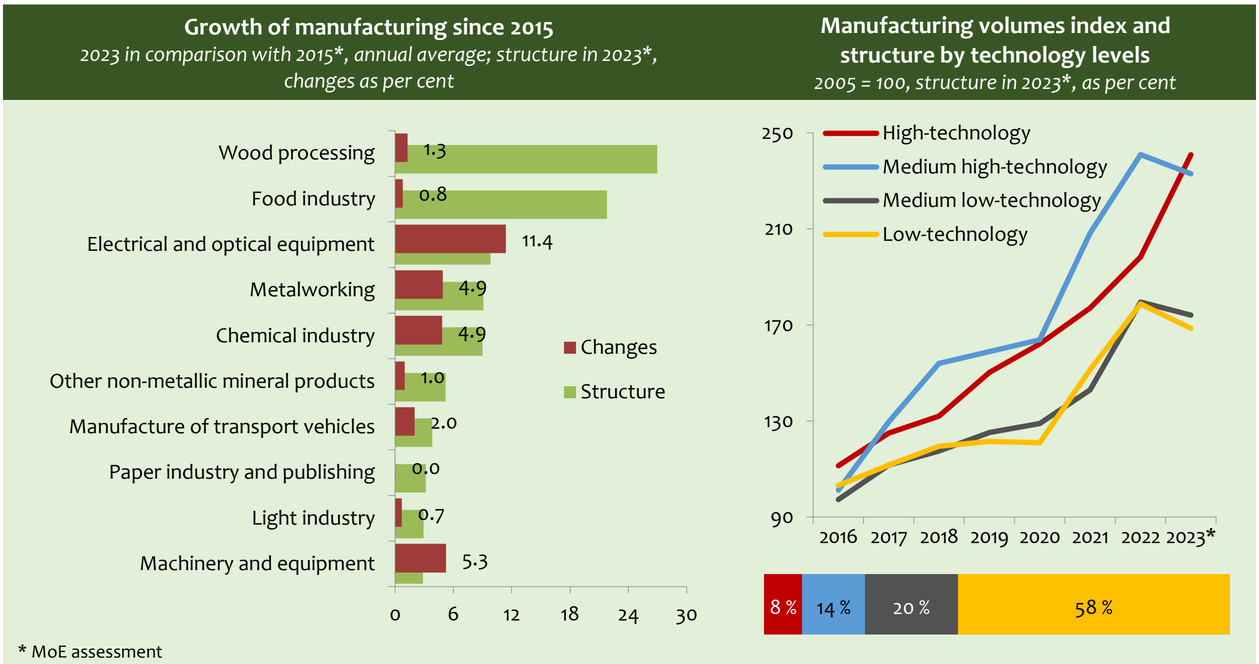
Figure 4.2




## 4.2. MANUFACTURING

Manufacturing contributes significantly to total economic growth. Between 2015 and 2022, output volumes of manufacturing were growing stably – by an average of 4% per year.

Figure 4.3



2017, when production volumes increased by 8%, was one of the most successful years in the development of manufacturing during this period. The development of food industry and manufacture of electrical and optical equipment was significant. Manufacturing continued to grow also in 2018 and 2019, yet at a slower rate than a year ago – by 2.7% and 2.1%, respectively. Woodworking, the largest sub-sector of manufacturing, made the largest contribution to the total growth of the sector, while metalworking and manufacture of electrical and optical equipment contributed to the development markedly.

Table 4.3

**Structure of manufacturing and development trends of sectors in January-October 2023**
*as per cent*

| | Output structure | Structure of occupied posts* | Share of exports in the sales of the sector | Changes in production volumes |
|---|---|---|---|---|
| **Manufacturing – total** | **100** | **100** | **66,0** | **-5,8** |
| Manufacture of food and beverages | 21,8 | 19,2 | 42,1 | 2,6 |
| Light industry | 2,9 | 8,0 | 86,0 | -5,8 |
| Wood processing | 27,0 | 20,0 | 67,5 | -9,5 |
| Paper industry and publishing | 3,2 | 4,3 | 63,8 | -24,7 |
| Chemical industry and related industries | 9,0 | 7,3 | 77,0 | -8,3 |
| Manufacture of other non-metallic mineral products | 5,2 | 5,0 | 50,3 | -17,9 |
| Manufacture of metals and metal articles | 9,1 | 11,4 | 65,2 | -7,4 |
| Manufacture of electrical and optical equipment | 9,8 | 6,2 | 87,9 | 16,3 |
| Manufacture of machinery and equipment | 2,9 | 3,0 | 90,9 | 2,9 |
| Manufacture of transport vehicles | 3,8 | 3,8 | 94,8 | -16,7 |
| Other manufacturing industries | 5,3 | 11,7 | 68,6 | -2,8 |

* – data on January–September 2023

2020 was full of challenges for manufacturing as it was for the economy as a whole. In April-May 2020, as the COVID-19 crisis hit, manufacturing volumes declined by 10.4%, which mainly provided for a small decline in the sector's annual volumes over the year. Meanwhile, in the second half of the year, increasingly more sub-sectors showed positive growth, and manufacturing volumes this year were only 0.9% lower than a year before.

In 2021, manufacturing developed dynamically. It can partially be attributed to the base effect. In Q1 2021, manufacturing volumes increased more moderately. In Q2 2021, volumes rose particularly rapidly, reaching a total growth of 7.5% during the year. Increases in manufacturing volumes during this period were observed in all manufacturing sub-sectors. Similarly to a year ago, woodworking made the largest contribution to the development of the sector. Manufacturing volumes of the chemical industry, manufacture of electrical and optical equipment, and other sub-sectors also increased significantly.

Growth of manufacturing continued in 2022, although at a slower pace. This was fostered by an increase in manufacturing volumes of metalworking and chemical industry. Shrinking manufacturing volumes could be seen in the industry in the second half of the year when viewed by months. Overall, the growth of manufacturing by 2.7% in 2022 was fostered by an increase in production volumes of metalworking, chemical industry, manufacture of vehicles and other non-metallic mineral products.

A picture similar to that seen in the second half of 2022 was observed also in 2023. Manufacturing output has been declining every month – more moderately at the beginning of the year and more rapidly in Q2. The decline in output of sub-sectors in January-October was significantly influenced by a decline in woodworking volumes and more moderately – by drops in output volumes in manufacture of other non-metallic mineral products, chemical industry, and paper industry and publishing. Positive trends during this period were observed in manufacture of electrical and optical equipment, as well as food industry.

In recent years, as producer prices have been rising, stable growth was observed also in turnover of manufacturing – both products sold in the domestic market and exported products. Turnover in manufacturing increased particularly rapidly in 2021, fostered by sales of products in the domestic market and exported products.

In 2022, the turnover of manufacturing continued to grow rapidly. Sales of products increased at a faster pace in the domestic market (by 21.9%) and slightly more moderately in the export market (by 16.7%). The turnover of woodworking and food industry increased considerably.

Opposite trends in the growth of industry turnover are observed in 2023. During the ten months of the year, the volumes of products sold in the domestic market have slightly increased, while the volumes of exported products have decreased, generally causing a drop in sales volumes by 2.2%. During this period, the sales of food industry products continued to increase, while the overall decline was underpinned by a significant decrease in the sales of woodworking products.

In recent years, as usual, around 2/3 of all products have been exported. Over the last five years, the share of exported products has slightly increased. The sub-sectors with a share of exports in sales above 85% are manufacture of vehicles, manufacture of machinery and appliances, manufacture of electrical and optical equipment, and light industry. Traditionally, most of the food industry's products are sold in the domestic market.

About 70% of products produced in manufacturing are sold in markets of the EU countries. The share of sales to CIS countries amounts to 10%. Sales of products in markets of other countries increased to 20%, when the United Kingdom withdrew from the EU in 2020.

The number of occupied posts in manufacturing increased moderately in 2016-2017; however, it decreased in 2019-2020, reflecting changes in production volumes showing a relative increase in productivity.

In 2021, the number of occupied posts in manufacturing increased by 4.5%, representing the largest increase since 2005. This was largely influenced by the rise in the number of occupied posts in woodworking, chemical industry, and manufacture of vehicles. Meanwhile, a decline in occupied posts is observed in the food industry.

In 2022, the number of jobs occupied was slightly lower than a year ago, while in Q1-Q3 2023, the decline was more rapid – by 2.5 thousand or 2.2%. It was largely affected by fewer jobs in woodworking, as well as manufacture of non-metallic mineral products and chemical industry. The reduction was partially compensated by increase in the number of jobs in manufacture of electrical and optical equipment, manufacture of vehicles and food products.

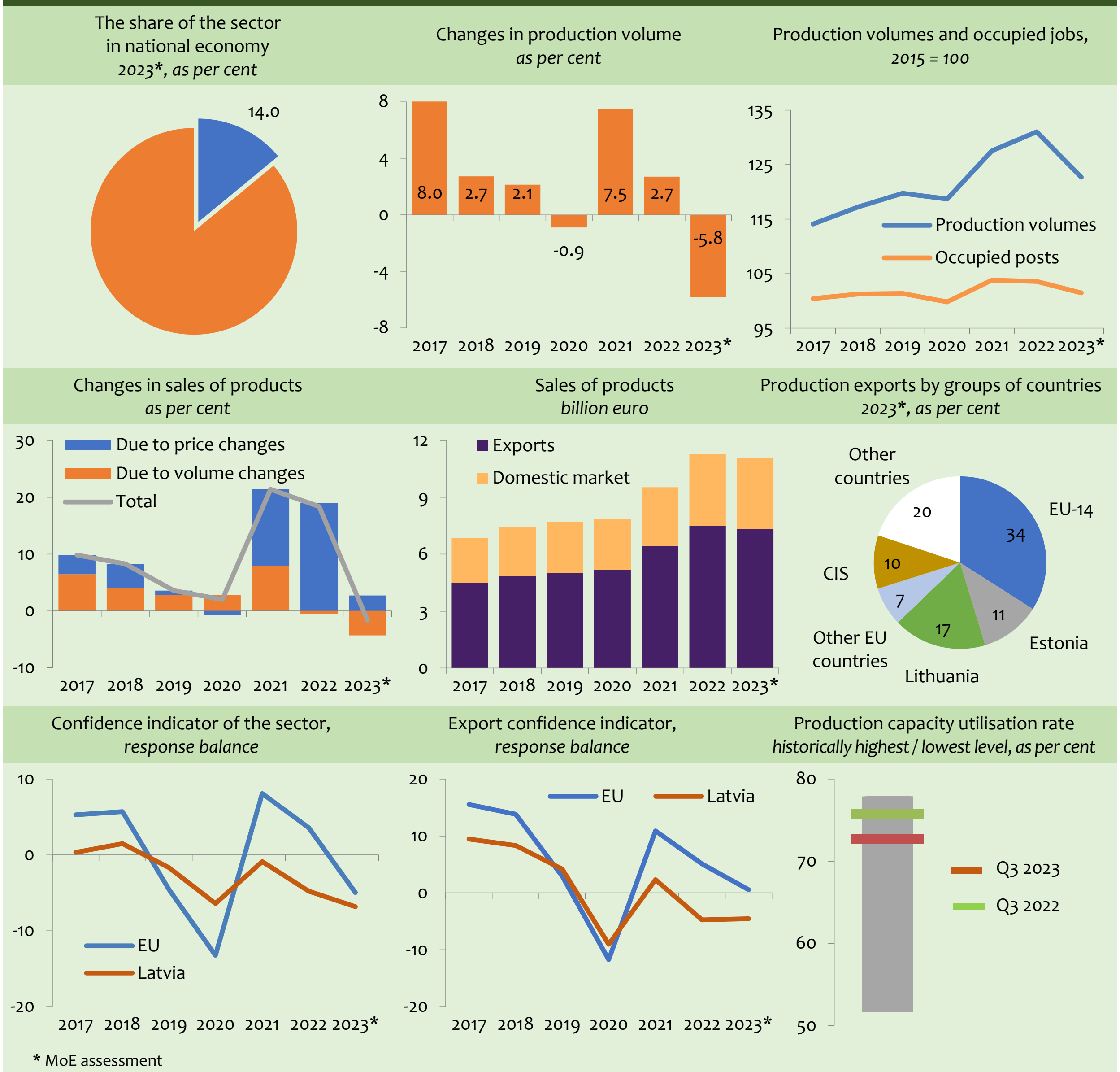
In recent years, the confidence indicator of manufacturing has been volatile. In 2020, confidence in manufacturing had a highly negative trend. Confidence of manufacturers deteriorated particularly rapidly under the influence of the COVID-19 pandemic – in April-June 2020. The decline in confidence was observed in all sub-sectors of the manufacturing industry. The indicator slightly improved in 2021 but deteriorated in 2022. In Q1-Q3 2023, the confidence indicator of manufacturing has been at the lowest level in the last ten years. The lowest indicators in September were observed in the manufacture of other non-metallic mineral products, paper industry and publishing, as well as manufacture of machinery and equipment.

The export confidence indicator in 2020, during the COVID-19 crisis, was strongly negative. In 2021, as COVID-19 restrictions reduced, the assessment of export opportunities by entrepreneurs improved to a positive level. An opposite picture was observed in the second half of 2022 and Q1-Q3 2023. In Q3 of the year, export opportunities were assessed strongly positively by entrepreneurs in manufacture of vehicles, while strongly negatively – by entrepreneurs in woodworking, manufacture of machinery and equipment, as well as manufacture of electrical and optical equipment.

Until 2019, production capacity levels in manufacturing had an increasing trend, exceeding the level of 76%. Changes were introduced by the COVID-19 crisis, when manufacturing capacity levels in Q2 2020 decreased to the level of 2012, i.e. 68.1%. After the crisis, this indicator resumed growth exceeding 77% at the end of 2021. In 2022-2023, manufacturing capacity levels slowly reduced to 72.7% in Q3 2023.

Figure 4.4

**Indicators characterising manufacturing**



**Manufacture of food and beverages** is the second largest manufacturing sub-sector in Latvia in terms of both the output and the number of occupied posts. Although it sells 60% of its products in the domestic market, its export sales have slowly increased in recent years. It should be noted that the main product sales market of the sector to date was CIS countries, including Russia, but given the geopolitical situation in the region, more manufacturers are switching to safer markets.

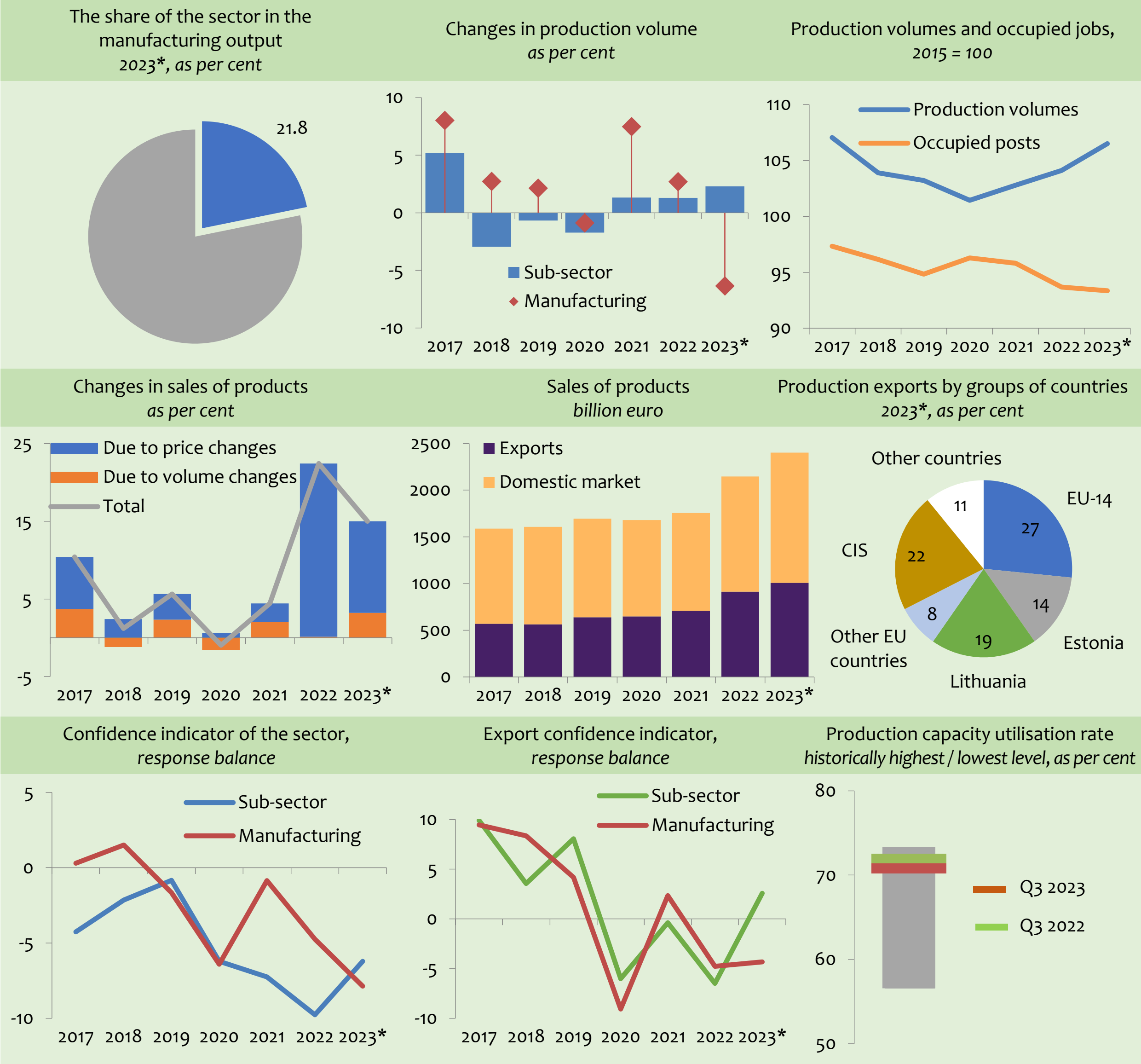
In 2020, manufacture of both food and beverages declined. By contrast, in 2021 and 2022, volumes of manufacture of food products slightly declined, while volumes of manufacture of beverages increased significantly defining the general development of the sub-sector. An opposite picture has been observed in January-October 2023. After five years of stagnation, volumes of manufacture of food have resumed growth, but volumes of manufacture of beverages have reduced, partially due to the base effect.

As producer prices of food products increased, in January-October 2023, the turnover of the sector continued to grow. It grew at a similar pace in the domestic market and export markets.

After an increase in 2020, the number of occupied posts in the food industry slightly declined in the following years. A small drop was also observed in the first half of 2023. The confidence indicator of the sector has been strongly negative since 2015. Compared to 2022, confidence of the sector has slightly improved in January-September 2023, while export confidence during this period was positive.

Figure 4.5

**Indicators characterising food and beverage industry**




* MoE assessment

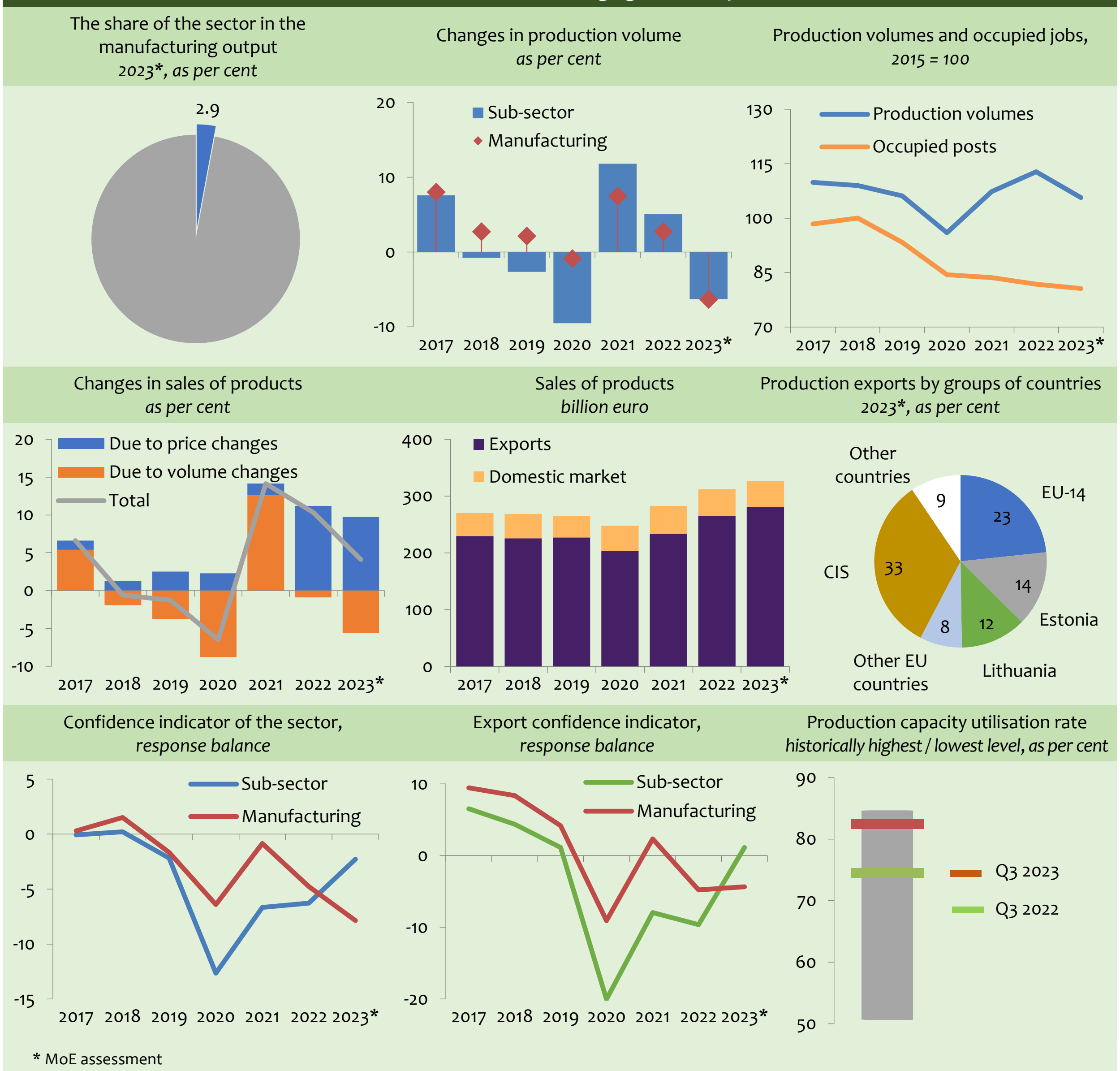
**Light industry** is considerably affected by global trends, and, under conditions of the open EU labour market, the sector cannot rely on the advantages of a cheap labour force like East Asia does. As with other sub-sectors, production volumes in the light industry decreased in 2020 but increased significantly in 2021-2022. By contrast, in January-October 2023, volumes of the sub-sector have reduced along with total manufacturing volumes. Volumes of manufacture of textiles and manufacture of wearing apparel declined.

In 2021 and 2022, sales of products of the sub-sector were growing stably. Contrary to manufacturing volumes, in January-October 2023, sales of products continued to grow – by 4.1%. This increase was fostered by the increase in exported products, while the volumes of products sold in the domestic market have slightly reduced.

The number of occupied posts in the sub-sector has been volatile in recent years. Their number slightly increased in 2021, while declined in 2022. A negative trend was preserved also in the first half of 2023. The confidence indicator has remained negative over the last four years, yet with a positive trend. 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. In the last four years, the capacity utilisation rate of the sector has been growing stably and in Q3 2023 it was the highest in manufacturing and exceeded the 80% mark.

Figure 4.6

**Indicators characterising light industry**




* MoE assessment

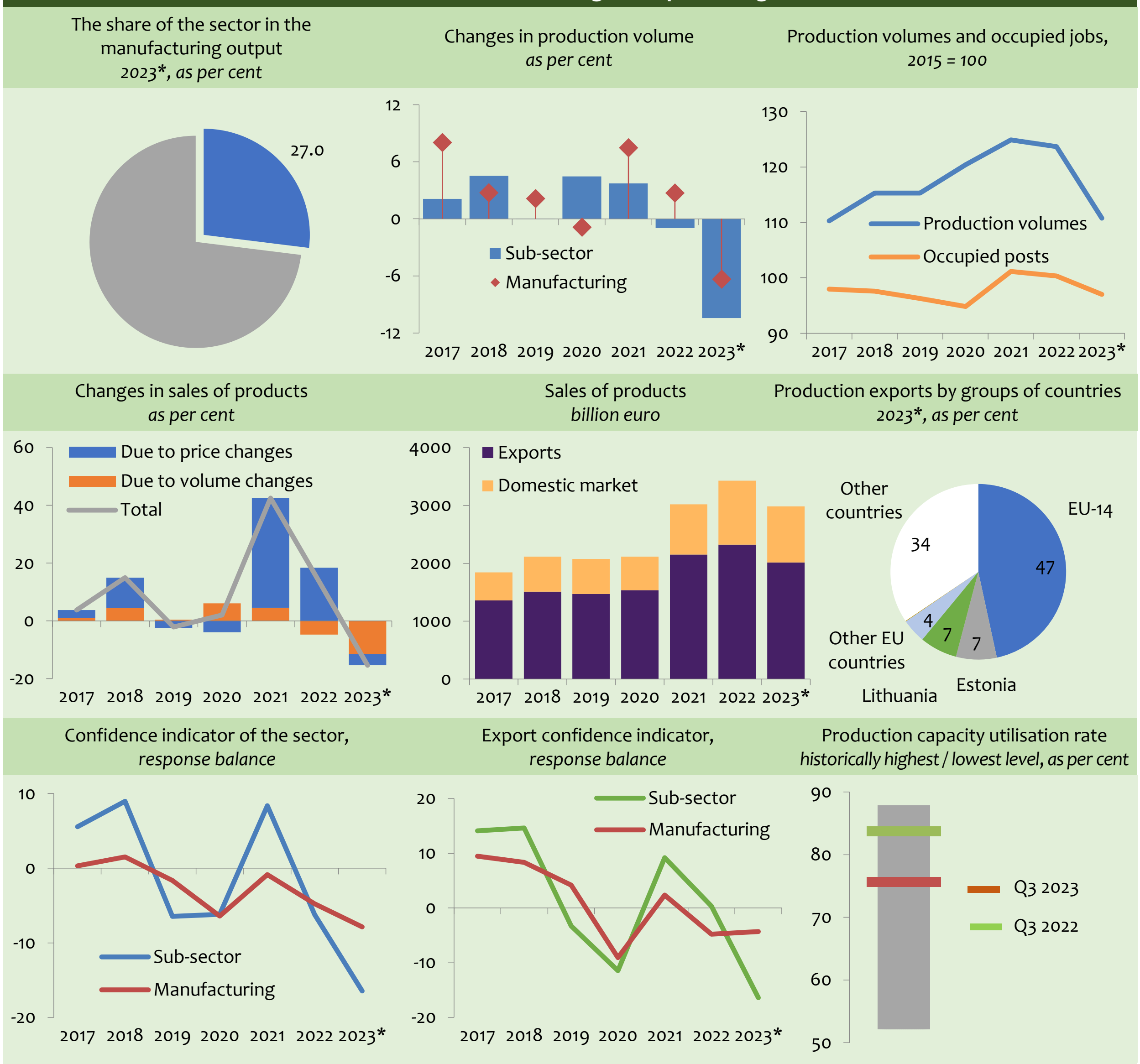
**Woodworking** is traditionally the largest manufacturing sector of Latvia. It accounts for one-fourth of the total manufacturing output. In 2020-2021, the sector showed stable growth. By contrast, in January-October 2023 production volumes of woodworking have declined considerably.

Woodworking is also mainly export-oriented – in January-October 2023, more than two-thirds of the production of the sector has been exported. EU countries have usually been the export market of this sector. In 2019, sales of products slightly declined due to the withdrawal of the United Kingdom from the EU. In 2021-2022, the increases in product sales in the sub-sector were record high because of high demand and growing prices of timber. In January-October 2023, sales of the sector have fallen considerably both in the domestic and export markets.

Like in other sub-sectors, the number of occupied posts in woodworking has been volatile year on year. Their most rapid growth was observed in 2021. However, in 2022 and the first half of 2023, the number of occupied posts decreased. The confidence indicator of the sub-sector in the last two years has remained strongly negative. The indicator was at its lowest level in late 2022 and early 2023. Future export opportunities of the sub-sector are also evaluated negatively. The capacity utilisation rate remains one of the highest in manufacturing.

Figure 4.7

**Indicators characterising wood processing**




* MoE assessment

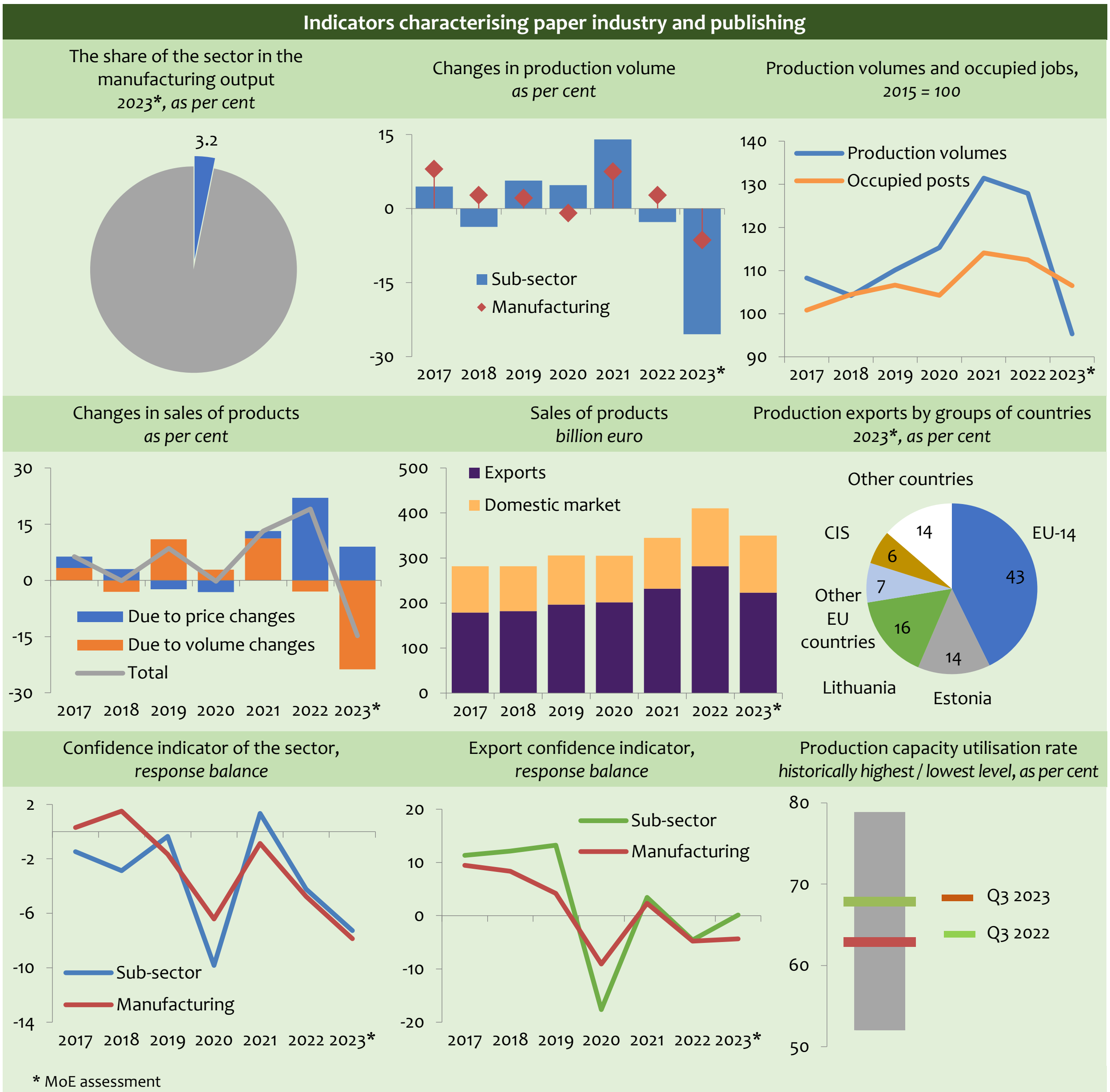
The **paper industry and publishing** are gradually switching from the domestic to export markets. In 2020-2022, the share of their products exported increased significantly every year, while in January-October 2023 it declined. The EU countries are the main market for the products of the sector.

In 2021, the growth of the sub-sector was much more rapid than the average rates in manufacturing. Production volumes continued to grow also in early 2022 but slightly reduced during the year. 2023 was not favourable for the sub-sector – manufacturing volumes in January-October have shrunk significantly, mainly due to weak external demand. Manufacturing of paper products declined more moderately, while the output of the printing sector more rapidly.

The turnover of the sector has been constantly growing in recent years. Significant growth in sales of the sector was observed in 2022. Export sales of products were growing at a faster pace. An opposite picture was observed in January-October 2023, sales of exported products have reduced considerably but slightly increased in the domestic market.

Similarly to other manufacturing sub-sectors, the number of occupied posts in the paper industry and publishing has been volatile in recent years. After a more rapid increase in 2021 and 2022, the number of occupied jobs shrank in the first half of 2023. Confidence of the sub-sector also remains negative, and future export opportunities of the sub-sector are evaluated cautiously. The capacity utilisation rate in the paper industry and publishing is comparatively low, it is slightly above 60% in 2023.

Figure 4.8



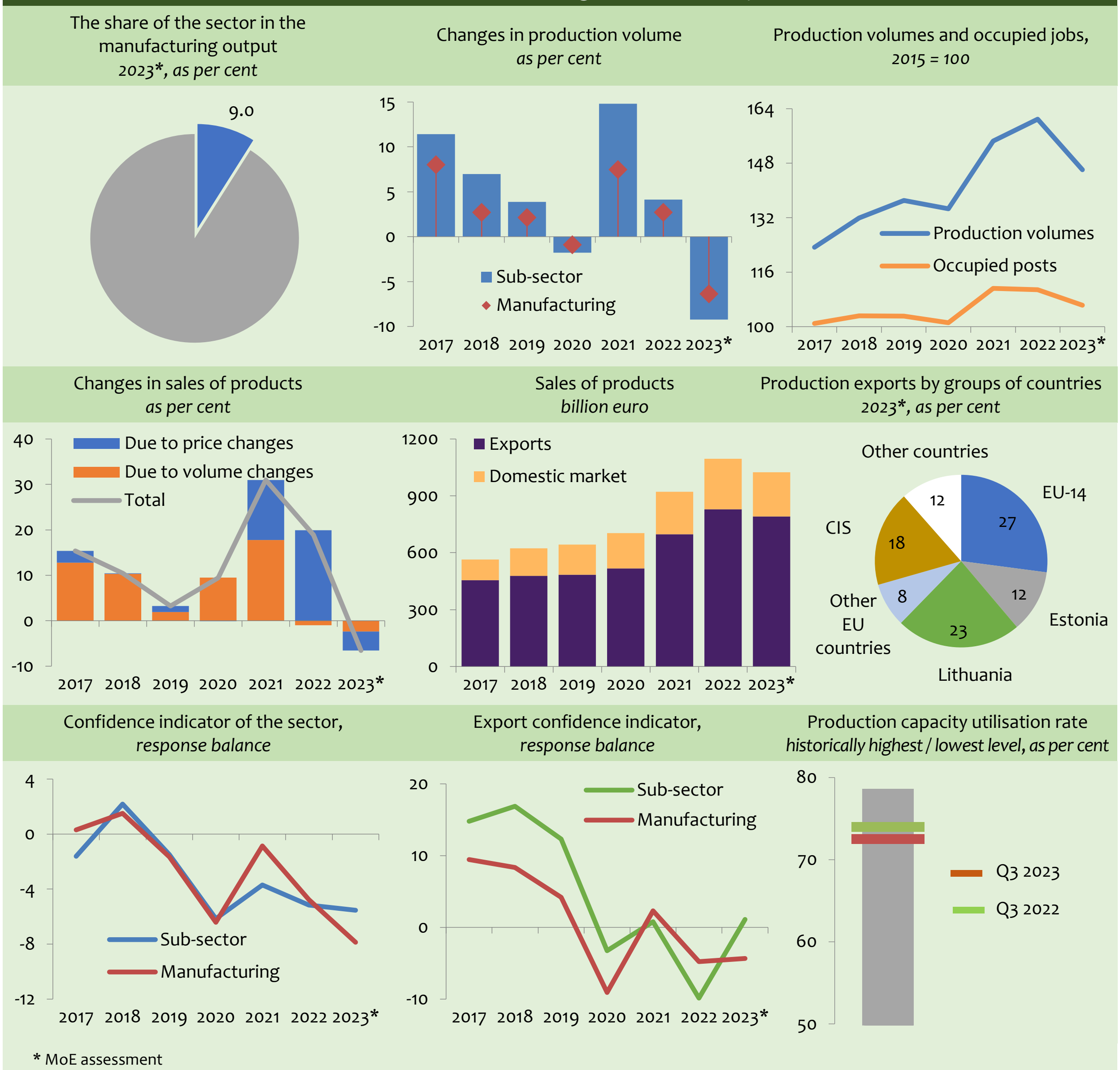
Rapid growth was observed in the **chemical industry** in 2021. Positive trends were also observed in 2022, particularly in its first half. Until now, 2023 was not favourable for the sub-sector, its volumes have shrunk by 8.3% in January-October of this year. Manufacturing volumes of chemical products, pharmaceutical products, rubbers and plastics have reduced.

Sales of products of the sub-sector in 2021-2022 increased significantly both in the domestic and export markets. By contrast, in January-October 2023, sales have shrunk, mainly affected by the drop in sales in the domestic market. It should be noted that 3/4 of the products are exported. Unlike in other manufacturing sub-sectors, a comparatively large part of chemical industry products, including pharmaceutical products, are sold in markets of CIS countries.

The number of occupied posts in the chemical industry increased significantly in 2021 but declined in 2022 and the first half of 2023. Confidence of the sub-sector remains negative, and export opportunities are evaluated positively. The average capacity utilisation rate in Q1-Q3 2023 is similar to that of manufacturing.

Figure 4.9

**Indicators characterising chemical industry**



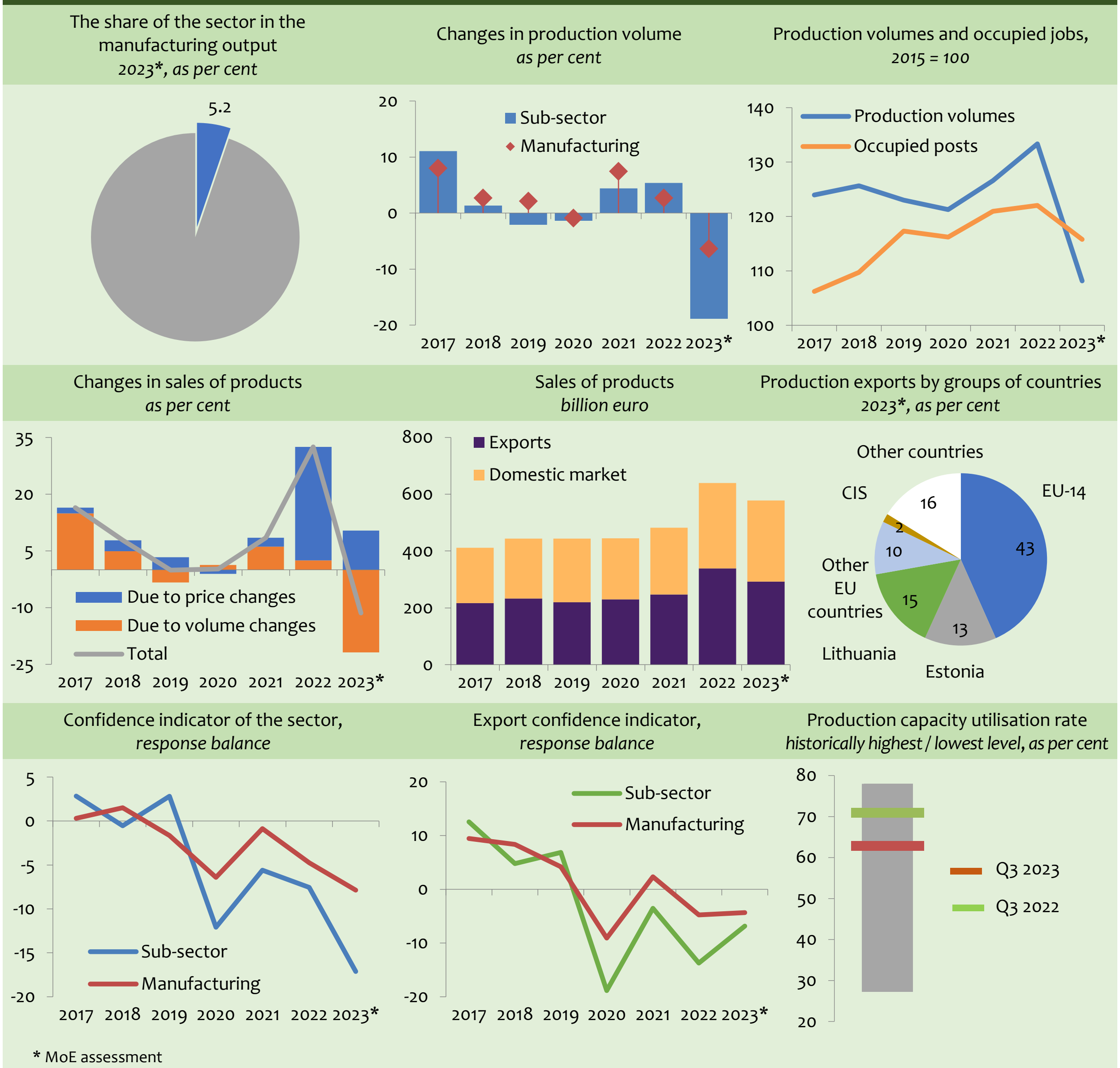
**Manufacture of other non-metallic mineral products** is closely related to the demand of the construction sector. As the demand for products grew, stable growth was observed in 2021-2022, but an opposite picture was observed in January-October 2023, when the output of the sub-sector reduced significantly.

As product prices increased, a record-high increase in sales of other non-metallic mineral products was observed in 2022. It reduced in January-September 2023: more moderately in the domestic market and more rapidly in exports. Most of the products are usually sold in markets of EU countries.

The number of occupied posts in the sub-sector increased in 2021-2022 but declined in the first half of 2023. In 2022 and Q1-Q3 2023, the confidence indicator of the sector was strongly negative. The assessment of export opportunities in recent years has been volatile, but it is lower than in manufacturing on average. The capacity utilisation rate in the sub-sector in 2023 is one of the lowest in manufacturing.

Figure 4.10

**Indicators characterising manufacture of other non-metallic mineral products**




* MoE assessment

In recent years, the growth of **metalworking** has been significant in the total growth of manufacturing. Stable growth was observed again in the sub-sector in 2021-2022, following the decline in production volumes in 2020. By contrast, in January-October 2023, the reduction in metalworking volumes has been similar to the average indicator in manufacturing.

Most of the products produced by metalworking are exported, which means that manufacture of basic metals and articles thereof is significantly affected also by the competitiveness of the EU steel manufacturing sector on the global market, which has been limited in recent years. The EU, as well as Turkey, have usually been the main market for the products.

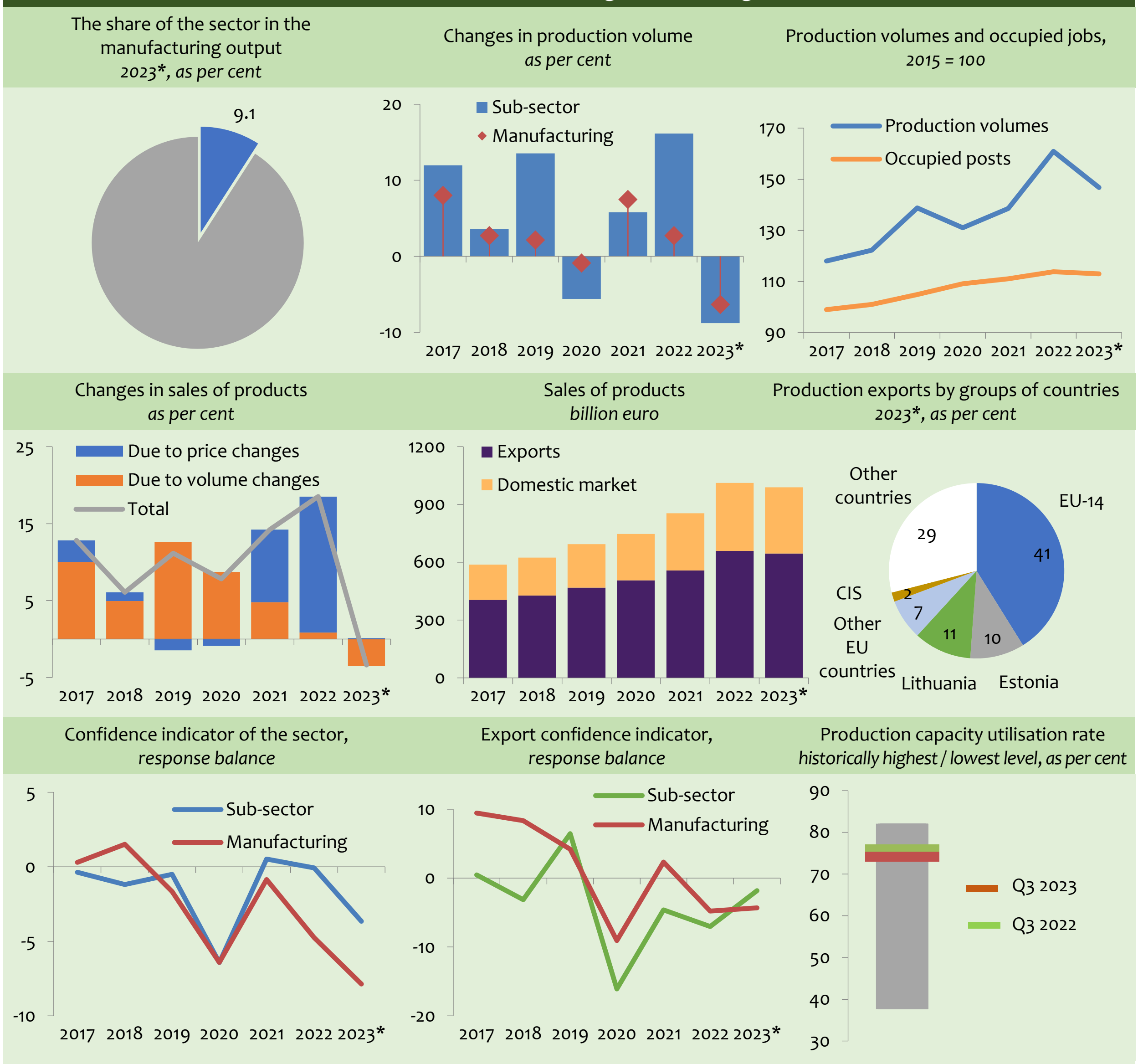
Sales volumes of products of the sub-sector increase considerably every year. In 2022, they were growing equally rapidly in the domestic and export markets. By contrast, in January-October 2023 production volumes have slightly shrunk.

The number of occupied posts in metalworking in recent years has been growing too. In 2020, the increase was more rapid, in 2021-2022 – more moderate. A small decline in occupied posts is observed in the first half of 2023.

In recent years, the confidence indicator of metalworking has been volatile, like in other sub-sectors of manufacturing. It should be considered that confidence of this sub-sector has been assessed more positively than other manufacturing sub-sectors in recent years. In the first half of 2023, future export opportunities are evaluated cautiously. Capacity utilisation in metalworking usually remains slightly above the average in manufacturing.

Figure 4.11

**Indicators characterising metalworking**




* MoE assessment

In the last ten years, **manufacture of electrical and optical equipment** has been the most rapidly growing manufacturing sub-sector during a year on average. Every year during this period, its growth rates were considerably higher than in manufacturing on average. After a small decline in growth rates in 2021-2022, the sub-sector has been the main driver of the development of manufacturing in January-October 2023.

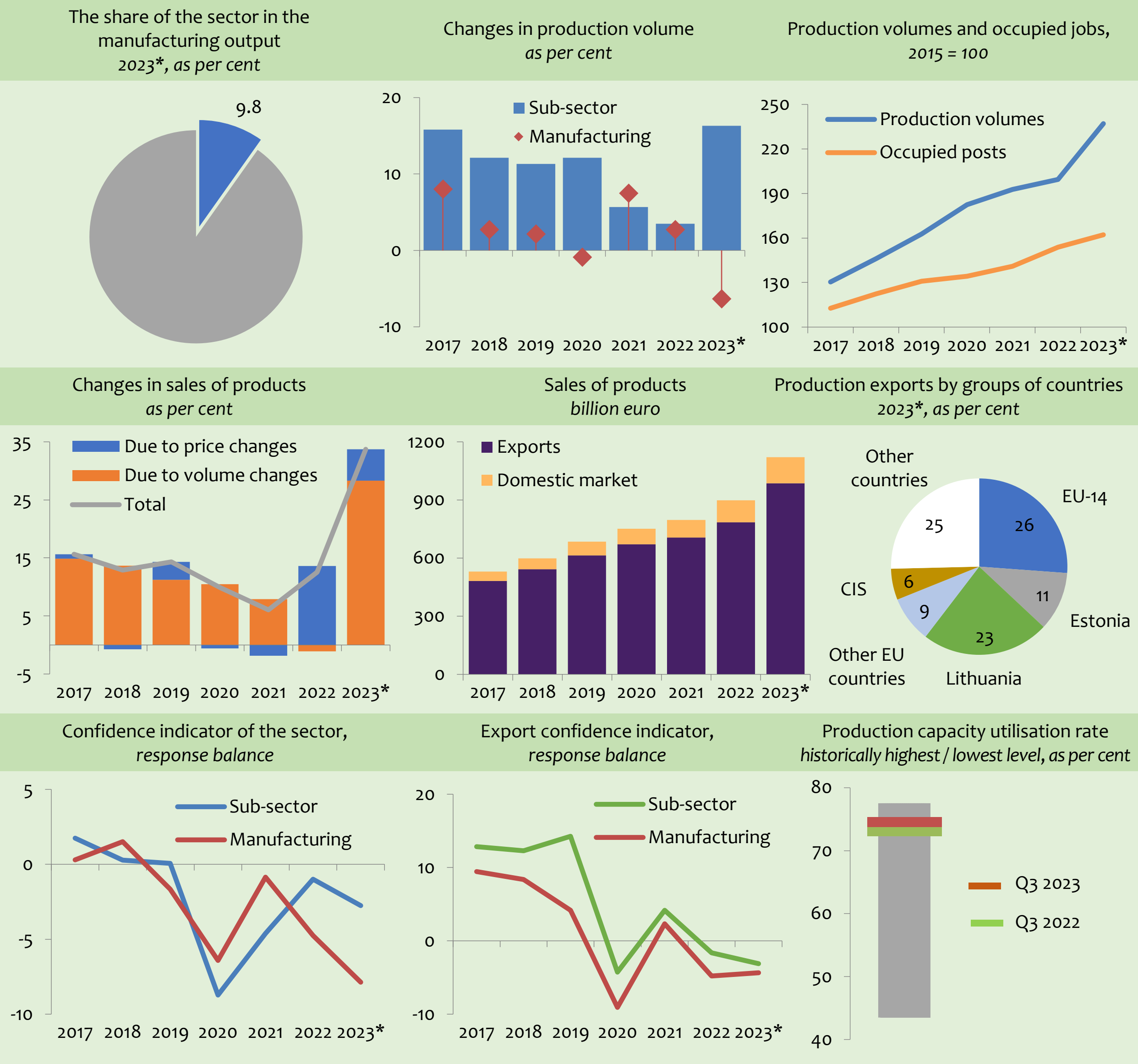
Although producer prices fluctuate, sales volumes in the sector are growing stably and at a fast pace. The development of the sector is closely related to external demand, almost 90% of the production is exported. In recent years, product sales volumes have been growing equally rapidly in the domestic and export markets.

Most of the sector's growth is ensured by a rise in productivity; however, the increase in the number of occupied posts has also been developing dynamically in recent years. Since 2015, the number of jobs in the sub-sector has been growing every year. In the first half of 2023, the increase in the number of occupied posts in manufacture of electrical and optical equipment has made the biggest contribution to manufacturing as a whole.

The confidence indicator of manufacture of electrical and optical equipment is volatile but still negative. Export opportunities are also evaluated in the same way. The capacity utilisation rate in manufacture of electrical and optical equipment has grown in the last four years.

Figure 4.12

**Indicators characterising manufacture of electrical and optical equipment**




* MoE assessment

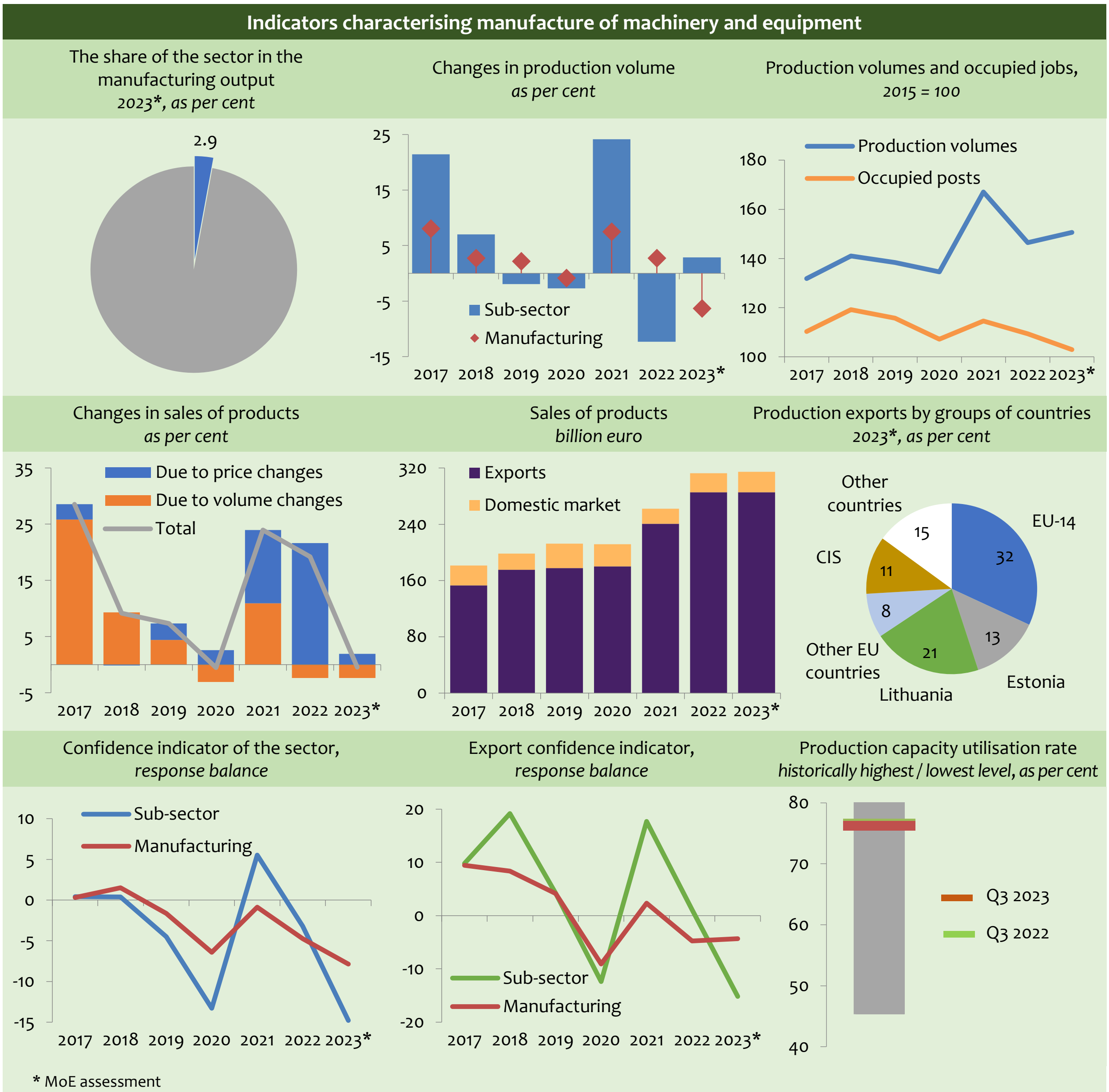
Growth in **manufacture of machinery and equipment** has been volatile in recent years. It was markedly rapid after the COVID-19 crisis in 2021 and negative in 2022, as the external demand reduced. After the decline in 2022, growth has been observed in manufacture of machinery and equipment in January-October 2023.

Similarly to other manufacturing sub-sectors, in recent years, sales volumes of machinery and appliances have been growing more rapidly than output. In 2021, the increase in turnover of all sub-sectors was secured by sales of products in export markets, while the turnover in the domestic market shrank significantly. It should be noted that more than 90% of the production of the sector is exported. In January-October 2023, sales volumes increased considerably in the domestic market but slightly shrank in the export market.

The number of occupied posts in the sector in recent years has been volatile. After a more rapid increase in 2021, their number slightly reduced in 2022 and the first half of 2023.

Confidence of the sector was negative in late 2022 and particularly in 2023. There is a similar sentiment in the assessment of export opportunities. In recent years, the capacity utilisation rate has been the second highest in manufacturing.

Figure 4.13



**Manufacture of vehicles** is evidently focused on external markets – more than 90% of products of the sector are exported. Since the sector largely depends on new orders, and also heavily depends on external demand and external shocks, it is characterised by considerable fluctuations in production volumes.

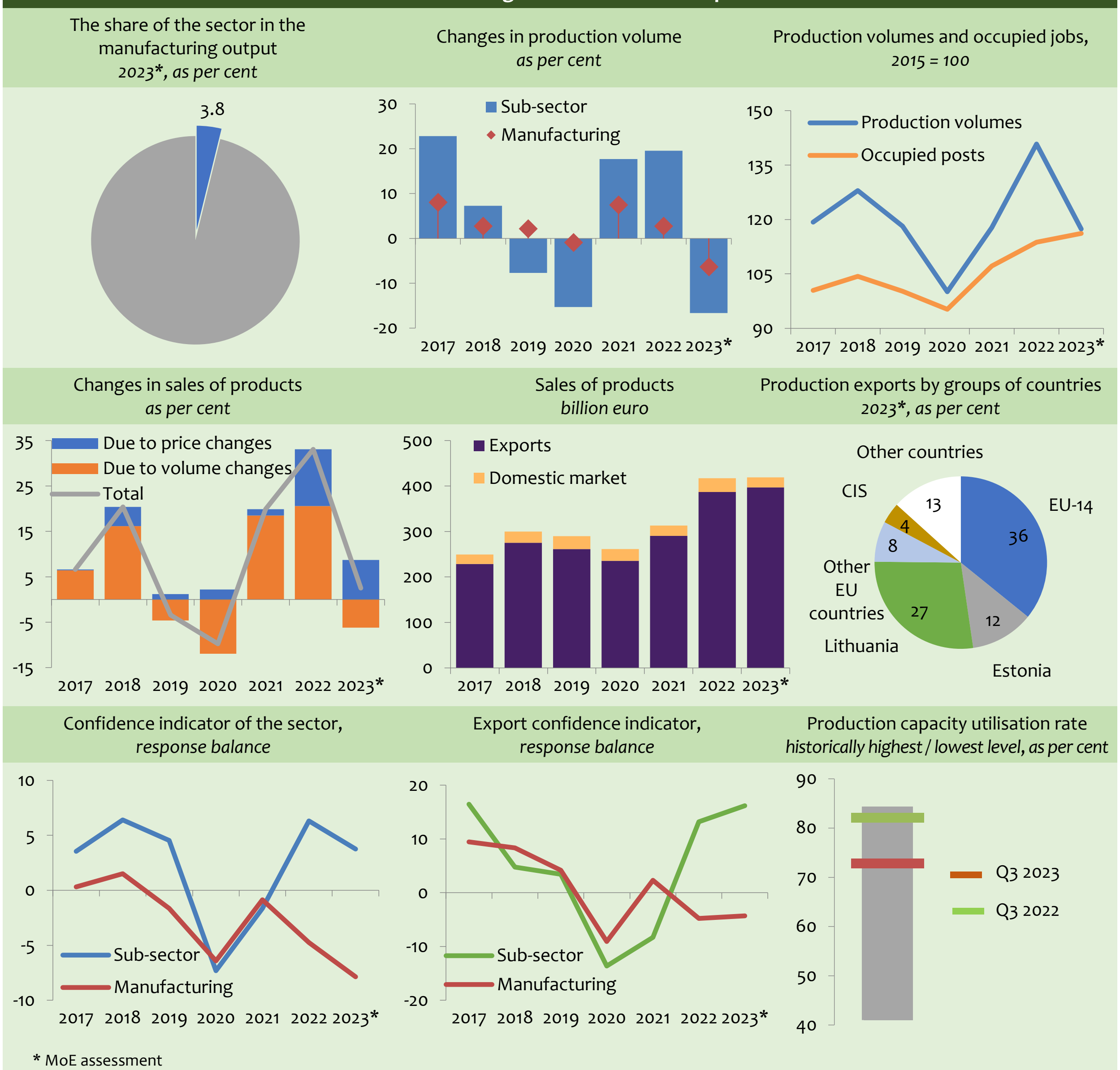
Following the decrease in manufacturing volumes in 2019-2020, rapid growth was observed in the sub-sector in 2021-2022, when external demand increased as prices of raw materials increased. An opposite picture is observed in January-October 2023, partially due to the base effect, when manufacturing volumes of the sub-sector reduced by 16.7%.

In recent years, sales volumes in manufacture of vehicles have been developing dynamically. In January-October 2023, production volumes have slightly increased thanks to stable producer prices. This is fully secured by the increase in sales of exported products, while the volumes of products sold in the domestic market during this period have significantly reduced.

The number of occupied posts in manufacture of vehicles in recent years has not significantly changed. After a small decline in 2020, the number of jobs has been growing every year. Despite the weak growth of the sub-sector, the confidence indicator in the last two years has been the highest in manufacturing. Export opportunities are also assessed strongly positively during this period. The capacity utilisation rate in manufacture of vehicles is above the average level in manufacturing.

Figure 4.14

**Indicators characterising manufacture of transport vehicles**




* MoE assessment

# 4.3. OTHER INDUSTRY

Electricity and gas supply dominate in the structure of **other industry** (mining and quarrying; electricity, gas, steam and air conditioning supply; water supply, sewerage, waste management and remediation activities). After a drop in 2017-2019, the share of other industry in total value added has resumed growth since 2020. The dynamics in production volumes in electricity and gas supply sectors are related to weather, as the amounts of electricity and heat produced depend on it.

After the increase in manufacturing volumes in 2015-2016, volumes of other industry declined in 2017-2019 caused by weather and consumed amounts of electricity and heat. However, in 2020, other industry experienced a rapid increase in production volumes again, driven by an increase in electricity and natural gas supply, as their consumption increased under the conditions of the COVID-19 pandemic. In 2021, production volumes in other industry sectors also continued to increase. Due to the cold weather, at the beginning of the year, the supply of natural gas and electricity increased, while at the end of the year consumption of energy sources decreased due to the rise in prices.

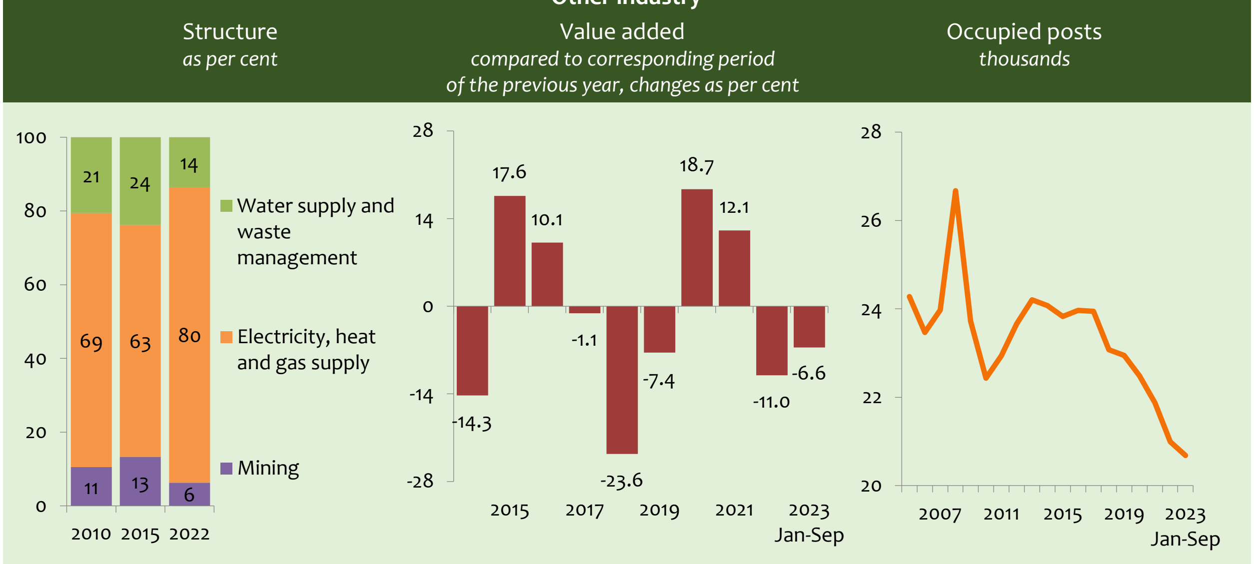
In 2022, volumes of other industry sectors showed a sharp decline. Volumes decreased significantly in electricity, gas, steam and air conditioning supply due to the disruption of natural gas supplies from Russia, moreover, natural gas consumption declined due to the price increase. Production of electricity and the amount of heat produced in combined heat and power plants reduced considerably because of higher average air temperature during the heating period, as well as austerity measures due to high energy prices.

In Q1-Q3 2023, compared to the corresponding period of the previous year, volumes of other industry sectors continued to reduce. The biggest impact came from the drop in volumes in electricity, gas, steam and air conditioning supply as the amounts of electricity produced by combined heat and power plants continued to shrink and their consumption reduced due to the increase in the price of energy sources. A rapid decline was also observed in mining and quarrying caused by the reduction of volumes in quarrying of gravel and sand, and extraction and processing of peat.

In recent years, the number of occupied posts in mining has been growing, while in other industry it has been declining rapidly. In Q1-Q3 2023, it shrank in all sub-sectors.

Figure 4.15

**Other industry**

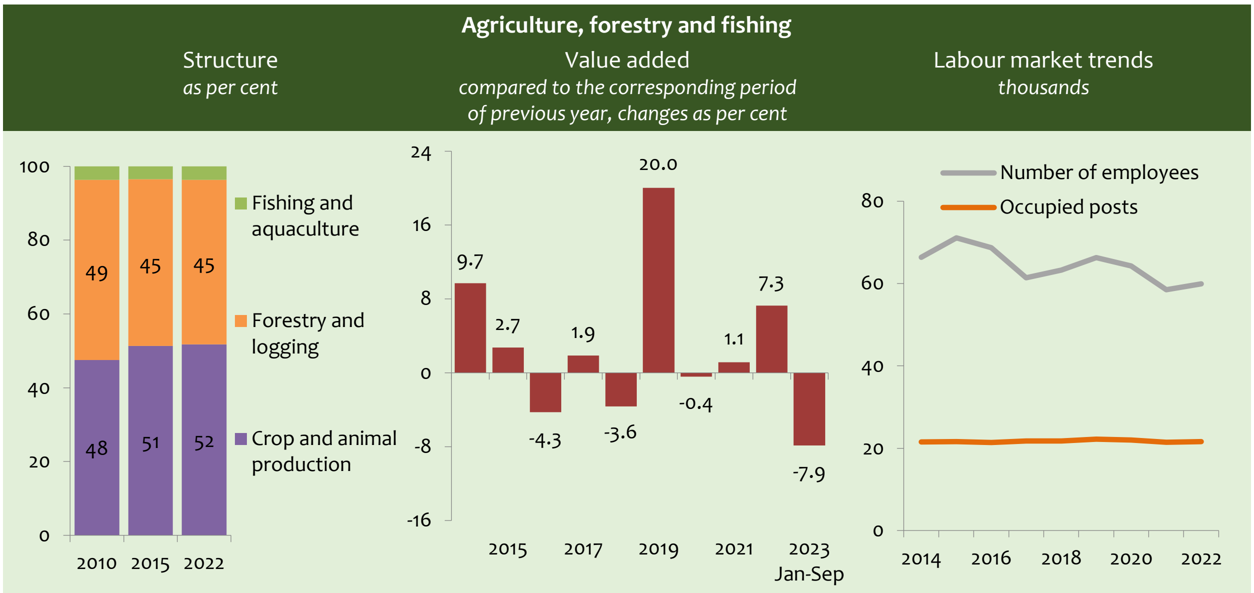



# 4.4. AGRICULTURE, FORESTRY AND FISHING

Agriculture and forestry dominate in the structure of **agriculture, forestry and fishing**. The activity of the industry is closely related to weather conditions; therefore, its growth is generally volatile. After the drop in 2016, the share of the sector in the total value added has been growing since 2017.

In 2014-2015, despite Russia's embargo on food imports, there was rapid growth in agriculture and forestry fostered by a good harvest of cereals. In 2016 and 2018, the sector was affected by a fall in crop production, while in 2017 the sector showed some growth due to a rise in forestry volumes. In 2019, very rapid growth was observed, which was attributed to an increase in crop production – that year Latvia had the highest total cereal harvest in its history.

Figure 4.16




In 2020, volumes of the sectors reduced slightly, with production volumes in crop production reducing more rapidly than production volumes in forestry increased. In 2021, volumes of the sectors grew moderately, with the rise in production volumes in forestry still being the cause of this growth.

In 2022, volumes of the sector increased significantly, underpinned by a rapid increase in volumes in forestry and logging. Although the volume of cut wood remained at the level of the previous year and forest renewal volumes increased by 1%, in 2022, the average purchase price for logs (of both coniferous and deciduous trees) in Latvia continued to grow rapidly. Russia's invasion of Ukraine created new economic instability in Europe and globally, leading to a sharp increase in costs of energy, raw materials and logistics. The increase in prices was significantly influenced by the growing demand for local timber resources – energy wood and pellets to mitigate the energy crisis. The increase in purchase prices was also influenced by the European Union sanctions against aggressor countries, deciding not to buy Russian and Belarus timber products anymore.

A more moderate rise in 2022 was recorded in crop and animal production. It was caused by a reduction in production volumes in crop production, mainly attributed to the increase in the total cereal harvest by 8.3% compared to the previous year. Although there was a long period of heat and drought in 2022, like a year before, the productivity of cereals per hectare increased. Animal production volumes remained practically unchanged in 2022. The number of farmed live cattle, pigs and sheep at farms reduced, while an increase was observed in the number of goats, horses and poultry. At the same time, the number of exported livestock increased, but the number of exported live pigs declined. Volumes of production of eggs increased rapidly, there was a small rise in meat production volumes, while milk production volumes decreased. Pork and poultry had the highest share in the meat production structure.

Because of the rapid increase in global prices of food, in 2022, prices of agricultural products rapidly increased also in Latvia. The average purchase price of grain increased considerably – to 279.95 euro per ton, i.e. by 42.2%. Average purchase prices increased considerably also in animal production. The largest increase in the purchase price was for mutton and beef. The average purchase price of fresh milk increased to 471 euro per ton or by 48.2%, reaching historically the highest price in Latvia.

After a rapid rise in 2022, production volumes reduced in Q1-Q3 2023 due to unfavourable weather. Production volumes decreased in crop and animal production, forestry and logging, but saw a rapid increase in fishing.

In recent years, the number of employees and occupied posts has been growing slowly before the pandemic, but in 2020, under the influence of COVID-19, the number of jobs shrank in agriculture and forestry but increased in fishing. In 2021, occupied posts shrank in all sub-sectors, but in 2022 – only in agriculture. In Q1-Q3 2023, the number of jobs in agriculture and forestry has increased.

## 4.5. CONSTRUCTION

Growth of construction is largely subject to cyclical fluctuations. In 2000-2007 the sector developed rather rapidly. Signs of overheating have been observed in the last years during the period. The annual average output increased by 14.1% and the average increase in 2006-2007 was even 25.1%. 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. Construction costs increased gradually until 2005. In 2006-2008, construction costs virtually exploded, labour costs increased 2.6 times, but costs of maintenance and operation of machinery and mechanisms almost doubled.

Production volumes dramatically declined during the crisis; industry output shrank more than twice in the period from 2008 to 2010. During the economic recession, the number of persons employed in the sector was significantly adjusted and reduced almost twice. The reduction also affected construction costs (mostly – labour costs). It should be noted that they remained at a higher level than before the overheating.

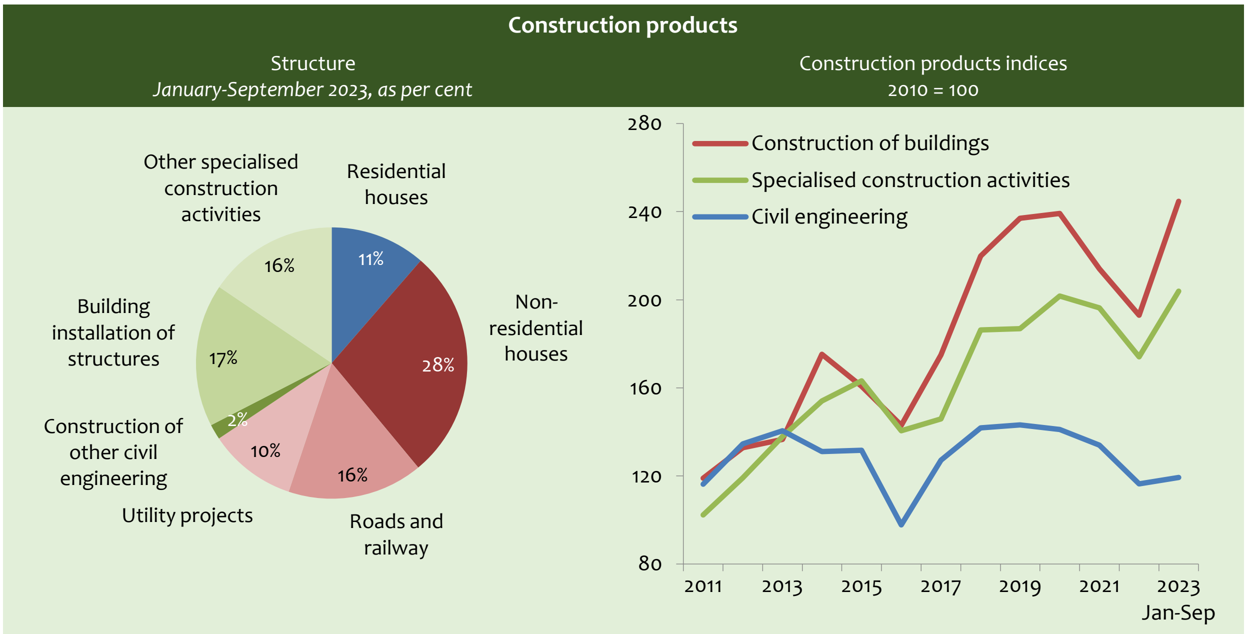
Figure 4.17


The demand for services of the sector resumed growth in 2011. During the period until 2019, the construction development rates were steeper than economic development rates. Average growth was 6.3% annually. The recovery of the construction sector was largely driven by public procurement and more active absorption of 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. For example, in 2011, the volume of construction products outside Latvia exceeded the indicator of 2008 more than five times. The increase in construction activities also reflected in the increase in the number of granted building permits.

It should be noted that during the transitional period of the EU Structural Funds, construction output decreased by 5.1% annually in 2015-2016 as a result of a reduction in investment in construction. 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 this period. In the next years, starting from 2017, the sector's development driver was 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.

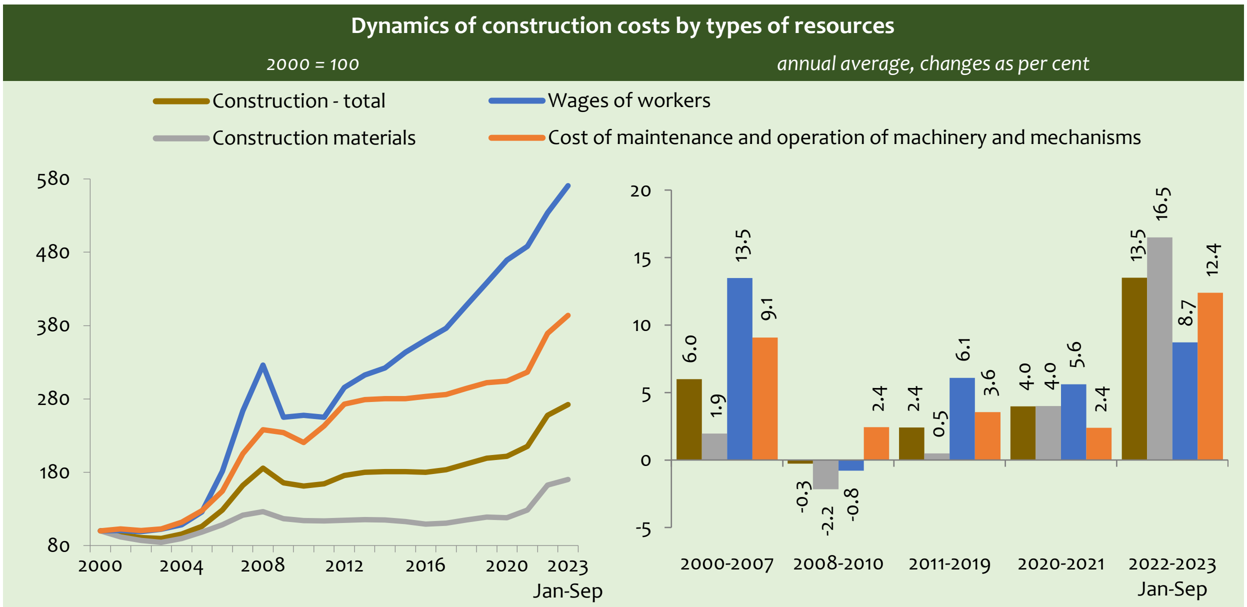
As economic activity increased, the number of the employed started to evenly increase in 2011. A reduction was observed in 2015 and 2016, when outputs of construction products reduced. In 2019, the number of the employed exceeded 60 thousand and was higher than in 2010; however, increase rates were considerably slower than the increase in outputs. This means that the sector was largely developing at the account of the increase in productivity. Construction costs increased uniformly during this period, with a more rapid increase between 2017 and 2019. Labour costs and costs of maintenance and operation of machinery and mechanisms made the biggest pressure, while the costs of materials remained almost unchanged.

Figure 4.18




The COVID-19 pandemic had a general negative influence on the sector, and in 2020-2021 average development indicators were negative. Unlike other sectors, in 2020, the construction sector was not subject to strict restrictions. Construction production volumes continued to increase, although in some quarters of the year the decline in private investment caused by the economic downturn has led to a downturn. In 2021, however, the sector experienced a bigger drop in demand due to the global rise in construction costs, in particular prices of timber and metal. In 2020-2021, the COVID-19 crisis caused a slight drop in the number of jobs in construction. Although the increase in labour costs had a greater impact during this period, since 2021, the cost of building materials has also had a significant impact on the level of sector's costs.

Figure 4.19



As investments in construction reduced, a downturn was observed in the sector in all quarters of 2022. The increase in construction costs had a strongly negative influence on the dynamics of activities of the sector. Rising prices hindered both existing construction projects and the commencement of new ones. In 2022, pressure on construction costs was stepped up by Russia's invasion of Ukraine, which considerably reduced the availability of individual construction materials, as well as considerably increased the costs of energy sources.

The decrease in activity also affects the demand for labour force – the number of jobs in construction has decreased. The dynamics of construction costs show that construction materials had become the main driver of the increase in construction costs during this period.

The construction sector shows a rapid recovery in 2023 after a downturn of several years. Construction output increased in all three quarters of the year, it is 16.1% higher in Q1-Q3 2023 than in Q1-Q3 2022. Differences in the rate increase of activities can be seen across main groups of construction. In 2023, construction of buildings and specialised construction activities are drivers of the development of the sector. Civil engineering activities have been growing much slower.

## 4.6. TRADE, ACCOMMODATION AND FOOD SERVICE ACTIVITIES

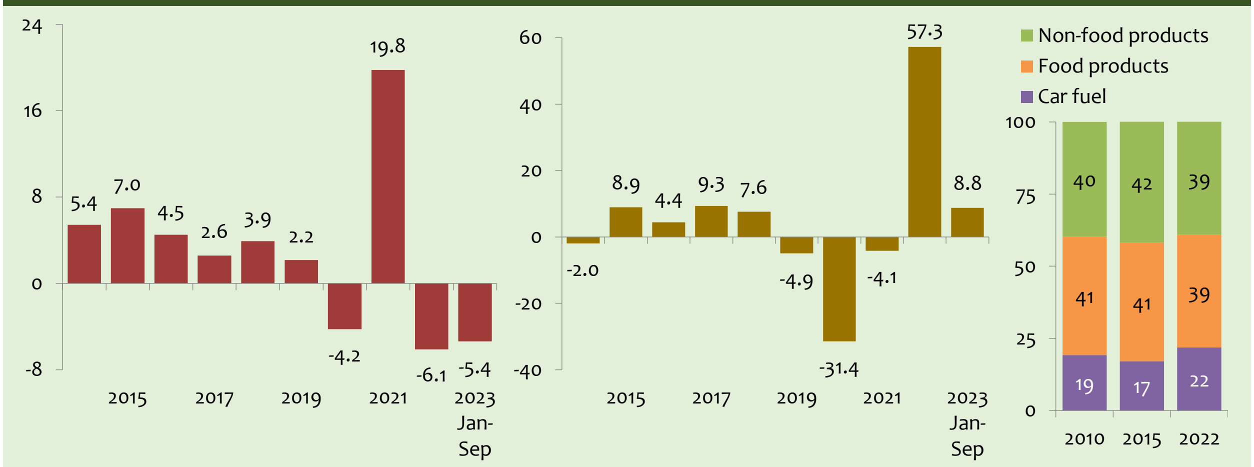
Trade dominates in **trade, accommodation and food service activities** – about 90%. Volumes of services provided in the sectors have been generally growing rapidly since 2014. The trade sector was positively influenced by an increase in private consumption and retail turnover. Furthermore, accommodation and food service activities were positively affected by the development of the tourism sector.

Figure 4.20

**Trade**
*value added, compared to the corresponding period of the previous year, changes as per cent*

**Accommodation and food service activities**
*value added, compared to the corresponding period of the previous year, changes as per cent*

**Retail trade turnover structure**
*as per cent*

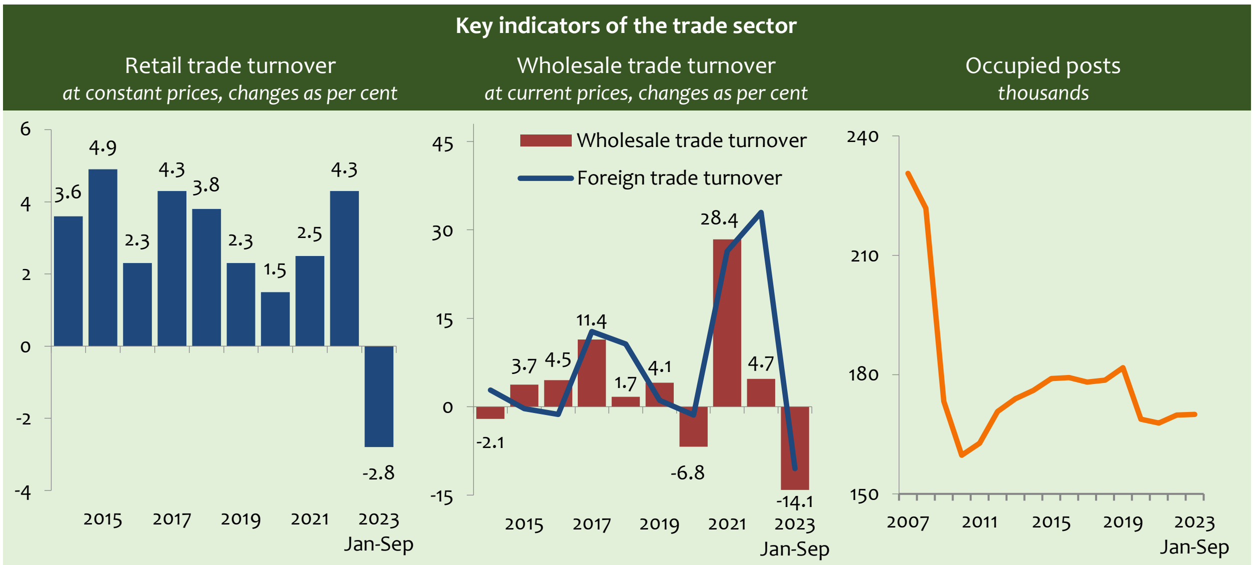



Between 2014 and 2019, services in trade increased every year and overall growth was rapid – on average by 4.2% per year. In general, accommodation and food service activities also experienced a sharp increase in volumes in this period – an average annual increase of 3.7%, but in some years there was a drop in service volumes. The increase in wages and improvements in the labour market ensured the growth of retail turnover, which increased by an average of 3.5% per year. The dynamics of the total retail trade turnover were mostly affected by the increase in non-food retail trade volumes, the turnover increased sharply for automotive fuel, while retail volumes increased somewhat slower in the group of food products. The dynamics of the retail sector were affected by external trade activities.

In 2020, the volume of services provided in trade, accommodation and food services activities generally reduced. The trade sector was negatively affected by the decline in private consumption, rising unemployment and falling incomes caused by the COVID-19 crisis. Retail turnover increased very moderately, wholesale turnover shrank rapidly, but the strict virus containment measures had a particularly negative effect on accommodation and food service activities.

In 2021, the volume of services provided in trade, accommodation and food services activities grew rapidly again. The trade sector was positively influenced by the easement of the restrictions introduced due to the COVID-19 pandemic. The rise in retail trade turnover in 2021 was also steeper than in 2020. In 2021, the volumes of accommodation and food service activities generally shrank due to the sharp decline in Q1.

Figure 4.21




In 2022, trade was negatively affected by the decrease in turnover of goods with Russian and Belarusian markets due to sanctions imposed in the EU, which resulted in a sharp decrease in wholesale trade volumes (at constant prices). Overall, trade volumes decreased by 6.1%. However, in 2022, retail trade turnover increased very rapidly – by 4.3%, which is explained by the rapid increase at the beginning of the year when COVID-19 containment restrictions were lifted, but from the middle of the year retail trade turnover was growing slower due to high prices. In 2022, growth of accommodation and food service activities was very rapid, but the recovery of this sector from the deep downturn in the two previous years should be considered.

In 2023, trade continued to be negatively affected by the unfavourable situation in the external environment, which reduced wholesale volumes (at constant prices) even more. Overall, trade volumes have reduced by 5.4% in Q1-Q3 2023. The increase in consumer prices exceeded the increase in income, real income of the population shrank and negatively affected household consumption. Retail trade turnover shrank by 2.8% in Q1-Q3 2023. The turnover of food products reduced at the fastest pace due to high prices of food. It shrank more moderately for non-food products but increased for fuel affected by lower trade volumes in the respective period of 2022 due to growing fuel prices. Growth of accommodation and food service activities continued also in Q1-Q3 2023 (by 8.8%) and has already exceeded the level before the COVID-19 crisis.

The largest share of occupied posts is in trade, but it has shrunk in recent years with jobs growing faster in the accommodation and food services activities sector. In 2021, under the influence of COVID-19, the decline in the number of jobs in accommodation and food service activities continued, while an increase was observed in trade. By contrast, in 2022 and Q1-Q3 2023, the number of jobs increased considerably again in accommodation and food service activities and declined in trade.

## 4.7. TRANSPORTATION AND STORAGE

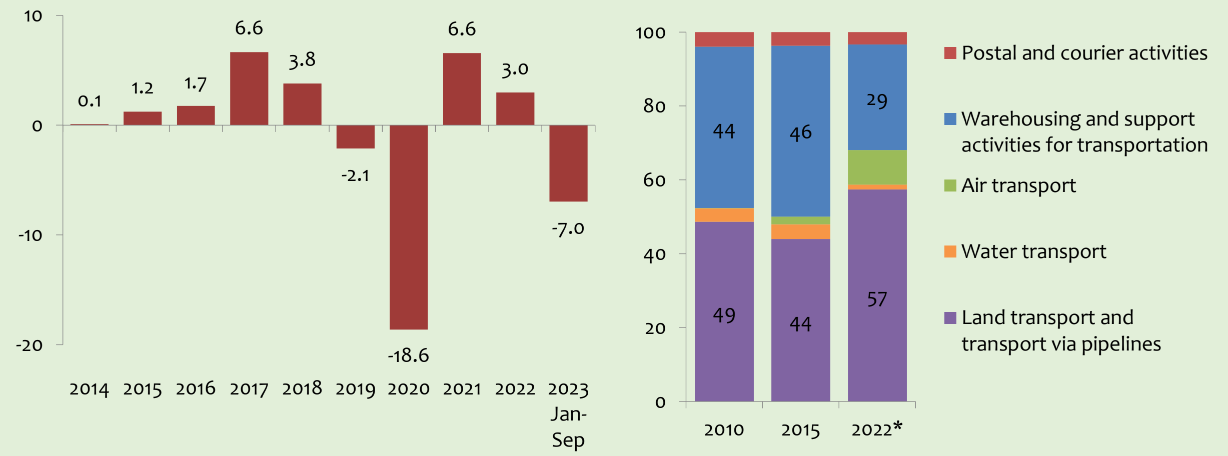
Transportation and storage are closely related to international transportation, including volumes of freight transported by railway, as well as through ports.

From 2014 to 2016, a small increase was observed – by an average of 1% annually. This indicator was affected by the decline in transit freight transport, mainly due to the Russian transport policy and growing competition. Since the end of the 1990s, Russia has been forwarding the goals to develop its own transportation infrastructure to be independent of transit countries. In 2017-2018, increases in the sector's volumes were the most rapid – an average of 5.2% annually. Although the volume of transit freights by railway and in ports declined, 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 2019, the increase in volumes in land transport was unable to compensate for the decline in other transportation sub-sectors. However, in 2020, volumes of the sector reduced sharply due to the movement restrictions caused by the COVID-19 crisis, having a significant impact on aviation, land transport and railway operations.

Figure 4.22

**Transportation and storage**

Value added *compared to the corresponding period of the previous year, changes as per cent* | Structure *as per cent*




* MoE assessment

In 2021, as the epidemiological situation improved and the restrictions introduced were removed, the sector's volumes increased rapidly again. In 2022, production volumes in the sector also continued to increase. A rapid increase in freight volumes was seen in ports, while the rail freight volumes decreased slightly, declining both in domestic and international transportation, and road transport freight volumes declined slightly, driven by a rapid drop in international freight volumes. In 2022, passenger transport increased rapidly as the flow restored after the COVID-19 restrictions were lifted – by 48.8% in ports and by 28% in inland transport. The number of passengers in air transport more than doubled compared to 2021.

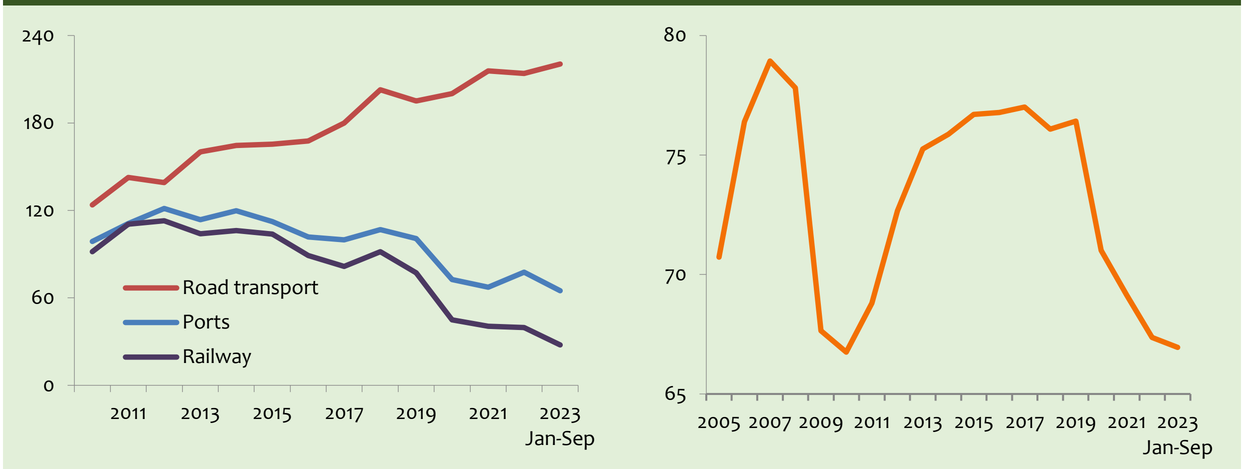
After growth in the previous two years, volumes of the transportation industry have shrunk in Q1-Q3 2023 due to a drop in all transportation sub-sectors, except air transport and road transport. Volumes of services declined at the fastest pace in land transport, transport via pipeline, and warehousing and support activities for transportation. Volumes of freight carried reduced in all modes of transport, except road transport. Rail freight volumes reduced most rapidly driven by a drop in international freight volumes, while the rise in road freight transportation was secured by an increase in domestic transportation. In Q1-Q3 2023, passenger transport has grown most rapidly in air transport – by 28.2%, it increased by 17.9% in land transport and by 3.8% in ports.

The biggest share of occupied posts in transportation and storage is in land transport, transport via pipeline, and warehousing and support activities for transportation. In 2020, the number of occupied posts declined in all transportation and storage sub-sectors under the influence of the COVID-19 pandemic. The number of occupied posts also declined in 2021 – in all transportation and storage sectors, except postal and courier activities and air transport. The steepest drop in the number of jobs was in water transport. In 2022, the number of occupied posts declined in all sub-sectors, except air and water transport, which showed a very rapid increase in the number of jobs. In Q1-Q3 2023, the number of occupied posts has increased only in air transport.

Figure 4.23

**Freight transport**
*2009 = 100*

**Occupied posts in the transportation and storage sector**
*thousands*




## 4.8. BUSINESS SERVICES

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

In 2014-2018, volumes of business services increased moderately – by an average of 1.8% annually. They increased in all main business services sectors, with the exception of financial and insurance activities, which was largely attributed to the decline in the volume of non-resident business in Latvia, and the consolidation of banks. In 2019, service sectors volumes declined, mainly affected by a drop in financial and insurance activities. In 2020, under the influence of the COVID-19 crisis volumes of business services reduced rapidly in all sectors, except information and communication and financial and insurance activities, where a small increase in volumes was observed. Volumes in arts, entertainment and recreation fell particularly rapidly due to stringent measures to contain the COVID-19 pandemic.

In 2021 and 2022, volumes of business services rose rapidly as they recovered from the COVID-19 crisis. Volumes of services increased in all sectors, except in 2022 a decline was observed in financial and insurance activities after a sharp rise in 2021, when revenues from commission fees, financial instrument transactions and insurance activities increased. The increase in information and communication services had the biggest impact. A considerable impact was also from the increase in professional, scientific and technical activities, administrative and support service activities, and real estate activities. In 2022, rapid increase rates were also observed in arts, entertainment and recreation, one of the sectors hit the hardest by the COVID-19 restrictions.

In Q1-Q3 2023, volumes of business services showed a moderate increase, compared to the corresponding period of 2022. Volumes increased in all business services sectors, with the exception of financial and insurance activities, mainly affected by the decline in financial services. The biggest impact was from the increase in real estate activities, information and communication, and arts, entertainment and recreation.

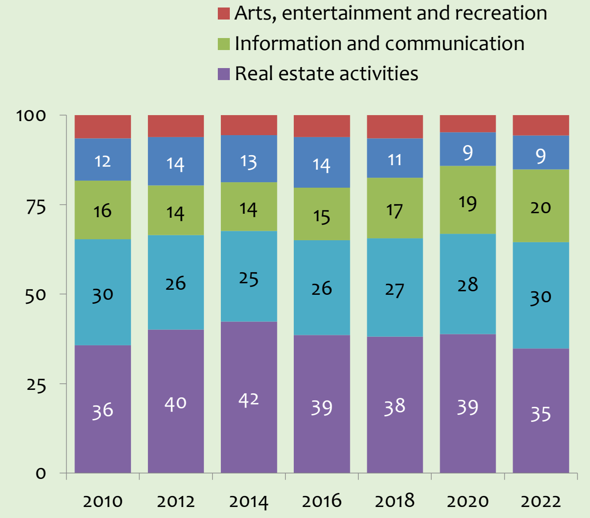
The largest share of occupied posts in business services was in professional, scientific and technical activities, administrative and support service activities, and information and communication. After the decline in the number of jobs in all sectors in 2020, in 2021, the number of jobs increased only in information and communication and in professional, scientific and technical activities. In 2022, the number of jobs increased in information and communication, financial and insurance activities, administrative and support service activities. In Q1-Q3 2023, the number of jobs has increased in all business services sectors, except other services.

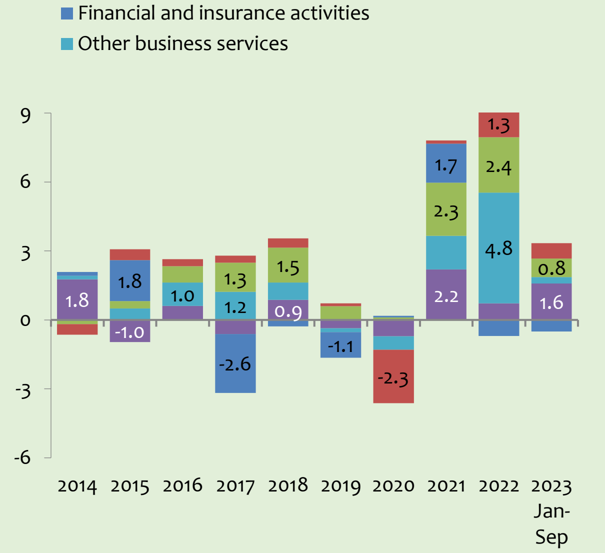
Figure 4.24

**Business services**

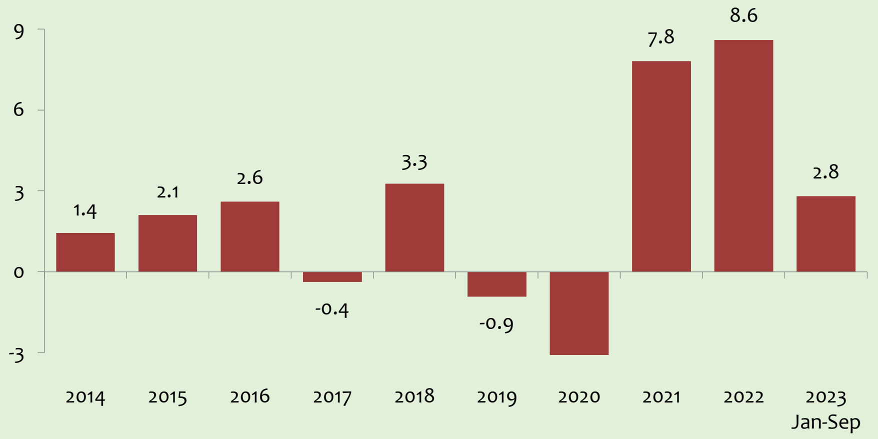
Structure
*as per cent*

Contribution to growth
*percentage points*

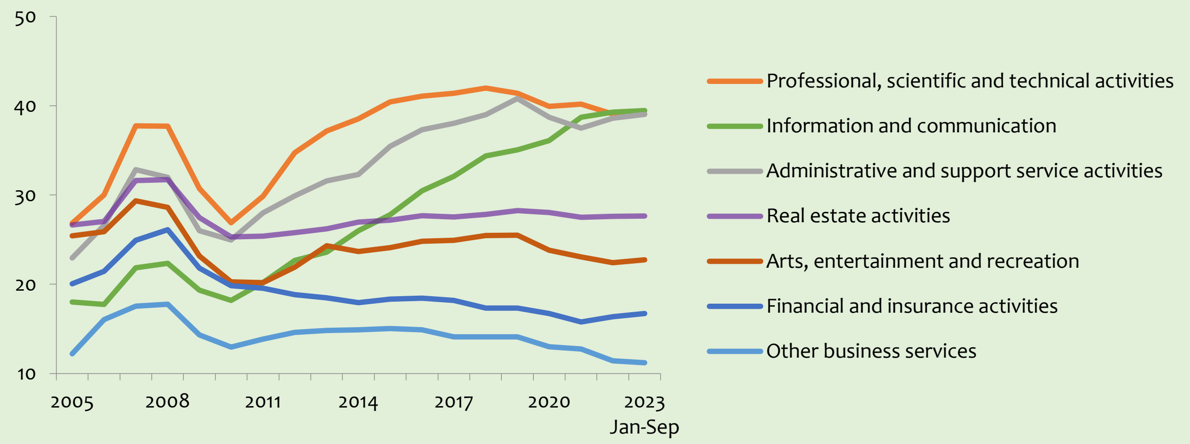



Value added
*compared to the corresponding period of the previous year, changes as per cent*




Occupied posts
*thousands*

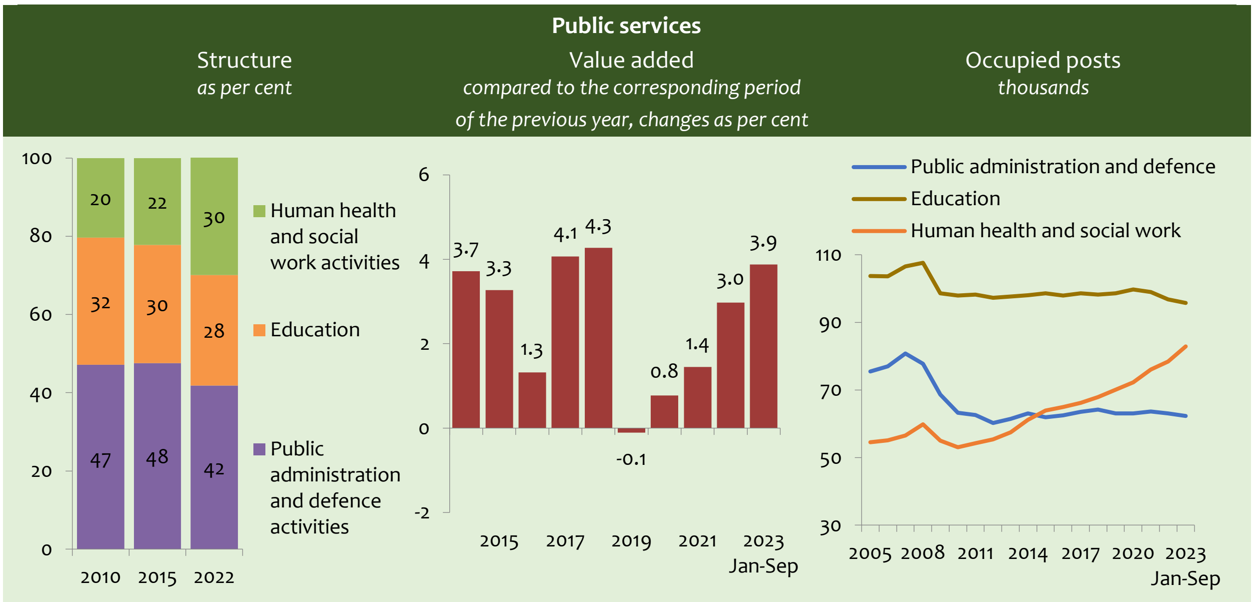


# 4.9. PUBLIC SERVICES

Public administration and defence activities dominate in the structure of **public services** (public administration and defence activities, education, health and social work activities). With the government expenditure increasing, steady growth was observed in the public services sectors in 2014-2018. It was slower in 2016 when only public administration and defence activities had a stable rise in volumes. Overall, in 2014-2018, volumes of public services increased by 3.3% per year on average. The most rapid increase was observed in health and the slowest – in public administration and defence activities. In 2019, volumes of public services almost did not change, with the increase in health compensating for the decline in education.

In 2020-2021, total volumes of services showed a moderate increase caused in 2020 by the increase in human health and social work activities (by 3.4%), while in 2021 they increased rapidly as this process was affected by the availability of services during the COVID-19 pandemic. In 2020, public administration and defence activities, as well as education increased most rapidly, while in 2021 public administration and defence activities showed very moderate growth, but volumes of education declined. In 2022, total volumes of services increased rapidly. This process was the most rapid in education services (by 4.1%) and public administration and defence activities (by 3.7%), while they increased moderately in human health and social work activities (by 1%). Public consumption to increase the defence capabilities of the state, health and education has been growing in recent years.

Figure 4.25




In Q1-Q3 2023, total volumes of services also continued to increase rapidly. The volumes have increased most rapidly in education – by 8.8%. Volumes of public administration and defence activities increased by 5.8%, but volumes of human health and social work activities shrank by 2.8%.

The highest share of occupied posts is in education. A rapid increase in jobs in recent years has been observed in health, while the number of jobs in education reduced. In 2022 and Q1-Q3 2023, the number of jobs shrank also in public administration and defence activities.

# 5. ECONOMIC DEVELOPMENT FORECASTS

## ECONOMIC DEVELOPMENT IN 2024[1]

In 2023, GDP is expected to remain close to the 2022 level, with estimated growth reaching just 0.1%. The situation in the economy is expected to improve in 2024. International institutions forecast economic growth in Latvia's major export markets in 2024, which will positively impact export opportunities. As real wages resume to grow, private consumption is expected to increase as well. The implementation of EU fund programmes will have a positive impact on investment dynamics. If the developments in the external environment do not significantly deteriorate economic growth could reach 2.1% in 2024.

The rapid rise in prices, including particularly high energy and food prices, restricted public consumption significantly in 2023. With inflation gradually decreasing and wages still growing rapidly, private consumption dynamics are expected to become positive soon. A 2.1% rise in private consumption is forecast for 2024. Besides rapid wage growth, it will also be positively influenced by developments in the labour market.

Investments of the EU funds programming period and the implementation of measures of Latvia’s Recovery and Resilience Facility Plan will keep having a positive impact on investments. However, private investment dynamics are likely to be moderate. This will be influenced by both high interest rates, which the ECB could revise only in the first half of 2024, and generally sluggish dynamics of lending to businesses. The MoE forecasts that, in 2024, investments in gross fixed capital formation could increase by 4.5%.

In 2023, weak demand in the main trading partner countries has negatively affected the performance of Latvian exporters. It should be noted that the price environment is no longer as favourable to certain sectors as it was in the second half of 2022 and early 2023. Russia’s war in Ukraine also continues to affect those companies for which the Russian market was an important market for supplies of raw materials and sales of finished products in previous years. International institutions predict that economic development in other Baltic States, Scandinavia and Western European countries will be more sustainable in 2024 than in 2023. This means that for those Latvian exporters whose main market is EU countries, the situation will improve, and external demand will increase. The increase in exports of goods and services is expected to grow by 1.9% in 2024.

A rapid rise in import volumes was observed in 2022 largely underpinned by the high uncertainty surrounding Russia’s war in Ukraine and sanctions imposed by the EU. This resulted in increased stockpiling of goods by many companies. In 2023, the dynamics of imports were increasingly influenced by the decrease in trade flows of goods with Russia. The dynamics of imports will further be increasingly determined by the dynamics of Latvia’s domestic demand. Goods and services imports are expected to grow by 2.4% in 2024.

As was the case in recent years, very different trends will still be present in the development of sectors in 2024. Like in 2023, the fastest growth in 2024 is expected in the construction sector. The development of the sector will be positively influenced by EU funds and public orders and by the decrease in inflation, which will have less impact on the increase of prices of construction projects to be implemented. According to forecasts, the growth in construction volumes may exceed 13% in 2024.

Manufacturing is expected to return to positive growth rates in 2024, mainly driven by improved export opportunities. Some businesses linked to the markets of Russia and CIS countries will keep facing difficulties and will have to keep looking for new supply opportunities and new markets. Domestic market oriented industry sectors will be influenced by the purchasing power of the population.

Relatively stable growth rates in 2024 are projected in agriculture and forestry. This will mainly be influenced by crop production, which experienced various challenges due to adverse weather conditions in 2023.

The trade sector will gradually recover after the decline in 2023. This will be positively influenced by the increase in foreign trade flows and the dynamics of wholesale trade. Retail trade will be positively affected by the increase in private consumption.

In 2024, there will be moderate dynamics in transportation and storage. The decreasing commodity flows from Russia will affect both railway and port performance and there is no reason to expect significant improvements in transit cargo flows in the near future. On the other hand, sector development will be positively affected by the dynamics of land and air transport services.

[1] The latest forecasts of the IMF and EC were used by the MoE to analyse external markets and evaluate the global economic development trends when making forecasts about economic development (see Chapter 2).

In 2024, different trends are expected also in business services. According to the forecasts, the volume of services in information and technology sectors could increase by 3% in 2024. The dynamics in other business services will be more moderate. After the sharp recovery from the restrictions imposed by the COVID-19 crisis, high growth rates are over in accommodation and food service activities, and also arts, entertainment and recreation. As the low base effect disappears, further dynamics of the sectors are expected to be around 2%. Moderate dynamics are expected also in financial services and real estate management.

In 2024, growth in public services may reach 2%, which will be greatly influenced by additional state budget funding for education and health.

## DEVELOPMENT PROSPECTS FOR 2025-2030

Two scenarios of slower and more rapid (or target) growth are developed for the medium term until 2030. The basic assumptions are based on different perspectives for the development of the global economy and the ability to successfully overcome the consequences of Russia's war in Ukraine, as well as the effectiveness of the structural policy implemented by Latvia, because without structural changes it is not possible to increase productivity and change the path of growth of Latvia.

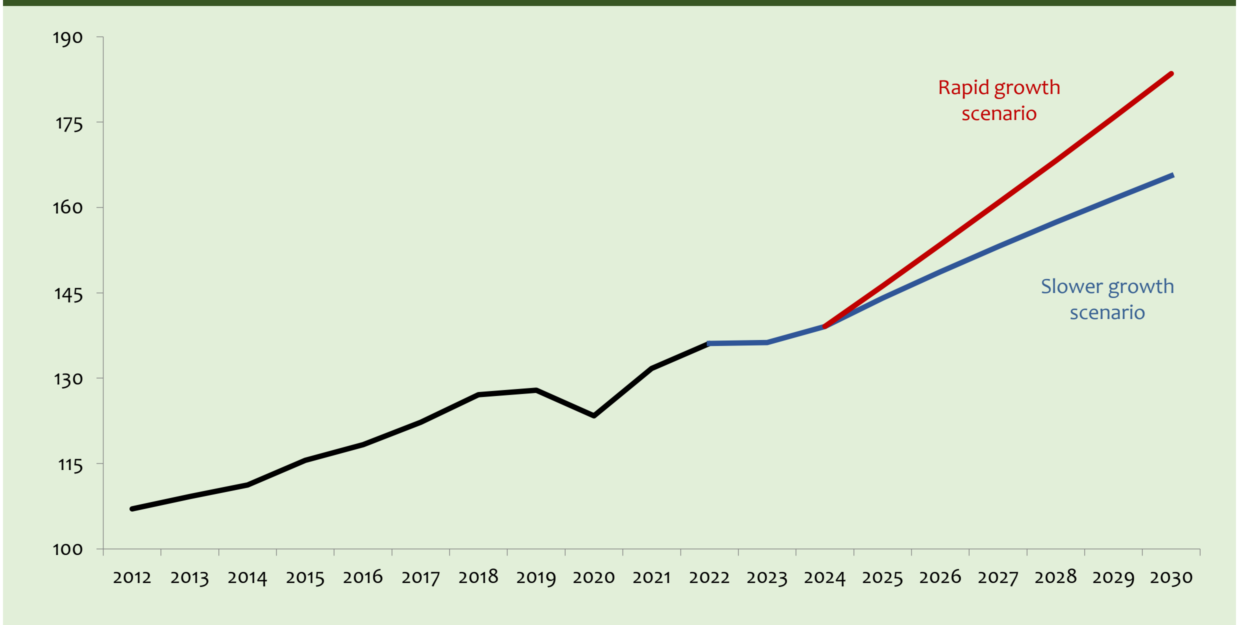
The essence of socio-economic development lies in gradual qualitative changes in several areas, such as manufacturing, education, science, culture and the well-being of the population. These changes are characterised by structural changes in the economy or structural transformation. Structural transformation is the process of moving labour and other production resources from low productivity to high productivity areas, sectors and economic activities. Structural transformation increases overall productivity levels and strengthens the potential for sustainable growth. Economic transformation involves fundamental changes in the economy, which increase the overall level of productivity while ensuring adequate quantity and quality of employment, fair income and its distribution, access to quality public services. The main purpose of structural policy is to promote motivation of businessmen to change their business model and learn and create new competitive advantages.

The slower growth scenario assumes that the process of economic transformation is slow, and the transition to a higher value-added economy will be gradual. Coping with the shock of high inflation, the economy will return to the average growth rates of the previous decade, which, in the medium term between 2025 and 2030, could reach 2.8% per year. During this period, slightly more rapid growth rates of exports, investments and private consumption are forecast, which may slightly exceed 3% per year.

Figure 5.1

**Forecast of Latvian GDP**

*2011 = 100*




Global technology development trends, the EU Green Deal and the development of strategically important sectors under the new geopolitical conditions open new opportunities for increasing the export capacity of the Latvian economy, increasing productivity level by investing in technology development, digitisation and innovation. Greater effect can be achieved through strategic and synergistic investment of public funds available both in the short and medium term. The medium-term scenario of more rapid growth foresees a more rapid increase in investments, which promotes the introduction of the latest technologies, the development of new products and services, the wider use of digital solutions, and the efficiency improvement of processes. In the rapid growth scenario, private investments will also play a vital role and will stimulate an increase in lending, the development of the capital market and the use of financial instruments. In this scenario, GDP growth rates until 2030 can on average reach 4.8% annually.

Efficient solutions to the labour shortage problem are also the most important factor in ensuring more rapid growth. Investments in human capital are very important. It is critical to provide the growing and productive sectors with the labour force needed for growth, which means reviewing existing adult education programmes and encouraging labour overflows from less productive sectors to productive sectors.

Table 5.1

**Forecast of Latvian GDP by expenditure items**
*changes as per cent*

| | | Fact | | Forecast | | |
|---|---|---|---|---|---|---|
| | 2020 | 2021 | 2022 | 2023 | 2024 | 2025-2030 annual average |
| **Gross domestic product** | **-3.5** | **6.7** | **3.4** | **0.1** | **2.1** | **2.8 .. 4.8** |
| Private consumption | -4.3 | 7.3 | 6.0 | -1.0 | 2.1 | 3.0 .. 4.8 |
| Public consumption | 2.1 | 3.5 | 2.8 | 6.0 | 1.8 | 2.1 .. 2.3 |
| Gross fixed capital formation | -2.2 | 7.2 | 0.6 | 5.9 | 4.5 | 3.6 .. 5.6 |
| Export | 0.4 | 9.0 | 10.3 | -5.2 | 1.9 | 3.1 .. 5.1 |
| Import | -1.1 | 15.1 | 11.1 | -2.6 | 2.4 | 3.3 .. 5.0 |

The rapid growth scenario envisages that exports and manufacturing retain a relatively rapid growth rate in the medium term, based on both the increase in competitiveness of Latvian producers and growing external demand. More rapid development is expected in high and medium-high technology sectors. Medium-term exports would have to grow faster than the rest of the economy.

Table 5.2

**Forecast of Latvian GDP by sectors**
*changes as per cent*

| | | Fact | | Forecast | | |
|---|---|---|---|---|---|---|
| | 2020 | 2021 | 2022 | 2023 | 2024 | 2025-2030 annual average |
| **Gross domestic product** | **-3.5** | **6.7** | **3.4** | **0.1** | **2.1** | **2.8 .. 4.8** |
| Agriculture, forestry | -0.4 | 1.1 | 7.3 | -7.5 | 3.0 | 2.2 .. 3.2 |
| Manufacturing | 0.1 | 10.3 | 2.7 | -6.1 | 3.0 | 2.9 .. 5.4 |
| Other industry | 19.6 | 12.8 | -11.0 | -6.8 | 1.1 | 1.8 .. 3.2 |
| Construction | -5.9 | -13.6 | -8.8 | 15.9 | 13.8 | 4.6 .. 7.2 |
| Trade, accommodation | -7.3 | 17.8 | -1.9 | -3.6 | 1.6 | 2.9 .. 5.4 |
| Transportation and storage | -18.6 | 6.6 | 3.0 | -6.5 | 0.8 | 2.7 .. 4.2 |
| Other business services | -3.4 | 7.8 | 8.4 | 2.9 | 1.9 | 2.8 .. 5.1 |
| Public services | 0.8 | 1.4 | 3.1 | 5.3 | 2.2 | 2.0 .. 3.2 |

In the medium term, rapid growth rates are anticipated in construction. On the one hand, it will be affected by public investment and the implementation of large investment projects (*Rail Baltica*). On the other hand, growing industries and the need for new industrial buildings will create a demand.

In the target scenario, rapid development is expected in information and communication technology services. This is related to the increasingly growing demand for digitalisation of production and services processes, as well as global ICT sector development trends. The availability of a qualified labour force will affect it as well.

# 6. ECONOMIC STABILITY AND COMPETITIVENESS

## 6.1. PRICES

### CONSUMER PRICES

After the deflation caused by the financial crisis, consumer prices started to grow again in 2011. External factors and global price fluctuations for crude oil and food started to affect the total price level increasingly more seriously. Price increases were also driven by internal factors, such as increased excise taxes on fuel, alcoholic beverages and tobacco products, fluctuations in administrative prices and increased private consumption. In 2014-2016, consumer price growth was very moderate, but it was more rapid in 2017-2019. The reduction in the demand caused by the restrictions introduced to combat the COVID-19 pandemic had a significant influence on the drop in consumer prices in 2020. In 2021, consumer prices increased rapidly again, as the economy was recovering from the COVID-19 crisis.

Figure 6.1

**Consumer prices**

Annual average changes *as per cent*


Changes by months, *as per cent*

| | | *compared to previous month* | *compared to corresponding month of the previous year* | *annual average* |
|---|---|---|---|---|
| 2022 | July | 2.2 | 21.5 | 10.8 |
| | August | 0.4 | 21.5 | 12.3 |
| | September | 1.6 | 22.2 | 13.7 |
| | October | 0.8 | 21.8 | 15.0 |
| | November | 1.1 | 21.8 | 16.2 |
| | December | -0.5 | 20.8 | 17.3 |
| 2023 | January | 0.5 | 21.5 | 18.5 |
| | February | 0.6 | 20.3 | 19.4 |
| | March | 0.7 | 17.3 | 19.8 |
| | April | 0.3 | 15.1 | 20.0 |
| | May | 1.3 | 12.1 | 19.5 |
| | June | -1.4 | 7.9 | 18.4 |
| | July | 0.7 | 6.4 | 17.0 |
| | August | -0.6 | 5.4 | 15.6 |
| | September | -0.4 | 3.3 | 14.0 |
| | October | -0.4 | 2.1 | 12.3 |
| | November | 0.0 | 1.0 | 10.6 |

In 2022, there was a very sharp rise in prices. Consumer prices rose by 20.8% in December 2022 compared to December 2021, showing the steepest rise since 1995 in January-December, but the annual average inflation was 17.3%. This was underpinned by the increase in global energy and food prices exacerbated by Russia's invasion of Ukraine and the subsequent sanctions, which caused a deficit of energy, food and raw materials for manufacturing. It should be noted that this has a downstream impact on the prices of industrial goods and services. Consumer prices increased in all the main groups of goods and services. The biggest impact was from the increase in prices of food and non-alcoholic beverages, goods and services related to housing, which was caused by the increase in prices of heat, natural gas and solid fuel, as well as goods and services related to transport, which was caused by the increase in prices of transport fuel.

In 2023, consumer prices stabilised and were shrinking every month compared to the corresponding month of the previous year – from 21.5% at the beginning of this year to 1% in November. This continued to be influenced by global prices and the unstable geopolitical situation. In November 2023, compared to December of the year before, consumer prices rose by 1.4%. Considering the base effect of inflation dynamics, the annual average inflation remained high – 10.6%.

The main factors affecting prices in Latvia in 2023 are mentioned below.

- The increase in prices of services had the largest impact on the total increase in prices in January-November 2023. Prices of services generally rose by 4.9%, which increased the overall level of consumer prices by 1.2 percentage points. The biggest increasing impact came from outpatient services, mainly the increase in the prices of specialised medical and dental services. Prices of catering services, recreational and cultural services (including television subscription fees, recreation and sports events, museum, cinema, theatre, concert visits), housing rent, waste collection, as well as maintenance and repair of personal vehicles also increased considerably. On the other hand, prices of sewerage services and passenger air transport declined significantly.
- In early 2023, food prices kept growing rapidly. Since April, the rapid rise in food prices in Latvia has stopped – in April, October and November, price increases typical for these months were observed, while in other months prices of food decreased. Overall, in January-November, prices of food and non-alcoholic beverages have increased by 2.7% increasing the total level of consumer prices by 0.7 percentage points. Prices rose across all major food groups except dairy products, oils and other fats. Non-alcoholic beverages, vegetables, meat and meat products, bread and cereals, sugar and confectionery had the most significant impact on the increase in the average price level. Local changes in food prices are largely determined by global price fluctuations. Since mid-2020, global food prices have been rising rapidly, driven by a sharp rise in import demand, delays in processing and transportation due to the shortage of labour force caused by COVID-19 and rising crude oil prices. The situation was worsened by Russia's invasion of Ukraine in February 2022, raising concerns about future global food supplies, as both Ukraine and Russia are important suppliers of agricultural products. However, global food prices have been falling since April 2022 after reaching the all-time highest price level in March 2022. They saw a slight rise only in April and July 2023. Overall, in November 2023, compared to December of the year before, global food prices reduced by 8.7%. The most rapid drop was recorded in prices of cereals, dairy products and vegetable oils, prices of meat remained almost constant, while prices of sugar rose rapidly. The drop in prices was driven by increased production in major producing countries, abundant export supplies and low demand due to inflation and a slowdown in economic activity. The increase in sugar prices was influenced by concerns about the potential impact of the *El Ninjo* natural phenomenon on the production outlook for 2023-2024. It should be noted that in November 2023, compared to December 2019, global food prices increased by 19.2%. The increase in prices of food in Latvia during this period was 43.5%.
- In January-November 2023, the average level of prices of alcoholic beverages and tobacco products increased by 7.7%, which increased the overall price level by 0.5 percentage points. Prices of alcoholic beverages increased by 8.4%, while prices of tobacco products increased by an average of 6.4%. The increase in prices of spirits and cigarettes had the most significant effect.
- In January-November 2023, the largest diminishing impact came from the drop in prices of energy sources related to housing – electricity, gas, solid fuel and heating energy that decreased the overall level of prices by 2.1 percentage points. The support measures introduced by the government to compensate for the rapid increase in energy prices from 1 October 2022 to 30 April 2023, partly compensating households for payments for electricity, natural gas and heating energy, and the state support for the partial compensation for the increase in the cost of distribution system services from September 1 to December 31 were very important and have slowed down even faster price increases in the group of energy sources related to housing. The practically constant increase in heating energy prices in all months except May, when the state support for reducing prices of energy sources was over, had the most significant impact in January-November. Overall, in January-November prices of heating energy decreased by 19.6% due to the decrease in prices of natural gas and wood chips. As prices of wood products used for heating reduced in the market, the prices of solid fuels shrank and reduced by 25.1% in January-November. A similar diminishing effect came from the drop in prices of natural gas and electricity. Prices of natural gas reduced by 27.7% affected by a rapid drop in prices of natural gas on the stock exchange, and in May 2023 they reduced to the lowest level since April 2021. The opening of the natural gas market for households from 1 May also had a large impact. Meanwhile, in January-November, the price of electricity reduced by 8.3%. The steepest decline in this indicator was significantly slowed down both by the end of the state support, which partially compensated the price for households for the first 100 kWh until April 30, and by the increase in the cost of distribution system services from July 1, which has been partially compensated by state support from September 1. It should be noted that the average price of electricity for the Baltic region in *the Nord Pool* system in January-November 2023, compared to the corresponding period of the previous year, had shrunk by almost 60%, mainly due to the higher generation of renewable energy sources – by solar, wind and hydroelectric power plants – as well as the decline of natural gas prices in Europe.
- Fuel prices in Latvia in January-November 2023 declined by 0.7% and did not significantly affect the overall level of consumer prices. The sharp drop in fuel prices in July-September was offset by a steeper drop in prices in March-June and November. Prices fell for diesel fuel but rose for petrol. It should be noted that global oil prices in November 2023 remained practically unchanged compared to December 2022. Global oil prices also fell in the first half of the year,

except in January and April. This was mainly driven by concerns about recession and declining crude oil demand affected by the decisions of central banks to continue raising interest rates. However, oil prices rose sharply in July-September, with the price of *Brent* crude oil reaching 96 US dollars per barrel, the highest level of the past ten months, in late September. The rise in crude oil prices was driven by Saudi Arabia and Russia's voluntary oil production cuts and announcements to maintain production restrictions until the end of the year, along with crude oil production restrictions imposed by other OPEC+ countries. Russia also imposed restrictions on fuel exports to stabilise its internal market, while crude oil stocks in the United States continued to fall. However, concerns about a slowdown in global demand in early October led to a sharp drop in global oil prices, but they rose again after the surprise attack of the terrorist group *Hamas* on Israel. Amid fears of a broader conflict in the Middle East, oil prices began falling again in the second half of October, with the price of *Brent* crude oil falling to 77 US dollars per barrel in mid-November. The drop in oil prices was also driven by disputes between OPEC+ member states over oil production levels and signs of strong supply, especially from non-OPEC countries such as the United States, where crude oil stocks are rising sharply.

The annual average inflation will reach 9% in 2023. The main impact on price changes will continue to be linked to the fluctuations in global prices for energy and food and will be determined by global development. At the same time, inflation in Latvia will be affected by different supply-side factors related to the increase of taxes and tariffs, as well as the demand side promoted by the increase in wages. Overall, the average annual inflation in 2024 is expected within 2% and may stabilise at about 2.5% in the following years.

Figure 6.2

**Goods and services with most effect on changes in consumer prices**

*contribution to 12-month changes in November 2023, percentage points*

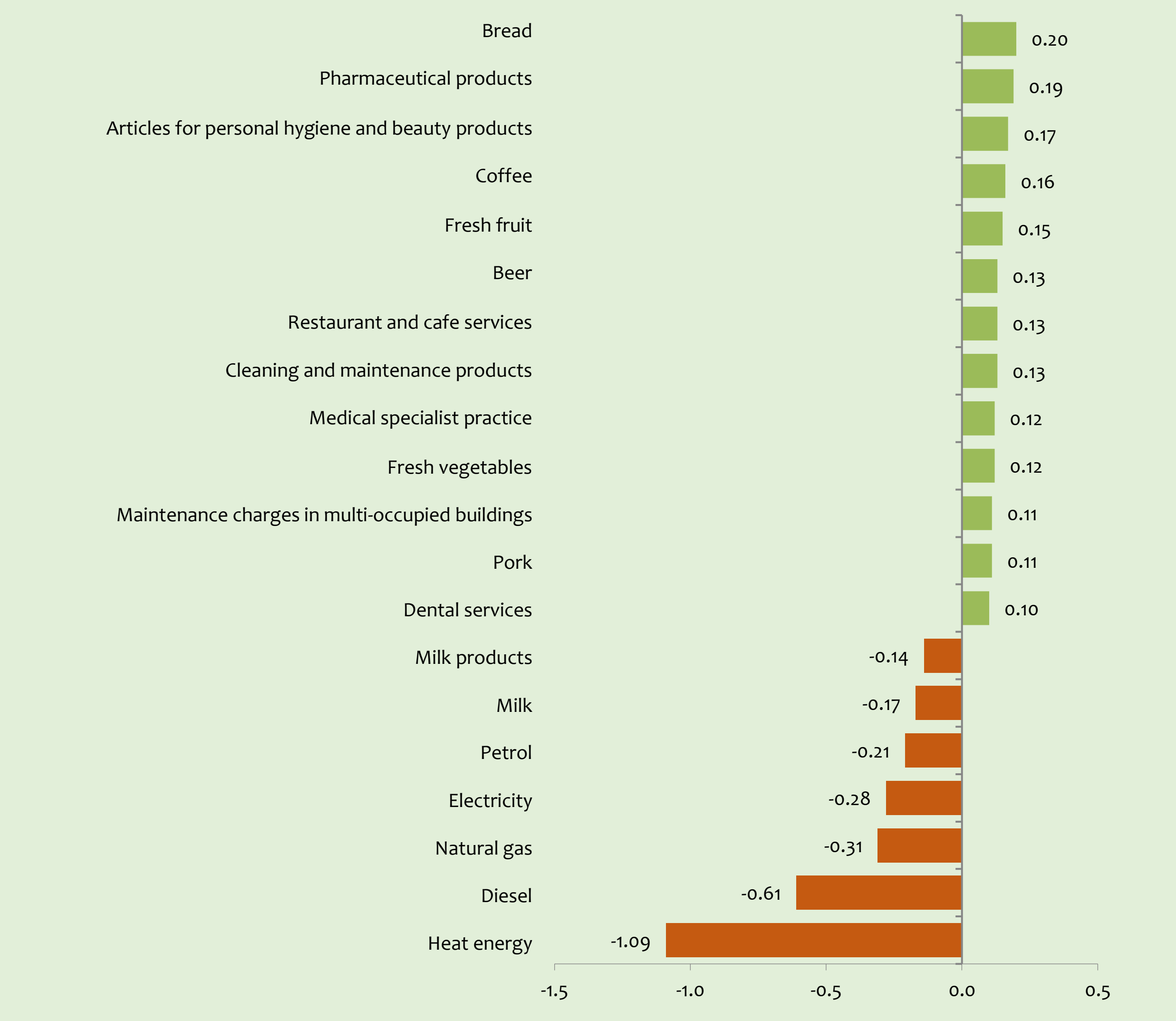
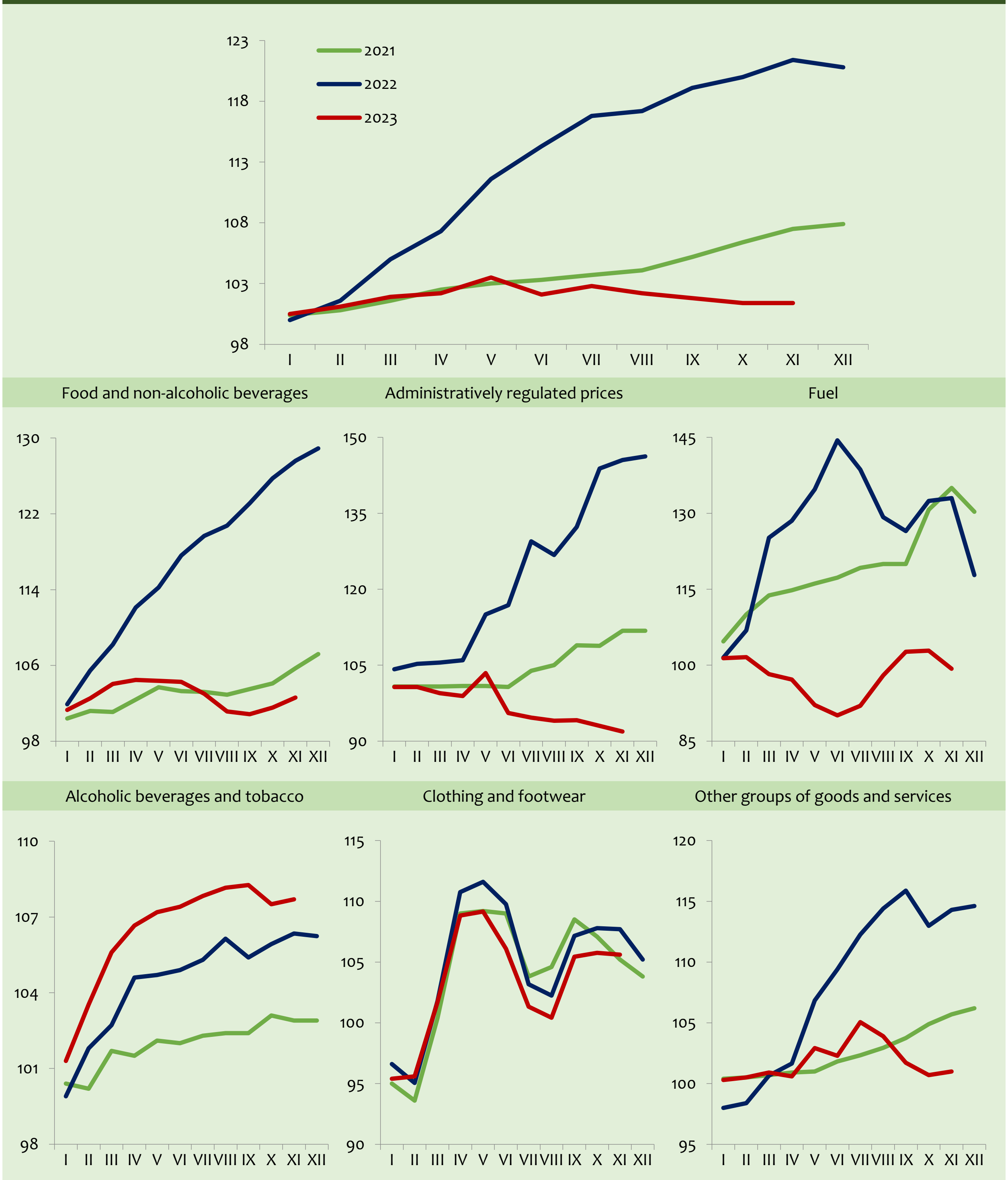


Figure 6.3

**Consumer price index by groups and subgroups**
*by months, December of the previous year = 100*

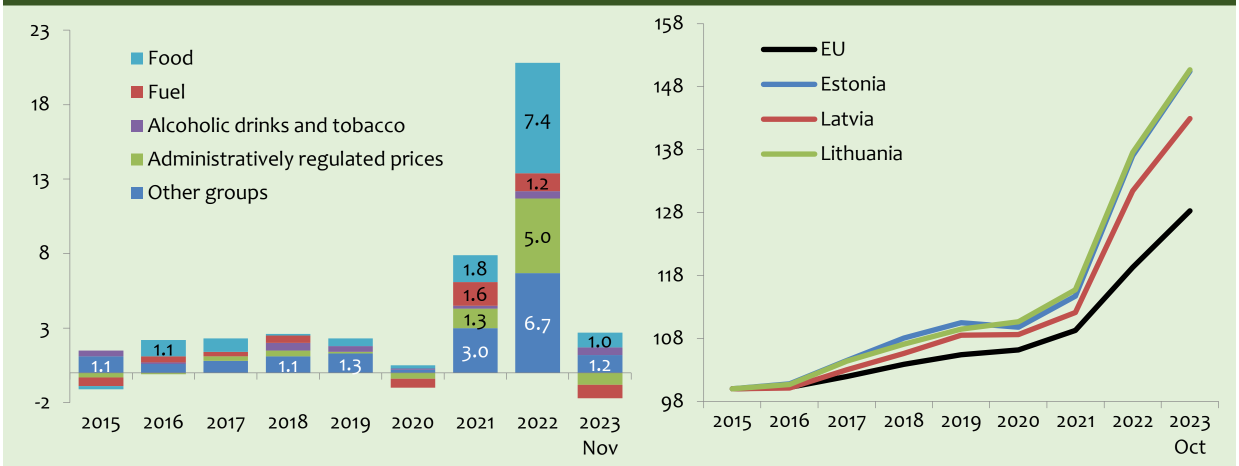



In the European Union, following a very moderate increase in prices in 2015-2016 driven by relatively weak economic growth, as well as by the drop in global prices for food and crude oil, a sharper rise in prices was seen in 2017-2019 as economic activities increased. On the other hand, in 2020, COVID-19 reduced consumer prices. With economic activity increasing and countries starting large-scale vaccination against COVID-19, consumer prices increased sharply in all main consumption groups in 2021. The rise in energy and food prices had the biggest increasing effect, which was driven by the sharp increase in global prices.

Figure 6.4

**Consumer prices in groups of goods and services**
*contribution to 12-month changes as per cent*

**Harmonised index of consumer prices**
*2015 = 100*

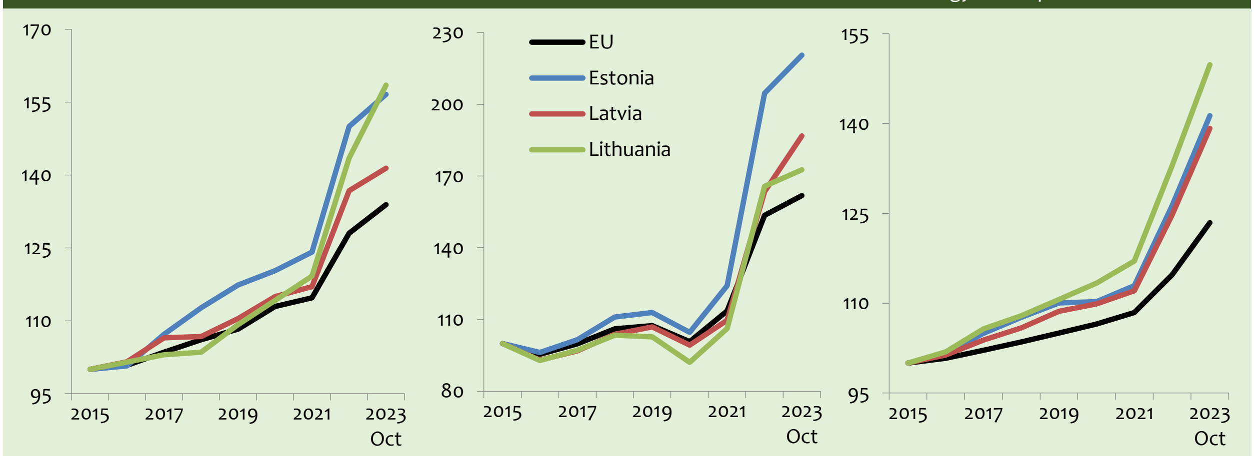



In 2022, with economic activity increasing following the lifting of the COVID-19 restrictions, consumer prices continued to grow. Russia's invasion of Ukraine and protest sanctions, which resulted in a shortage of energy and production raw materials, have added to the impact on price growth all over the world. In 2022, annual average inflation in the EU was 9.2%. Prices increased in all the main consumption groups. The rise in energy prices still had the biggest effect, which was driven by the sharp increase in global prices of crude oil and natural gas on stock exchanges in the first half of the year and in prices of natural gas, which reached record-high levels in summer months. Food prices also continued growing significantly, as the rapid increase in global food prices continued at the beginning of the year, reaching their highest level in March 2022. A considerable increasing impact came from the increase in prices of services, among them the most in catering service activities and accommodation, rentals for housing and passenger air transport. Even though global energy and food prices returned to the levels of 2021, before Russia invaded Ukraine, with the tense geopolitical situation continuing and given the base effect of inflation dynamics, the average annual inflation in 2023 remains high. In October 2023, it was 7.6% in the EU.

Figure 6.5

**Components of the harmonised index of consumer prices**
*2015 = 100*

Unprocessed food | Energy | Overall price index excluding energy and unprocessed food



When comparing the **Baltic countries**, in 2022, the highest annual average inflation was in Estonia, slightly lower inflation was in Lithuania, while inflation in Latvia was the lowest. The increase in energy prices has the biggest impact in all three countries (the highest in Estonia and the lowest in Lithuania). The rise in food prices also had the biggest effect (the highest in Latvia and the lowest in Estonia). Meanwhile, the increase in prices of services in all the countries had the lowest impact – similar in Estonia and Lithuania and the lowest in Latvia.

It should be noted that since 2015 Latvia has been having the lowest core inflation among the Baltic countries, because the increase in private consumption in Latvia is slower than in the two other countries and the increase in prices of services is slower as well. Prices of alcoholic beverages and tobacco in Latvia also increased slower, while the equalisation of the excise tax with the EU level in Estonia and Lithuania is more rapid. Prices of communication increased in Latvia more rapidly.

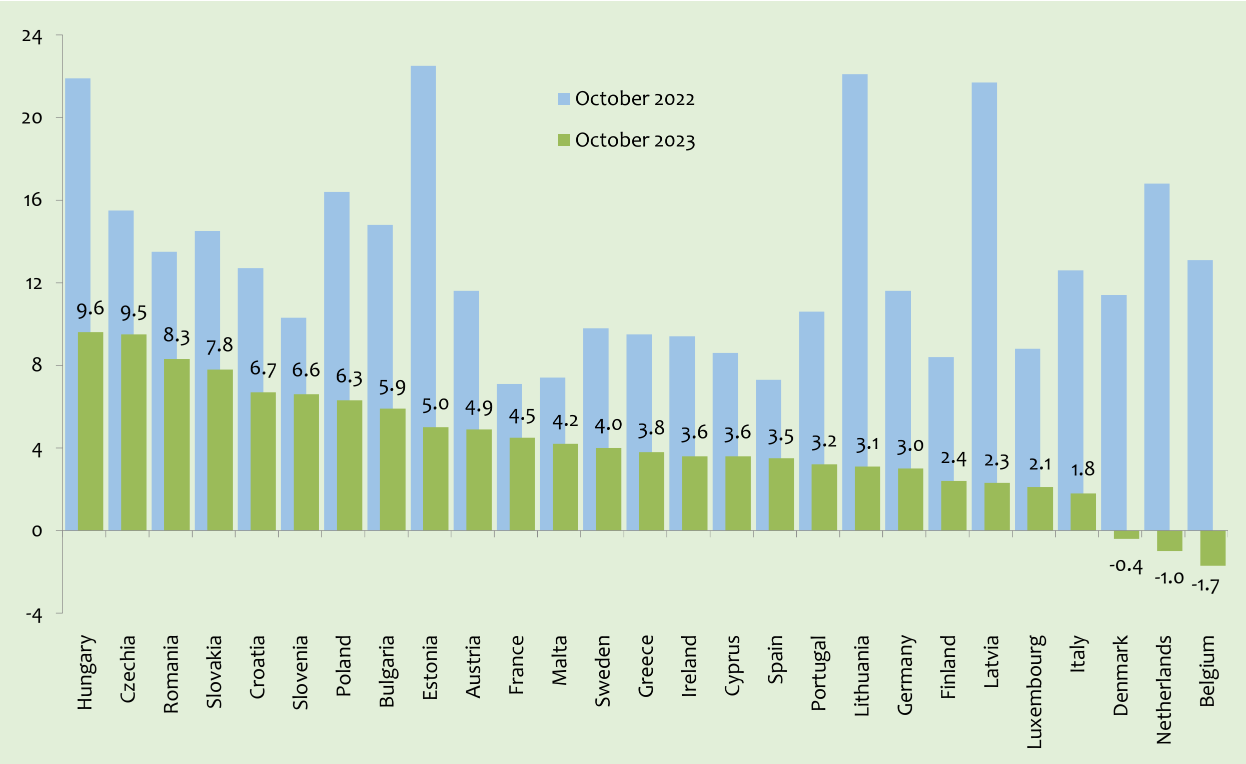
In October 2023, the Baltic countries showed one of the most rapid annual average inflation indicators in the EU. In October 2023, the highest annual average inflation was in Latvia – 12.4%. In Lithuania, the annual average inflation was 11.7%, while in Estonia it was 11.6%. The rise in prices of food and services had the biggest effect. It was similar in all the Baltic countries. The impact of energy prices was the lowest, the highest increase in energy prices was in Latvia.

In October 2023, compared to October 2022, the price level grew by 3.6% in the EU countries, and by 2.9% in the Euro area. The highest inflation in October 2023 was in Hungary and Czechia but deflation was observed in Belgium, the Netherlands and Denmark.

Figure 6.6

**Changes in the harmonised index of consumer prices in the EU member states**

*12-month inflation, as per cent*




## PRODUCER PRICES

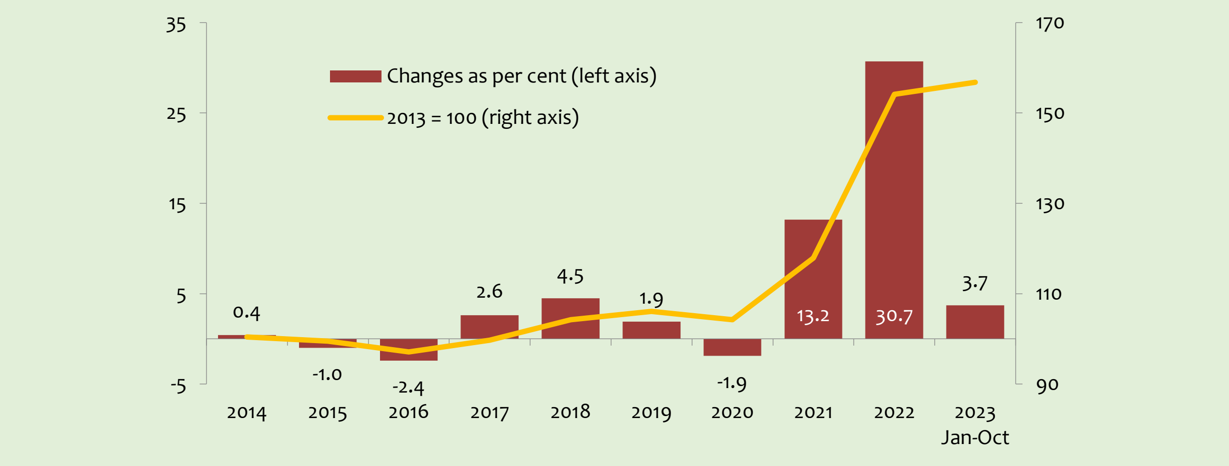
After a drop in 2015-2016, producer prices showed a considerable increase in 2017-2018, which slowed down in 2019. In 2020, producer prices decreased under the influence of COVID-19 in all major industry sectors (mining and quarrying, manufacturing, electricity, gas, steam and air conditioning supply, and water supply, sewerage, waste management and remediation activities). In 2021, they increased rapidly, reflecting the rapid growth of prices of energy sources and other raw materials in the world.

In 2022, a very rapid rise continued in this price group due to the energy crisis, which was exacerbated by Russia's invasion of Ukraine and subsequent sanctions against Russia and Belarus, as well as the limited export of Ukrainian goods under conditions of war, which caused shortages of both energy sources and raw materials. In 2022, the producer prices of products sold on the domestic market increased by 48.1%, while the producer prices of exported products – by 16.1%. Producer prices increased in all major industrial sectors, and electricity, gas, steam and air conditioning supply had the biggest effect on the increase in producer prices.

In 2023, the increase in producer prices has slowed down, largely influenced by falling global energy prices. Energy prices have returned to the level of 2021, before Russia invaded Ukraine, and have stabilised. In January–October 2023, producer prices in the industry increased by 3.7% compared to the relevant period of the previous year. Prices of products sold on the domestic market grew by 6.7%, while prices of exported products remained almost unchanged – increased by 0.1%. Producer prices increased in all large industrial sectors. Electricity, gas, steam and air conditioning supply had the biggest effect on the increase in producer prices.

Figure 6.7

**Producer prices**




A similar trend has been observed in producer prices in manufacturing since 2014. Following the faster increase in 2017-2018, in 2019, producer prices in manufacturing experienced very moderate increases related to slower growth in the EU and a slight drop in prices of energy sources and raw materials. Although 2020 was marked by the COVID-19 pandemic and a rapid drop in energy prices, producer prices in manufacturing reduced just slightly during this period, while they increased very sharply in 2021-2022. In 2022, the increase in producer prices in manufacturing was more rapid for the products sold in the domestic market – 25.5% and producer prices increased by 15.9% for the exported products. Furthermore, in January-October 2023, compared to the corresponding period of the previous year, producer prices in manufacturing continue growing for the products sold on the domestic market – by 5.9% but reduced by 0.2 for the exported products.

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 products for exports. The prices of products for exports are mainly determined by the price dynamics of the Latvian key export goods, including timber, metal products, and food, in global markets. In 2022, global energy and raw material prices continued to climb sharply because of the energy crisis and Russia's invasion of Ukraine, especially in the first half of the year and summer months, but since autumn they fell sharply. It should be noted that global energy and raw material prices continued to decrease in 2023, but since the beginning of autumn, they have been increasing slightly, which could also affect producer price dynamics. Uncertainty in the supplies of raw materials in the context of the tense geopolitical situation continues to have a significant impact on producer prices. Prices of products sold in the domestic market are also growing more moderately in 2023, mainly influenced by the drop in prices of both energy sources and raw materials (for example, wood, in recent months also unprocessed food, etc.) in the world and in the domestic market. At the same time, the dynamics of producer prices for products sold in the domestic market are influenced by growth rates, which will be generally very moderate or even negative this year.

If we assess sectors, in 2022, producer prices in manufacturing increased in all the manufacturing sectors. The increase in producer prices had the biggest influence in wood processing, where the impact of the increase in producer prices of products sold in the domestic market and exported products was similar. The price rise in manufacture of food products also had a big impact on the producer prices. It should be noted that global food prices increased rapidly from mid-2020 to March 2022, when, despite the effects of the COVID-19 pandemic, high demand persisted. Prices in manufacture of food products were mostly affected by the high prices of products sold on the domestic market. In 2022, the increase in producer prices in manufacturing – manufacture of other non-metallic mineral products, finished metal products and chemicals – was also significant.

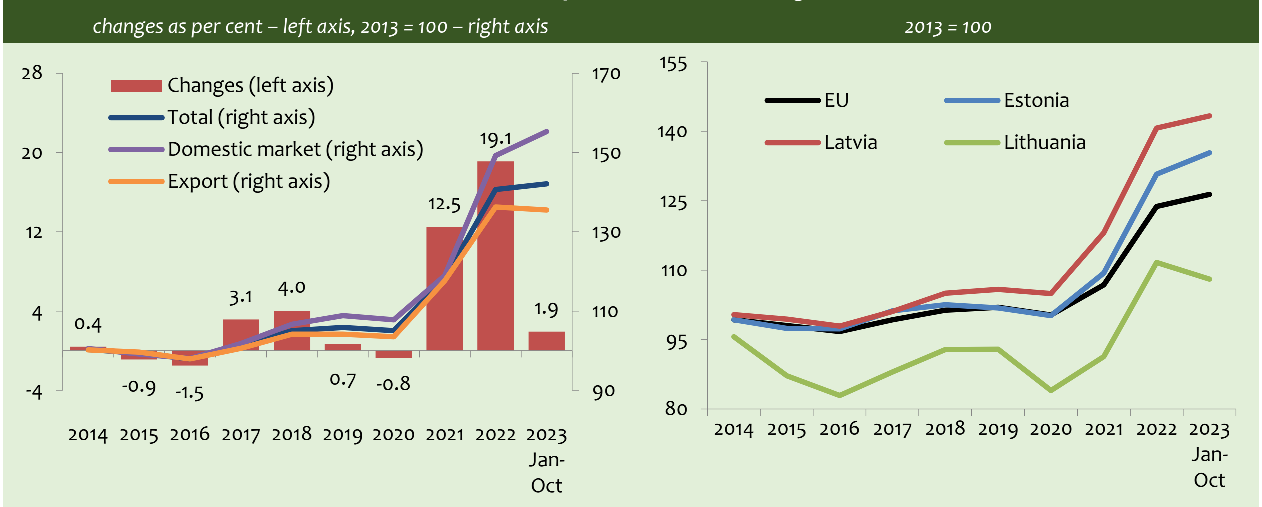
In January-October 2023, the most impressive increase in producer prices in manufacturing was in manufacture of food, which was affected the most by the growing prices of products sold in the domestic market. It should be noted that despite the drop in global food prices since April 2022, the rapid rise in food prices in Latvia has not stopped until April 2023. The increase of producer prices in manufacture of other non-metallic mineral products was also significant, but after the rapid increase in previous years, producer prices decreased in wood processing, which also had the biggest diminishing effect. The drop in prices in wood processing was largely affected by the drop in prices of exported products. The drop in producer prices in manufacture of chemical substances also had a big effect.

Following the faster increase in producer prices in the EU in 2017-2018, the rise slowed down in 2019 mainly due to the drop in world energy prices and the slowdown of global economic growth. The fluctuations in supply and demand of energy sources and raw materials due to the COVID-19 pandemic affected the fall in producer prices in 2020. Producer prices in the EU increased very rapidly in 2021, with the economy recovering and significantly growing demand for raw materials and energy sources. This continued also in 2022, when the crisis of energy prices and supplies was enhanced by the Russian invasion of Ukraine. In 2022, producer prices in manufacturing saw the most rapid increase both across the EU and in all three Baltic countries. As prices of energy sources and other raw materials declined, the increase in producer prices in manufacturing in 2023 has slowed down. In January-October 2023, compared to the corresponding period of the previous year, they increased by 2.1% in the EU, most rapidly in Cyprus, Hungary and Slovenia, but declined most rapidly in Czechia, Greece, Luxembourg and Lithuania.

When comparing the Baltic countries, producer prices in manufacturing in January-October 2023, compared to the respective period of the previous year, increased most rapidly in Estonia – by 3.5%, they increased by 1.9% in Latvia, but reduced by 3.2% in Lithuania.

Figure 6.8

**Producer prices in manufacturing**




## FOREIGN TRADE UNIT VALUE INDICES

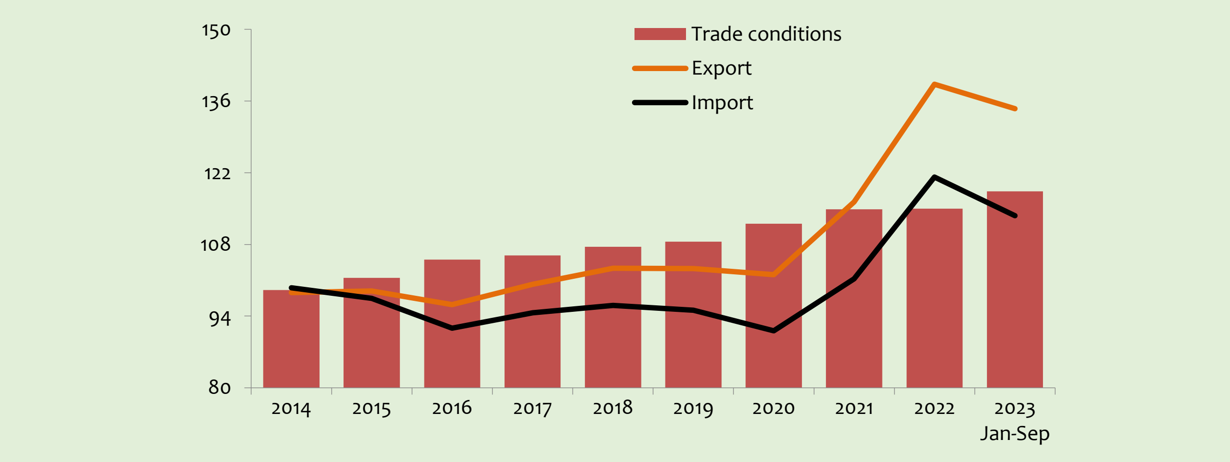
Trade conditions have been improving rapidly since 2016. In 2016-2019, the biggest impact on the export unit value and import price came from the fluctuations in prices of wood and its products, as well as coke and refined petroleum products. In 2020, trade conditions continued to improve with the import price index declining more rapidly than the export unit value index. In 2021, trade conditions still improved, and the unit value index for exported goods exceeded the price index for imported goods.

In 2022, trade conditions remained almost the same: the unit value index for exported goods was growing in the same way as the price index for imported goods – by 19.7% and 19.6%, respectively. The export unit value index was most affected by the increase in the unit value of mining of valuable minerals, wood and wood products, food products, agricultural products, coke and refined petroleum products, chemical substances and chemical products. The total import price index was most affected by the increase in prices of coke and refined petroleum products, food products, chemical substances and chemical products, base metals, as well as wood and wood products.

In 2023, trade conditions continued to improve with the import price index declining more rapidly than the export unit value index. In January-September 2023, the unit value of exported goods reduced by 3.5% compared to the relevant period of the year before, while the prices of imported goods – by 6.4%. The unit value index for exported goods exceeded the price index for imported goods by almost 21 percentage points. The total export unit value index was most affected by the drop in the unit value of agricultural products, mining of valuable minerals, wood and wood products, and chemical substances and chemical products. The total import price index was most affected by the drop in prices of coke and refined petroleum products, base metals, as well as chemical substances and chemical products. The biggest increasing effect came from the increase in both export unit value and import prices of food products.

Figure 6.9

**Export unit value and import price index and trade conditions**
*export unit values and import price index 2013 = 100; trade conditions as per cent*




## 6.2. BALANCE OF PAYMENTS

### CURRENT ACCOUNT

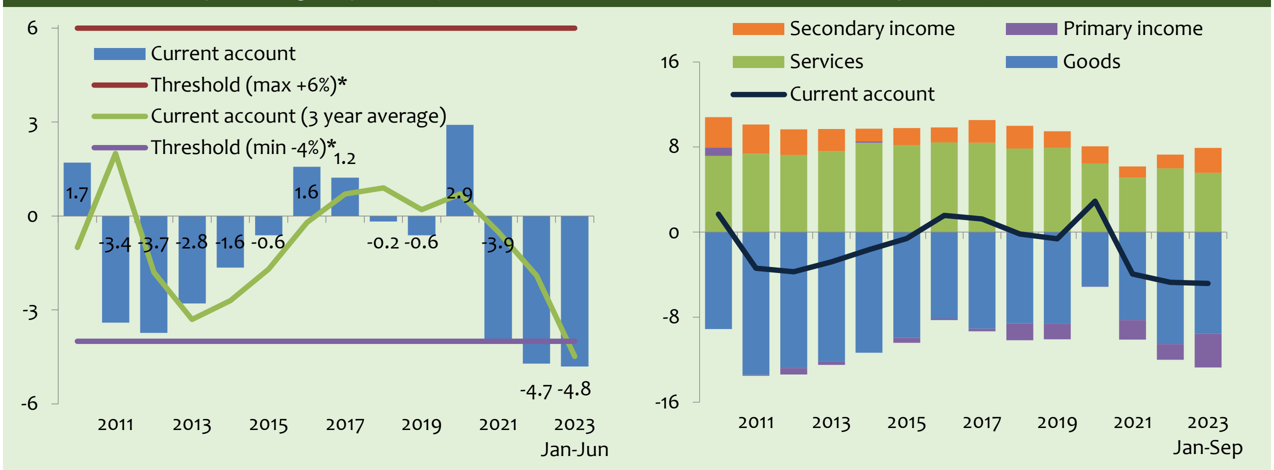
Since 2021, external shocks have led to an increase in the current account deficit. It was significantly influenced by the rise in energy prices, which began in the second half of 2021 as economic activity recovered, and rapidly increased in 2022 due to Russian aggression against Ukraine. The current account deficit remains at a relatively high level in 2023.

Before the COVID-19 pandemic (2015–2019), the current account balance was positive – 0.3% of GDP. Its fluctuations were moderate, yet the general trend was turned downwards – from a surplus of 1.6% of GDP in 2016 to a deficit of 0.6% of GDP in 2019.

Figure 6.10

**Current account balance**
*three-year average, as per cent of GDP*

**Current account by items**
*as per cent of GDP*




* Indicative threshold set in the EU alert mechanism

The reduction of the COVID-19 pandemic restrictions and the increase in economic activity caused significant corrections in the current account. The current account balance improved under the conditions of the rapid decline in global trade reaching a surplus of 2.9% of GDP in 2020. With economic activity and domestic demand increasing, in 2021 current account balance was negative – 3.9% of GDP. A downward trend was observed also in the following years, significantly affected by the changes in the geopolitics after the Russian invasion of Ukraine.

In 2022, the negative balance of the current account reached 4.7% of GDP, which is the highest level of deficit (calculated over the year) since 2009. The level of deficit remained high in 2023 as well. In the nine months of this year, it reached 4.8% of GDP mainly due to the increase in the negative balance of primary income.

Despite the increase in the current account deficit of the balance of payments, it will not exceed the indicative thresholds set in the EU Alert Mechanism and is evaluated as sustainable. However, it should be noted that with downward trends in the current account preserved, external imbalance risks are growing.

The state of the current account is mainly determined by changes in the balance of goods and services and, to a lesser degree, by net flows of primary income and secondary income.

Weakening of external trade flows has been observed in recent years. Economic shock was its main reason, first caused by the COVID-19 pandemic, then Russia's invasion of Ukraine, which enhanced the uncertainty of the external environment.

In the last five years before the COVID-19 pandemic (2015–2019) the external trade deficit was 8.9% of GDP on average. The COVID-19 pandemic containment measures had a strong impact on trade intensity. In 2020, imports of goods shrank due to low demand. The drop in imports along with stable goods export dynamics reduced the deficit of the external trade balance from 8.6% of GDP in 2019 to 5.1% of GDP in 2020. In the following two years, the export value of goods grew slightly faster than the import value, which also determined the increase in the foreign trade balance deficit. In 2021, the negative balance of external trade in goods increased to 8.3% of GDP.

Table 6.1

**Balance of payments of Latvia**
*as per cent of GDP*

| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 Jan-Sep |
|---|---|---|---|---|---|---|
| **Current account** | **-0.2** | **-0.6** | **2.9** | **-3.9** | **-4.7** | **-4.8** |
| Trade balance | -8.6 | -8.6 | -5.1 | -8.3 | -10.5 | -9.6 |
| *Export* | 43.2 | 41.7 | 44.7 | 48.6 | 53.4 | 45.8 |
| *Import* | 51.8 | 50.4 | 49.8 | 56.9 | 63.9 | 55.4 |
| Balance of services | 7.9 | 7.9 | 6.4 | 5.1 | 6.0 | 5.6 |
| Primary income | -1.6 | -1.5 | 0.0 | -1.9 | -1.5 | -3.2 |
| Secondary income | 2.1 | 1.5 | 1.6 | 1.1 | 1.3 | 2.4 |
| **Capital account** | **1.7** | **1.5** | **1.7** | **1.4** | **0.7** | **1.5** |
| **Financial account** | **2.3** | **1.2** | **6.1** | **-1.0** | **-1.4** | **-1.1** |
| Direct investment | -2.2 | -3.0 | -2.2 | -2.5 | -3.1 | -2.7 |
| *Assets* | -0.9 | 0.3 | 0.6 | 7.0 | -0.3 | 1.7 |
| *Liabilities* | 1.3 | 3.3 | 2.7 | 9.5 | 2.9 | 4.4 |
| Portfolio investment* | -4.3 | -1.8 | 13.1 | -0.8 | 3.5 | -3.4 |
| *Assets* | -3.7 | 1.0 | 10.4 | 0.6 | 3.7 | 0.2 |
| *Liabilities* | 0.6 | 2.8 | -2.7 | 1.5 | 0.2 | 3.6 |
| Other investment | 9.2 | 6.2 | -6.3 | 1.9 | -0.7 | 4.4 |
| *Assets* | -1.4 | 0.1 | -0.3 | 0.8 | 7.6 | 2.1 |
| *Liabilities* | -10.7 | -6.1 | 6.1 | -1.1 | 8.2 | -2.3 |
| Reserve assets | -0.4 | -0.3 | 1.5 | 0.4 | -1.1 | 0.5 |
| **Deviation** | **0.7** | **0.3** | **1.5** | **1.6** | **2.6** | **2.2** |

* Portfolio investment and financial derivatives

In 2022, high prices of energy sources and the need to change their sources of supply due to the Ukrainian war significantly increased the import value. As exports continued to grow at a slower pace than imports and the price increase had a greater impact on the prices of imported products, the trade deficit increased to 10.5% of GDP. In January-September 2023, export dynamics were more rapid than import dynamics, compared to the corresponding period of 2022, and the foreign trade deficit decreased to 9.6% of GDP.

The balance of services is positive in Latvia. In 2015-2019, the surplus of the balance of services was 8.2% of GDP on average. In the last three years (2020–2022), the positive balance of services was 5.1% of GDP on average, which is less than in the pre-pandemic years (8.1% of GDP on average).

In 2020, cross-border flows of services decreased considerably under the influence of the shock related to the COVID-19 pandemic. Movement restrictions and the cautious attitude of the population to leisure and business trips affected the drop in the value of trips and air and road transport services. Total exports of services decreased slightly more rapidly than imports, thus the surplus of the balance of services decreased from 7.9% of GDP in 2019 to 6.4% of GDP in 2020.

Although the partial cancellation of the pandemic restrictions contributed to an increase in exports and imports of services, in 2021 the surplus of the services balance continued to shrink, reaching 5.1% of GDP. In 2022, imports of services at current prices were 36% higher than a year ago, while exports increased slightly more moderately – by 35.6% and the surplus of the balance of services reached 6% of GDP.

In January-September 2023, compared to the corresponding period in the previous year, imports of services increased almost twice as rapidly as exports reducing the surplus of the balance of services to 5.6% of GDP.

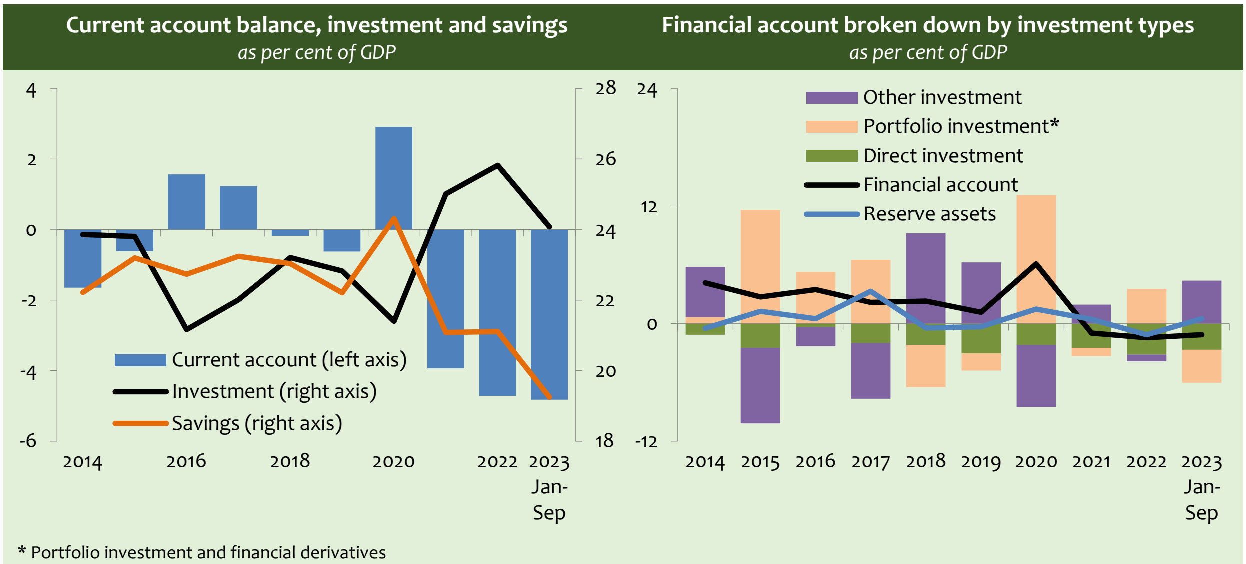
Overall, in the last three years (2020–2022), the positive balance of services was 5.8% of GDP on average, which is a 2.2 percentage points lower level than in the pre-pandemic years.

The primary income balance in the last three years (2020-2022) has been negative – 1.3% of GDP per year on average, which is slightly lower than in the years before the COVID-19 pandemic. The fluctuations in primary income balance were relatively small and were mainly driven by changes in non-residents' investment income. As the income earned by foreign investors in Latvia declined under the influence of the crisis; in 2020, the primary income balance was in balance. By contrast, in 2021 and 2022, the primary balance was already in deficit, 1.9% and 1.5% of GDP, respectively. In January-September 2023, the primary income balance deficit increased to 3.2% of GDP and was higher than a year ago (in January-September 2022 – 2.7% of GDP) driven by the increase in direct foreign investment earnings.

The condition of the secondary income and capital account is mainly affected by flows of EU funds, as well as Latvia's contributions to the EU budget. External shocks have not significantly affected the condition of the secondary income account. In the last three years (2020–2022) it had a surplus – 1.3% of GDP per year on average, which is equivalent to that in the years before the COVID-19 pandemic. The secondary income account balance was positive also in January-September 2023 – 2.4% of GDP.

The inflow of EU structural funds dominates in the capital account. Since 2020, the average capital account surplus has been 1.3% on average, including 0.7% of GDP in 2022. In January-September 2023, the capital account surplus increased reaching 1.5% of GDP. Changes in capital account surplus are mainly related to changes in EU structural funds financing.

Figure 6.11



The condition of the current account balance until 2019 proved that savings and domestic investments were balanced. In 2020, the current account surplus was determined by an increase in "forced" savings and a decrease in investments. On the other hand, since 2021, the increase in the current account deficit has been mainly affected by the increase in investment activities, while provisions decreased.

### CROSS-BORDER FINANCIAL FLOWS

In recent years, the status of the financial account balance has been determined by the geopolitical instability in the region, the restructuring of debts of the public sector, as well as the implementation of restrictive monetary policy by the ECB for combatting inflation.

From 2015 to 2019, external assets generally increased more than liabilities, and the financial account balance (assets less liabilities) was positive – 2.4% of GDP on average. In 2020, the positive financial account balance increased to 6.1% of GDP compared to 2019, which was significantly affected by the increase in assets of the Bank of Latvia and credit institutions in the form of portfolio investments. In 2021 and 2022, financial account assets grew more modestly than liabilities, which determined a negative financial account balance of 1.0% and 1.4% of GDP, respectively. The trends observed in the previous years were also present in 2023. In January-September of this year, the financial account balance (with reserve assets) was negative – -1.3% of GDP. The status of the balance of payment accounts in the near future will be determined by changes in the geopolitical situation and their impact on global supply chains, cross-border flows and the Latvian economy in general.

The **foreign gross debt of Latvia has slightly increased**. This was mainly due to an increase in long-term debt liabilities of the government. Moreover, foreign liabilities of non-financial corporations and households are declining. According to Latvia's international investment balance data, at the end of September 2023 gross external debt was almost 99.6% of GDP, including the government's gross external debt amounted to 11,127 million euro (27.5% of GDP). The balance of international investment at the end of September 2023 was -27% of GDP and did not exceed the indicative threshold defined in the EU Alert Mechanism (-35% of GDP). Since Latvia's liabilities mainly consist of government bonds and foreign direct investment, the balance of international investment is assessed as stable.

## 6.3. FOREIGN DIRECT INVESTMENT

In recent years, the intensity of foreign direct investment (FDI) flows in the world has been generally moderate. This was mainly affected by the COVID-19 pandemic containment restrictions, as well as instability in the global economy. The war in Ukraine increased the uncertainty caused by geopolitical events and caused a negative impact on global FDI flows.

The COVID-19 containment restrictions were a significant obstacle to cross-border investment flows. After a rapid drop in 2020 and a rapid rise in 2021, global foreign direct investment declined by 12% to 1.3 trillion US dollars in 2022. FDI cross-border flows were adversely affected by the war in Ukraine, high food and energy prices and growing public debt liabilities. International project financing was also severely constrained by tighter funding conditions, rising interest rates and uncertainty in capital markets. High geopolitical tensions were present also in 2023, adding to the uncertainty of the investment environment and sustaining weak FDI trends.

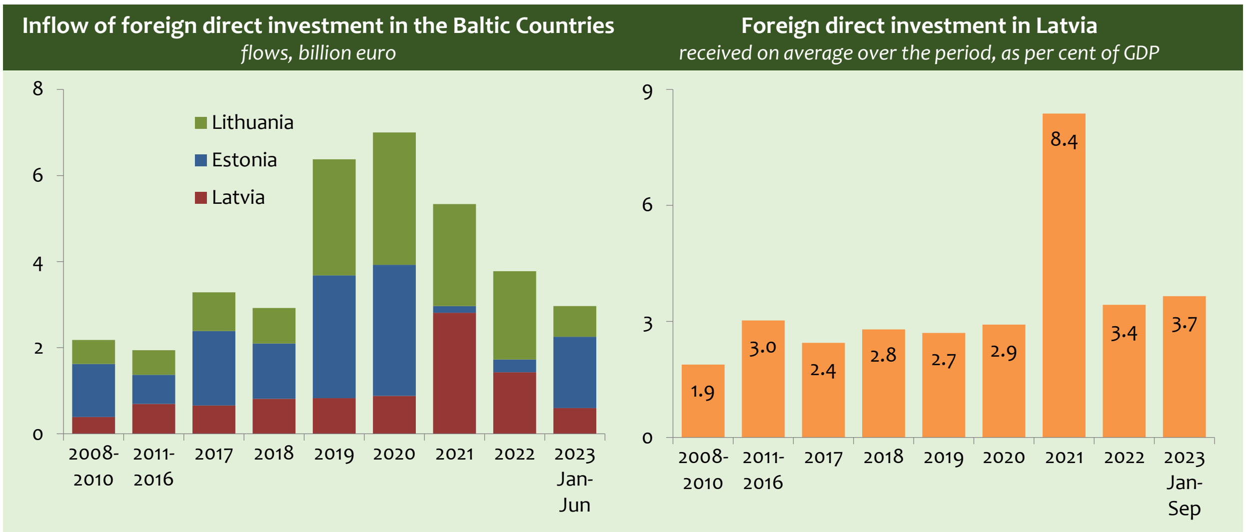
The intensity of FDI flows in EU countries remains low. In the last three years (2020–2022), compared to the years before the COVID-19 pandemic (2017–2019) the volume of attracted FDI was almost 88% lower. Moreover, in 2022, FDI flows in the EU countries were generally negative evidencing an outflow of capital.

Cross-border flows of direct investment in the Baltic States in the last three years were 35% higher than before the COVID-19 pandemic in 2017-2019. In the first half of 2023, total cross-border flows of direct investment in the Baltic States were more rapid than a year ago. They reached 4.2% of GDP, where most of FDI flows were in the Estonian economy. In January-June of this year, the Baltic States attracted 3 billion euro in net FDI flows. Almost 20% of the total amount of FDI transactions was in the Latvian economy. The share of Lithuania and Estonia in total FDI transactions amounted to 24% and 56%, respectively.

The impact of external shocks on FDI attraction in Latvia differed drastically. In the years of the global financial crisis (2008–2010), FDI flows declined almost by half and for a long time remained at a lower level than in the years of rapid growth (2004-2007). In recent years before the COVID-19 pandemic (2017-2019), FDI flows in the Latvian economy fluctuated within 2.4 to 2.9% of GDP on average annually. It should be noted that the intensity of FDI flows attracted to Latvia has not decreased in the years of the COVID-19 crisis. In 2021, net FDI flows attracted to Latvia amounted to 2,809 million euro, i.e., 1,929 million euro more than a year before. This was due to the extensive investments of the Swedish company

*Swedbank AB* in the equity capital of companies registered in Latvia. FDI flows attracted to the Latvian economy as a result of this transaction reached 8.4% of GDP. In 2022, attracted net FDI flows were by half smaller than a year before. The rapid decline in attracted FDI transactions is partly explained by the high base effect. Moreover, these trends were also driven by negative flows of investment in companies' equity in response to EU sanctions against Russia.

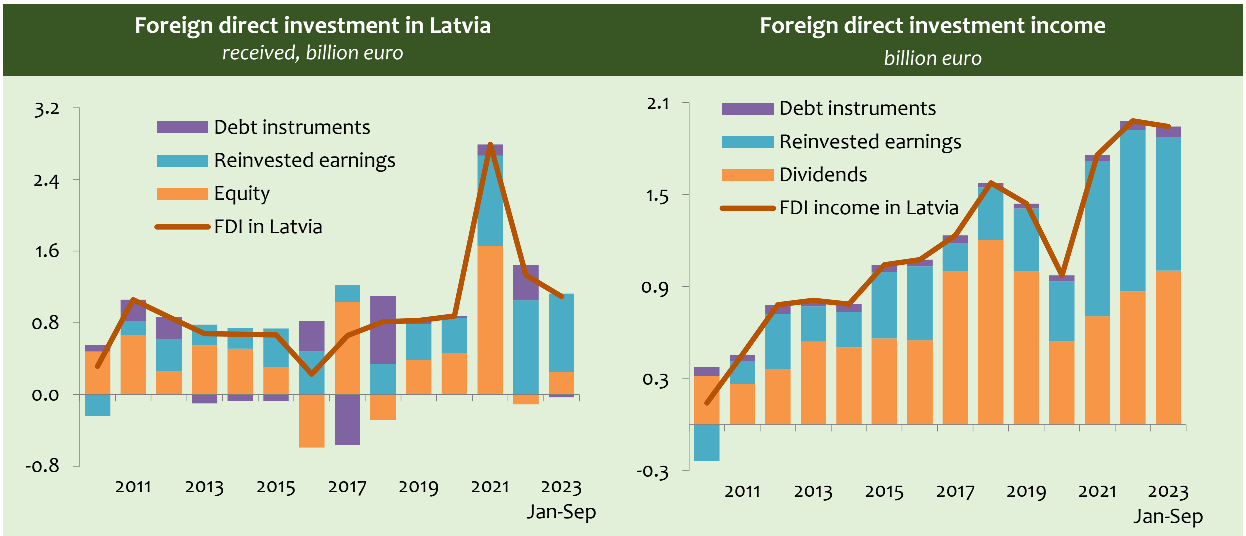
Figure 6.12




In January-September 2023, FDI transactions were slightly more moderate than a year before and amounted to 3.7% of GDP (in January-September 2022 – 4.5% of GDP). The largest inflow of foreign direct investment was in manufacturing, trade, financial services, as well as professional, scientific and technical activities.

The long-term income of foreign direct investors has a positive dynamic, reflecting the high profitability of FDI in Latvia. From 2010 to 2018, direct investment income in Latvia was growing by an average of 35% per year. After peaking in 2018 (5.4% of GDP), FDI income in Latvia decreased in 2019 and 2021, as economic growth slowed down. However, in the next two years, it almost doubled compared to 2020 and reached 5.2% of GDP. Weak economic activities have not had a significant impact on foreign direct investment income, and it has rather rapid dynamics in 2023. In January-September, compared to the corresponding period of the previous year, the income of foreign direct investors increased by 22.2% and amounted to 6.5% of GDP. Most of it was paid in dividends.

Figure 6.13



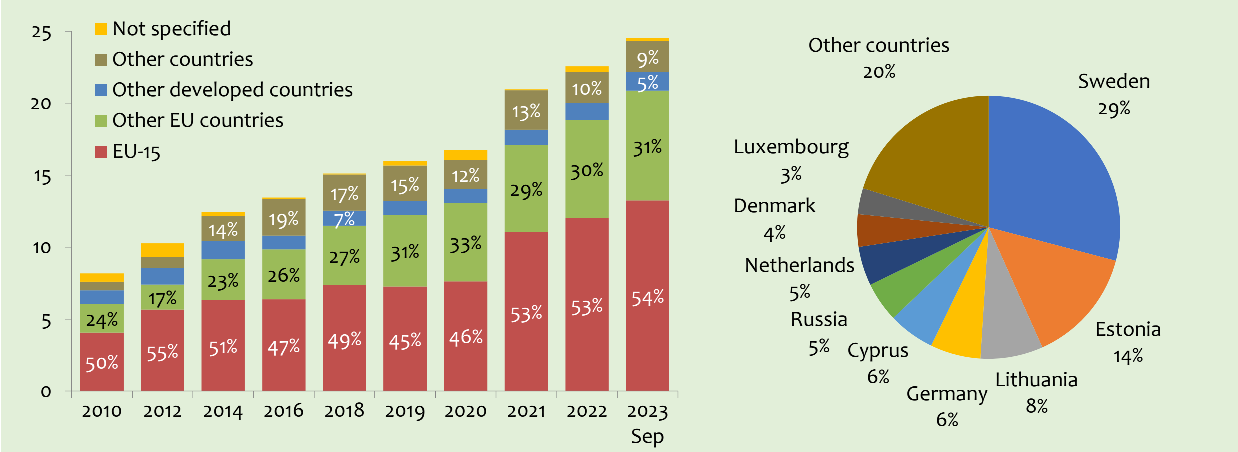

The amount of FDI accumulated in the Latvian economy is growing year on year. The amount of FDI accrued at the end of September 2023 reached 24.5 billion euro (61% of GDP). It increased by 8.8% compared to the end of 2022 mainly due to the increase in investments in professional, scientific and technical activities, as well as financial intermediation, trade and financial services sectors.

The geopolitical structure of FDI accrued is relatively stable. Investments of businesses from the EU countries dominate, amounting to 83.5% of the total FDI accrued in the Latvian economy at the end of September 2023.

Figure 6.14

**Foreign direct investment accrued in Latvia at the end of September 2023**

by groups of countries *million euro* | FDI by countries *accrued, as per cent*




Sweden is the largest investor in the economy of Latvia. The initiatives of its entrepreneurs reached almost 29.1% of total accrued FDI (16.5% at the end of 2020). Entrepreneurs from Estonia, Lithuania, Germany, Cyprus, Russia, the Netherlands, Denmark and Luxembourg also make extensive investments.

The introduction of sanctions against Russian affected investments of its businesses in the Latvian economy. At the end of September 2023, accrued direct investments of Russia were almost 35% lower than at the end of 2021. However, it should be noted that Russia is still the sixth largest investing country in the economy of Latvia by accrued FDI.

Investments by Lithuanian and Estonian businesses make up almost one-fifth of accrued FDI in Latvia. Activities of Latvian businessmen in the Baltic neighbouring countries are, on the contrary, much more moderate.

Table 6.2

**FDI by sectors**
*balances at the end of the period*

| | *million euro* | | | *structure, as per cent* | | |
|---|---|---|---|---|---|---|
| | 2019 | 2022 | 2023 Sep | 2012 | 2022 | 2023 Sep |
| Agriculture | 669 | 916 | 1015 | 4.2 | 4.1 | 4.1 |
| Manufacturing | 1906 | 2775 | 3112 | 11.9 | 12.3 | 12.7 |
| Other industry | 681 | 815 | 1084 | 4.2 | 3.6 | 4.4 |
| Construction | 471 | 432 | 419 | 2.6 | 1.9 | 1.7 |
| Trade and accommodation | 2722 | 3171 | 3498 | 17.0 | 14.1 | 14.3 |
| Transportation and storage | 789 | 757 | 799 | 4.9 | 3.4 | 3.3 |
| Financial intermediation | 3898 | 3477 | 3798 | 24.3 | 15.4 | 15.5 |
| Real estate activities | 2662 | 3204 | 3330 | 16.6 | 14.2 | 13.6 |
| Other services | 1190 | 5926 | 6547 | 7.4 | 26.3 | 26.7 |
| Unclassified activity | 1065 | 1093 | 942 | 6.6 | 4.8 | 3.8 |
| **Total** | **16 053** | **22 566** | **24 544** | **100** | **100** | **100** |

Most of FDI is attracted in service sectors. At the end of September 2023, the accrued FDI in the services activities constituted 77% of the accrued FDI in the economy of Latvia. It rose by 53.4%, compared to the end of 2019. At the same time, the structure of sectors of accrued FDI changed. At the end of 2021, the direct investment of Sweden in credit institutions of Baltic Countries was reoriented through a Latvia-registered undertaking because of the *Swedbank* group reorganisation strategy. Thus, foreign direct investment of Sweden in Latvia increased in professional services sector. The share of this sector in the total amount of accrued FDI increased to 21.5% at the end of September 2023 (1.7% – at the end of 2019).

Almost 55% of accrued FDI in service sectors are investments in financial intermediation, real estate and trade activities. Investment dynamics in these sectors are generally positive (except financial intermediation). Since the end of 2019, the volume of accrued foreign investments in this sector has reduced by 2.6%.

At the end of September 2023, the accrued FDI in goods-producing sectors amounted to 23%. Almost 12.7% of total accrued FDI was invested in manufacturing and mainly in traditional sectors. Only one-fifth of accrued FDI in manufacturing was invested in high-technology and medium-high-technology sectors evidencing of low attractiveness of these activities for foreign capital. Since the end 2019, the amount of accrued FDI in manufacturing has increased by 63.3%. Although the FDI attraction dynamics are positive, the volume of FDI accrued in manufacturing in Latvia is smaller than in Lithuania and Estonia.

In the nearest years, FDI flow intensity will most probably be moderate. This will largely be driven by the geopolitical tension maintaining uncertainty in the investment environment. An active FDI attraction policy will be particularly important under the conditions of high uncertainty.

The Investment and Development Agency of Latvia (LIAA) plays a major role in the attraction of foreign investment in Latvia. The strategy of the LIAA for attracting investment is oriented towards qualitative servicing of incoming investment projects and active action 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 in Latvia conducted by the FICIL make it an important contribution to the improvement of the investment environment. (For details about FDI attraction policy see Chapter 11.3.)

## 6.4. MONETARY INDICATORS

The banking sector has managed to maintain its stability after the economic and geopolitical shock caused by the COVID-19 pandemic and Russia's invasion of Ukraine and is working with profit. The development of lending is still evaluated as weak – lending to businesses is developing irregularly, while lending to households has positive signs. Deposit volumes continue to rise.

In accordance with the information from the Bank of Latvia, bank profitability has been improving in recent years. The bank sector's profit performance has increased significantly due to the increase in credit rates caused by the ECB's policy to combat inflation. In the first half of 2023, the profit of the banking sector reached 350.3 billion euro, which is 2.6 times higher than the indicator of the first half of 2022. The banks' windfall profits suggested a broader discussion about their taxation. Several EU Member States have introduced additional taxes. Amendments to the Corporate Income Tax Law have been adopted in Latvia, which provides for introducing a mandatory advance payment for banks.

Overall, 9 banks and 4 branches of EU banks are operating in Latvia. The capitalisation level of the banking sector remained high. In Q2 2023, the average capital adequacy ratio of the banking sector reached 21.56% (24% – a year ago). The return on assets (ROA)[1] and the return on equity (ROE)[2] of the banking sector increased and were 2.56% and 23.01%, respectively (1.03% and 8.6% – a year ago).

The increase in the assets of Latvian banks has been seen since Q3 of 2018. This trend continued in 2023 and at the end of Q2 banks' assets were 3.7% higher than a year before amounting to 27.2 billion euro The share of non-bank credits in total assets amounted to 56.5%, remaining at the level of the previous year. The share of debt securities amounted to 9.8% or 2.3 percentage points down compared to the previous year.

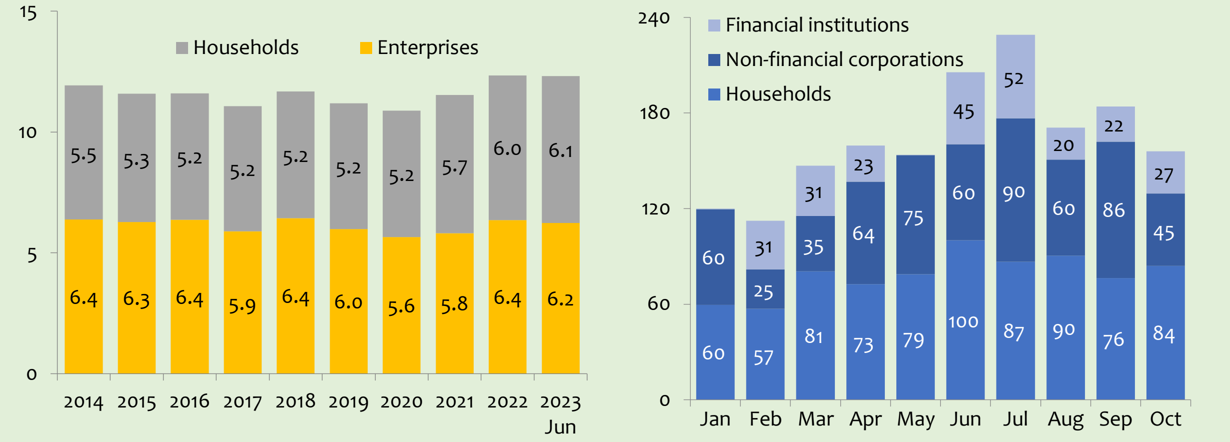
Although the volume of issued loans is gradually growing, the development of lending is still generally evaluated as weak. According to the data of the Bank of Latvia, outstanding amounts of loans to non-banks in Q2 2023 were 3.3% higher than at the end of the respective period in the previous year. The domestic lending portfolio increased by 4.1% during this year. The credit portfolio of non-financial corporations increased at the same pace but lending to small and medium-sized enterprises developed slower. The increase rates of lending to households were also slower, 3.5% during the year.

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

Figure 6.15

**Credit portfolio of households and non-financial corporations**
*at the end of the period, billion euro*

**New loans granted to residents by category of borrowers**
*2023, million euro*




Source: Bank of Latvia

The overall dynamics of the credit portfolio of households are positive. Most of the loans granted to households are loans for house purchase, reconstruction and repair. The impact of the consequences of the COVID-19 pandemic on lending to households was smaller than on lending to businesses.

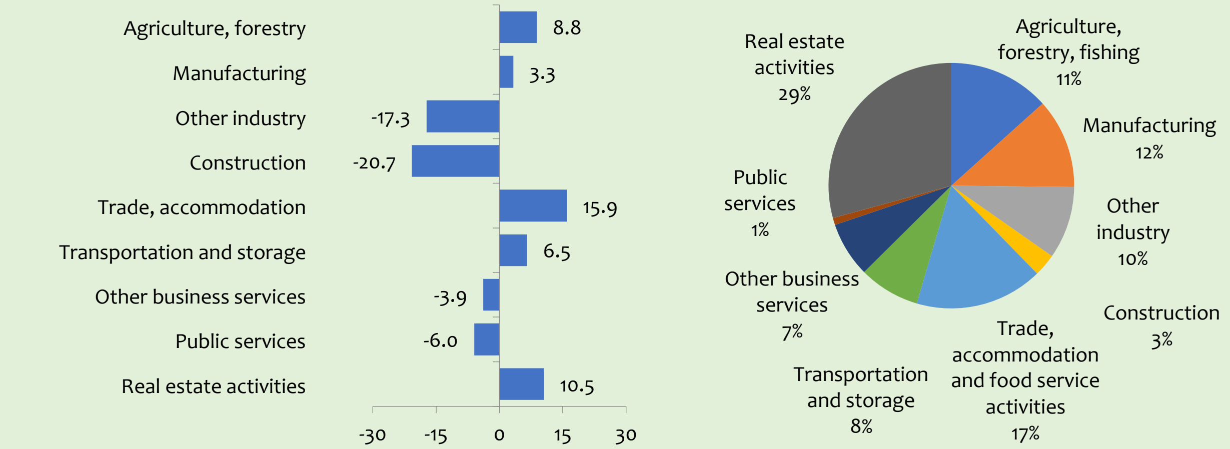
Lending to businesses is still developing slowly and unevenly. The ability of entrepreneurs to borrow has reduced in the sectors most affected by the pandemic (accommodation and food service activities, as well as transportation and storage). This, in turn, had a negative effect on the volume of investments. Overcoming the crisis caused by the pandemic and the improvement of the economic situation also had a positive impact on the lending dynamics of enterprises. At the end of Q2 2023, the balances of credits issued to non-financial corporations were 4.1% higher than a year before.

Figure 6.16

**Loans for domestic non-financial corporations by sectors of economy**

*changes, at the end of Q2 2023, compared to the end of Q2 2022, as per cent*

*structure, at the end of Q2 2022, as per cent*

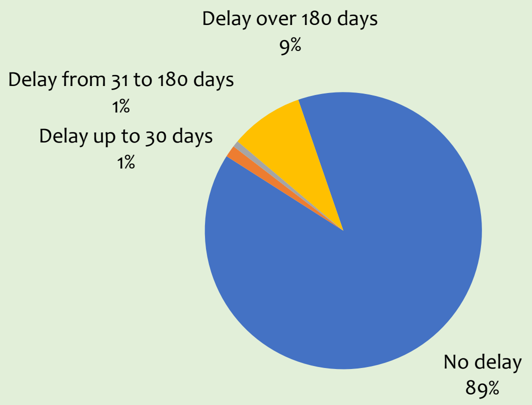



Source: Bank of Latvia

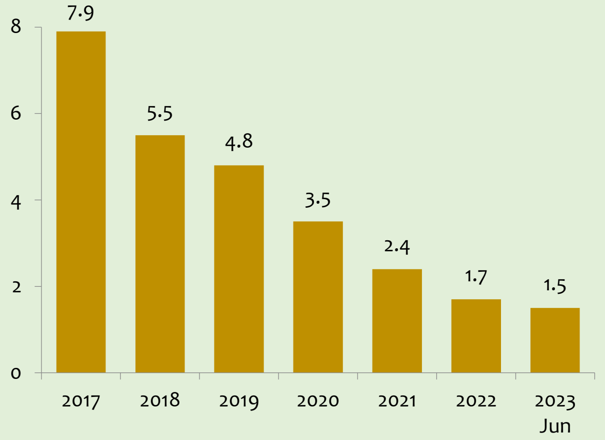
When looking at the credit portfolio of sectors, real estate activities (29.2% of issued loans) and trade (14.1% of issued loans) remained leaders at the end of Q2 2023. These sectors were also growing rather rapidly during the year. It should be noted that the share of non-performing loans is gradually shrinking. 1.8% of loans granted to domestic non-financial corporations are non-performing loans (2.8% at the end of Q2 2022).

Figure 6.17

**Structure of overdue liability payment days**
*as a share of liability balance in Ocober 2023, as per cent*




**Share of non-performing loans in the portfolio of domestic non-bank customers**
*as per cent*




Source: Bank of Latvia

**New lending** is developing moderately. Loans amounting to 158.9 million euro were newly issued in October 2023. The amount of loans issued to households amounted to 84.1 million euro. Most of them or 70.6% were mortgage loans for purchasing housing, and the share of loans issued for purchasing consumer goods was 25.6%.

The development of lending to businesses is uneven. The Credit Register Data evidence that loans amounting to 45.4 million euro were newly issued to non-financial corporations in October 2023. Most or almost 2/3 of these loans have been issued to microenterprises and 1/4 to large enterprises. During this year, most new loans across sectors have been issued for financial and insurance activities, transportation and storage, as well as real estate activities.

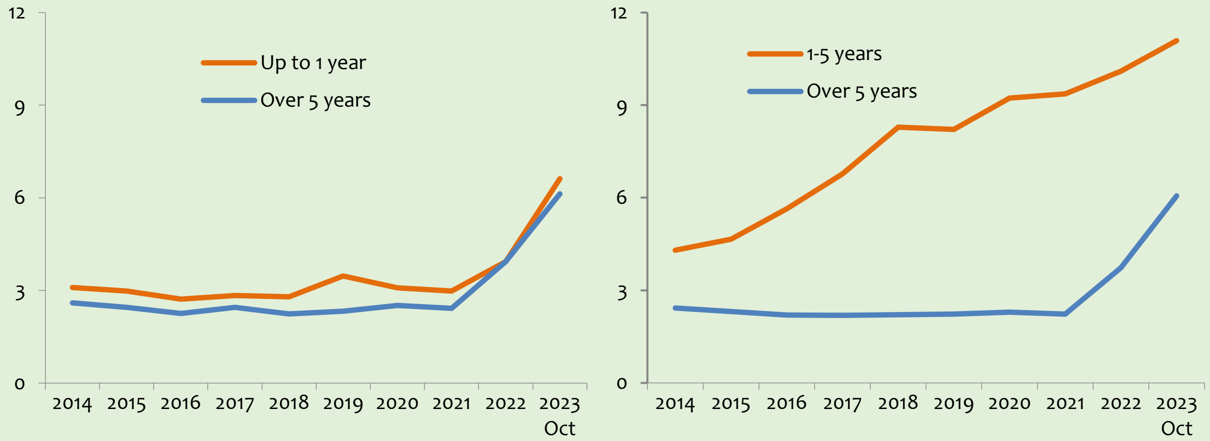
Before the pandemic, the **quality of the credit portfolio** had been gradually improving since 2011, mainly due to the improvement of the economic situation and writing off bad debts. The quality of the credit portfolio remained high also during the pandemic. The situation was improved by the credit moratorium and other solutions offered by banks implemented for the support of borrowers and therefore they helped entrepreneurs and households to overcome short-term liquidity problems. In October 2023, 10.5% of the total bank loan portfolio constituted liabilities with payment delays, most of which (8.5%) were with a delay longer than 180 days. It should be noted that the quality of the loan portfolio keeps improving.

Figure 6.18

**Weighted average interest (outstanding amounts) rates on loans granted in euro in credit institutions**
*at the end of the period, as per cent*

Non-financial corporations

Households – for house purchase




Source: Bank of Latvia

During the last decade, **interest rates** (on outstanding amounts) for credits granted to non-financial corporations – long-term and short-term – were very stable until 2022, when their rapid increase started. Long-term interest rates increased from 2.4% at the end of 2021 to 6.1% in October 2023; the dynamics of short-term rates during this time were from 3.0% to 6.6%. Similar trends were observed in the dynamics of long-term interest rates of credits granted to households for purchasing housing. The increase was from 2.2% at the end of 2021 to 6.1% in October 2023. On the other hand, short-term (1-5 years) credit rates have been showing a stable upward trend in the last decade. The significant increase in credit rates over the past two years was triggered by the ECB's decisions to raise base interest rates to curb inflation.

In Latvia, most mortgage loans issued to households have a variable interest rate linked to the EURIBOR reference interest rate. Due to its rise, households have experienced quite significant increases in interest payments on loans. To partially compensate for the increased loan payments, the Saeima has adopted amendments to the Consumer Rights Protection Law, which provides for compensation of 30% of mortgage interest payments in 2024. The compensation may not exceed two percentage points of the total borrowing rate fixed for the period. A mortgagee protection fee will be introduced for credit institutions to finance it.

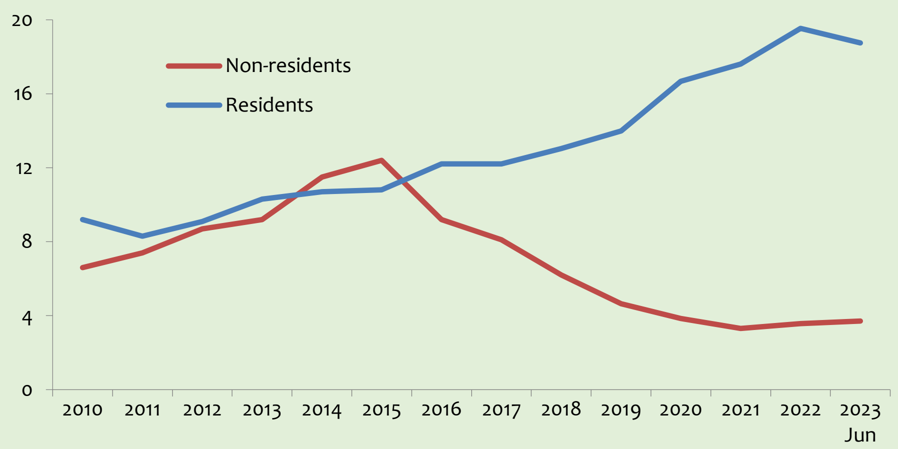
A more rapid increase in **deposit volumes** started in Q2 2020, which coincided with the onset of the COVID-19 crisis, when the population was more cautious in its spending and was more inclined to make savings because of the uncertainty of future economic developments. The formation of savings was also boosted by the limited opportunities to spend due to the restrictions on trade in the country. Since 2021, deposit increase rates have increased significantly along with the increase in spending of the population. At the end of the first half of 2023, deposits amounted to 22.4 billion euro.

The structure of deposits by customer nationality has experienced significant changes. The share of deposits of non-residents has shrunk from 53% in Q2 2015 to 16.5% in Q2 2023. The balance of deposits of non-residents in Q2 2023 amounted to 3.7 billion euro, which is 4.9% more than a year before. On the other hand, deposits of non-residents from non-EU countries decreased by 24.3% during this time. Higher requirements for liquidity and capital adequacy are set for the banks working with non-resident deposits. Small commercial institutions mainly work with the money of non-residents in Latvia.

When looking at the volume of resident deposits, generally positive dynamics can be seen during the year. In Q2 2023, the growth rate was 4.3% compared to the corresponding period of 2022. Banks attracted 18.7 billion euro in deposits of residents during this time.

Figure 6.19

**Non-bank deposits at banks**
*billion euro*




Source: *Bank of Latvia*

Overall, in the financial sector, as in other sectors, further development of the situation will depend on the stabilisation of the economic situation in the region and the world in general and the effectiveness of the policy measured implemented by the ECB to combat inflation.

## 6.5. FISCAL POLICY AND PUBLIC DEBT

The COVID-19 pandemic led to significant changes in the fiscal policy that has been implemented so far, which is based on meeting the structural deficit target, i.e., -0.5% of GDP. In 2020*, the general escape clause of the Stability and Growth Pact (SGP*) was activated in the EU, enabling EU countries to increase their general government deficits in 2020-2022 to the extent necessary to mitigate the economic harm caused by the pandemic. Given Russia's invasion of Ukraine war and all the related consequences, the general exception clause of the SGP also remained in force in 2023, which actually means that fiscal (budgetary) numeric conditions are not in force in EU Member States and EU Member States should observe recommendations of the EU Council. The general escape clause has been cancelled starting from 2024.

Table 6.3

**General government budget**

| | billion euro | | | | | as per cent of GDP | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2018 | 2019 | 2020 | 2021 | 2022 | 2018 | 2019 | 2020 | 2021 | 2022 |
| Revenue | 11.2 | 11.6 | 11.5 | 12.5 | 13.9 | 38.5 | 37.9 | 38.0 | 37.5 | 35.8 |
| Expenditure | 11.5 | 11.7 | 12.8 | 14.9 | 15.7 | 39.3 | 38.4 | 42.5 | 44.7 | 40.4 |
| Balance | -0.2 | -0.1 | -1.3 | -2.4 | -1.8 | -0.7 | -0.5 | -4.5 | -7.2 | -4.6 |

The EU Council's country-specific recommendations for Latvia 2023 concerning the fiscal policy, among other things, recommend: "Ensure prudent fiscal policy, in particular by limiting the nominal increase in nationally financed net primary expenditure in 2024 to not more than 3.0%. For the period beyond 2024, continue to pursue a medium-term fiscal strategy of gradual and sustainable consolidation, combined with investments and reforms conducive to higher sustainable growth, to achieve a prudent medium-term fiscal position.".

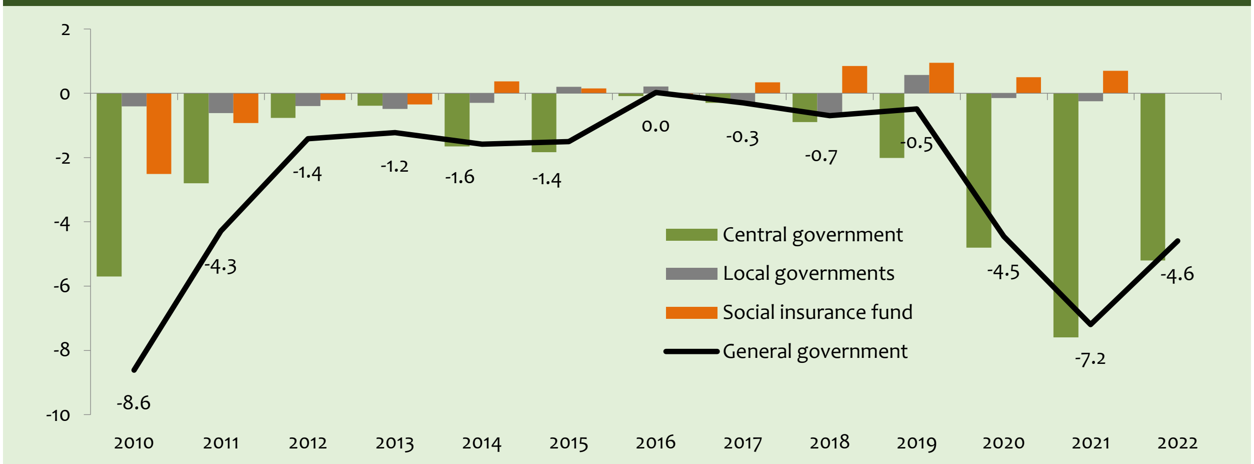
Due to the COVID-19 pandemic, the budget deficit in Latvia increased to 4.5% of GDP or 1.3 billion euro in 2020 and to 7.2% of GDP or 2.4 billion euro in 2021. It slightly reduced in 2022 and was 4.6% of GDP or 1.8 billion euro (see Table 6.3).

The Saeima approved the budget for 2023 with a deficit of 4.2% of GDP or 1.77 billion euro. In accordance with the MoF assessment prepared in October 2023, the general government budget deficit in 2023 is expected at 2.7% of GDP, revenue – 37.1% and expenditure – 39.8% of GDP.

In 2022, the budget deficit was in the central government budget. There was a surplus in the Social Insurance Fund and the local government budget (see Figure 6.20).

Figure 6.20

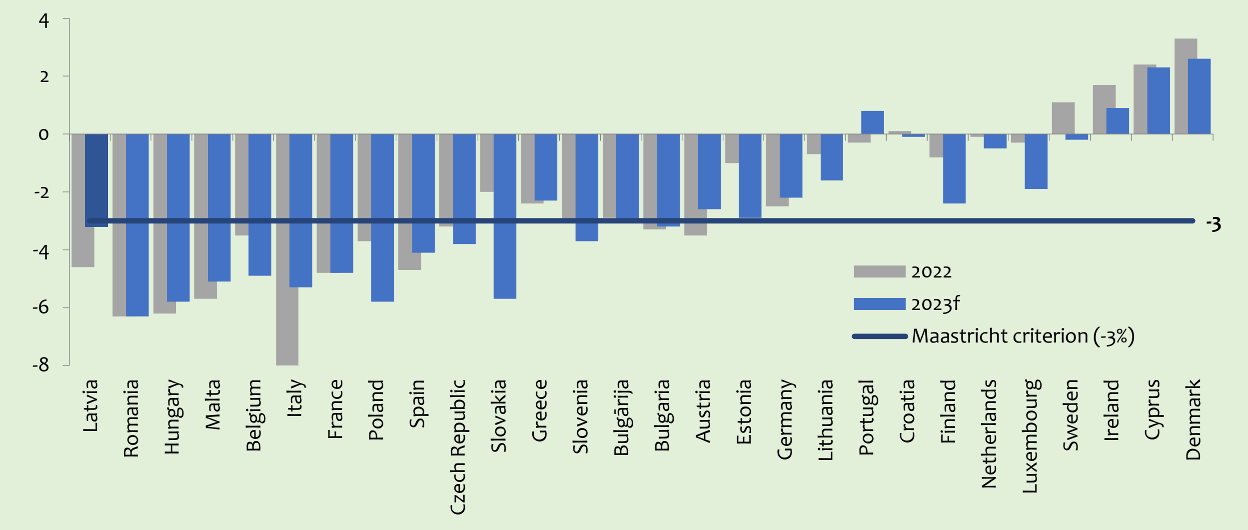
**General government budget balance by sub-sectors**
*as per cent of GDP*




According to Figure 6.21, in 2022, the Latvian budget balance to GDP showed a higher deficit than average in EU countries. In 2022, the general budget deficit of EU countries amounted to 3.3% of GDP. It was the highest in Italy, Romania, Hungary and Malta (5.7% or more in all of them). There was a deficit in 22 EU Member States. The budget had a surplus in five EU Member States.

Figure 6.21

**General government budget balance in the EU member States in 2022 and 2023 as per cent of GDP**




f – forecast of the EC

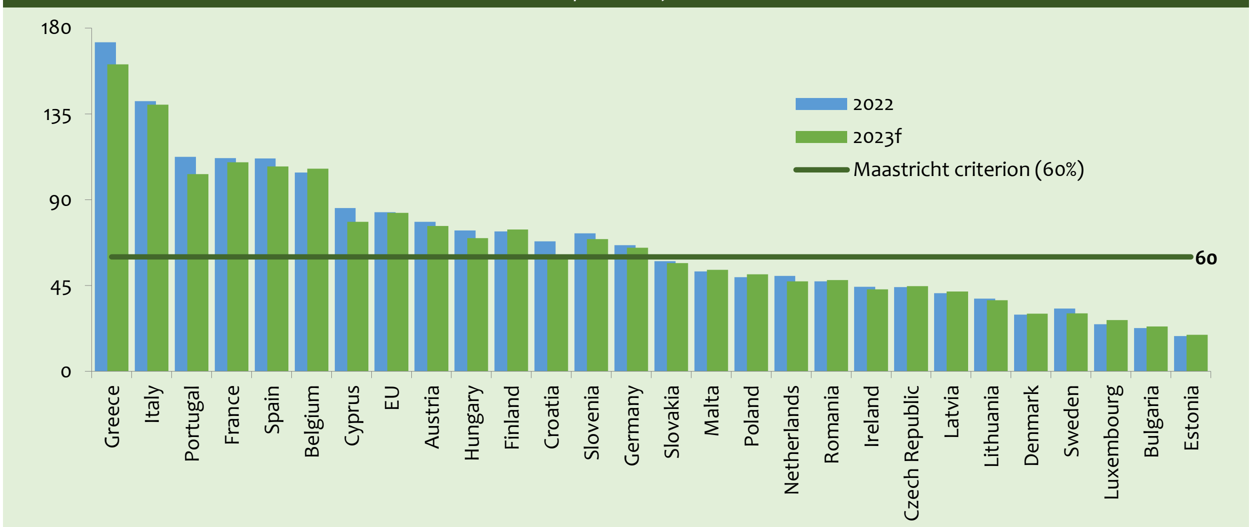
In accordance with the EC's forecasts in autumn 2023, the average level of budget deficit in the EU is expected to be 3.2% of GDP in 2023 and 2.8% in 2024. The highest budget deficit in 2023, which may exceed 5.5% of GDP, is expected in Romania, Slovakia, Hungary, and Poland.

On 1 November 2023, the Cabinet of Ministers approved the draft law on the state budget for 2024. The state budget for 2024 was prepared taking into account the EU fiscal provisions and provisions of the Fiscal Discipline Law – the general government budget is estimated to be 2.8% of GDP in 2024, 2.3% of GDP in 2025 and 0.9% of GDP in 2026. In 2024, the total general government budget revenue is planned to be 17.8 billion euro, while expenditure – 19.1 billion euro.

The **general government debt** in Latvia is still among the EU's lowest (see Figure 6.22).

Figure 6.22

**General government budget balance in the EU member States in 2022 and 2023**
*as per cent of GDP*

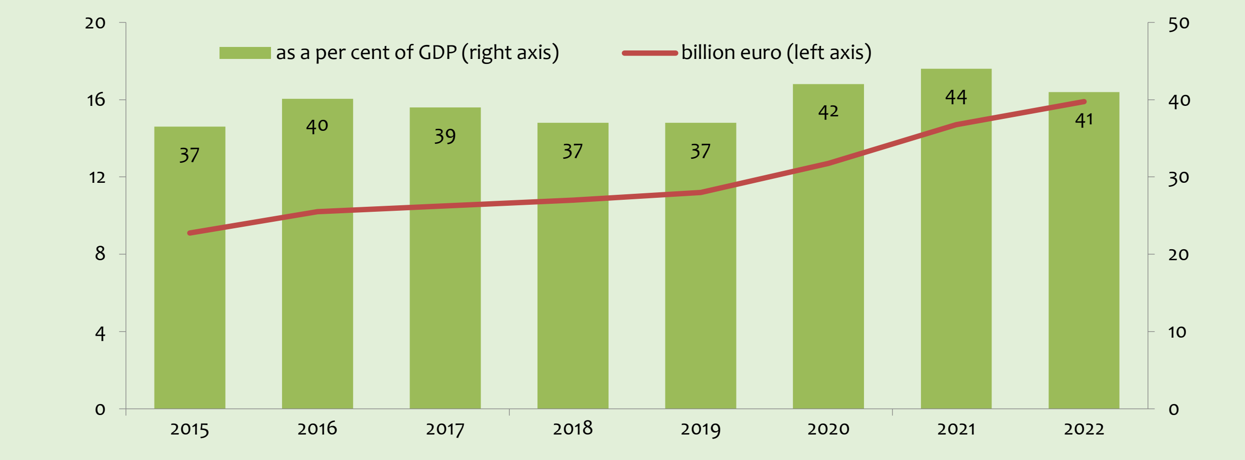



f – forecast of the EC

The average level of public debt in the EU in 2022 was 83.5% of GDP (in 2021 – 87.4% of GDP). In 2022, across 13 EU Member States, the public debt exceeded the Maastricht criterion, which is 60% of GDP. The highest public debt to GDP in 2022 was in Greece, Italy, Portugal, France and Spain, where it exceeded 110% of GDP. The lowest general government debt to GDP was registered in Estonia, Bulgaria, and Luxembourg. As indicated by the EC forecasts for autumn 2023, the average level of public debt in the EU will slightly reduce to 83.1% of GDP in 2023 and to 82.7% in 2024.

Figure 6.23

**General government consolidated gross debt by nominal value at the end of the year**




Similarly to other EU Member States, in Latvia, the outbreak of COVID-19 caused the need to provide considerable amounts of funding to mitigate the impact caused by the pandemic crisis. The government debt increased to 42.0% of GDP or 12.7 billion euro in 2020 and continued to increase to 44% of GDP or 14.7 billion euro in 2021. Since the nominal GDP increase under high inflation conditions is rapid, then its ratio to GDP in 2022 reduced to 41% but increased to 15.9 billion euro in nominal terms (see Figure 6.23).

According to the MoF assessment, government debt is expected to be 39.9% of GDP in 2023. For 2024, it is expected to be 41.0% of GDP.

The debt provision of 60% of GDP defined in the Fiscal Discipline Law is expected to be observed in the medium term, and Latvian general government debt will stabilise at a level below 40% of GDP.

## 6.6. BUDGET REVENUE AND EXPENDITURE

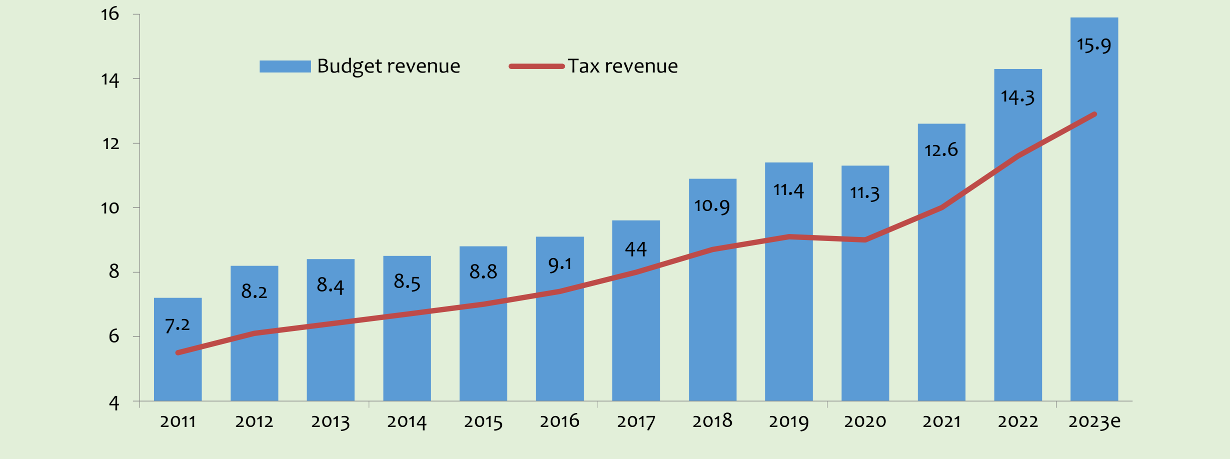
### BUDGET REVENUE[1]

Since 2011, as the economic situation has improved after the economic crisis, the budget revenue has increased. From 2010 to 2022, consolidated general budget revenue increased 2.2 times. In 2022, budget revenue amounted to 14.3 billion euro or 1.7 billion euro more compared to the previous year. The budget revenue growth trend continues also in 2023, and in January-October 2022 it was 10.3% higher than in the respective period of the previous year.

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

Figure 6.24

**General government consolidated budget revenues**
*billion euro*




e – evaluation by the MoE

Tax revenue is the main revenue item and constitutes approximately 4/5 of all budget revenue. A stable increase in this revenue was observed in 2011-2019. In 2020, there was a small reduction in tax revenue due to the COVID-19 pandemic, and the growth trend has resumed since 2021.

In recent years **employment taxes** have accounted for approximately half of all tax revenue. After the fall caused by the COVID-19 pandemic in 2020, employment tax revenue has been growing in the following years.

In 2012-2019, personal income tax revenue increased, primarily affected by improvements of the situation in the labour market. After the fall in 2020, positive dynamics resumed in 2021. In January-October 2023, personal income tax revenue was 9.5% higher than in January-October 2022. In January-October 2023, revenue from mandatory state social insurance contributions increased by 8.6%, compared to the corresponding period of 2022.

Table 6.4

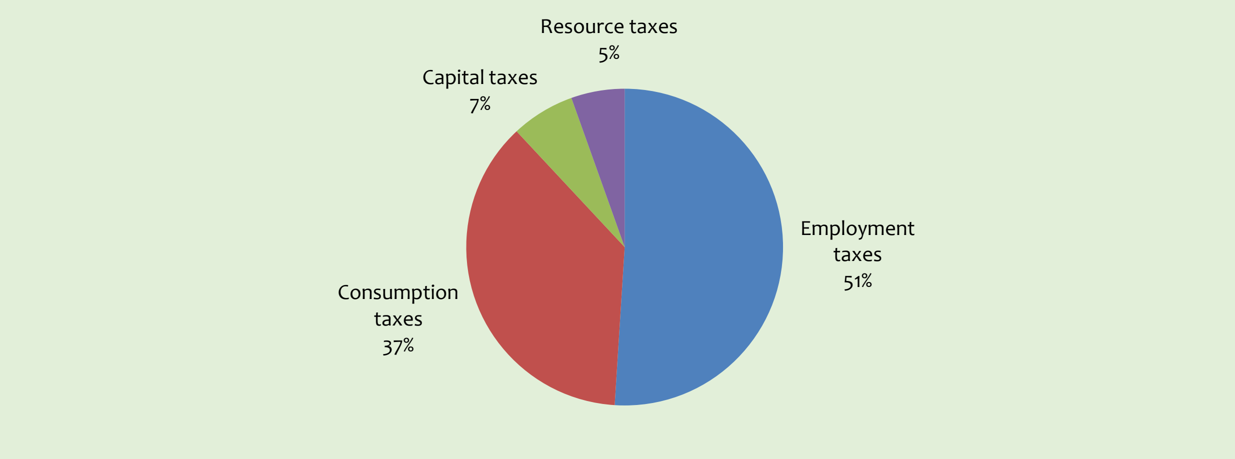
**Budget revenue**
*as per cent of GDP*

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 Jan-Sep |
|---|---|---|---|---|---|---|---|
| **General government consolidated budget revenues** | **35.7** | **37.3** | **37.3** | **37.7** | **37.6** | **36.8** | **38.9** |
| **I Tax revenues** | **29.7** | **29.7** | **29.6** | **29.9** | **30.1** | **29.7** | **31.2** |
| *1. Indirect taxes* | 11.6 | 12.1 | 12.3 | 12.1 | 11.8 | 12.3 | 12.8 |
| – value-added tax | 8.1 | 8.4 | 8.7 | 8.5 | 8.3 | 9.2 | 9.8 |
| – excise tax | 3.4 | 3.5 | 3.5 | 3.5 | 3.3 | 2.9 | 3.0 |
| – customs duty | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 |
| *2. Income taxes and property taxes* | 8.7 | 7.7 | 7.2 | 7.5 | 7.3 | 7.4 | 8.2 |
| – corporate income tax | 1.6 | 1.0 | 0.1 | 0.7 | 0.8 | 1.0 | 1.5 |
| – personal income tax | 6.3 | 5.9 | 6.3 | 6.0 | 5.8 | 5.8 | 6.0 |
| – real estate tax | 0.8 | 0.8 | 0.7 | 0.7 | 0.7 | 0.6 | 0.7 |
| *3. Social insurance contributions* | 8.6 | 9.1 | 9.5 | 9.7 | 9.4 | 9.4 | 10.1 |
| *4. Other taxes* | 0.8 | 0.7 | 0.7 | 0.6 | 0.6 | 0.6 | 0.6 |
| **II Other revenues** | **6.0** | **7.6** | **7.7** | **7.8** | **7.6** | **7.0** | **7.7** |

**Consumption tax** revenue constitutes slightly more than 1/3 of all tax revenue. In recent years, consumption tax revenue has increased due to the rise in private consumption and, consequently, the increase in retail turnover. In January-October 2023, consumption tax revenue was 11.4% higher compared to the corresponding period of 2022.

Figure 6.25

**General government consolidated budget tax revenues by tax groups**
*January-October 2023, as per cent*




In 2023, the increase of excise duty on tobacco products and non-alcoholic sweetened beverages, liquids used for electronic smoking devices and tobacco replacement products continued.

From 2010 to 2019, value added tax revenue increased. After the fall in 2020, the increase resumed the following year. In January-October 2023, the growth rate was 14.1% compared to January-October 2022. A similar trend is observed in the area of the consumption part of the excise tax revenue, but with a slower growth rate.

**Capital tax** revenue increased until 2017. The reduction in 2018 and 2019 was underpinned by the changes made within the tax reform in the field of corporate income tax. In 2020, capital tax revenue resumed growth. In January-October 2023, corporate income tax and real estate tax revenue have increased exceeding the indicator of January-October of the previous year – by 47.8% and 3.1%, respectively.

Since 2010, **resource tax** revenue has been growing. Growth trends are observed in revenue from natural resource tax and excise tax on petroleum products and natural gas. Resource tax revenue in January-October 2023 was 3.5% higher than in the respective period of 2022.

## BUDGET EXPENDITURE

Since 2011, after an extensive cutting down of expenditure during the economic crisis, the **general government consolidated budget expenditure** has gradually increased (barring 2016, when general government budget expenditure slightly declined). It was 15.7 billion euro in 2022 – 9.2% more than in the previous year. The increase continued also in 2023. In January-October, general government consolidated budget expenditure increased by 6.7%. The dynamics of budget expenditure items were driven by fewer funds channelled for support measures than in the previous years and much better absorption of EU funds, as well as growing expenditure on remuneration. The channelling of funds for COVID-19 support measures shrank considerably, while support for compensation of energy prices and support to Ukraine remained the same.

Since 2011, **current expenditure** has been growing. In January-October 2023, this expenditure group was 3.3% higher than in January-October 2022.

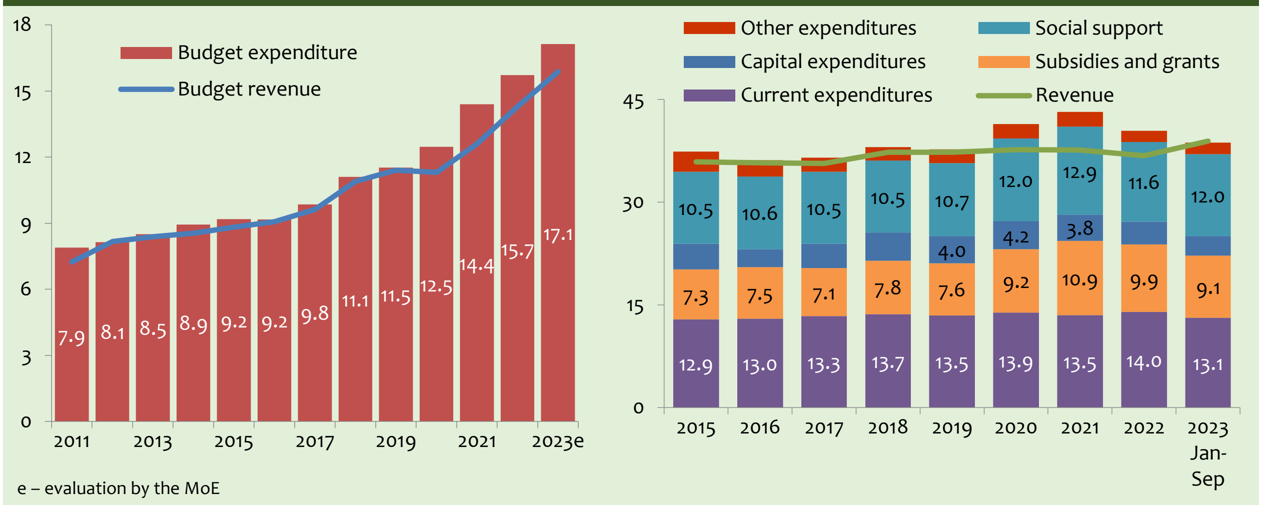
Since 2016, **expenditure on subsidies and grants** has been growing. In January-October 2023, the growth trend has continued – up 7% compared to the corresponding period of 2022.

**Capital expenditure** growth has been observed since 2017. This trend continues in January-October 2023. Expenditure of this group increased by 17.2%. It was driven by the much more intensive absorption of EU Funds.

Figure 6.26

**General government consolidated budget expenditure**

*billion euro* *as per cent of GDP*

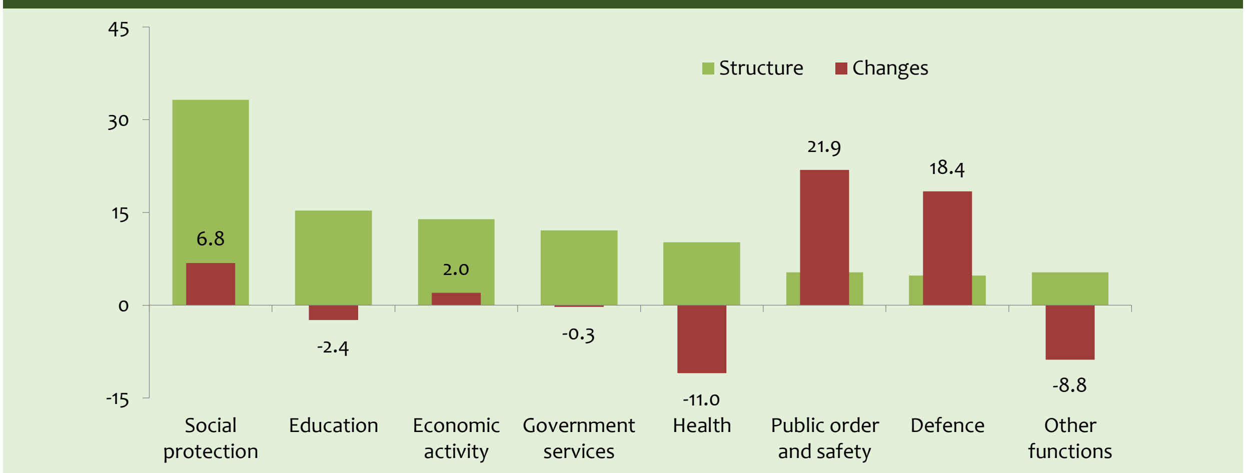



The factors affecting budget expenditure have introduced changes also in the structure of expenditure by functional categories. In January-October 2023, a more rapid increase has been observed in areas like public order and safety activities, defence, as well as social protection.

Figure 6.27

**General government consolidated budget expenditure by function in January-October 2023**

*as per cent*



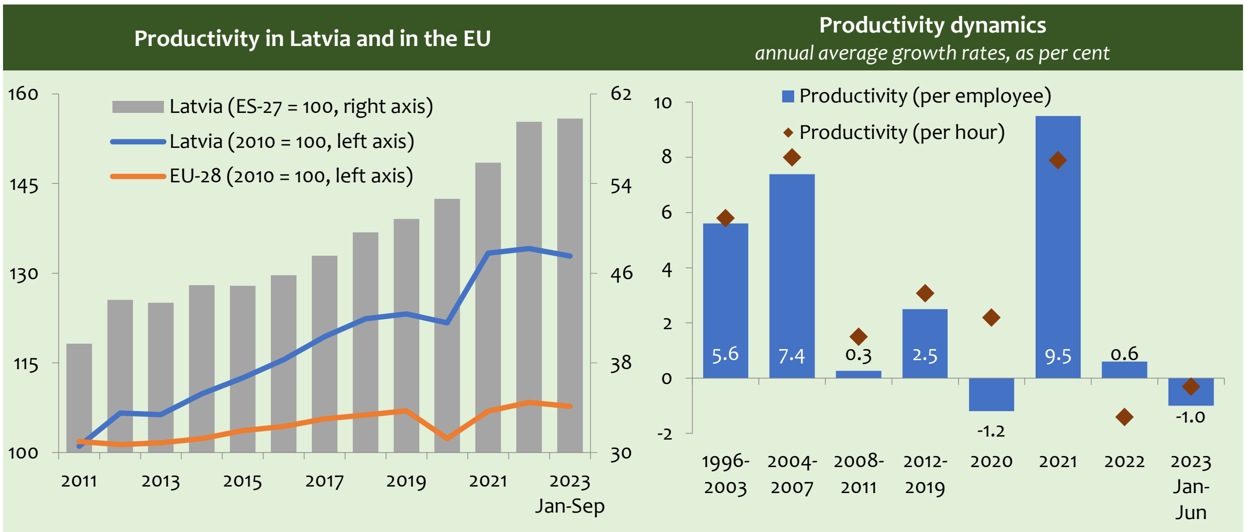

# 6.7. PRODUCTIVITY AND COMPETITIVENESS

## PRODUCTIVITY

Latvian economic growth is supported by the increase in productivity. However, productivity rates tend to decrease in the long term, while the increase in labour costs remains persistently high.

The most rapid increase in productivity was observed before 2008, especially after Latvia acceded to the EU, which became a significant incentive for the inflow of foreign investments. The global financial crisis had a negative impact on productivity. In the first two years of the economic recession (2008–2009), it declined by 2.3%, which was still rather insignificant compared to the drop in GDP (by 17%) mainly due to the strong adjustments in the labour market. The effects of the crisis have not been long and positive productivity dynamics have been observed again since 2010. From 2012 to 2019, productivity grew annually by an average of 2.5% per year, which is half slower than from 1996 to 2007 on average.

Figure 6.28




Since 2020, the productivity dynamics have been volatile. They were determined by adjustments in product and labour markets in response to external shocks. In 2020, productivity was 1.3% lower than in 2019 under the influence of the measures for containment of the COVID-19 pandemic. Moreover, the impact of the crisis caused by the pandemic on productivity indicators was unclear. When calculating productivity per employee, in 2020, it decreased by 1.2%, but, when calculating productivity per hour, it increased by 2.2%, just slightly lower than the average over the past decade. Markedly different fluctuations in productivity rates in the first year of the COVID-19 pandemic were largely affected by state support, mainly in the form of subsidised wage schemes, which contributed to the preservation of jobs, while the number of hours worked reduced.

In 2021, as restrictions eased and economic activity resumed, productivity (per employee) in the Latvian economy was at a 9.5% higher level than in the period concerned a year ago, but productivity per hour – 7.9% higher. This was mainly driven by a sharp increase in productivity in services sectors, including trade, transport services and financial intermediation sectors.

After a rapid rise, productivity growth rates have drastically slowed down, and in 2022, labour productivity (calculated per employee) exceeded the level of the previous year by only 0.6%. Moreover, productivity per hour decreased by 1.4%. Also in 2023, economic growth has been weak. In January-September of this year, compared to the corresponding period of the previous year, productivity decreased by 1% (productivity per hour – by 0.3%). It was mostly affected by the decrease in productivity in the trade and manufacturing sectors. The decline in productivity in these sectors was partially offset by the increase in labour productivity in the construction sector.

Despite significant productivity fluctuations and more moderate dynamics than in previous years, the convergence of Latvia to the EU-average productivity level continues. Overall, in 2022, GDP per employee in the Latvian national economy reached almost 60% (74.5% according to PPS) of the EU average. Since 2019, the productivity gap with the EU average (according to PPS) narrowed by almost 7 percentage points.

In the short term, productivity fluctuations lead to changes in product, labour and capital markets as businesses respond to external and internal shocks (such as COVID-19 pandemic, energy crisis, etc.) and to measures to prevent them and stabilize the economy. The impact of these measures on long-term productivity trends will largely determine change in business models and consumer behaviour. In recent years, there have been significant changes in labour and product markets and the degree of digitisation increases (e-services, remote work, etc.). However, great uncertainty regarding the stability of these changes and their impact on long-term productivity trends remains. Structural changes in the Latvian economy towards higher value-added activities and knowledge-intensive industries will also greatly determine the positive dynamics of productivity.

## 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, thus weakening the competitiveness of Latvian entrepreneurs in the field of costs. The increase in nominal unit labour costs (ULC)[1] also evidences of the growing risks of losses in cost competitiveness.

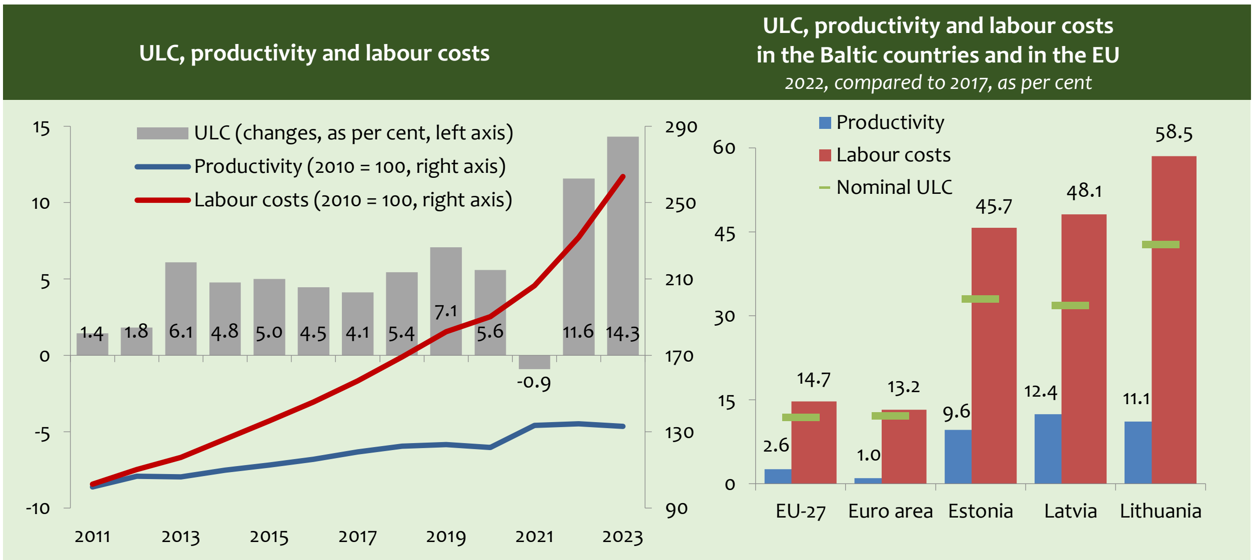
Latvia has long been showing that, in years of high economic growth, the gap between productivity and labour costs was widening, while in recession it was getting smaller. However, labour costs have continued to rise rapidly since 2021, despite declining economic activity and slow productivity growth. This is a sign of the growing mismatch between labour demand and supply.

Particularly strong dynamics of nominal ULC were observed in the last years before the COVID-19 pandemic. In 2019, compared to 2015, ULC rose by 4.3%, driven by a nearly fourfold faster increase in labour costs (in nominal terms) compared to productivity growth. Before 2019 the increase in labour costs was affected both by wage convergence processes in the EU labour market and the tense situation in the Latvian labour market due to the increase in labour shortage.

ULC continued to grow also in the years of the COVID-19 pandemic. Due to the decline in economic activity, labour costs increased more slowly in 2020 than a year ago – by 4.3% (by 7.8% in 2019). Despite a more moderate increase in labour costs, ULC still increased by 5.6% due to the drop in productivity (by 1.2%). In 2021, labour costs kept growing rapidly and exceeded the level of the year before by 8.5%. This did not put pressure on labour unit labour costs, because productivity increased more rapidly, and ULC decreased by almost 1%.

In 2022, the labour costs growth rate accelerated even more. The remuneration of employees increased by 12.2% and, as productivity remained at the level of the previous year, this significantly worsened the cost competitiveness indicator. Nominal ULC grew by 11.6% showing the steepest rise in the past decade. Labour costs are growing rapidly also in 2023. In January-September of this year, labour costs increased by 13.8% compared to the corresponding period of the previous year, exceeding the productivity dynamics considerably.

Figure 6.29

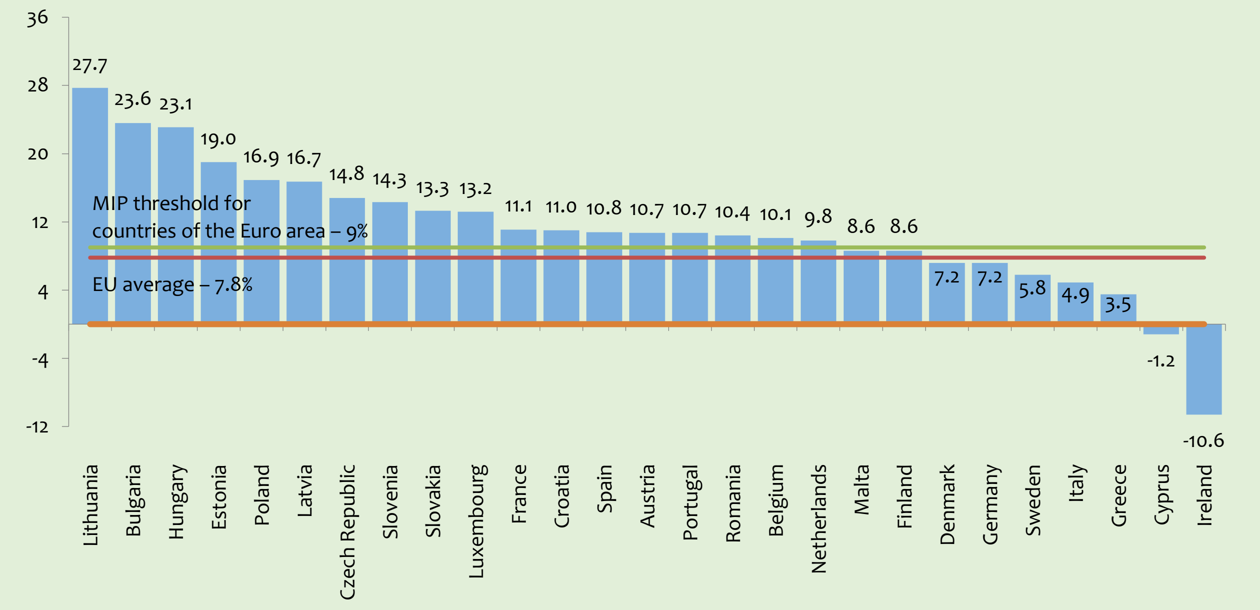



Nominal ULC in the neighbouring Baltic States in recent years has been growing at a faster pace than in Latvia. In 2022, compared to 2019, nominal ULC increased by 16.7% in Latvia, by 19% in Estonia and by 27.7% in Lithuania. Overall, ULC growth in the Baltic States is much faster than the EU average (7.8%) and this indicator is significantly above the threshold set by the EU Alert Mechanism (MIP) (9%) (see Chapter 6.8 for details).

[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 6.30

**Nominal ULC in the EU countries**
*changes as per cent, over three years (2022, compared to 2019)*




Cost competitiveness reduction risks are observed in both manufacturing and market services sectors. The dynamics of labour costs in the last five years (2015–2019) before the COVID-19 pandemic in both mentioned groups of sectors were very similar – they increased by almost 7.2% and 8.1% on average every year, respectively. However, productivity in producing sectors increased slightly more rapidly than in the services sectors – by 2.7% and 2.4%, respectively. Therefore, also the nominal ULC increase in producing sectors was more moderate.

The shock related to the COVID-19 pandemic and Russia's war in Ukraine has a stronger impact on the products market than the labour market. In three years (2020–2022), labour costs (at current prices) in producing and market services sectors increased by 17.6%. Although overall productivity had positive dynamics, it was almost three times slower in the commodity producing sectors and was unable to compensate for the rise in labour costs. In 2022, nominal unit labour costs increased by 20.5% compared to 2019. In market services sectors, the lagging of productivity growth rates behind the dynamics of labour costs was more moderate than in producing sectors, and ULC also grew slower (by 14%). The largest increase in nominal ULC in the three years was observed in construction, agriculture, mining, information and communication. In financial services, unit labour costs of products in 2022 were at a lower level than in 2019, mainly due to the decrease in the number of employees.

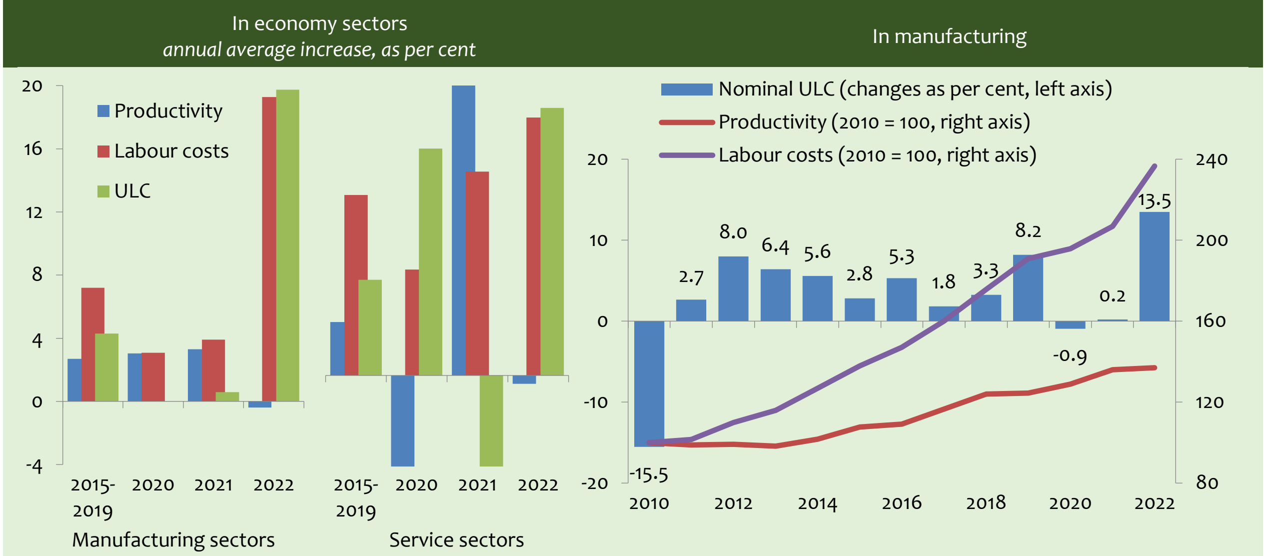
In manufacturing the gap between the rise in productivity and labour costs is slightly more moderate than in the economy overall. However, annual changes in nominal ULC are rather volatile; they are largely affected by factors in the goods market, while labour costs show stable upward dynamics. Labour costs in manufacturing were growing two times faster than productivity in the last five years before the COVID-19 pandemic (2015–2019).

In 2020, productivity grew at a faster pace than labour costs – by 3.6% and 2.6%, respectively, thus decreasing nominal unit labour costs of products by almost 1%. It means that under the influence of the measures to restrict the COVID-19 pandemic the changes in the number of employees were stronger than the decline in manufacturing volumes. Nevertheless, labour costs in companies in manufacturing sectors continue to increase.

In 2021, productivity dynamics in manufacturing were slightly more moderate than labour cost dynamics. Compared to the previous year, productivity in the sector increased by 5.4%, but labour costs – by 5.7%. A relatively steady increase in productivity and labour costs kept the industry's costs competitive at the level of the previous year – nominal ULC increased by only 0.2%. In 2022, trends have changed dramatically – nominal ULC in manufacturing grew by 13.5%, mainly due to the rapid increase in labour costs (by 14.4%).

Figure 6.31

**ULC, labour costs and productivity**



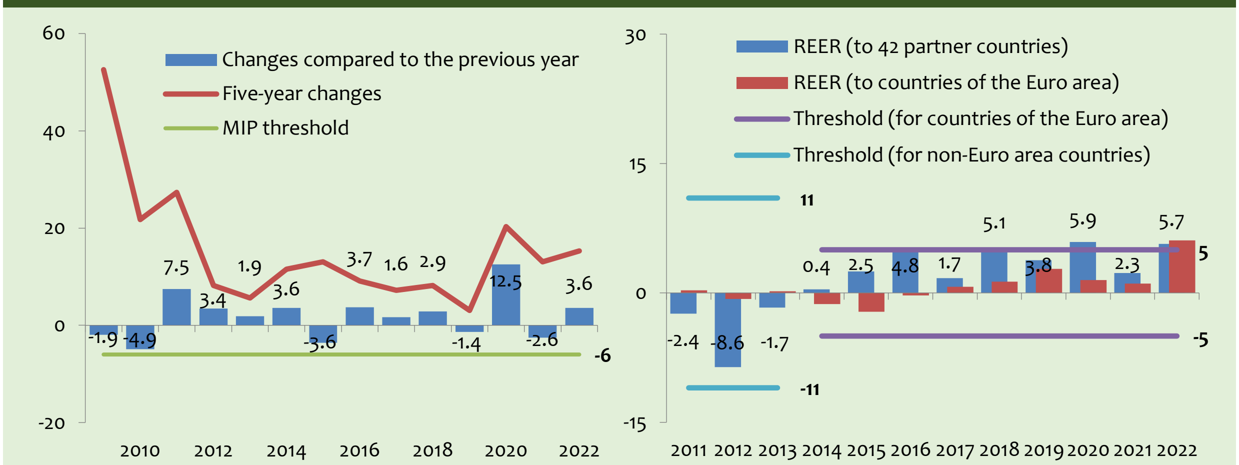

The labour costs dynamics in Latvian manufacturing significantly exceed EU average labour costs and nominal ULC growth rates. Considering that the EU countries are Latvia's main trade partners, such trends reduce the competitiveness of Latvian producers in the field of costs.

The real effective exchange rate (REER) is growing. The consumer price index (CPI) based REER to 42 trade partner countries has increased by 5.7% in the last three years (2019-2022), which is slightly higher than the threshold set by MIP. However, it should be noted that the increase in the export share along with the rapid increase in labour costs implies that the increase in wages is compensated in prices only partially.

Despite the negative trends in cost competitiveness indicators, the long-term dynamics of Latvia's export market share are improving. In the five years (2018–2022), Latvia's export market share in world markets increased by 15.3%, largely affected by the positive changes in the goods export market in 2020. Since 2018, Latvia's share in the export market of goods increased by almost 20%, while in the export market of services – by 5.5%, mainly due to the decrease of the market share by 3.4% in 2019 and by 4.7% in 2021, due to the pandemic containment restrictions.

Figure 6.32

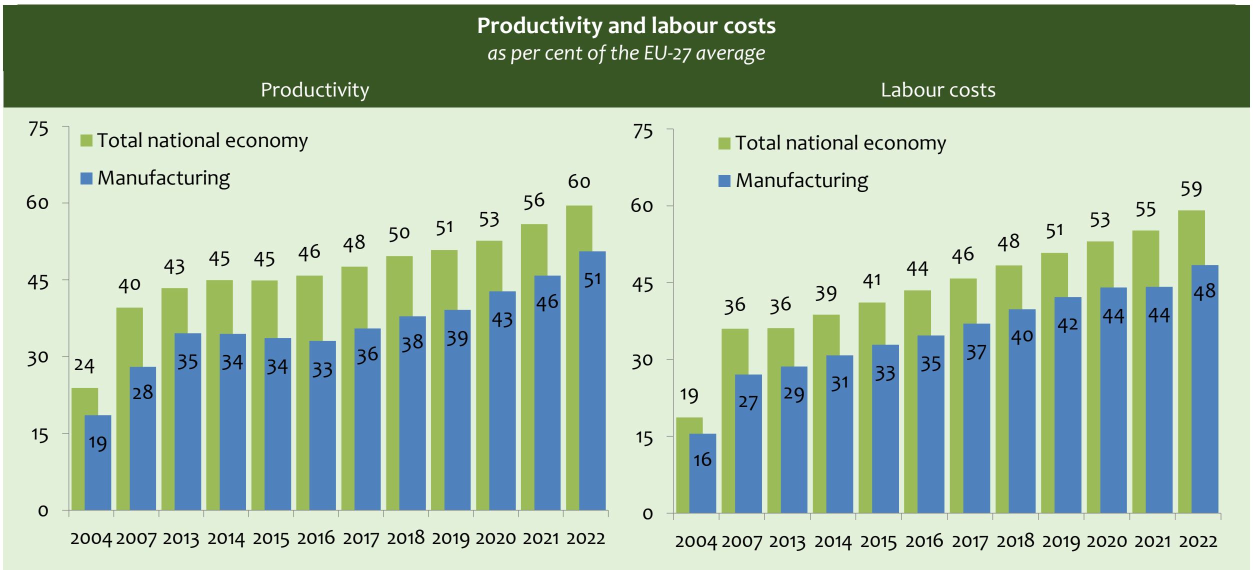
**Changes in export market share** *as per cent* | **Changes in real effective exchange rate (REER)** *three-year changes, as per cent*




Although Latvia's export share in world markets is growing, the risks of decline in competitiveness remain elevated. In the long term, the increase in labour costs, which is not compensated by a corresponding rise in productivity, may have a negative impact on competitiveness and reduce the share of company profits, which entrepreneurs will be forced to adjust to keep price competitiveness in external markets.

Labour costs in Latvia are among the lowest in the EU Member States. In 2022, labour costs per employee in the Latvian economy were almost 59% of the EU average, whereas in the manufacturing industry – 48.4%. Compared to 2019, in 2022, the labour cost gap decreased by 8.3 percentage points (in manufacturing – by 6.2 percentage points), while in terms of productivity in the economy it fell by a total of 8.7 percentage points (by 11.4 percentage points in manufacturing). This means that the wage and productivity convergence process in the economy has generally been the same, but the productivity convergence rate in manufacturing has been the most rapid in recent years.

Figure 6.33




In the context of slow productivity dynamics, the increase in labour costs puts significant pressure on the cost competitiveness of Latvian entrepreneurs. The weakening of economic activity has had little impact on the labour market situation. This shows that the problem of labour shortages is acute for entrepreneurs and, despite the slowdown in economic activity, jobs are preserved. Wages, on the other hand, continue to rise as a result of high inflation pressures. These trends keep widening the gap between productivity and labour costs. The increase in productivity is the main factor determining competitiveness, and structural changes in the Latvian economy towards higher value-added activities and knowledge-intensive industries will also greatly determine the positive dynamics of productivity.

## 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 9.1) to ensure consistency with the analyses and recommendations made under other economic surveillance tools.

On 21 November 2023, the EC published the *Alert Mechanism Report*[1] (AMR) for 2024, which identifies the countries with excessive imbalances – Cyprus, France, Germany, Greece, Italy, Hungary, the Netherlands, Portugal, Romania, Spain and Sweden. Risks of new imbalance/disbalance have been stated in Slovakia. In-depth reviews were prescribed for the countries. Some countries, such as Czechia, Estonia, Latvia, Lithuania and Luxembourg, which were analysed in depth in the spring of 2023 in certain topics, do not need further review as the macroeconomic situation has normalised, while other countries, such as Bulgaria, Croatia, Denmark and Poland, still need further review in certain topics.

[1] The report is available at: https://commission.europa.eu/publications/2024-european-semester-alert-mechanism-report_en.

The scoreboard reading for Latvia shows that four indicators were beyond their indicative thresholds in 2022, namely the real effective exchange rate, unit labour costs, the activity rate, and the youth unemployment rate (see Table 6.5).

Table 6.5

**List of indicators of the macroeconomic imbalance procedure for Latvia**

| | Thresholds | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|
| External imbalances and competitiveness | | | | | | | |
| Current account balance (% of GDP, 3-year average) | -4 % / 6 % | 0.7 | 0.9 | 0.2 | 0.7 | -0.5 | -1.9 |
| Net international investment position (% of GDP) | -35 % | -51.1 | -45.1 | -40.1 | -34.0 | -27.3 | -26.5 |
| Real effective exchange rate – 42 trading partners, HICP deflator (3-year % change) | ±5 %* / ±11 % | 1.7 | 5.1 | 3.7 | 5.9 | 2.3 | 5.7 |
| Export market share – % of world exports (5-year % change) | -6 % | 7.2 | 8.2 | 3.1 | 20.3 | 13.1 | 15.3 |
| Nominal unit labour cost index (3-year % change) | 9 %* / 12 % | 14.2 | 14.7 | 17.5 | 19.2 | 12.0 | 16.7 |
| Internal imbalances | | | | | | | |
| Deflated house prices (% y-o-y change) | 6 % | 5.3 | 6.3 | 5.5 | 3.5 | 7.2 | -1.0 |
| Private sector credit flow (as % of GDP, consolidated) | 14 % | 2.8 | -0.2 | 1.1 | -1.8 | 0.9 | 3.0 |
| Private sector debt (as % of GDP, consolidated) | 133 % | 75.6 | 69.8 | 66.4 | 65.2 | 58.5 | 52.5 |
| General government sector debt (as % of GDP) | 60 % | 38.9 | 37.0 | 36.7 | 42.2 | 44.0 | 41.0 |
| Unemployment rate (3-year average, %) | 10 % | 9.4 | 8.6 | 7.5 | 7.3 | 7.3 | 7.5 |
| Total financial sector liabilities (% y-o-y change) | 16.5 % | 6.2 | -3.5 | 4.6 | 10.6 | 13.3 | 4.1 |
| Employment indicators | | | | | | | |
| Activity rate – % of total population aged 15-64 (3-year change, percentage points) | -0.2 percentage points | 2.5 | 1.9 | 1.1 | 1.1 | -1.8 | -0.5 |
| Long-term unemployment rate – % of economically active population aged 15-74 (3-year change, percentage points) | 0.5 percentage points | -1.5 | -1.5 | -1.7 | -1.2 | -1.1 | -0.7 |
| Youth unemployment rate – % of economically active population aged 15-24 (3-year change, percentage points) | 2 percentage points | -2.6 | -4.1 | -4.8 | -2.1 | 2.6 | 2.6 |

* for countries of the Euro area
Note: highlighted number exceed the limits of thresholds set in the alert mechanism
Source: MIP Scoreboard, Eurostat

It is noted in AMR that, in accordance with EC's forecasts, the real GDP drop in Latvia may reach 0.2% in 2023, but a rise in real GDP by 2.4% would follow in 2024.

A sharp decline in nominal inflation has been seen from a peak of 22% in September 2022, compared to September of the previous year, to 2.4% in October 2023, compared to October of the previous year.

External sustainability is affected by the current account deficit, which remains relatively sizeable. It increased from 3.9% of GDP in 2021 to 4.7% in 2022 but is expected to narrow to 4.2% in 2023 and 3.2% in 2024, supported by improvements in the goods balance and the capital account. The net international investment position (NIIP) remained broadly stable at -27% of GDP in 2022. Latvia's liabilities largely consist of government bonds and foreign direct investment. Their amount exceeds the amount of other financial instruments.

Cost competitiveness concerns persist. Nominal unit labour costs have been increasing rapidly for several years and grew particularly sharply in 2022. In 2023, unit labour costs are expected to continue growing at a similarly high rate, driven by high wage increases amid labour shortages. For 2024, the growth rate of unit labour costs is projected to slow down significantly. The HICP-based real effective exchange rate appreciated markedly in 2022 with higher inflation at home.

The non-financial corporate debt and household debt-to-GDP ratios were low and declined further in 2022. The non-financial corporate debt ratio remained broadly unchanged in the first half of 2023, while household debt continued to edge down.

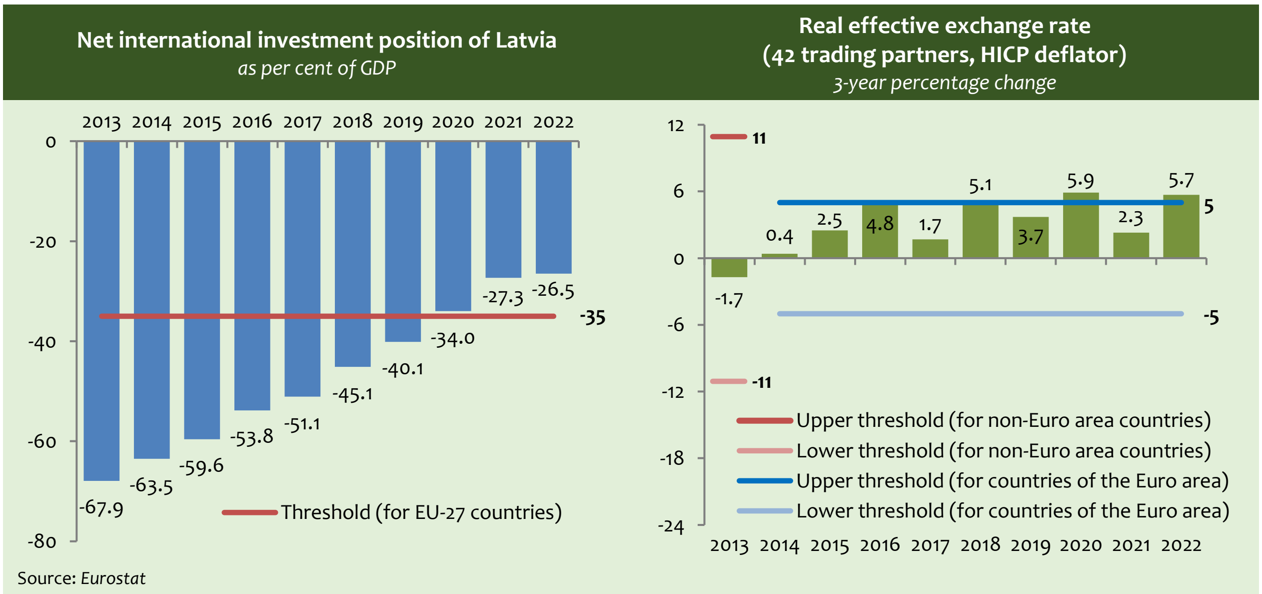
House price growth accelerated in the first half of 2022 but then moderated. As a result of recent increases, house prices are estimated to be overvalued by 12%.

The banking sector is sound and well capitalised. Profitability improved in 2022 and is close to the EU average. In Q1 2023, the non-performing loans ratio declined to 1.3%. Credit dynamics have been rather muted.

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

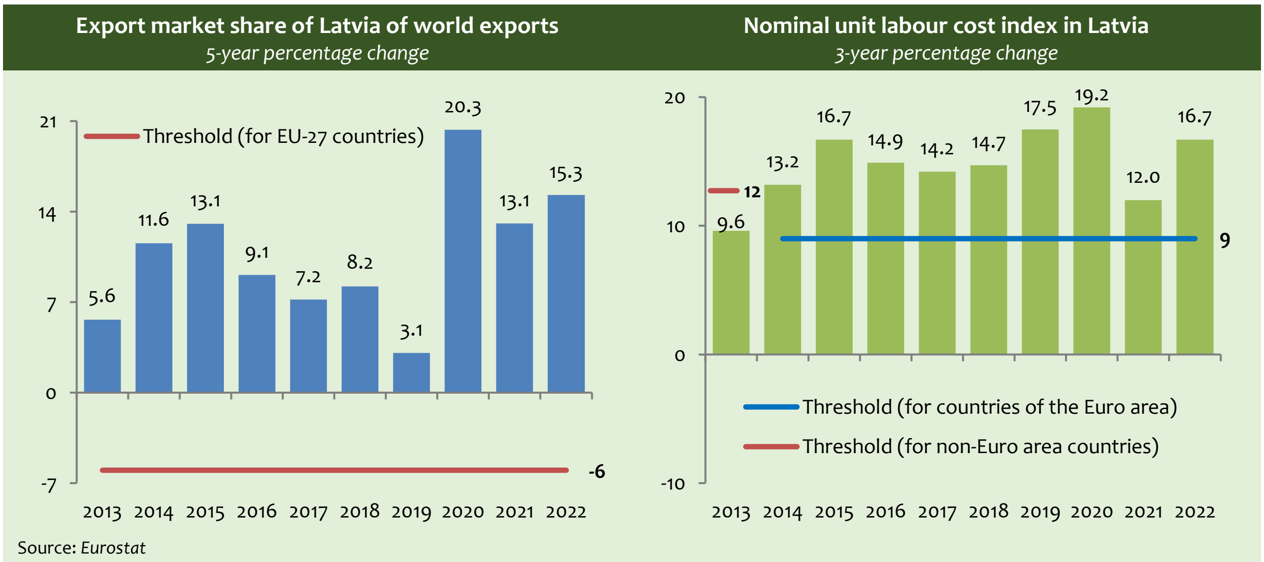
External imbalances and competitiveness are characterised by current account balance, net international investment position, real effective exchange rate, export market share and nominal unit labour cost index.

Figure 6.34




The 3-year average current account balance of Latvia does not surpass the thresholds. From 2017 to 2020, including, it was positive. The countries, where the 3 year average current account balance in 2022 surpassed the upper threshold, were Denmark, the Netherlands, Luxembourg, Germany and Ireland, and the lower threshold was surpassed in Cyprus, Greece, Romania and Hungary.

Figure 6.35



Since 2020, the net international investment position (NIIP) of Latvia no longer surpasses the threshold (see Figure 6.34). Meanwhile, in 2022, NIIP exceeded the threshold in Romania, Hungary, Spain, Slovakia, Portugal, Cyprus, Ireland and Greece. FDI is considered the safest means of raising foreign capital included in NIIP. In 2022, FDI constituted 40% of the total attracted foreign capital in Latvia.

Until 2020, Latvia surpassed the real effective exchange rate 3 year change neither before nor after its accession to the Euro area. However, in 2020 and 2022 it surpassed the upper threshold, and as data of the previous years were updated, it was stated that the upper threshold was surpassed also in 2018 (see Figure 6.34). Out of the EU-27 countries, only real effective exchange rate 3 year changes of Bulgaria, Estonia, Lithuania and Czechia surpassed the thresholds in 2022.

In 2021, the share of the Latvian export market slightly shrank, but in 2022 increased again, therefore, in 2022, the export market share 5 year % changes indicator slightly grew (see Figure 6.35) and was one of the highest among EU-27 countries. Meanwhile, this indicator in Germany, France, Italy, Speain, Czechia and Slovakia was below the -6% threshold.

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 6.35). 12 Euro area and 4 non-Euro area EU-27 countries exceeded this threshold in 2022.

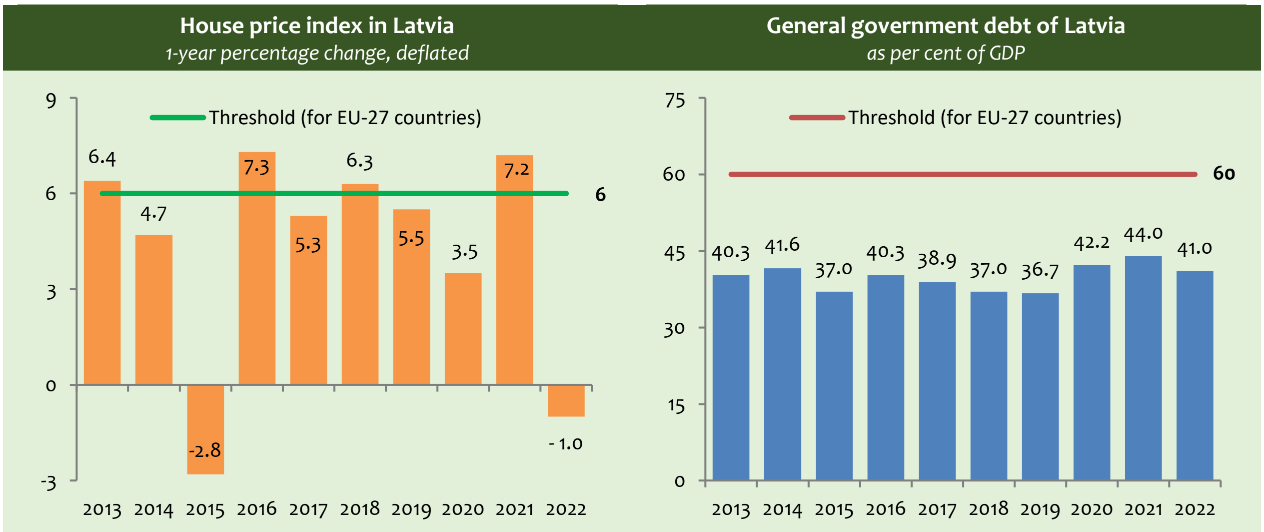
Internal imbalances are characterised by deflated house prices, private sector, private sector debt, general government debt, unemployment rate and financial sector liabilities together.

After 2010, the house price index of Latvia exceeded the threshold in 2013, 2016, 2018 and 2021 (see Figure 6.36). Out of the EU-27 countries, only the Netherlands exceeded the house price index threshold in 2022.

The private sector credit flow of Latvia has not exceeded the threshold since 2010. In 2022, this indicator did not exceed this threshold in any EU-27 countries.

The private sector debt approached the threshold in Latvia only in 2010. After 2010, the private sector debt continues to decrease. In 2022, this indicator exceeded this threshold only in 10 out of EU-27 countries.

Figure 6.36




Source: *Eurostat*

The general government debt of Latvia reached its highest level (47.6% of GDP) in 2010, however, it did not exceed the threshold. Then government debt reduced to 36.7% of GDP with small variations in 2019, then increased for two years, but in 2022 declined again to 41% of GDP (see Figure 6.36). In 2022, this indicator exceeded the threshold in 13 EU-27 countries.

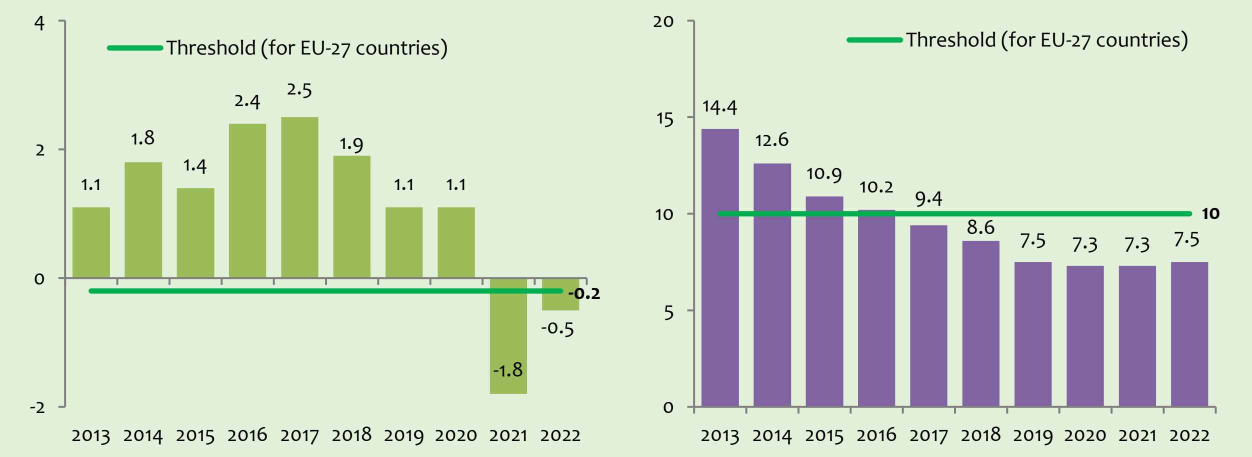
The increase in total financial sector liabilities in Latvia has never exceeded the set 16.5% threshold. In 2022, this indicator did not exceed this threshold in any EU-27 countries.

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.

Three year changes in percentage points in the economically active population level in Latvia have exceeded the threshold since 2012, but in 2021, exceeded the threshold under the influence of the COVID-19 crisis. In 2022, the situation was no longer deteriorating so rapidly, but the indicator still surpassed the threshold (see Figure 6.37). In 2022, out of EU-27 countries this indicator still surpassed the threshold only in Italy.

Figure 6.37

| **Changes in economic activity rate of working age population in Latvia**<br>as per cent of population aged 15-64<br>*(3-year change, percentage points)* | **Unemployment rate in Latvia**<br>*3-year average, as per cent* |
|---|---|

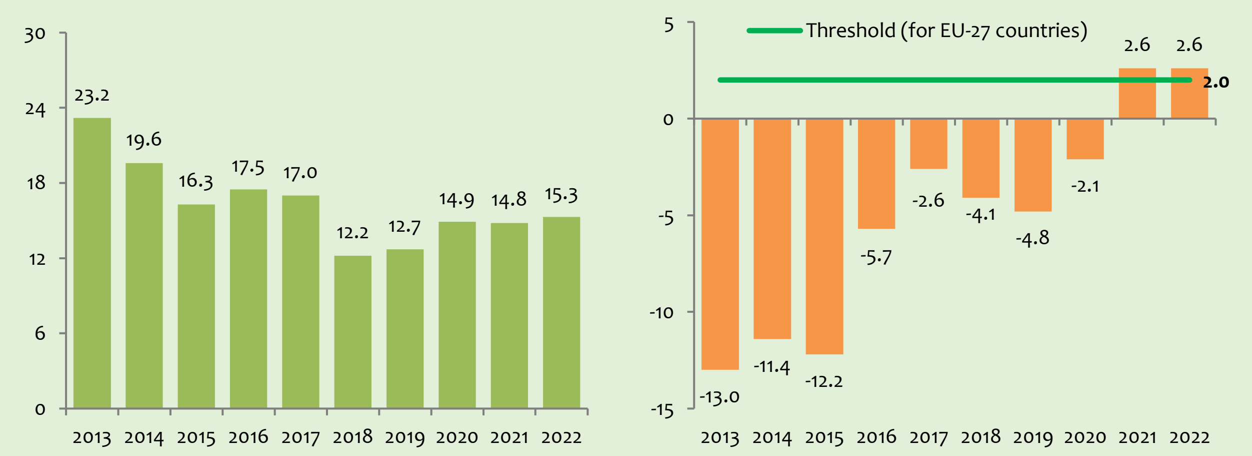



Source: *Eurostat*

The three-year average unemployment rate in Latvia exceeded 10% from 2010 to 2016. It was the highest in 2011, but then reduced. It was 7.5% in 2022 (see Figure 6.37). In 2022, out of EU-27 countries the 3 year average unemployment rate exceeded the 10% threshold only in Greece and Spain.

Figure 6.38

| **Youth unemployment rate in Latvia**<br>*as per cent of economically active population aged 15-24* | **Changes in youth unemployment rate in Latvia**<br>as per cent of economically active population aged 15-24<br>*(3-year change, percentage points)* |
|---|---|




Source: *Eurostat*

After 2012, 3 year average long-term unemployment indicator in Latvia never exceeded the set threshold, because long-term unemployment continued to decrease, although no longer so rapidly in recent years (see Table 6.5). In 2022, this indicator did not exceed this threshold in any EU-27 countries.

If we look at annual changes, they show that youth unemployment reduced rather rapidly, while after 2015 there were years, when youth unemployment increased again (see Figure 6.38). In 2021, the change in youth unemployment rate exceeded the threshold under the influence of the COVID-19 crisis, and this growth trend continued also in 2022 (see Figure 6.38). Change in the youth unemployment rate exceeded the threshold in 2022 also in EU-27 countries such as Estonia, Slovakia, Sweden, Cyprus and Slovenia. In 2022, 8.6% of youths aged 15-24 in Latvia were not in employment, education or training.

# 6.9. LATVIA IN INTERNATIONAL RATINGS

## INDICES

The indices 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 indices below have been arranged starting from the highest place reached (see Figure 6.39), but their descriptions are broken down into main thematic groups. Many indices are published once in two years, while the preparation of other indices was delayed by the COVID-19 pandemic, and some indices were created only once.

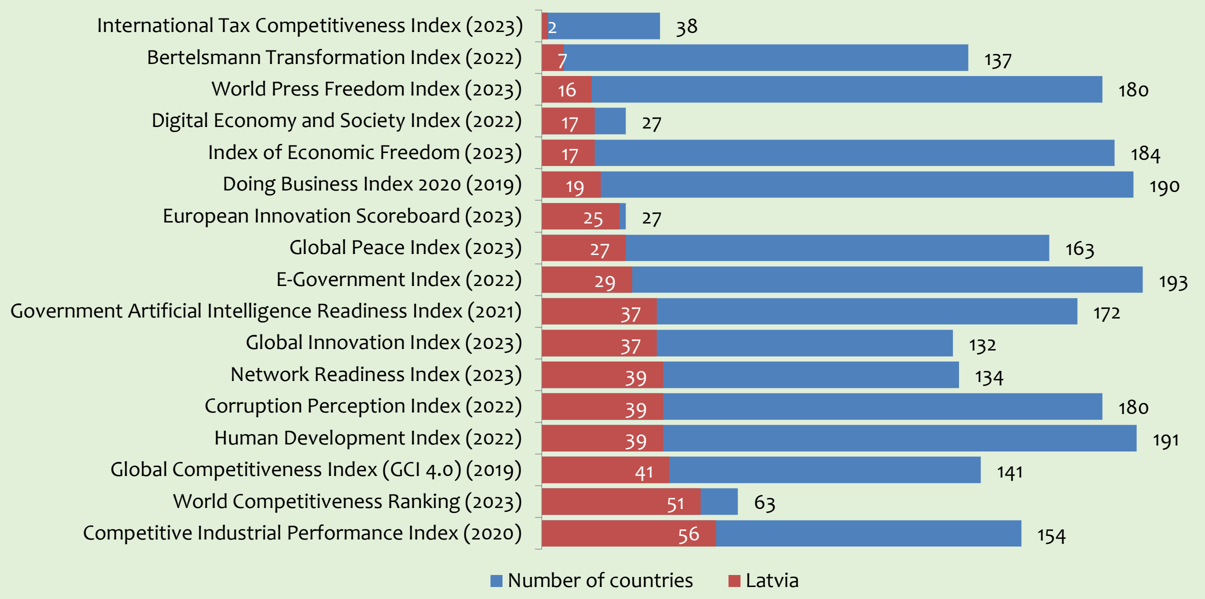
### Comprehensive indices

In 2019, in the ***Global Competitiveness Index (GCI 4.0)*** of the World Economic Forum Latvia occupied the 41st place (Estonia – 31st place, Lithuania – 39th place) among 141 countries of the world. 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 GCI methodology was changed and the index was renamed into GCI 4.0. In 2020, the preparation of the index was skipped because of the difficulties in collecting data due to the COVID-19 pandemic, and therefore a special edition was issued and was devoted to the ability of 37 countries to overcome the COVID-19 crisis. Latvia was not included in this list. This index has not been updated since 2019.

Figure 6.39

**Latvia's Position in the Most Popular International Ratings in 2023**

*position according to the year of the latest publication; number of countries in the index*




Sources: *International Tax Competitiveness Index 2023, Tax Foundation; Bertelsmann Stiftung's Transformation Index, Bertelsmann Stiftung; 2023 World Press Freedom Index, Reporters Without Borders; Digital Economy and Society Index, European Commission; Index of Economic Freedom 2023, The Heritage Foundation; Doing Business 2020: Sustaining the Pace of Reforms, International Bank for Reconstruction and Development, The World Bank; European Innovation Scoreboard 2023, European Commission; Global Peace Index 2023: Measuring Peace in a Complex World, Institute for Economics and Peace; United Nations E-Government Survey 2022, United Nations; Government Artificial Intelligence Readiness Index 2021, Oxford Insights, International Development Research Centre; The Global Innovation Index 2023: Innovation in the face of uncertainty, World Intellectual Property Organization; The Network Readiness Index 2023: Trust in a Network Society: A crisis of the digital age?, Portulans Institute; Corruption Perceptions Index 2022, Transparency International; Human Development Report 2021/2022, United Nations Development Programme; The Global Competitiveness Report 2019, World Economic Forum; World Competitiveness Ranking 2023, International Institute for Management Development; Competitive Industrial Performance Index 2022, United Nations Industrial Development Organization.*

In the ***World Competitiveness Ranking 2023*** published annually by the International Institute for Management Development (IMD) Latvia was ranked 51st (Estonia – 26th, Lithuania – 32nd) among 63 countries of the world moving 16 positions down compared to 2022. Factors related to concerns about Latvia's ability to maintain economic security, as Russian aggression against Ukraine began, are the biggest influence in the rating drop in 2022. The rise in energy prices led to high consumer price inflation, which in turn put pressure on wages and labour costs. There was a high risk of economic recession. As a result, business sentiment was reflected both in the assessment of government efficiency and in the assessment of business efficiency. Some long-term risks, including long-term labour availability, the low level of stock market capitalisation, etc., also worsened the overall assessment. At the same time, however, the assessment recognises that the level of foreign investment against GDP is relatively high and skilled labour is a key factor in the attractiveness of an economy.

In the ***Human Development Index*** created by the UN Development Programme in 2022, which summarises the data of 2021 and includes life expectancy, literacy, education level, GDP per capita and other indicators, Latvia was ranked 39th (Estonia – 31st, Lithuania – 35th) among 191 countries of the world moving two positions down compared to 2020.

Indices characterising institutional environment

In the ***Transformation Index 2022*** created by *Bertelsmann Stiftung*, which evaluates the quality of democracy, market economy and political governance Latvia is placed 7th among 137 countries of the world (Estonia – 2nd, Lithuania – 4th) having improved its performance by one position compared to 2020.

In the ***Corruption Perceptions Index 2022*** created by the international anti-corruption organisation *Transparency International,* Latvia was ranked 39th (Estonia – 14th, Lithuania – 33rd) among 180 countries of the world moving three positions down compared to 2021, although the point score of Latvia has not changed.

In the ***2023 World Press Freedom Index*** created by the international press and freedom of expression organisation *Reporters Without Borders*, Latvia was ranked 16th (Lithuania – 7th, Estonia – 8th) among 180 countries of the world having improved its rank by 6 positions compared to the result of 2022.

In the ***Global Peace Index 2023*** created by the Institute for Economics and Peace, Latvia was ranked 27th (Estonia – 26th, Lithuania – 36th) among 163 countries of the world having moved eight positions up compared to 2022.

Indices characterising ICT development

In the ***E-Government Survey 2022*** created by the UN Department of Economic and Social Affairs, which analyses the progress of using e-government, Latvia was ranked 29th (Estonia – 8th, Lithuania – 24th) among 193 countries of the world moving 20 positions up compared to 2020.

In the ***Government Artificial Intelligence Readiness Index 2021*** by *Oxford Insights* and the International Development Research Centre, Latvia was ranked 37th (Estonia – 21st, Lithuania – 30th) among 172 countries moving one position down compared to 2020.

In the ***Network Readiness Index 2023*** created by the Portulans Institute, which analyses digital transformation by four pillars (technology development, human capital, governance, economic and social effects), like a year ago, Latvia was ranked 39th (Estonia – 22nd, Lithuania – 33rd) among 134 countries of the world.

In the ***Digital Economy and Society Index (DESI) 2022*** by the EC, Latvia is 17th (Estonia – 9th, Lithuania – 14th) among EU-27 countries. Since 2021, the DESI index has been structured into four key areas: human capital, connectivity, integration of digital technology and digital public services. Latvia performs above the EU average only in digital public services. The results for 2023 were published for individual indicators without creating a single joint index, so the positions of the countries cannot be determined. Several indicators are showing Latvia's progress, for example, 5G rollout, converging considerably towards the EU average, an increase in the share of households subscribed to fixed broadband, as well as an increase in the share of businesses using digital technology.

Indices characterising business environment

In 2019 ***Doing Business 2020*** by the World Bank Group, which compared the business environment of 190 countries, Latvia was placed in the 19th place (Estonia – 18th, Lithuania – 11th). This was a high evaluation, because Latvia was the 4th among EU countries. Unfortunately, the issuing of the index has been permanently suspended, because the data integrity audit revealed that many countries provided false information.

In the ***International Tax Competitiveness Index 2023*** published annually by the US Think Tank *Tax Foundation* Latvia was ranked 2nd (Estonia – 1st, Lithuania – 9th) among 38 OECD countries of the world, retaining the second position since 2020. The International Tax Competitiveness Index includes more than 40 tax policy variables measuring not only the size of tax rates, but also how taxes are structured. The index looks at national corporate taxes, personal income taxes, consumer taxes, property taxes and attitudes toward foreign profits. Latvia is noted in the index report as the country that has adopted the highest-ranked corporate tax system and has a relatively efficient system for taxing labour income. A version (***2023***

*European Tax Policy Scorecard*), including 32 European countries (27 EU countries and Switzerland, Iceland, the United Kingdom, Norway and Turkey), was created for this index. Latvia is placed 5th among the European countries (Estonia – 1st place, Lithuania – 10th place) showing the best performance in the corporate tax system.

In the *2023 Index of Economic Freedom* created by *the Heritage Foundation*, which consists of four pillars characterising rule of law, government size, regulatory efficiency and open market, Latvia was ranked 17th as mostly free economy (Estonia – 6th as mostly free economy, Lithuania – 20th as mostly free economy) among 184 countries moving 1 position up compared to 2022.

In the *Competitive Industrial Performance Index 2022* created by the UN Industrial Development Organization, which is based on the data of 2020 and analyses the ability of industrial enterprises of countries to produce and export competitively by adapting to change, Latvia was placed 56th (Estonia – 50th place, Lithuania – 38th) among 154 countries of the world.

Indices characterising innovation environment

In the *Global Innovation Index 2023* created by the World Intellectual Property Organisation Latvia was ranked 37th (Estonia – 16th, Lithuania – 34th) among 132 countries of the world moving four positions up compared to 2022. The following indicators were noted as strengths of Latvia: pupil-teacher ratio in secondary education, tertiary enrolment, ICT use, environmental performance, females employed w/advanced degrees, gross domestic expenditure on research and development financed by abroad, high-tech exports, cultural and creative services exports, national feature films, printing and other media, creative goods exports.

In the *European Innovation Scoreboard 2023* created by the EC Latvia, like a year ago, is placed 25th among EU-27 (Estonia – 12th place, Lithuania – 19th place) and is included in *the group of moderate innovators*. The report notes that over the last two years Latvia's point score has improved due to both the increase in the employed ICT specialists and the increase in the employed science and technology specialists.

## CREDIT RATINGS

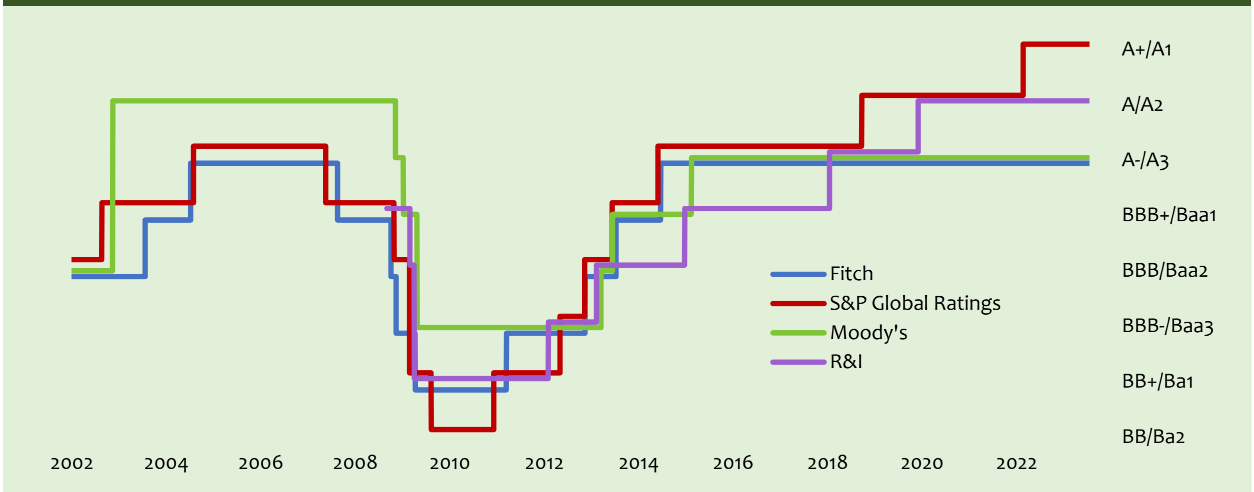
The credit rating of a country is the evaluation of its creditworthiness, which is an essential indicator for potential creditors and investors. The higher it is, the more beneficial the terms of borrowing financial resources are making it possible to reduce service costs of the public debt. The credit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

Figure 6.40

**Credit ratings for Latvia for long-term liabilities**




Source: State Treasury

On 21 February 2020, the international rating agency *S&P Global Ratings* increased the credit rating of Latvia from "A" to "A+", which is historically the highest credit rating set for Latvia. In the assessment made on 6 December 2022, this agency confirmed that Latvia still corresponded to level A but downgraded the outlook from stable to negative justifying it by the impact of the protracted Russian hostilities in Ukraine and high inflation on the Latvian economy. Other rating agencies have also not changed their rating of Latvia since COVID-19 (see Figure 6.40).

The assessment of the agencies is based on conclusions that the measures reducing Latvia's energy dependence on Russia, participation in NATO and EU, moderate public debt level and overall effective state economic policymaking are sufficient to maintain its high credit rating.

On 28 July 2023, the credit rating agency *Fitch Ratings* kept the credit rating of Latvia at "A-" level and was the first of credit rating agencies to improve its credit rating future assessment from stable to positive. This agency indicated that Latvia as a small and open economy has shown relative resilience to external shocks. The level of GDP has exceeded its pre-pandemic level because the overall impact of the pandemic was smaller than in the EU on average and has successfully resolved difficulties relating to the availability of energy sources, where Russia had a big share.

The credit rating agency *Fitch Ratings* indicated that the strengths of Latvian credit rating are the relatively low level of public debt to GDP and its service costs, as well as the moderate level of debt liabilities of the private sector. However, GDP per capita below same-category peers, uncertainty with negative current account development trends and unfavourable demographic trends may restrict the credit rating growth of Latvia in the future.

According to *Moody's Investors Service*, international ratings agency, a new factor that may limit further positive developments in the ratings is the relatively high debts of state-owned enterprises.

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 6.7

**Credit ratings for the Baltic countries for long-term liabilities in 2023**

| | *Moody's Investors Service* | *S&P Global Ratings* | *Fitch Ratings* |
|---|---|---|---|
| Estonia | A1/Stable | AA-/Negative | A+/Stable |
| Lithuania | A2/Stable | A+/Negative | A/Stable |
| Latvia | A3/Stable | A+/Negative | A-/Positive |

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

The credit rating of Estonia is one to two levels higher than the credit rating of Latvia and Lithuania. On 6 December 2022, the credit rating agency *S&P Global Ratings* kept the credit rating of Estonia at "AA-" level but reduced the credit rating future outlook from stable to negative justifying it by the impact of the protracted Russian war in Ukraine, which brings higher public defence costs, as well as an extra burden for the national economy already experiencing a decline in growth rates. In 2023, *Moody's* and *S&P Global Ratings* kept the credit rating of Estonia at the existing level and kept the same future outlook. Meanwhile, on 28 July 2023, Fitch lowered Estonia's credit rating from "AA-" to "A+" and, after it was downgraded, changed the credit rating future outlook from negative to stable. This was affected by the deterioration of the financial situation of the country, which took the form of an increase in the government deficit from 0.9% in 2022 to 4.2% in 2023. This was due to rising wages and raising the basic allowance, as well as increased spending on defence and education. As a result, the level of public debt also increased and is expected to increase further in the medium term.

Lithuanian credit ratings are lower than Estonian credit ratings, but future outlooks are similar. On 2 December 2022, the credit rating agency *S&P Global Ratings* kept the credit rating of Lithuania at "A+" level but reduced the credit rating future outlook from stable to negative justifying it by growing expenditure on public defence and high inflation leading to an increase in government budget deficit. Economic forecasts at that time were not encouraging either, as Lithuanian export opportunities deteriorated. At the same time, expenditures related to the reception of Ukrainian refugees and the provision of support to households to mitigate the impact of high energy prices also increased. However, public debt was projected to remain moderate.

# 7. LABOUR MARKET

## 7.1. EMPLOYMENT AND UNEMPLOYMENT

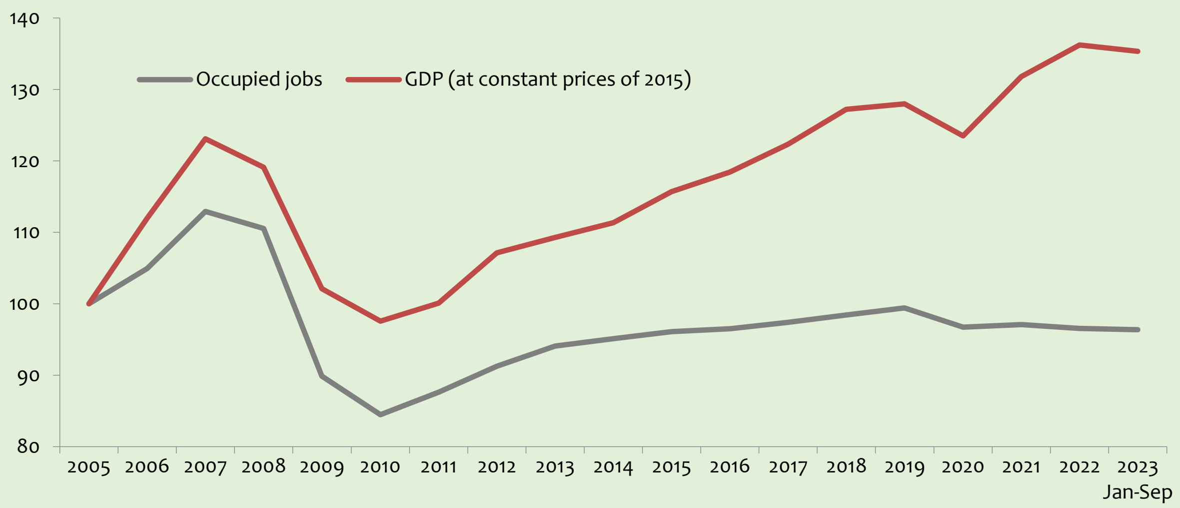
Along with the increase in economic activity, since April 2021 employment growth has resumed while unemployment continues to fall. At the same time, along with the increase of labour demand, the labour shortage is becoming more noticeable. This is evidenced both by the return of unemployment indicators to pre-crisis (2019) levels and by the increase in vacancies and workplace load. The COVID-19 crisis as a whole has had a negative impact on the economic activity of the population, which, along with demographic processes, narrows the labour market supply and increases the risks of labour shortages.

However, while the employment rate is growing, overall demand for the labour force remains limited and there is still a slight decrease in the number of occupied posts. As pressure from the labour supply side increases, both in terms of access to human resources and in terms of remuneration, it is increasingly difficult for employers to create new jobs and attract employees.

Figure 7.1

**GDP and occupied jobs***

*2005 = 100*




* From 2021, data of the State Revenue Service are used to calculate occupied jobs, and this has caused a break in time series

In Q1-Q3 2023, the employment has grown by 1.6 thousand or 0.2%, compared to the corresponding period of 2022. In Q1 2023, the increase in employment continued to be sustained by the low base effect and the recovery of the labour market from the COVID-19 pandemic, while, starting from Q2, employment growth rates slowed down, and in Q3 there was a decrease in the number of employed people – by 8.6 thousand or 1%, compared to Q3 2022. The decrease in employment in Q3 2023 was largely influenced both by the slowdown of the economic growth rate and by the labour market supply side factors of the– the decrease of the working-age population, as well as the decrease of the total labour supply.

In Q3 2023 the total employment increased to 890.9 thousand people in age group 15-74. These were 64.7% of the total population aged 15-74 in private households. During the year, the employment rate of the population has increased by 0.1 percentage points reaching its highest point since the beginning of 2020. At the same time, the unemployment rate in Latvia is still lower than in its neighbours – 4.4 percentage points lower than in Estonia (69.1% in Q3 2023) and 2 percentage points lower than in Lithuania (66.7% in Q3 2023).

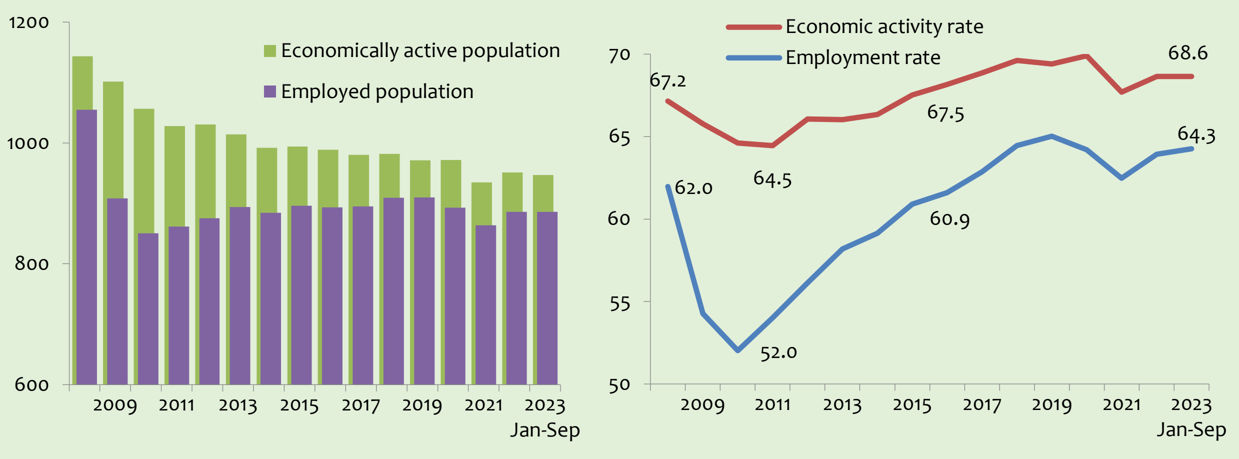
Considering the slowdown in labour demand growth, the decline in unemployment is also generally slowing down. Yet, despite all that, unemployment rates remain low and close to pre-pandemic (2019) rates. The unemployment rate in Q3 2023 was 6.5%, down 0.4 percentage points from Q3 2022 (6.9%). At the same time, the average unemployment rate in Q1-Q3 decreased to 6.4%, down 0.5 percentage points from the corresponding period of 2022. In Q3, the unemployment rate in Latvia was 0.3 percentage points higher than in Lithuania (6.2% in Q3 2023) and 0.8 percentage points lower than in Estonia (7.3% in Q3 2023). Overall, 61.5 thousand people aged 15-74 were looking for a job in Q3 2023 which is 7.4% or 4.9 thousand less than in Q3 2022.

Figure 7.2

**Employment and economic activity of the population**

Employed and economically active population *aged 15-74, thousands*

Employment and participation rate *aged 15-74, as per cent of economically active population*




* 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.

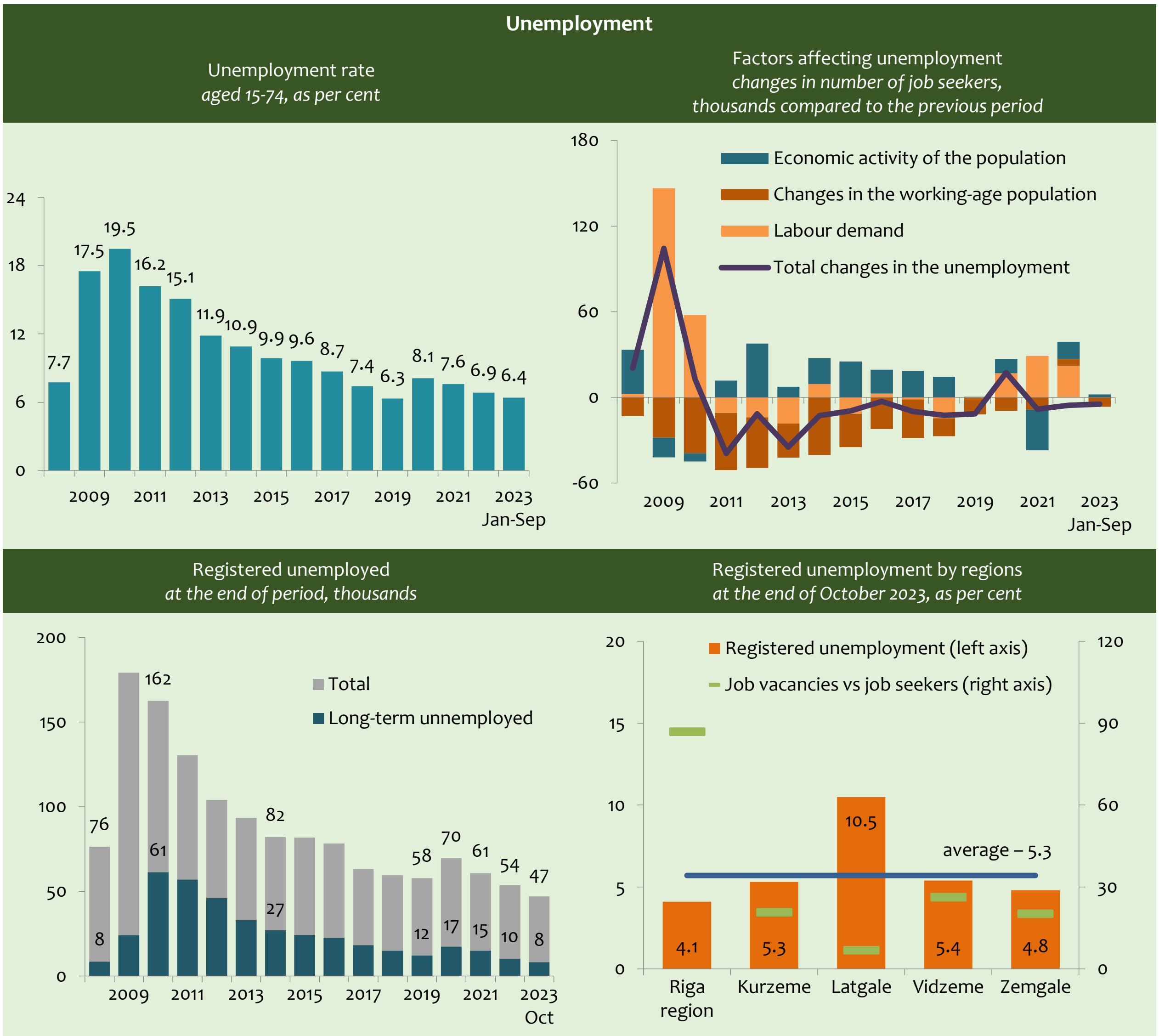
Positive trends are also observed in the dynamics of the long-term unemployed. Both the number of long-term unemployed and their share in the total number of job seekers is gradually decreasing. The number of long-term unemployed registered during the year has decreased by more than 22% or approximately 2.3 thousand, which is a general indication of a more pronounced decrease in labour stock. At the end of October 2023, approximately 8.2 thousand registered job seekers or about 17.4% of all registered unemployed were unemployed for more than one year.

Despite the decline in unemployment, there is still a risk that some of the unemployed may have problems finding jobs that match their skills since the complete recovery in the sectors that had most jobs in the previous years might be long, but in sectors where job opportunities are created, skills previously acquired will not necessarily be required. It should also be considered that long long-term unemployment can cause structural unemployment risks, namely, the longer this person is unemployed, the greater the risk of losing job skills and abilities, and the more difficult it is to adapt to new labour market requirements.

It is to be noted that the COVID-19 pandemic has generally accelerated structural changes in the labour market fostering automation of workplaces in labour-intensive industries and thus reducing the demand for low and medium qualification workforce without professional skills and increasing the share of jobs requiring higher qualification, in particular in information and communication services.

Similarly, structural problems are exacerbated by regional differences in the labour market, which together hinder the recovery of the labour market. Although regional disproportions are gradually converging, the process is still slow. Distinct problems have long been observed in the Latgale region, where the unemployment rate is almost twice as high as the average rate in the country, which, amid the low geographic mobility of the labour force, increases the risks of structural unemployment.

Figure 7.3




Supply-side factors are still restricting the labour market considerably. In Q3 2023, compared to Q3 2022, the number of economically active population aged 15-74 decreased by 13.5 thousand – to 952.4 thousand. The decrease in the economically active population has been influenced both by the decrease in the economic activity of the population and by the decrease in the number of the population capable of working.

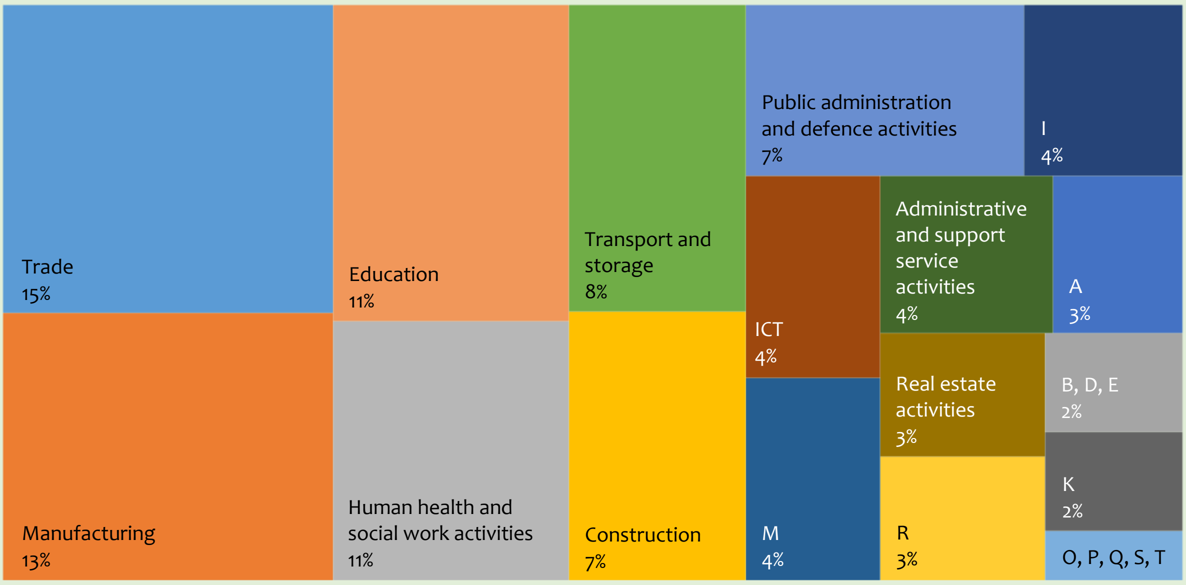
The economic activity rate of the population decreased by 0.3 percentage points to 69.1% in Q3 2023, compared Q3 2022. At the same, in Q3 2023, the number of persons in private households declined by 15.3 thousand compared to the corresponding period of the previous year.

It should be noted that along with the decrease in the inflow of Ukrainian war refugees, this positive effect of the flow on the dynamics of labour supply is gradually waning. It should also be considered that some of the war refugees are returning home, so the negative impact of demographic factors on the dynamics of labour supply could become more pronounced again in the coming years.

Despite the increase in employment, at the end of Q3 2023, the number of occupied posts declined to 888.3 thousand – a reduction of 7.9 thousand posts or by 0.9%, compared to the corresponding period of 2022.

Figure 7.4

**Occupied jobs by sectors**
*structure at the end of September 2023, as per cent*

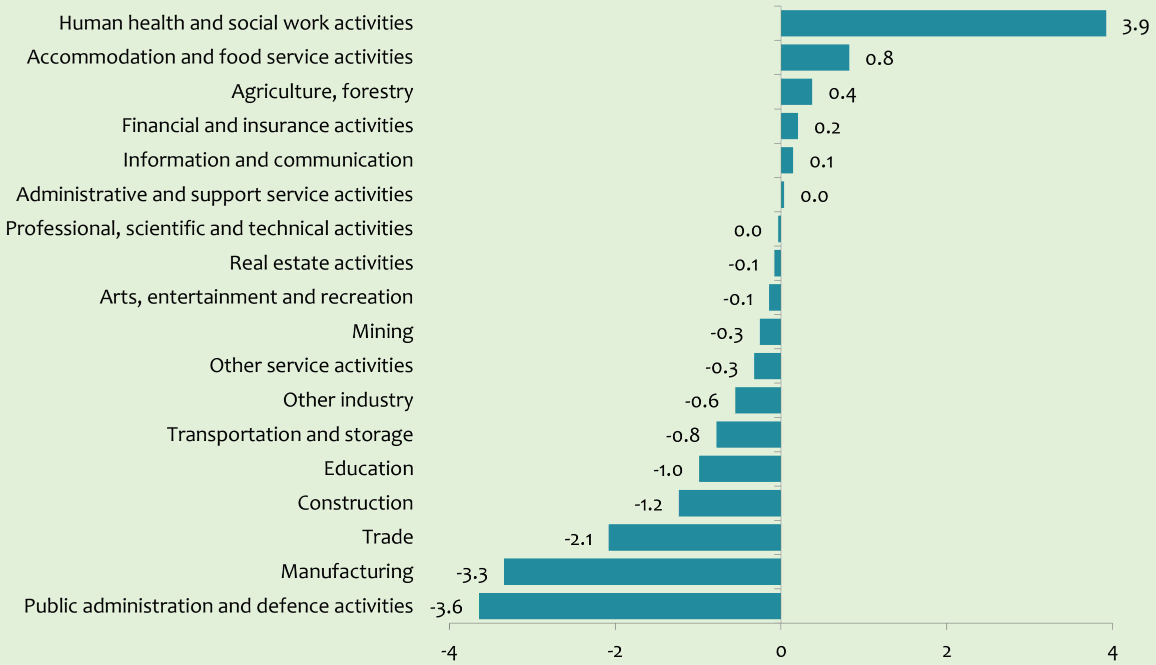



A – Agriculture, forestry and fishing; B, D, E – Other industry; I – Accommodation and food service activities; K – Financial and insurance activities; M – Professional, scientific and technical activities; R – Arts, entertainment and recreation; O, P, Q, S, T – Other services

The most significant decrease in the number of jobs was observed in public administration (by 3.6 thousand or 5.6%) and manufacturing (by 3.3 thousand or 2.9%).

Figure 7.5

**Changes in the number of occupied jobs in economic sectors***
*Q3 2023 to Q3 2022, thousands*




* From Q1 2021, data of the State Fevenue Service are used to calculate occupied jobs, and this has caused a break in time series.

At the same time, the most significant increase in the number of jobs in Q3 2023 was in human health and social work activities and accommodation and food service activities. Compared to the same quarter in 2022, the number of occupied posts increased by 3.9 thousand or 4.9% in human health and social work activities and by 0.8 thousand or 2.7% in accommodation and food service activities. Despite the gradual recovery of those sectors, the number of occupied posts in them is still lower than it was before the COVID-19 crisis in 2019.

Overall, in the past 10 years (between Q3 2012 and Q3 2023) the total number of occupied posts increased by 39.8 thousand or 4.7%. The largest increase in jobs was observed in human health and social work activities (by 28.3 thousand), information and communication (by 16.9 thousand) and administrative and support service activities (by 8.6 thousand). Meanwhile, the biggest job cuts were observed in the retail sector (by 7.4 thousand), as well as transportation and storage services (by 6.5 thousand).

## 7.2. WAGES

Considering the return of activities to the labour market after the COVID-19 pandemic, as well as the growing pressure on the labour market supply side, the average wages continue to rise at a rapid pace. In Q3 2023, the average annual increase in wages reached 11.8%, while the average gross wage increased to 1549 euro. It should be noted that already in 2021 the average gross wage increase reached almost 12%, being the fastest wage increase in the last 13 years, thus the total wage increase over the last 2 years amounts to 27.8%, whereas compared to the pre-COVID-19 period (Q3 2019), the average wage has increased by more than 1/4.

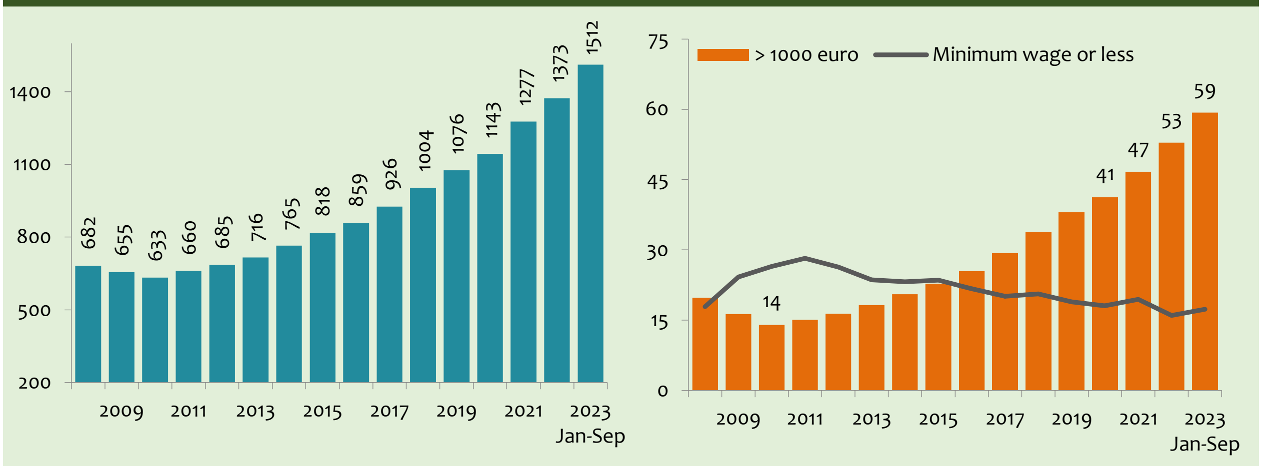
The increase in average wages in 2023 was significantly affected by an increase in the minimum wage rate by 24% – from 500 euro in 2022 to 620 euro, as well as a reduction in the share of lower-paid jobs, for example, job cuts in sectors like accommodation and food service activities, transport services, as well as administrative and support service activities. Meanwhile, wage growth in 2022 continues largely to be driven by both acute shortage of workers and rising inflationary pressures. It should be noted that due to inflation, a decrease in real wages in Latvia has been observed for the first time since 2011. In Q1-Q3 2022, real wages decreased by an average of 7.7% compared to the corresponding period of 2021 a year earlier, while in Q3 real wages decreased by 12.9%.

Figure 7.6

**Gross wage**

Average gross monthly wage of workers
*euro*

Distribution of the employed by groups of gross wages
*as per cent of the total number of the employed*




It should be noted that stable wage growth has persisted in Latvia since the end of 2010, moreover, in the last five years the average annual growth rate of gross wages has been close to 8%. A positive pressure on wages keeps coming from the wage convergence process closer to the wage levels of the EU's economically developed countries as well as from the growing shortage of skilled labour – shrinking of the labour market, which makes it necessary for entrepreneurs not only to think more actively about how to attract new professionals but also how to keep existing ones, including through a review of wage rates.

Wage growth in previous years partly ensured labour productivity growth – real labour productivity per employee in 2022 was approximately 34% higher than in 2010. At the same time, the average wage growth in previous years has significantly exceeded the increase in labour productivity, thus negatively impacting the competitiveness of Latvian enterprises. Between 2010 and 2022, real wages have grown by an average of 4% per year, while real labour productivity alone has increased by an average of 2.5% per year.

In the three quarters of 2023, wages have increased in both the private and public sectors. Compared to the corresponding period of 2022, the average gross wage in the public sector increased by 13.7% (to an average of 1564 euro) and by 11.1% in the private sector (to an average of 1546 euro). If we compare Q3 and Q2, the average gross wage increased by an average of 1.0% for those working in the public sector and by 1.8% for those working in the private sector.

Since 2010, wages have increased in both the private and public sectors. At the same time, wage growth in the private sector has been on average more rapid in the previous years, partially affected by a more significant increase in labour demand – in 2011-2023 (three quarters), the number of occupied posts grew by 15.7% in the private sector and only by 0.4% in the public sector.

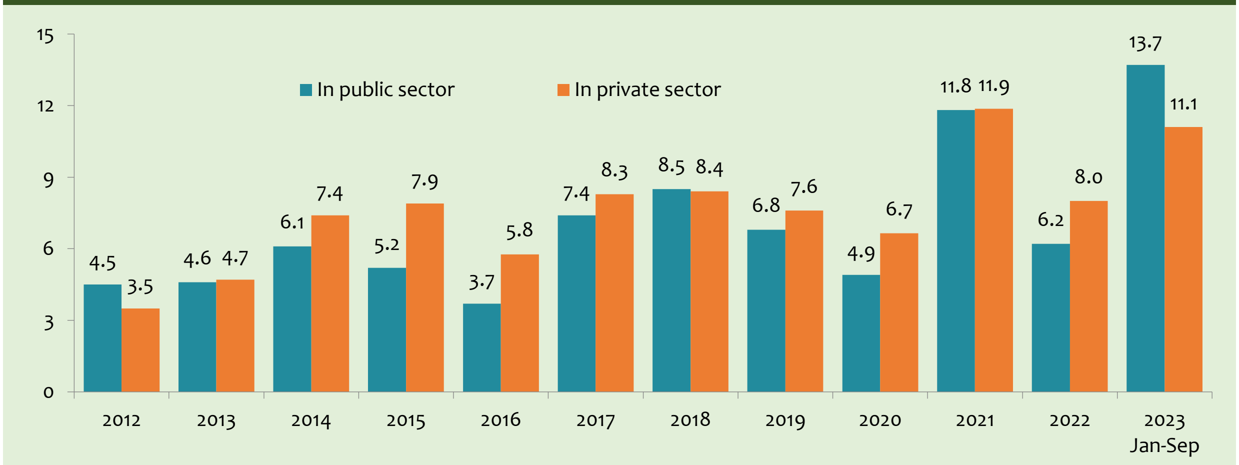
Along with the average wage increase, positive trends are also observed in the remuneration structure – on the one hand, the proportion of recipients of the minimum wage continues to decrease, but on the other hand, the share of employees who receive a wage above 1000 euro per month increases. In the three quarters of 2023, more than half (about 53%) of all employees had gross remuneration exceeding 1000 euro, while the share of employed receiving the minimal wage or less has reduced to 16.6%.

Between 2010 and 2023 the share of employed receiving the minimal wage or less has reduced by approximately 10 percentage points, while the share of employed receiving more than 1000 euro has increased by almost 47 percentage points during this period.

Figure 7.7

**Wages in the private and public sector**

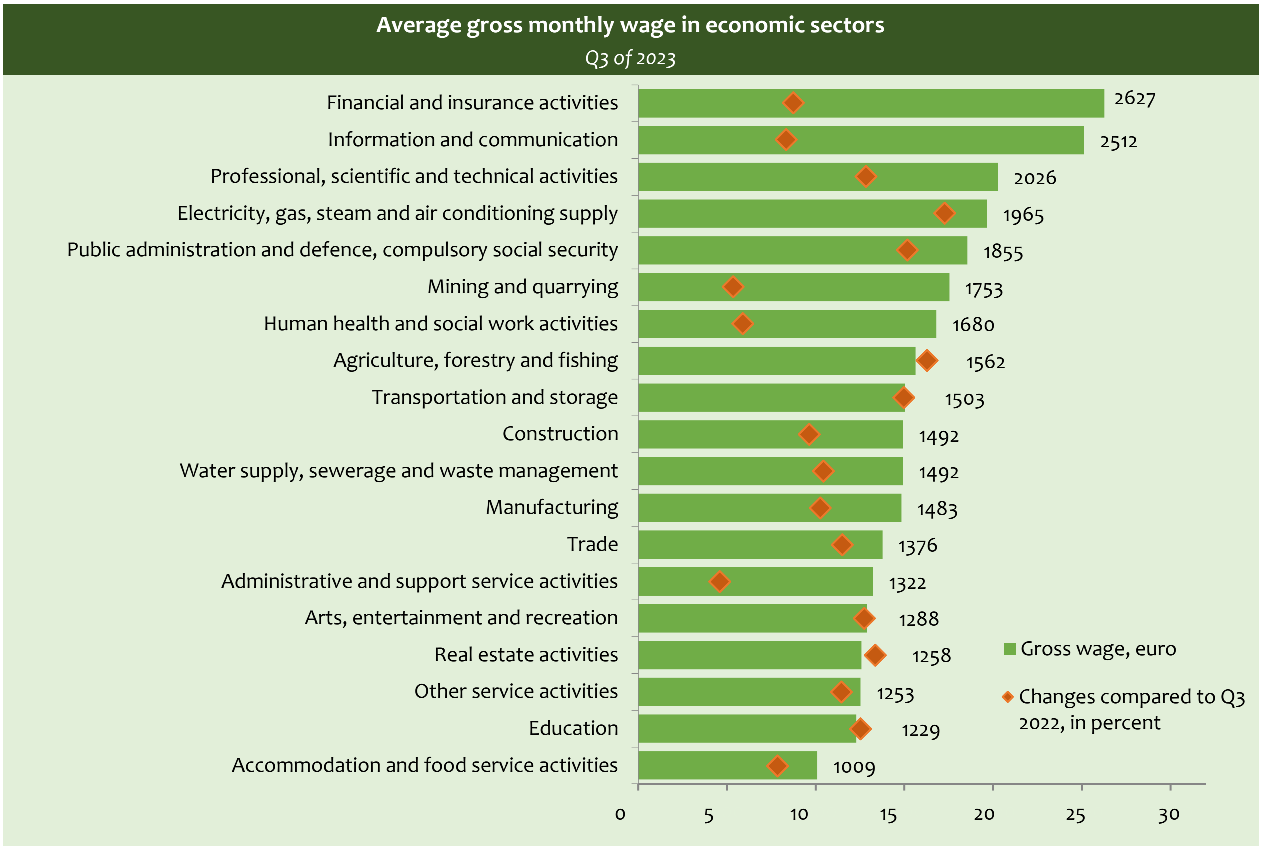
*changes as per cent compared to the previous year*




In Q3 2023, an increase in wages was observed in all sectors of the economy. The most significant increase in wages over the year (in Q3 2023, compared to Q3 2022) was in energy – by 17.7%, agriculture, forestry and fishery – by 16.7% (the highest increase was in forestry and logging), public administration – by 15.7%, transportation and storage – by 15.5% (the highest increase was in air transport), real estate activities – by 14.1%, professional, scientific and technical activities – by 13.6%, arts, entertainment and recreation – by 13.5%, and education – by 13.3%. The rapid increase in real estate activities was affected not only by the increase in funds intended for wages but also by the decline in full-time workers.

The highest wage level in Q3 2023 remained in financial and insurance activities (2627 euro), information and communication (2512 euro), professional, scientific and technical activities (2026 euro), energy (1965 euro), public administration (1855 euro), mining and quarrying (1753 euro), human health and social work activities (1680 euro) and agriculture, forestry and fishery (1562 euro). The lowest wages for full-time work were paid in accommodation and food service activities – 1009 euro before tax.

Figure 7.8




## 7.3. LABOUR MARKET FORECASTS

The labour market forecasts until 2030 are prepared in accordance with the medium-term economic growth forecasts (see Chapter 5).

The slowdown of economic growth in 2023 has also had an overall impact on the labour market situation. Although activity in the labour market continued to increase in 2023, the increase in new jobs and employment has slowed down compared to 2022. According to the provisional MoE estimates, the increase in the number of employed persons in 2023 against 2022 could be an average of 0.1% (an increase by an average of 0.9 thousand), thus the total labour demand remains close to the level of 2022 – the average employment in 2023 could amount to 887.1 thousand or 64.3% of the population aged 15-74. The most significant increase in employment in 2023 was observed in human health and social work activities (according to MoE estimates – by 7.1 thousand), transportation and storage (increase by 3.4 thousand) and agriculture and forestry (an increase by 2.6 thousand). The most significant decrease in labour demand was observed in trade (a decrease of 12.8 thousand).

In 2023, supply factors continued to influence the labour market situation alongside weaker demand. As inflows of Ukrainian war refugees diminished, so did the positive impact of this flow on labour supply. If there was a stabilisation of the population aged 15-74 and even a slight increase in 2022 (by 0.3% or 4.5 thousand, compared to 2021), then the population in this age cohort generally continued to decline in 2023 – by an average of 0.5% or 7.5 thousand, compared to 2022. Considering the shrinking numbers of the population, according to the MoE assessment, the number of economically active population (labour supply) could have decreased by 0.4% or 3.4 thousand in 2023, compared to 2022, to an average of 947.9 thousand.

Considering both labour demand and supply trends, according to MoE's provisional estimates, the average unemployment rate in 2023 may have decreased on average to 6.4% or 0.5 percentage points, compared to 2022. The number of job seekers per year may have decreased to around 61 thousand (4.3 thousand less than in 2022).

## LABOUR MARKET DEVELOPMENTS IN 2024

Given the tense geopolitical situation and still high economic uncertainty in the economy, a wait-and-see situation is expected to continue in the labour market in 2024. It should be noted that the change of economic cycles in the labour market was reflected with an average of 2-3 quarter shift, so the slowdown of economic rates in 2023 could partly affect the dynamics of labour demand also in Q1 2024. **According to MoE forecasts, the increase in employment in 2024, compared to 2023, could remain within 0.1%, while the unemployment rate could decrease to 6.3%.** The total number of employed persons in 2024 could come close to 888 thousand or approximately 64.8% of the population aged 15-74 (0.4 percentage points higher than in 2023), but the number of job seekers should decrease to an average of 59.3 thousand per year.

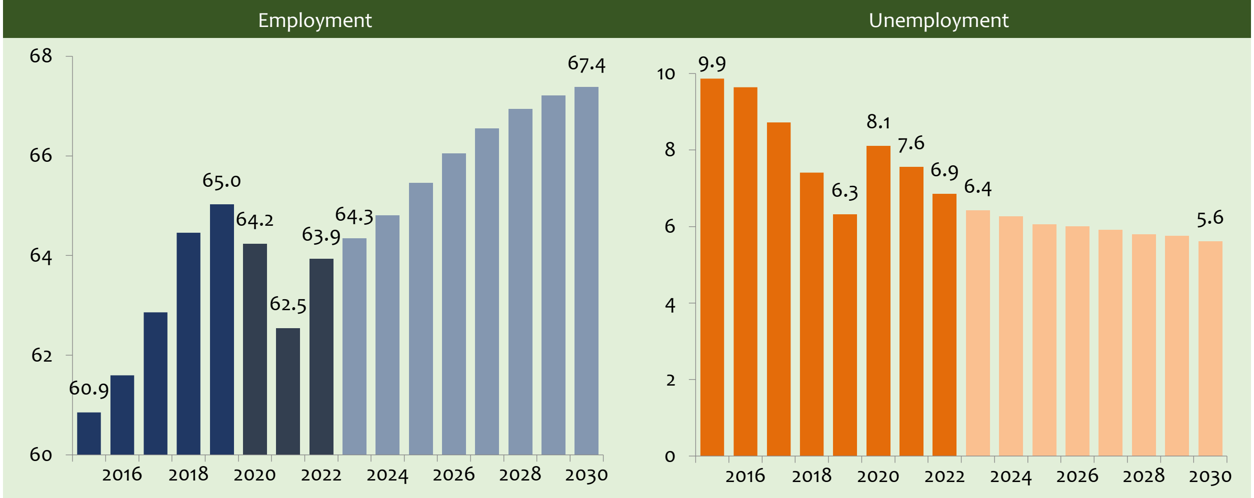
Similarly to 2023, labour market supply factors will continue to drive the situation in the labour market in 2024. In view of the demographic processes (in 2024, the population aged 15-74 could decrease by approximately 0.6% or 8.8 thousand, compared to 2023), the total economically active population count in 2024 could decrease to an average of 947 thousand or 0.1%, compared to 2023. At the same time, labour supply will be positively affected by the increase in economic activity of the population – by 0.4 percentage points (up to 69.1%), compared to 2023 driven by both the overall tense situation concerning the sufficiency of the labour force in the labour market and by the increase in labour remuneration (according to MoE forecasts, gross wages could increase by 7.8% in 2024 compared to 2023).

Overall, in 2024, the most significant increase in labour demand is expected in construction influenced by further construction of *Rail Baltica* and construction of other public infrastructure facilities. The increase in employment could also be observed in human health and social work activities, ICT services, as well as accommodation and food service activities.

It is to be noted that as early as 2024, relative employment and unemployment figures could return to the levels seen before the COVID-19 crisis in 2019. However, account should be taken that the number of employed persons in absolute terms is likely to remain below the level of 2019 in the coming years, considering both the demographic processes (less working age population in the labour market) and the need for higher labour efficiency – economic growth will be based more on labour productivity growth.

Figure 7.9

**Employment and unemployment rate**
*as per cent*




## LABOUR MARKET FORECASTS FOR 2025-2030

From 2025 to 2030, economic growth will further be based on the increase in labour productivity, therefore the total labour demand and increase in the number of employed persons will be slower than economic growth. Until 2030, **the number of employed persons is expected to grow by an average of 0.1% per year and the total labour demand in 2030 could be close to 892 thousand.**

Although employment could grow slowly, the population employment rate (the share of the employed in the total population of the relevant age) will keep growing stably. From 2025 to 2030, the employment rate in age cohort 15-74 could grow by an average of 0.4 percentage points per year and could reach an average of 64.7% in 2030.

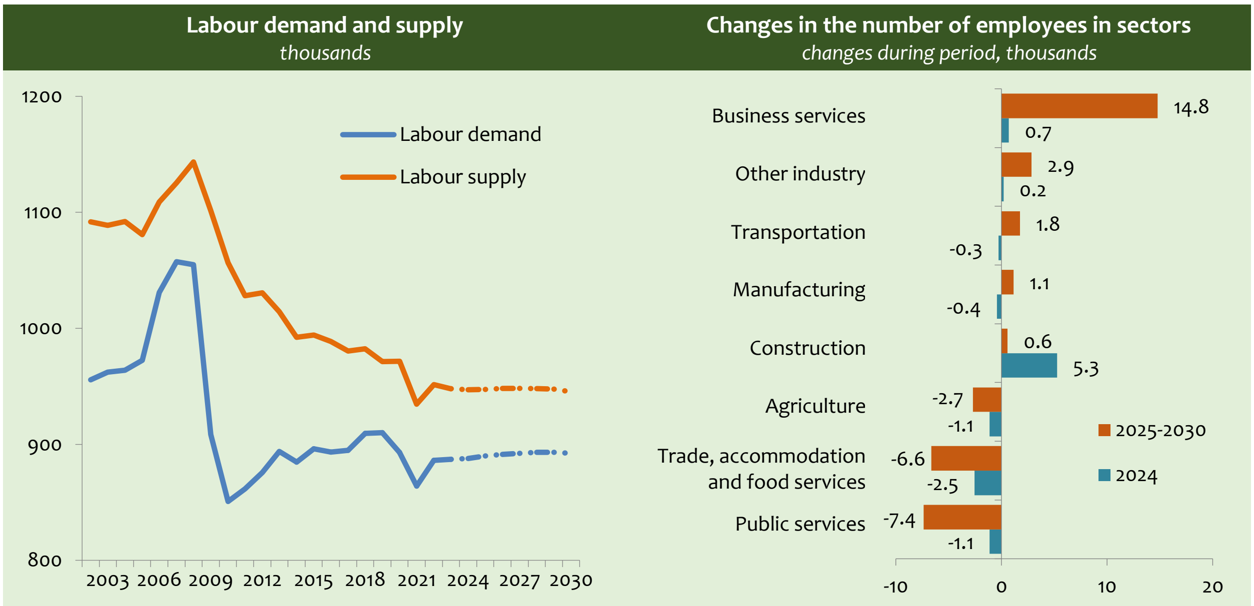
Available labour resources will continue to shrink in the coming years, and the labour shortages might become more pronounced. The decline in labour stocks will be largely determined by the reduction in the number of the population capable of working, as well as ageing of existing labour force and leaving of the labour market.

It should be noted that the COVID-19 pandemic crisis has had a negative impact on the participation of the population in the labour market, which altogether also reduced the number of workers available in the labour market. According to MoE estimates, in 2023, the economic activity rate of the population was still 0.6 percentage points lower than in 2019. Although labour market participation is gradually growing, the pre-pandemic level could still be fully restored only in 2025. Given the growing labour shortages, the participation rate is expected to increase further until 2030. By 2030, the participation rate for the 15-74 age group could increase to 71.4%.

Although economic activity is expected to increase, the overall labour supply will stay below the level of 2019 until 2030. Demographic factors, such as an ageing population and a declining working-age population, will have a major impact on this trend. Although the population in private households aged 15-74 has increased in 2022, the medium- and long-term trend is still downward, due to an ageing trend. According to demographic forecasts of the MoE of 2022, the Latvian population might decrease to 1.78 million or by approximately 106 thousand by 2030, compared to the beginning of 2023. The most significant reduction will be observed among people of working age. The population aged 15-64 is expected to fall by nearly 89 thousand or 7.5% by 2030, which will have a negative impact on the overall labour supply.

Given the trend towards an ageing workforce, the main job opportunities in the coming years will come from replacement demand. According to the MoE projections, almost 2/3 of all vacancies between 2022 and 2030 could be due to replacement demand.

Figure 7.10




From 2025 to 2030, labour demand is expected to further restructure in favour of business services. The most significant increase in labour demand until 2030 is expected in the commercial services sector, in particular in information and communication and professional, scientific and technical activities. Overall, employment in business services might increase by 15 thousand by 2030, compared to 2024.

A significant increase in labour demand in the medium-term is expected also in other industrial sectors – mining and quarrying; electricity, gas, steam and air conditioning supply; water supply, sewerage, waste management and remediation activities. It is related to the increase in demand for construction raw materials, the transformation of energy sectors and the implementation of the EU Green Deal. Overall, employment in other industrial sectors could increase by almost 3 thousand employees from 2025 to 2030.

The number of employed people in the medium term will keep growing also in transport services, but it should be noted that the structure of the sector has changed significantly during the crisis (a significant drop in labour demand in passenger transport by air, water and rail), therefore the number of employed in the sector might not return the level of 2019 by 2030.

Considering the demographic trends, unemployment will generally keep shrinking until 2030 and will be close to the natural level (within 5-6%). GDP is expected to get close to 6.1% already in 2025 and reduce to 5.6% by 2030. The highest unemployment risks are expected among the population with a low level of education and without professional skills/professional qualifications.

In 2025, labour demand could resume growth also in manufacturing sectors. However, the employment increase in manufacturing and other traditional tradable sectors will remain sluggish, as the growth of those sectors will mainly depend on the productivity increase, which plays a decisive role in ensuring competitiveness. Overall, employment in manufacturing might increase by approximately 1.1 thousand by 2030, compared to 2024.

Considering the implementation of *Rail Baltica* and other large infrastructure projects, labour demand will remain high in the construction sector in the medium term. In construction, the highest level of labour demand is expected to be reached around 2026/2027, with the most active construction phase of *Rail Baltica*. Overall, employment in construction might increase by approximately 5.6 thousand by 2026, compared to 2024 and reach approximately 84 thousand in 2026.

Along with job automation trends, employment could continue to decline in the retail segment in the coming years along with the broader entry of self-service cash register systems as well as other automated trading solutions in the sector. Employment in trade is expected to increase by more than 8 thousand employees from 2024 to 2030.

At the same time, in the medium term, labour demand will continue grow in accommodation and food service activities, however, considering the slower economic growth rate and the uncertain geopolitical situation, the number of employees in the coming years might not return to the level of 2019.

The reduction in employment could be seen also in agriculture and logging largely due to the continued effectivization of the sectors. In the period from 2025 to 2030, employment in agriculture and logging could decline by 2.7 thousand.

The most significant reduction in employment from 2025 to 2030 is expected in public services, mainly in public administration and education, considering both the planned reduction in the number of staff working in public administration and the continued optimisation of the school network. Overall, by 2030 the number of employed in public administration might decrease by about 6 thousand, while in education – by 5.9 thousand, compared to 2024. At the same time, the number of employees could continue to grow in human health and social work activities. From 2025 to 2030, employment in human health and social work activities could grow by 4.5 thousand.

# PART II. ECONOMIC POLICY PRIORITIES

## 8. HUMAN CAPITAL DEVELOPMENT

### 8.1. MANAGEMENT OF HUMAN CAPITAL DEVELOPMENT MATTERS

The main challenges in Latvia's labour market have long been the negative demographic trends and the ageing of the labour force, as well as the mismatch between demand and supply of skills of the labour force and the lack of workers with adequate qualifications (for information on labour market forecasts see Chapter 7.3).

Measures to promote labour availability are important for the competitiveness of the Latvian economy in the medium term. They include both the offer of formal education and active labour market measures promoting the economic activity of the population, as well as a sound labour migration policy. At the same time, it should be emphasised that the sustainability of the economic growth of Latvia cannot be related to the attraction of a cheap workforce from third countries.

Labour market mismatches aggravate pronounced regional differences. New jobs mainly appear in more economically active regions and larger cities, while high unemployment persists in less developed regions, particularly Latgale. The regional disparities impede a balanced development of the labour market. Meanwhile, the regional equalization of the labour market is hampered by the low regional mobility of the labour force, i.e., the ability to rapidly change their place of work and residence.

To achieve faster economic growth and growing population income, the MoE takes the leading role in ensuring coordinated management of human capital issues, facilitating labour supply adjustment to the needs of the future labour market. In July 2023, a Human Capital Development Department was established, whose mission is to contribute to the development and monitoring of the implementation of a national human capital policy, the management of appropriate policy implementation tools, as well as continuous structural policy analysis in line with the policy objectives set, to ensure a uniform and integrated work of a national economy sector as a whole and the ability to fulfil the tasks assigned.

**MoE Human Capital Development Department**

Main functions of the Human Capital Development Department.

1. To develop, organise and coordinate human capital policies to promote the development of human resources in line with future demand and transformation of the national economy towards the creation of higher added value:
    1.1. in consultation with ministries, social partners, and other non-governmental organisations, to develop a *Human Capital Development Strategy*, including:
    – to define the main directions and strategic objectives of the strategy;
    – to define long-term priority action directions for achieving the strategic objectives;
    1.2. to ensure the development of an action plan for the achievement of the strategic objectives and the performance indicators of the *Human Capital Development Strategy* and the supervision of its implementation.
2. To provide secretarial functions for the Human Capital Development Council coordinating it's work in the decision-making regarding the skills needed in the labour market and appropriate reskilling areas.
3. To form and coordinate a joint commission with a purpose to estimate, analyse and make proposals for improving the quality and effectiveness of adult education programs.

On 6 June 2023, the Cabinet of Ministers approved the *By-law of the Human Capital Development Council*, supporting the agreement of the three Ministers (the Minister of Economics, the Minister of Education and Science and the Minister of Welfare) to transform the current Employment Board, forming a closer link with the tasks specified in the government declaration in the field of management of labour matters and human capital development.

The new geopolitical reality, the development of digital technologies, globalisation, automation, the ageing of the labour force – these changes have a significant impact on jobs, industrial and service sectors, business models, the economy, society and every individual. Sustainable economic growth and transformation need to provide a labour for the growing and productive sectors that demand ever-new skills and knowledge. By strengthening existing cooperation between ministers and defining new objectives, the Human Capital Development Council is expected to contribute to improving inter-ministerial cooperation and resolving management matters more effectively.

**Human Capital Development Council**

The Human Capital Development Council is a collegial institution established to implement coordinated inter-departmental cooperation and make decisions in the planning, development, implementation and supervision of necessary labour market rearrangements, promoting the development of human resources in line with future labour market demand and structural changes of the economy towards the creation of higher added value, which would benefit the entire society. The Council includes the Minister of Economics, the Minister of Education and Science and the Minister of Welfare. The Minister of Economics is the chairman of the Council. Representatives and specialists of other ministries, cooperation partners, non-governmental organisations and other institutions who are experts in specific agenda matters are expected to be involved in the work of the Council.

Key functions of the Human Capital Development Council:

- to assess the labour market situation and labour market development scenarios and forecasts, including the unemployment situation and its impact on the competitiveness of different population groups in the labour market;
- in consultation with social partners and other non-governmental organisations, to define strategic objectives and action directions for the development of human capital for the achievement of these objectives, preparing proposals for support measures for the development of human capital, as well as to monitor progress in achieving the objectives set;
- to evaluate the functions and tasks of the subordinate institutions of the MoE, MoW and MoES (CSB, SEA, State Education Development Agency and LIAA) in the field of promoting lifelong learning, labour market and competitiveness of sectors and to provide proposals for their more efficient implementation to foster supervision of the offered (adult) training and the quality and efficiency of the training;
- to prepare proposals for adult learning courses co-financed by the state budget and EU funds;
- to evaluate and prepare proposals for quality requirements for adult education providers;
- to prepare proposals to be included in draft legislation and policy planning documents on lifelong learning, employment and economic competitiveness.

With the establishment of the Human Capital Development Council, the Employment Board (the discussion platform of the Ministers of Economics, the Minister of Education and Science and the Minister of Welfare, which has been functioning since 2016) ceased to exist.

In 2023, the Human Capital Development Council continued the activities initiated by the Employment Board:

- discussed the priority measures of the MoE, MoES, MoW, as well as the planned support programmes of the Recovery Fund and EU Funds for the promotion of human capital development;
- proposals have been prepared to increase the efficiency of cooperation formats, maintaining the involvement of social and cooperation partners in solving human capital development issues, including support for the transformation of the Employment Board into the Human Capital Development Council, as well as the creation of a joint commission to identify adult learning needs;
- discussed issues related to the reduction of administrative burden on labour attraction from third countries and proposals for amendments to legislation prepared in cooperation with sectoral entrepreneurs and sectoral ministries;
- supervised the progress of development of the *Human Capital Development Strategy 2024-2027* and approved strategy's draft;
- discussed matters of the management of volunteering work.

**Human Capital Development Strategy**

*The Human Capital Development Strategy 2024-2027* (hereinafter - Strategy) is currently being developed under the guidance of MoE. Its overarching objective is to ensure coordinated management of human capital issues by promoting the adaptation of labour supply to the needs of the future labour market. The strategy is developed in cooperation with sectoral ministries, their subordinate institutions and other organisations which make proposals and recommendations within the scope of their competence.

Five thematic action directions with two horizontally integrated components - human capital management and data and evidence-based decision making and analytics, have been defined for the Strategy and approved by the Human Capital Development Council:

1) formal education and STEM skills, including increasing the participation of employers in the development of human capital in the STEM fields, strengthening of quality and management, improving the financial support system for students in the STEM fields and providing learning materials, including STEM learning materials;
2) expansion of the labour market, including promoting regional labour mobility and housing availability, increasing motivation and involvement in the labour market of economically inactive population groups, creating healthy working environment;
3) attraction of qualified employees, including improvement of labour immigration processes and attraction of foreign students;

**Box continued**

4) offer and quality of adult education and training, including development of culture of adult learning within society and provision of support for employee's skills development and retraining;
5) support for the entrepreneurial spirit of entrepreneurs, including availability of support for entrepreneurs for training opportunities for knowledge capacity building.*

* As the Strategy is still in the process of development, the priority action directions may change.

To implement coordinated cooperation and management of the institutions involved in the field of adult education to achieve the strategic objectives of human capital development, work has been initiated to establish a joint coordination commission for adult education. The main task of the commission will be to determine the adult training needs to be supported in the programmes financed by the state budget, the *Latvia's Recovery and Resilience Facility Plan* and the EU Funds under the responsibility of the MoE, MoW and MoES.

## 8.2. SUPPORT FOR BUSINESSES IN HUMAN CAPITAL DEVELOPMENT

MoE, alongside MoW and MoES, has developed and implements several measures to support human capital development. The measures within the competence of MoE are mainly related to support entrepreneurs for the improvement of skills of employees and the attraction of qualified labour.

### DEVELOPMENT OF SKILLS

To ensure support for the improvement of skills of employees and to promote the introduction of technological innovations and increase of labour productivity, until 31 December 2023 support of the 2014-2020 programming period of the EU Funds will be available within activity *1.2.2.1 Support for the training of employees* and Specific Objective *13.1.6 Recovery measures in the economic sector – training of employees (ERDF)* and activity *1.2.2.3 Support for ICT and non-technology learning, as well as learning aimed at attracting investors*. A total of 14.2 million euro are available within the scope of the activity. By 2023, 22.5 thousand employees have attended the training.

To promote the digital transformation and competitiveness of companies, on 12 September 2023, the CM approved MoE developed Regulations No. 529 *Implementing Regulations of Investment 2.3.1.2.i. "Development of Digital Skills of Enterprises" of Reform and Investment Direction 2.3 "Digital Skills" of Component 2 "Digital Transformation" of the Recovery and Resilience Facility Plan of the European Union*, which provides support for the development of digital skills of employees of companies starting from 2024. The objective is to improve the digital skills of micro, small, medium-sized and large Latvian enterprises, including skills that contribute to export promotion, basic high-level digital management skills at the level of enterprise management and skills for the use of digital technologies in different business processes. Training for the improvement of digital skills development for company employees will be available through European Digital Innovation Hubs (EDIHs) or organisations representing companies or industry associations selected in a competition. To receive support for the improvement of skills of employees of entrepreneurs, the entrepreneur will need to undergo a digital maturity test and receive a Digital Development Roadmap, which will have to provide recommendations for the improvement of skills of employees. The RRF financing available for the investment is 20 million euro, and at least 3000 companies are expected to receive support for the improvement of the digital skills of employees within the framework of the programme. This investment is planned to continue within the EU CF 2021-2027, with 10 million euro more channelled to it.

In 2023, the EC Technical Support Instrument project *Support Employers in Promoting Skills Development in Latvia*[1] was concluded. It was implemented by the OECD in cooperation with the EC Directorate-General for Structural Reform Support. The project's objective was to support Latvia in developing a regulatory framework that would support and stimulate employers to improve their employees' skills or promote reskilling. As a result of the project, Latvia has been provided with recommendations aimed at improving and adapting different types of support to SMEs and building skills of companies and learning culture in companies. Several measures have been initiated to implement recommendations and ensure sustainable reform in the improvement of skills of employees of employers.

[1] For more information about the project, see: https://www.oecd.org/skills/employer-training-support-latvia.htm.

To implement the OECD recommendation to extend tax exemptions in higher education and general education programmes, on 7 December 2023, the Saeima adopted the law *Amendments to the Law On Personal Income Tax*, which stipulates that the tuition fees paid by the employer for the employee's higher education in state-accredited Latvian educational institutions, in educational institutions of EU member states and European Economic Area countries shall not be considered as income from paid work, if the acquisition of higher education is related to the acquisition of such skills that are required by the employer. The mentioned amendments will enter into force on 1 January 2024. Thus, with the amendments to the law *On personal income tax*, entrepreneurs are given the opportunity to pay for employees' higher education, without taxing the said benefit to the employee/employer with labour taxes.

To implement the recommendation of the OECD to provide tailored support to SMEs and promote competitiveness and productivity of entrepreneurs, and to promote access to learning based on the needs of sectors in the EU Funds 2021-2027 programming period, the MoE has developed the draft CM Regulations *Support Measures for Adult Education Based on the Needs of Sectors and its Implementation Procedure* providing for the channelling of ESF Plus funding of 14 million euro (activity *4.2.4.1 Support for Training of Company Employees Based on the Needs of Sectors*). Training is expected in the fields of design, languages, hotel management, project management, tourism management, financial management, physical sciences, mathematics and statistics, business management, environmental protection, engineering and engineering trades, marketing and trade, forestry, health services, hotel and restaurant services, travel and leisure organisation, quality assurance and management, catering and hotel business. Support to businesses is expected to be available from 2024. More than 8,000 company employees are expected to be involved in the training.

## ATTRACTION OF QUALIFIED LABOUR FORCE

Given that sustainable economic growth and competitiveness need to provide a labour force for growing and productive sectors, the Human Capital Development Council has agreed on several measures to be taken to reduce administrative barriers to attracting a labour force from third countries. At the same time, it is proposed to develop control mechanisms for the use of “employee leasing” to attract third-country nationals and prevent uncontrolled immigration.

The proposals prepared for amendments to the laws and regulations include:

- to define that no less than the average monthly gross wages of the employees working in the Republic of Latvia in the sector (according to the information last published by the CSB) or the minimum wage defined by the general agreement of the sector which is concluded in accordance with the fourth part of Article 18 of the *Labour Law*, is set for the foreign labour force, if the foreigner receives a visa and the right to employment;
- to define that a company will be able to attract a labour force from abroad, if the employer has published an open vacancy in the Unemployment Accounting and Registered Vacancies Information System administered by the SEA, providing complete information regarding the job offer, and cooperated with the SEA in the selection process of suitable applicants for not less than 10 working days, evaluating the candidates offered by the SEA. If the vacancy has not been filled in as a result of the selection, then the employer, upon receipt of a conclusion issued by the SEA, will have the right to apply for an invitation or a call to the Office of Citizenship and Migration Affairs within the period of one year;
- to waive the requirement to submit a copy of a document certifying the education/experience of a foreigner in cases where the profession is not regulated in Latvia. At the same time, it is intended to maintain the obligation for the inviter (employer) to verify the qualification and suitability of the invited employees for the performance of the work;
- to restrict dishonest employers – inviters of the foreign labour force, providing for the right for the Office of Citizenship and Migration Affairs to decide on a prohibition to a natural or legal person to invite foreigners for a period of up to one year. This will reduce the number of applicants for dishonest visas and residence permits who do not comply with the requirements of the laws and regulations related to the employment of foreigners, as well as reduce the risks endangering Latvia's reputation.

It is planned to continue discussions on the development of the *green corridor* policy in the attraction of foreign labour force to reduce administrative burden for undertakings and accelerate administrative coordination processes while promoting Latvia’s competitiveness in the field of investment attraction.

# 9. INTEGRATION OF LATVIA IN THE EU ECONOMIC AND STRUCTURAL POLICIES

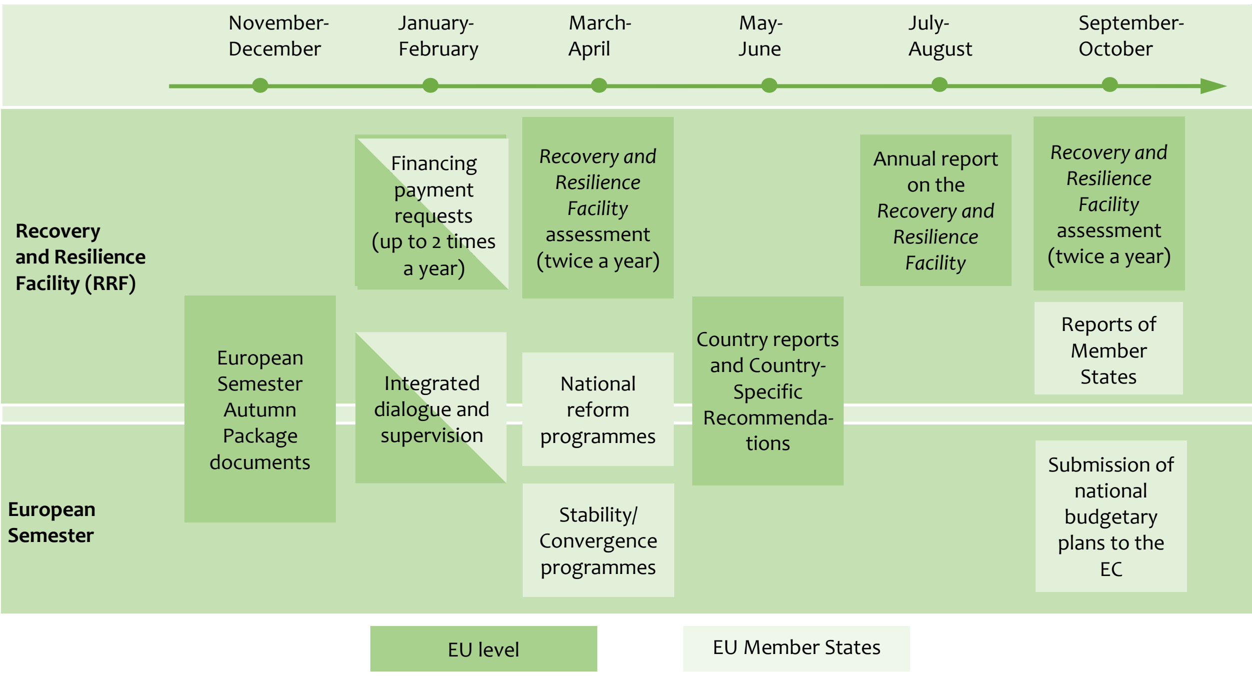
## 9.1. EUROPEAN SEMESTER

On 12 January 2010, the EC published its *Annual Growth Survey* offering to launch a new economic policy surveillance and coordination mechanism in the EU – the European Semester. Since 2011, the European Semester starts every year in November, when the EC publishes the key documents (the so-called *European Semester Autumn Package*), the evaluation of which starts the European Semester of the next year, and those are: the *Annual Sustainable Growth Survey*, the *Alert Mechanism Report*, the *Draft Joint Employment Report,* the *Proposal for EU Council's Recommendations* to the Euro Area and other documents. In these documents the EC evaluates the economic situation across the EU and offers economic policy priorities for the next year. These documents are the basis for further discussions between EU Member States and the EC at different meetings of the EU Council.

The EC reports on each EU Member State (Country Reports), which are published every year in spring, are another important element of the European Semester. In these reports, the EC offers a detailed analysis of each EU Member State, its economic situation, main challenges and ongoing reforms.

Figure 9.1

**Integrated European Semester and Recovery and Resilience Facility implementation process**




Meanwhile, at national level, in accordance with the European Semester process every year EU Member States should draft and by mid-April submit to the EC national programmes (the *National Reform Programme*, the *Stability Programme or Convergence Programme*). After both documents have been submitted, the EC prepares its assessment and at the end of May makes proposals for EU Council's Country-Specific Recommendations, which are discussed at different EU Council meetings and are approved at the European Council meeting in June.

With the establishment of the RRF (see Chapter 9.2), which was integrated into the European Semester process, EU Member States should report twice a year to the EC on the implementation of the *National Recovery and Resilience Plans*, the achievement of their milestones and targets, etc. In addition, *National Reform Programmes* should contain references to the *Recovery and Resilience Plans* as both processes are integrated. In Country Reports, the EC evaluates progress in the implementation of the *Recovery and Resilience Plans* (see Figure 9.1).

Following the European Semester process, on 21 November 2023, the EC published the *European Semester Autumn Package*: the 2024 *Annual Sustainable Growth Survey*, the *2024 Alert Mechanism Report* (see Chapter 6.8), the *Draft Joint Employment Report*, the *Proposal for EU Council's Recommendations to the Euro Area* and other documents.

**EC proposal for EU Council's *Recommendations on the Economic Policy of the Euro Area***

The EC proposal for EU Council's *Recommendations on the Economic Policy of the Euro Area* published on 21 November 2023, urges euro area Member States to take action, individually, including through the implementation of their national *Recovery and Resilience Plans*, and collectively within the Eurogroup, in the period 2024–2025 to:

1) Adopt coordinated and prudent fiscal policies to keep debt at prudent levels or put debt ratios on a plausibly downward path. Achieve an overall restrictive fiscal stance in the euro area and thus facilitate the timely return of inflation to the 2% target, while remaining agile in view of the high uncertainty. Wind down crisis-related energy support measures as soon as possible and use the resulting savings to reduce deficits. While ensuring compliance with the expenditure maxima recommended by the Council, modulate the fiscal stance to avoid lasting divergences in inflation. In the medium term, develop fiscal strategies to achieve a prudent medium-term fiscal position and strengthen debt sustainability where necessary, through gradual and sustainable consolidation, combined with high-quality public investments and reforms. Where needed, include in these strategies measures to further increase the efficiency and quality of public expenditures and to improve the sustainability and adequacy of the pension and healthcare systems.
2) Sustain a high level of public investment, to support the green and digital transition, strengthen productivity and resilience. Accelerate the implementation of the *Recovery and Resilience Plans*, including their *REPowerEU* chapters. Make full use of cohesion policy programmes and ensure that their mid-term review takes into account, among others, the challenges identified in the European Semester and the progress in implementing the *European Pillar of Social Rights*, without reducing their overall ambition.
3) In accordance with national practices and respecting the role of social partners, support wage developments that mitigate purchasing power losses, especially for low-income earners, taking due account of competitiveness dynamics and avoiding lasting divergences within the euro area. Promote upskilling and reskilling as well as active labour market policies to address labour and skill shortages and increase productivity. Take measures to facilitate managed legal migration of third countries workers in shortage occupations, in full complementarity to harnessing talents from within the EU. Safeguard and strengthen adequate and sustainable social protection and inclusion systems. Ensure the effective involvement of social partners in policymaking and strengthen social dialogue.
4) Remove investment obstacles to reduce the prevailing gap in investment for the green and digital transitions. Improve access to finance, in particular for innovative companies and SMEs, through further progress towards the Capital Markets Union. Ensure that public support to relevant strategic sectors is targeted, with no distortions of the level playing field in the Single Market and with a view to enhancing the euro area competitiveness and open strategic autonomy. Continue strengthening the international role of the euro and make further progress in the work on the digital euro.
5) Monitor risks linked to tighter financial conditions, in particular those related to the asset quality and to potential corrections in asset prices, including in real estate markets. Monitor developments in the non-bank financial intermediation to prevent the build-up of systemic risk and negative spillovers to the economy. Complete the Banking Union by continuing to work on all elements, including on a *European Deposit Insurance Scheme*.

***2024 Annual Sustainable Growth Survey***

In its *2024 Annual Sustainable Growth Survey*, the EC emphasises that the EU economy remains resilient despite the shocks experienced in recent years (COVID-19 pandemic, Russia's invasion of Ukraine, etc.). However, EU economic growth rates declined in 2023 in the face of high inflation and tighter financing conditions. A modest increase in growth is expected in 2024. EU economy faces several structural challenges, including low productivity gains, green and digital transitions, ageing and social inclusion of the population that need to be addressed to retain sustainable competitiveness progress. Disruptive geopolitical events have demonstrated the need for the EU to further remain competitive in a global market while ensuring that no one is left behind. *2024 Annual Sustainable Growt*h Survey emphasises that the coordinated EU policy response should be strengthened to improve the competitiveness of the EU using the green and digital transition while ensuring social and territorial cohesion. Resolution of structural and emerging challenges to fully unlock the competitiveness potential in each Member State will be one of the priorities of the European Semester in 2024. This includes removing barriers to private and public investment, supporting a friendly business environment and ensuring the development of skills required for the green and digital transition. In this respect, the European Semester cycle of 2024 will focus on synergies and complementarities between the implementation of the *Recovery and Resilience Plans* and the cohesion policy programmes, while pinpointing areas with further investment and reform needs at national and regional level. Moreover, the general escape clause of the *Stability and Growth Pact* is expected to be deactivated in 2024. Fiscal policy needs to support monetary policy in reducing inflation and safeguard fiscal sustainability, while providing sufficient space for additional investments and supporting long-term growth. In light of this, the EC believes the **four priority dimensions** defined in the previous years are still relevant.

**Box continued**

1. **Macroeconomic stability** – risks related to the high national debt level and price divergences remain relevant. Fiscal emergency measures taken to respond to the energy price shock should be wound down as soon as possible.
2. **Environmental sustainability** – actions taken by the EU and its Member States helped bring energy prices closer to pre-crisis levels, while investments in clean energy sources help stabilise the future energy supply. Member States are focusing their efforts on implementing the REPowerEU chapters of the *Recovery and Resilience Plans*, complemented by cohesion policy funds. The updated energy and climate plans of EU Member States need to be implemented. Strengthening the EU net zero greenhouse gas emission industry is essential for providing the technologies and components needed to deliver on the European Green Deal and for Europe's industry to remain competitive.
3. **Productivity** – while productivity is the main driver of competitiveness, average productivity growth in the EU has stagnated over the last decade. Boosting productivity hinges on improving the framework conditions, deepening the EU Single Market and on respect for the rule of law. Fostering a fair and small- and medium-sized enterprises-friendly business environment is key to strengthening the EU Single Market. The EU's growth path relies heavily on the uptake of digitalisation. Reducing productivity gaps in the EU requires a focus also on those regions where productivity has stagnated and that can benefit from complementarities between the *Recovery and Resilience Plan* and cohesion policy funds at regional level.
4. **Fairness** – the EU labour market continues to perform strongly overall despite slower economic growth, even though regional disparities persist, with some population groups feeling no improvement in the labour market situation. The high levels of labour and skills shortages are a major bottleneck for sustainable growth, innovation and competitiveness and require targeted action. Policy actions at the appropriate levels should be geared towards increasing labour market participation to improve employment and social outcomes. Despite marked wage increases in the EU in 2022 and the beginning of 2023, the wage increase rate remained below the high inflation rates and resulted in reduced purchasing power, affecting lower incomes the most. The need for adequate and sustainable social protection and inclusion policies remains high. Cohesion policy funds, together with *Recovery and Resilience Plans* of EU Member States, support Member States in progressing towards their 2030 national targets on employment, skills and poverty reduction. The continued implementation of the *European Pillar of Social Rights* remains a policy priority promoting social convergence in the EU.

The *National Reform Programme of Latvia for the implementation of the Europe 2020 strategy* (hereinafter – NRP of Latvia) was approved by the CM 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.

According to the European Semester process and timeline, the CM approved the twelfth ***Progress Report on the Implementation of the NRP of Latvia*** (hereinafter – Progress Report) submitted together with *Latvia's Stability Programme for 2023-2026* on 25 April 2023.

***2023 Country Report – Latvia***

*2023 Country Report – Latvia* provides analysis of the development of Latvian economy, characterises the RRF Plan of Latvia, reflects the EC vision of Latvian economic policy priorities requiring government's attention, and reflects the main conclusions of the EC.

2023 Country Report – Latvia provides that Latvia's economic development challenges are related to the geopolitical situation, namely, Russia's invasion of Ukraine and the related increase in energy prices causing inflation. The EC believes that the support measures for businesses and households implemented by the government were valuable and have helped to soften the negative impact of COVID-19 and the energy crisis. The EC mentions addressing the remaining socioeconomic and environmental challenges as a basis for sustainable growth.

The EC proposes the following priority measures requiring government's attention:

- improving tax compliance;
- making the use of energy and natural resources more efficient and sustainable and reducing reliance on fossil fuels;
- improving access to finance for small and medium-sized enterprises;
- improving access to education and training to address the needs of employers;
- tackling poverty and income inequality;
- providing adequate resources for healthcare and long-term care.

2023 Country Report – Latvia is the basis for the *EU Council's Country-Specific Recommendations for Latvia*.

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 issued by the EU Council in 2022, provides information on the implementation of the *European Pillar of Social Rights* in Latvia and characterises the progress of Latvia in the achievement of objectives of the UN sustainable development goals. The Progress Report shows that the implementation of all the EU Council Recommendations is ongoing, and Latvia is generally moving towards the achievement of the UN sustainable development goals.

When evaluating the programmes submitted by the EU Member States and their implementation, on 24 May 2023 the EC published Country Reports, including about Latvia, and proposals for EU Council's Country-Specific Recommendations for the EU Member States, which were approved at the meeting of the European Council on 29-30 June 2023 after discussions at different EU Council's meetings. The European Semester of 2023 has been completed with the approval of these recommendations by the European Council.

The measures planned by the government for the fulfilment of EU Council's Country-Specific Recommendations are included in the government's action plan. EU Council's Country-Specific Recommendations for Latvia are considered to be a significant element when setting economic policy priorities, formulating necessary reforms and policy activities, as well as successfully implementing the *National Reform Programme of Latvia*, *Latvia's Recovery and Resilience Facility Plan* and *Stability Programme of Latvia*.

It should be noted that the *National Reform Programme of Latvia*, *Latvia's Recovery and Resilience Facility Plan* and the *Stability Programme of Latvia* are being implemented in close cooperation with the European Commission. The progress in the implementation of the above-mentioned programmes is being regularly discussed in the bilateral meetings between Latvia and the EC. The MoE will continue monitoring the progress in the implementation of measures reflected in 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 for 2024*, which will have to be submitted to the EC by the end of April 2024 together with the *Stability Programme of Latvia*.

**The EU Council's Country-Specific Recommendations for Latvia 2023**

The following recommendations are made for Latvia for 2023–2024:

1) Wind down the energy support measures in force, using the related savings to reduce the government deficit in 2023 and 2024. Should renewed energy price increases necessitate new and existing support measures, ensure that these are targeted at protecting vulnerable households and firms, fiscally affordable, and preserve incentives for energy savings. Ensure prudent fiscal policy, in particular by limiting the nominal increase in nationally financed net primary expenditure in 2024 to not more than 3%. Preserve nationally financed public investment and ensure the effective absorption of RRF grants and other EU funds, in particular to foster the green and digital transitions. For the period beyond 2024, continue to pursue a medium-term fiscal strategy of gradual and sustainable consolidation, combined with investments and reforms conducive to higher sustainable growth, to achieve a prudent medium-term fiscal position. Broaden taxation, including of property and capital, and strengthen the adequacy of healthcare and social protection.
2) Continue the steady implementation of its *Recovery and Resilience Plan* and swiftly finalise the *REPowerEU* chapter with a view to rapidly starting its implementation and proceed with the speedy implementation of cohesion policy programmes, in close complementarity and synergy with the *Recovery and Resilience Plan*.
3) Improve access to finance for small and medium-sized enterprises through public lending and guarantee schemes aimed at facilitating investments of strategic importance, in particular in the areas of the green transition and regional development.
4) Reduce overall reliance on fossil fuels by accelerating the deployment of renewables, in particular onshore and offshore wind as well as solar energy, and strengthening energy efficiency measures, e.g. through new financing and support measures to meet the targets of the long-term renovation strategy; ensure sufficient capacity of interconnections to increase security of supply and continue synchronisation with the EU electricity grid; step up policy efforts aimed at the provision and acquisition of the skills needed for the green transition.

## 9.2. USE OF EU FUNDING FOR ECONOMIC DEVELOPMENT

### GENERAL DESCRIPTION OF THE 2014-2020 PROGRAMMING PERIOD

In the 2014–2020 programming period, the total financing available to Latvia was 4.64 billion euro – by 31 August 2023 1675 of 2468 projects have been completed and payments of 3.9 billion euro or 84.3% of the main EU allocation have been made.

The preparations for closing the 2014-2020 programming period took place in 2023 and measures were taken to ensure the achievement of the results set in support measures.

Table 9.1

**Progress of the implementation of activities in competence of the MoE**
*as of 30 September, 2023*

| | Support programme | EU funds funding (allocation) *million euro* | Scope of paying *million euro* | *as per cent of allocation* |
|---|---|---|---|---|
| 1.2.1.1. | Competence centres | 63.2 | 62.36 | 98.67 |
| 1.2.1.2. | Technology transfer system | 30.0 | 26.7 | 89.00 |
| 1.2.1.4. | Introduction of new products | 45.1 | 37.01 | 82.06 |
| 1.2.2.1. | Employee training | 22.5 | 22.42 | 99.60 |
| 1.2.2.2. | Motivation for innovation | 4.8 | 4.30 | 89.60 |
| 1.2.2.3. | ICT and non-technological training | 11.16 | 11.15 | 99.96 |
| 3.1.1.1. | Loan guarantees | 48.8 | 48.02 | 98.40 |
| 3.1.1.2. | Mezzanine loans | 7.0 | 6.90 | 98.57 |
| 3.1.1.3. | Support for attracting financing for small and medium-sized enterprises in the capital markets | 1.0 | 0.076 | 7.68 |
| 3.1.1.4. | Microcredits and start loans | 15.0 | 15.00 | 100.00 |
| 3.1.1.5. | Production premises | 39.0 | 27.40 | 70.25 |
| 3.1.1.6. | Business incubators | 31.7 | 27.93 | 88.10 |
| 3.1.2.1. | Venture capital | 29.2 | 26.20 | 89.73 |
| 3.1.2.2. | Technology accelerator | 16.0 | 16.00 | 100.00 |
| 3.2.1.1. | Cluster programme | 6.7 | 6.69 | 99.40 |
| 3.2.1.2. | International competitiveness | 83.4 | 79.98 | 95.90 |
| 4.1.1. | Energy efficiency of manufacturing enterprises | 23.7 | 13.80 | 58.00 |
| 4.2.1.1. | Energy efficiency of multi-apartment buildings | 141.5 | 88.60 | 62.60 |
| 4.2.1.2. | Energy efficiency of public buildings | 93.4 | 55.90 | 59.90 |
| 4.3.1. | Energy efficiency of district heating | 49.6 | 40.50 | 81.60 |
| **Total** | | **762.76** | **616.93** | **80.88** |

## GENERAL DESCRIPTION OF THE 2021-2027 PROGRAMMING PERIOD

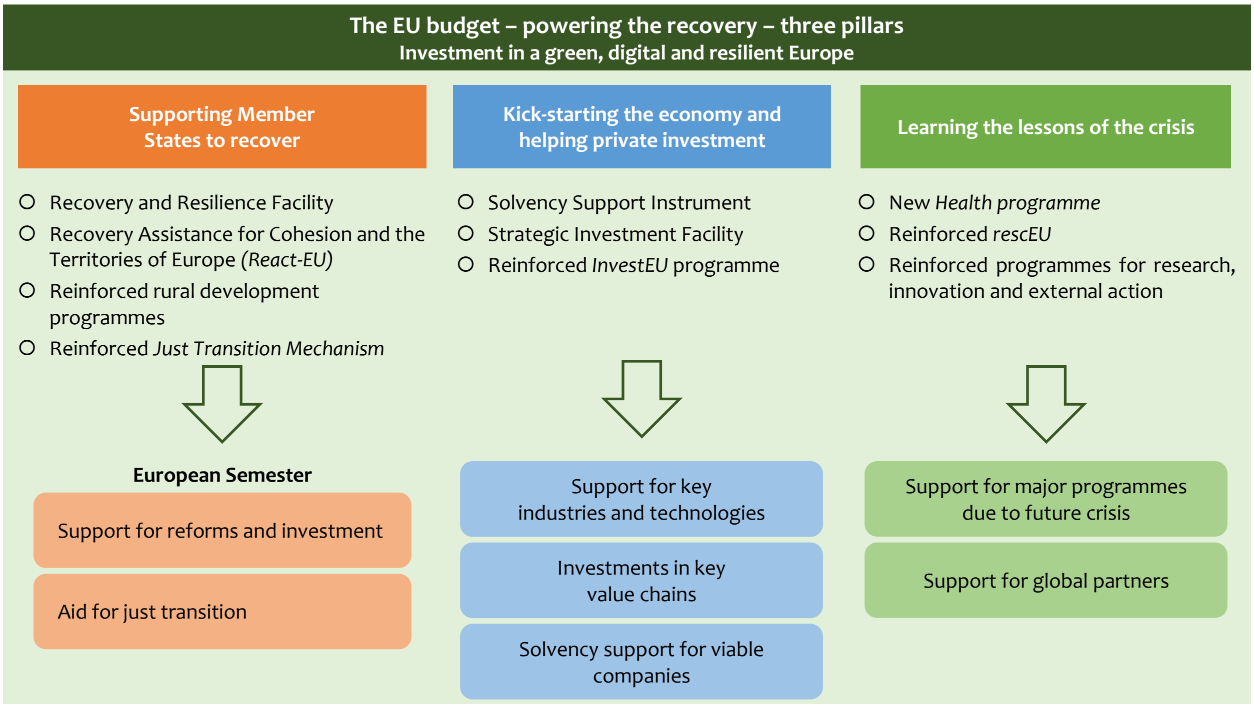
On 2 May 2018, the EC published the communication *A Modern Budget for a Union that Protects, Empowers and Defends. The Multiannual Financial Framework for 2021–2027.*[2] It marked the EC's vision of the new EU's multiannual financial framework for 2021–2027 (this communication is reflected in detail in the *Report on the Economic Development of Latvia for 2019*). The communication from the EC of 2 May 2018 served as a basis for discussions between EU Member States and the EC on the new multiannual EU budget for 2021-2027. However, considering the COVID-19 pandemic and the crisis caused by it, the EC was urged to present a revised EU multiannual financial framework for 2021–2027.

On 27 May 2020, the EC presented a revised proposal for the EU multiannual financial framework for 2021–2027 by publishing a communication ***The EU budget powering the recovery plan for Europe***[3]. The EU's long-term priorities to boost the green and digital transitions have been integrated into the new proposal for the EU multiannual financial framework. These horizontal priorities are embedded into all instruments and programmes of the multiannual EU budget. The reviewed EU budget proposal is based on three pillars:

- tools to support EU Member State efforts to recover, repair and emerge stronger from the crisis;
- measures to boost private investment and support undertakings in difficulty;
- the reinforcement of key EU programmes to draw the lessons from the crisis and make the EU Single Market stronger and more resilient (see Figure 9.2).

[2] The report is available at: https://eur-lex.europa.eu/resource.html?uri=cellar:c2bc7dbd-4fc3-11e8-be1d-01aa75ed71a1.0023.02/DOC_1&format=PDF .
[3] The report is available at: https://eur-lex.europa.eu/resource.html?uri=cellar:4524c01c-a0e6-11ea-9d2d-01aa75ed71a1.0003.02/DOC_1&format=PDF .

Figure 9.2




Source: EC

In order to foster a more rapid recovery of the EU and EU Member States from the current COVID-19 crisis (pillar 1 of the EU budget), the EC offered to create a new European Recovery Instrument *Next Generation EU*. This supplements the budget with new funding from financial markets and is a one-off emergency instrument, put in place for 2021–2024, which can be used by EU Member States exclusively for economic recovery measures.

In the context of the ***European Recovery Instrument*** (*Next Generation EU*) it is important to mention the new ***Recovery and Resilience Facility***, which will be closely linked to the European Semester and respective Reform Programmes of EU Member States (see Chapter 8.1). The RRF aims to support investments and reforms essential to a lasting economic recovery, to improve the economic and social resilience of EU Member States, and to support the green and digital transitions.

The facility comes with a proposed budget of 560 billion euro to help fund EU Member States' *Recovery and Resilience Plans*. It is equipped with a grant facility worth up to 310 billion euro and will be able to make up to 250 billion euro in loans.

For EU Member States to be able to qualify for financing from the RRF, they have to draft their *Recovery and Resilience Plan*, which is part of National Reform Programmes. The EC urged EU Member States to take into account the EU Council's Country-Specific Recommendations to EU Member States made in 2019 and 2020 when preparing their national *Recovery and Resilience Plans* and planning funding for the necessary investments and reforms. In order to ensure efficient and effective use of funding, specific milestones and targets to be reached are set for each EU Member State within *Recovery and Resilience Plans*. The funding to EU Member States is allocated in instalments. EU Member States will be able to receive the next portion of the funding, if they fulfil the set milestones and targets within the set time limits.

Cohesion policy plays an essential role in supporting a balanced and sustainable recovery through a new ***REACT-EU*** initiative. It aims to tackle the most pressing economic and social needs and adjustments to future cohesion programmes to make them more flexible and fully aligned with economic recovery priorities.

The European Agricultural Fund for Rural Development helps farmers and rural areas to deliver the green transition and support investments and reforms essential to the achievement of environmental targets.

The EC has significantly strengthened the Just Transition Mechanism aiming to help EU Member States accelerate the transition to a green economy and in doing so boost their economies.

As part of Pillar 2 of the EU budget, the EC proposed to strengthen Europe's flagship investment programme ***InvestEU*** to mobilise private investments in strategic projects across the EU. As part of this, the Commission proposed to create a new ***Strategic Investment Facility*** *to* invest in key value chains crucial for Europe's future resilience and strategic autonomy. Considering the impact of the COVID-19 crisis on the financial condition of viable companies, the Commission also proposed a new Solvency Support Instrument to provide urgent support to companies and help them overcome the difficulties.

Pillar 3 of the EU budget provides for the strengthening of the EU's capacity to respond to potential crises in the future. In this context, the Commission proposed to create a new *EU4Health* programme to strengthen health security and prepare for future health crises. *RescEU* or the Union's Civil Protection Mechanism, was expanded and reinforced to equip the Union to prepare for and respond to future crises. The flagship programme *Horizon Europe* was also reinforced to fund vital research in health, resilience and the green and digital transitions. Other EU programmes, including its external instruments, were strengthened to align the future EU financial framework fully with economic recovery needs. Special instruments were also reinforced to make the EU budget more flexible and responsive to the new challenges.

The total funding of the EU multiannual financial framework for 2021–2027 offered by the Commission is 1850 billion euro, which is historically the highest amount so far, of which 1100 billion euro came from the EU multiannual financial framework, 750 billion euro came from the European Recovery Instrument *Next Generation EU* and 540 billion euro came from the European temporary mechanism *Support to Mitigate Unemployment Risks in an Emergency (SURE)/European Stability Mechanism (ESM)*.

The *National Development Plan of Latvia* (NDP) is the main policy planning document in the country. EU funds are being planned and EU funds programmes are implemented in accordance with it. On 2 July 2020, the Saeima approved the *National Development Plan of Latvia for 2021–2027* (NDP2027). The strategic goals of the NDP2027 are productivity and income, social trust, equal opportunities and regional development. Each strategic goal has its priorities, each priority has dependent action lines and indicative funding.

**EU funds support in 2021-2027**

The EC has distributed legislative proposals on EU support for regional development and cohesion, as well as investment in human resources, social cohesion and values. These proposals were the beginning of discussions between Member States on the implementation conditions for the allocation of EU Structural Funds – ERDF, CF and ESF+ (hereinafter – EU Funds) – among Member States and support programmes.

The **Ministry of Economics**, as the authority responsible for the EU funds, is planning support for the sectors within its competence in line with the national priorities identified in the NDP2027.

The total investment planned by the MoE is 1.6 million euro and covers priorities such as digital transformation, productivity, social inequality, and climate and energy efficiency.

The programme includes measures to:

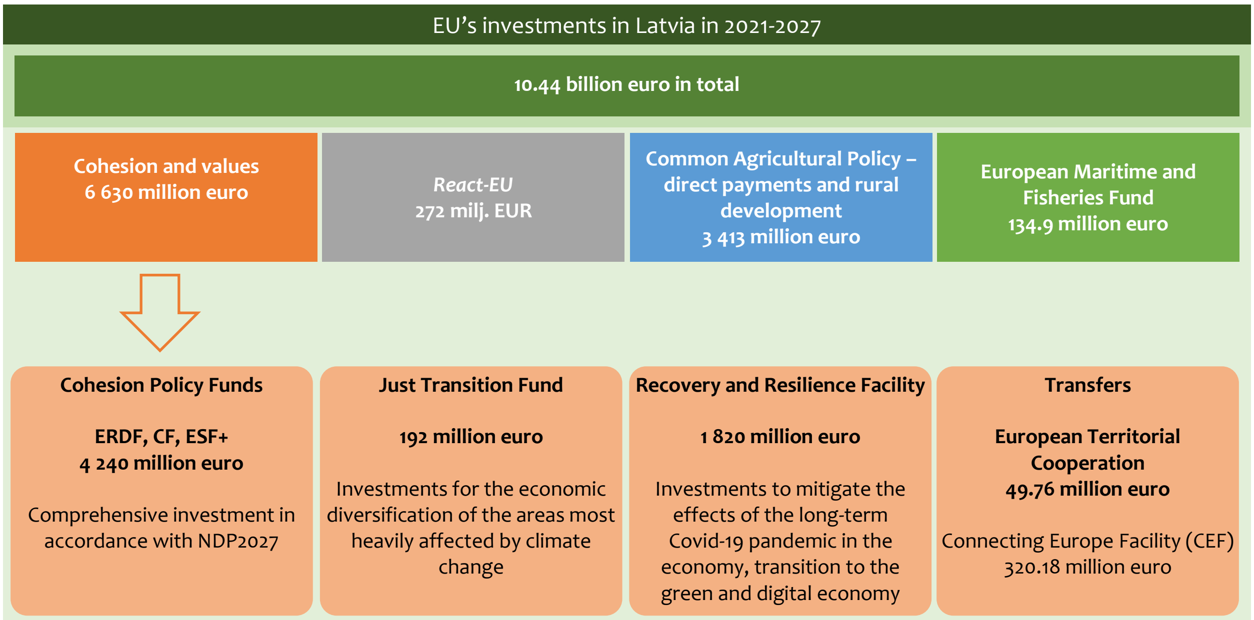
- ensure the transformation of the economy to the production of products and services with higher added value;
- promote digital skills of entrepreneurs and promote the digital transformation of entrepreneurship (digitalisation of processes);
- promote a more climate-friendly and energy-efficient business;
- provide support for the introduction of more energy-efficient measures for both households (residential buildings) and the public sector (public buildings).

Indicative financing of EU funds for the MoE activities for:

- digital transformation – 54.8 million euro, including support for digitalisation for the development of new products and services – 15.15 million euro, development of digital skills (training) – 10 million euro, EDIH and digitalisation of processes in business – 24.65 million euro and digitisation of financial instruments – 5 million euro;
- productivity – 390.3 million euro, including support for the development of SME business – 109.7 million euro, financial instruments for research and development – 228.9 million euro, support for research and innovation in the development of new products, technologies and services – 41.11 million euro;
- reducing inequalities – 83 million euro, including access to social housing – 60.9 million euro and improving accessibility of the environment – 21.75 million euro;
- climate and energy efficiency – 431.2 million euro, including support for energy efficiency in residential buildings – 173.2 million euro, energy efficiency in public buildings – 149.5 million euro and energy efficiency in business – 108.5 million euro.

In order to start using the EU funding and implementing the support programmes funded by EU funds, the Latvian *Partnership Agreement for EU investment funds programming period 2021-2027* and the *EU Cohesion Policy Programme 2021-2027* were approved by the CM in the autumn of 2022. The programme states the political objectives, priorities and specific support objectives, as well as the planned actions to be supported within its framework, the amount of financing and corresponding national co-financing, as well as the target indicators. Information about the planned EU investments in Latvia in 2021-2027 is reflected in Figure 9.3.

Figure 9.3




Source: MoF

*Latvia's Recovery and Resilience Facility Plan* (hereinafter – Latvia's RRF Plan) is another important document for acquiring EU funding in Latvia in the context of the European *Recovery and Resilience Facility*. Latvia's RRF Plan was submitted for review to the EC on 30 April 2021 and was approved on 22 June 2021. Then followed the evaluation of Latvia's RRF Plan at the EU Council, where it was approved on 13 July 2021. Main six directions of Latvia's RRF Plan (see Figure 9.4):

1) climate change and environmental sustainability (676.2 million euro or 37% of total available funding);
2) digital transformation (365.2 million euro or 20% of total available funding);
3) reducing inequalities (370 million euro or 20% of total available funding);
4) health (181.5 million euro or 10% of total available funding);
5) economic transformation and productivity reform (196 million euro or 11% of total available funding);
6) rule of law (37 million euro or 2% of total available funding).

Latvia's RRF Plan includes investment projects and reforms that contribute to a faster economic recovery from the COVID-19 crisis. The plan is closely linked to the European Semester process, the implementation of the EU Council's Country-Specific Recommendations for Latvia and the National Reform Programme of Latvia (see Chapter 9.1). Financing from the Recovery Fund will be available until 30 June 2026.

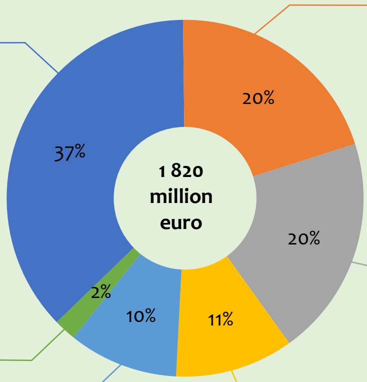
Immediately after Russia invaded Ukraine, on 8 March 2022, the EC proposed to supplement the Recovery Fund with an additional allocation in the field of energy – the *RePowerEU* initiative. The EC's *REPowerEU* plan aims to phase out EU dependence on Russian fossil fuels sooner than planned before Russia's invasion of Ukraine and broadly increase the resilience of the EU-wide energy system. Against this background, the EC urged the EU Member States to complement their Recovery and Resilience Facility Plans with a separate section dedicated to the implementation of the *REPowerEU* initiative.

On 26 September 2023, the CM approved a supplement to Latvia's RRF Plan with the *REPowerEU* section, which was also submitted to the EC. 123.8 million euro will be channelled for the new *RePowerEU* component. It is the maximum allocation for Latvia from the *RePowerEU* initiative. Given the importance of the new priority for energy, an additional 10.9 million euro will be attracted demanding a transfer from the Brexit Adjustment Reserve. The objective of the component is to strengthen energy security and the transition to renewable sources, as well as to strengthen the production capacity of wind components at European level to ensure the implementation of the EU Council recommendation on energy independence.

Figure 9.4

**Investments and action lines of the *Latvia's Recovery and Resilience Facility Plan***

**Climate – 676.2 million euro**
- Improvement of the Riga Metropolitan area transport system
- Energy efficiency of private and public buildings
- Use of renewable energy sources
- Strengthening of the disaster management system




**Reduction of inequality – 370 million euro**
- Improvement of the road network
- Development of industrial parks and territories in regions
- Construction of low rent housing
- Social inclusion
- Improvement of infrastructure of education institutions

**Digital transformation – 365.2 million euro**
- Digital transformation of public services
- Digital transformation and innovation of companies
- Development of digital skills
- Infrastructure – 5G network in the *Via Baltica* corridor

**Rule of law – 37 million euro**
- Reduction of shadow economy
- Increase of transparency and competition in the field of public procurement
- Strengthening of analytics and development of data management in the field of tax administration and customs

**Health – 181.5 million euro**
- Development of medical education system
- Improving the efficiency of healthcare services
- Readiness of medical institutions to epidemiological crises
- Methodological management of the oncology sector

**Economic transformation – 196 million euro**
- Innovation and raising private funding in research
- Creation of a state support instruments for the development of innovation clusters
- Ensuring a change in the governance model of higher education institutions

Source: MoF, EC

Having fulfilled 9 milestones, in June 2022, Latvia submitted its first payment request for 231 million euro, which the EC supported on 7 October 2022. As of September 2023, Latvia has fulfilled 56 out of 214 milestones set out in Latvia's RRF Plan (see Figure 9.5). According to the MoF information, the fulfilment of the milestones is delayed preventing Latvia from requesting a second payment of 503 million euro from the EC. Work on the fulfilment of the milestones included in Latvia's RRF Plan continues.

Figure 9.5

**Progress in fulfilment of milestones by Latvia**

**56 milestones have been fulfilled** | **214 milestones in total**

| Q2 2022 | Q2 2023 | Q2 2024 | Q2 2025 | Q2 2026 | Q3 2026 |
|---|---|---|---|---|---|
| 9 milestones | 49 milestones | 35 milestones | 40 milestones | 22 milestones | 59 milestones |
| **231 million euro** | **503 million euro** | **419 million euro** | **293 million euro** | **168 million euro** | **212 million euro** |

## 9.3. EU SINGLE MARKET

In 2024, 20 years will have passed since Latvian businesses started to enjoy the free movement of goods, services, capital and people in the EU Single Market. It unites 30 countries (27 EU Member States and 3 EEA countries, i.e. Norway, Iceland and Liechtenstein) having over 470 million consumers. The EU Single Market as we see it today is the result of continued work. By coordinating decisions gradually, step-by-step the requirements have been harmonised and closer integration has been achieved – unified principles and rules for economic operators have been developed, border control has been cancelled, consumers have been provided with a wider range of goods and services, freedom for citizens to live, work and study in other Member States has been provided, a possibility was found to introduce a single currency, and those are not the only benefits. Nevertheless, the EU Single Market is still being improved.

To promote the production of more sustainable products, work on the Proposal for Ecodesign for Sustainable Products Regulation continued in 2023. It foresees that in future the regulation will also apply to the products with circularity potential not only the energy-related ones, thus covering the broadest range of products possible. The proposal provides not only new requirements for energy efficiency and sustainability of products relating to durability, reusability, upgradability, reparability, and resource efficiency but also for the introduction of a digital product passport, which will be a source of information for consumers on the environmental impact of products. In the EU Single Market, ecodesign requirements for products are an important tool for achieving climate, environmental and energy objectives. For example, as of 20 September 2023, the ecodesign requirements applicable to smartphones, mobile phones, wireless phones and tablets forsee that product manufacturers are not allowed to place on the EU market products that circumvent testing procedures and products manufactured to reduce their performance shortly after they are put into service, thereby encouraging consumers to purchase a new electronic device more quickly.

From the end of 2024, all new portable devices placed on the EU market (mobile phones, tablets, digital cameras, hand-held video game consoles, headsets, portable speakers, readers, keyboards, computer mice, portable navigation systems, wireless headsets) should be equipped with a single charging standard so that consumers can charge their devices with a single (USB Type-C) charger, regardless of the brand of the device. In addition, the charging speed of the devices with any compatible charger should be the same. This has been unduly delayed by manufacturers so far. Devices and their chargers are expected to be sold separately in the future to reduce the number of unnecessarily purchased and unused chargers and electronic waste.

In October 2023, an agreement was reached about the Directive on empowering consumers for the green transition, which aims to promote sustainable consumption enabling consumers to adopt information-based decisions when buying. The proposal also aims to prevent unfair commercial practices when consumers are misled about sustainable consumption possibilities.

Along with some initiatives and legislative proposals, active work is ongoing towards open strategic autonomy of the EU to maintain the economic, technological and industrial competitiveness of Europe and the resilience of the Single Market in crisis situations. For example, to reduce shortcomings in supply chains of goods and services and promote a more resilient EU Single Market in crisis situation, the development of the Single Market Emergency Instrument package continued in 2023. This Instrument aims to introduce a horizontal set of measures capable of resolving emergencies, forecasting a potential crisis in the EU, monitoring and offering response measures to a potential crisis, which would be uniform and applicable across all economic sectors and all Single Market areas.

The Regulation establishing a framework of measures for strengthening Europe’s semiconductor ecosystem (Chips Act) was adopted in September 2023 to promote the technological competitiveness of the EU in strategic sectors. The Regulation aims to address the shortage of semiconductors, ensure the security and resilience of supply chains, and strengthen Europe’s technological leadership. It provides for the establishment of a network of competence centres in each EU Member State.

The EC’s communication on the long-term competitiveness of March 2023 set the objective to reduce administrative burdens for entrepreneurs by reducing reporting requirements by 25% and at the same time simplifying and combining them. To achieve this objective, the EC has already published 15 proposals for streamlining reporting requirements and is planning to publish another 26 proposals in 2024. The EU statistics regulation was one of the first areas that was revised to reduce the number of reports to be completed and submitted by companies to statistical institutions of Member States.

To get closer to the objectives of the EU Green Deal, on 22 March 2023, the EC adopted a proposal on common EU rules promoting the repair of goods that will enable consumers to save while reducing the amount of waste. The proposal will encourage consumers to repair rather than replace goods. Moreover, higher demand will promote the development of repair companies at the same time stimulating manufacturers and sellers to develop more sustainable business models.

On 22 March 2023, the EC published a proposal for a new EU directive on substantiation and communication of explicit environmental claims (Green Claims Directive). The proposal lays down provisions for consumer protection obliging companies selling goods or services in the EU to substantiate and check any environmental claim, thus reducing the risks of greenwashing. The proposal supplements the proposal for a directive of March 2022 on empowering consumers for the green transition amending directives on unfair commercial practices and consumer rights.

On 14 September 2022, the EC made a proposal for a regulation on prohibiting products made with forced labour, including child labour, on the Union market. The proposal applies to all products available in the Union market, regardless of whether they are produced for domestic consumption, export or are imported. The provisions of the proposal would apply to any types of products, including components, regardless of the sector.

Work on the implementation of the requirements of the **Single Digital Gateway Regulation** was concluded on 12 December 2023 to facilitate the digital transition in the EU and improve access to information and procedures in all EU Member States regarding the most common life situations for residents and entrepreneurs. The Regulation obliges the EC and the Member States to publish information and make public services available on the Your Europe portal (www.youreurope.eu) to make them transparent and accessible in one place.

The freedom of provision of goods and services and the right to do business provided for in Articles 34 to 36, 49 to 62 of the *Treaty on the Functioning of the European Union* (TFEU) in Latvia are supervised and coordinated by the MoE. Within the scope of its competence is also the identification of legal provisions which may hinder the use of freedoms of the Single Market, including the evaluation of draft laws and regulations.

The **technical regulations notification** is a preventive, unified and transparent monitoring tool to evaluate and prevent the inclusion of requirements into laws and regulations, which might create barriers to the free circulation of goods, as well as information society services. Not only responsible authorities of EU Member States, but any economic operator can participate in the process and provide comments and objections regarding draft laws prepared by any Member State, which might potentially affect product export or cross-border information society services. Draft technical regulations notified by the Member States can be found in the database of the Technical Regulations Information System TRIS[4] in the field of goods and in the Internal Market Information System (IMI) notification summary[5] in the field of services. If an economic operator has any objections to draft technical regulations of other countries which might potentially negatively affect sales of its product or provision of its services in the market of a specific EU country, the economic operator has the right to submit its objections to the responsible ministry which is competent to coordinate the respective policy area in Latvia.

When providing support and public services to businesses and residents, authorities of Member States have to verify the information indicated in applications of legal entities and individuals, the authenticity of documents issued in other Member States and clarify other issues according to respective EU laws and regulations. The **Internal Market Information System (IMI)** is a tool for faster and more effective communication and document exchange among the public authorities with EU/EEA countries. Hence, the applicant is free from bureaucratic barriers in the resolution of different cross-border issues in the Single Market. MoE is the national coordinator of the IMI system in Latvia. The scope of IMI is expanded and adapted to the needs of national administrations every year. In 2023, the Single Digital Gateway Module was included in the IMI system, through which EU Member States will be able to exchange information related to the Single Digital Gateway Regulation. So there are already 41 modules in the IMI system in 2023. From January to October 2023, Latvia processed 155 information requests in the IMI system: 82 in the area of professional qualifications, 70 in the area of posting of workers, 2 in the services area and 1 in the area of patients' rights.

**SOLVIT Centre** is an alternative Single Market problem solution network, created by the EC and the Member States, operating in Latvia since 2004. Its task is to find a fast and practical solution to the problems caused by administrative decisions of public authorities of the Member States in case of incorrect application of EU law. In situations, when a resident or a businessman is harmed by incorrect decisions taken by responsible authorities of Member States, the SOLVIT Centre operates as a free of charge, pre-trial problem-solving tool. There are SOLVIT Centres in each EEA Member State. From January to October 2023 the Latvian SOLVIT Centre received 33 complaints on problems of Latvian citizens in other EU countries and 11 complaints on problems of EU citizens in Latvia. In this period, all complaints were resolved within the defined time – not more than 10 weeks. To submit a complaint to the 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) norms arising from the EU law (regulations, directives, etc.) have been violated.

Most frequently the Latvian SOLVIT Centre receives complaints from individuals related to social benefits and issues of residence permits, while complaints of businesses are related to restrictions on the freedom of provision of goods and services, repayment of value added tax and recognition of professional qualifications.

[4] Database of the Technical Regulations Information System TRIS (TRIS): https://technical-regulation-information-system.ec.europa.eu/lv/home.
[5] Internal Market Information System (IMI) notification summaries: https://ec.europa.eu/internal_market/imi-net/repositories/services-directive-notifications/index_en.htm.

# 10. IMPROVEMENT OF THE BUSINESS ENVIRONMENT

A favourable business environment is one of the most important elements for increasing the competitiveness of the national economy. The better business conditions a state is able to create, the higher investments flow into the national economy, subsequently leading to new jobs and better welfare of people. There are several obstacles to business identified by entrepreneurs as disruptive in long-term planning of activities and development, such as frequent and unpredictable changes in the regulatory framework, tax system, sectoral supervision and control measures, deficiencies in tax administration, as well as slow decision-making process of the state administration. The business environment should be accessible and understandable to entrepreneurs reducing the bureaucratic and administrative burden as much as possible, simplifying the regulatory environment and strengthening cooperation with sectoral associations.

## ACTION PLAN FOR IMPROVEMENT OF THE BUSINESS ENVIRONMENT

Different measures for the improvement of the business environment in Latvia have been implemented since 1999. The MoE, with the participation of a wide range of sectoral ministries and organizations representing entrepreneurs, is implementing business environment improvement measures to create for entrepreneurs an attractive business environment with accessible and understandable services.

In 2023, the MoE continued working on initiatives to improve the business environment and, together with cooperation partners – Latvian Chamber of Commerce and Industry, Employers' Confederation of Latvia and FICIL and RIS3 management groups – identified areas/processes, where automation or acceleration would be critical, as well as identified priority measures to reduce administrative barriers for the promotion of export capacity and competitiveness of businesses.

To improve the regulatory enactments regulating entrepreneurship and the services provided by the state administration to promote the competitiveness of the Latvian business environment, the MoE, together with cooperation partners, defined the following five areas requiring an evaluation process as a priority, so that a decision in the public administration is taken within 3 working days:

- the decision-making process of the Register of Enterprises on services;
- customs procedures for importing goods (release of goods into circulation);
- issuing permits in the energy sector;
- acceleration of evaluation of foreign market programmes – projects of LIAA;
- preparation of *de minimis* forms.

In 2024, the MoE will continue active cooperation with social and cooperation partners to build a business environment focused on sustainable development and economic transformation.

Further discussions are expected between the parties concerned on the listed lines of action in order to reach agreements on specific works to be done, the result indicators to be achieved, and to coordinate these measures with the responsible national regulatory authorities.

## DIGITALISATION OF THE BUSINESS ENVIRONMENT (see also Chapter 12.5)

One of the priorities in creating an excellent business environment is the formation of a favourable and modern business environment based on innovation, the full use of modern technologies, the availability of proactive and life-oriented business-related services, increasing business productivity and boosting competitiveness at local, European and global levels.

Modern digital technologies (broadband, big data, data centres, cloud services, artificial intelligence, etc.) create unprecedented opportunities for the improvement of existing processes, procedures, the development of new products and services, and process analysis and optimisation. At the moment, however, Latvian companies are significantly lagging behind in the use of digital technologies, entrepreneurs lack digital skills and the necessary knowledge, skills and proper tools for transformation (such as productivity tools for digital trade, online cross-border trade, etc.) compared with OECD member states.

Industry associations recognise that ICT solutions and services are too expensive. Many entrepreneurs lack skills and experience, as well as information on the benefits of digitisation in business. Given that most of the companies in Latvia are

SMEs, it is necessary to stimulate SMEs to use advanced technologies and new innovative business methods, thus implementing digital transformation in enterprises and promoting their competitiveness.

Ambitious European digital targets provide that 90% of businesses reach at least the basic level of digital intensity by 2030. According to the DESI assessment, there are 38% of such businesses in Latvia, an average of 55% in Europe, which means that the progress of businesses must be very important in the coming years. Almost half of Latvian enterprises have digitised at least 50% of all processes taking place in the company, as well as most enterprises have introduced some basic ICT solutions, but the acquisition of state-of-the-art technologies is hampered by the lack of finances and knowledge, which is consistent with generally low digital skills in Latvia.

Improving citizens' digital skills is a prerequisite for creating inclusive labour markets, and for increasing the productivity of the companies that currently enjoy very little digital benefits. Regions still have untapped potential for broadband-optic internet connectivity, which would provide reliable and fast digital infrastructure for businesses, as well as remote job opportunities for employees. Despite the availability of basic infrastructure in regional centres, the provision of electronic communications services to citizens in regions is still not possible until the "last mile" connection and adequate service provision policy are provided.

Ongoing dialogue with entrepreneurs on the latest technologies and trends in the digital economy is an important tool in the digital age. It is necessary to assess all public investment in digital transformation solutions, which include transforming business processes with the latest technological opportunities, including in the public sector. Public investment in digital transformation must have clearly defined benefits for entrepreneurs.

# 11. INNOVATION AND NEW TECHNOLOGIES

An important precondition for the transition to a knowledge economy is strengthening of the Latvian innovation system by eliminating its deficiencies and facilitating mutual cooperation between all parties to the innovation system – business, science and education, as well as public sector representatives.

The ***European Innovation Scoreboard*** 2023 has appreciated Latvia's achievements in several innovation indicators. Since the previous reporting year, job-to-job mobility of HRST has increased by almost 32%, employed ICT specialists have increased by 20%, most cited publications have increased by 17%, environment-related technologies have increased by 13%, and lifelong learning has increased by 12%.

In the *European Innovation Scoreboard*, Latvia is ranked 25th among EU Member States, i.e. in the group of Emerging Innovators, for the second year. This group includes countries below at least 70% of the EU average. Compared to the previous year, in the report of 2022 Latvia's indicators significantly increased in three dimensions of innovation: linkages, use of information technologies, and attractive research systems. Compared to EU indicators, Latvia has a proportionally large share of the population with tertiary education (122.5% of the EU average), very good results in the number of trade mark applications per billion GDP (106% of the EU average) and also in the share of public-private co-publications (98.9% of the EU average). Latvia has the lowest indicators in government support for business research and development (6.8% of the EU average), innovation expenditures per employee (9.2% of the EU average) and R&D expenditure in the business sector (12.5% of the EU average).

In 2023, Latvia ranks 37th among 131 countries in the ***Global Innovation Index***. It was 41st in 2022. In order to measure the increase in output of innovative and internationally competitive products, Latvia's assessment in the subcategory of knowledge and technology outputs is of the essence – it shows that Latvia was 49th among 131 countries in 2023. It was 44th in 2022 and 45th in 2021 among 132 countries.

**Proportion of innovative businesses**

Between 2018 and 2020, an average of 32.5% of all Latvian companies were innovative, which is 0.4 percentage points more than in the previous period (2016-2018), however, this indicator is lagging behind the average in the EU countries (2018: EU-27 – 50%). The turnover of innovative companies in the total turnover of companies increased by 0.9 percentage points over this period reaching 60.6%, indicating that demand for the products of innovative companies or services has slightly increased. Overall, the share of innovative companies has been exceeding 30% of the total number of companies since 2016. The current trends have also been positively influenced by public intervention in the form of various actions, including information campaigns, support programmes, regulatory frameworks and improvements in the business environment.

In the report Innovation Development Trends and Proposals to Promote Innovation during the Economic Crisis drafted within the project Economic, Political and Legal Framework for Preserving the Potential of the Latvian National Economy and Promoting the Growth of Competitiveness in the Wake of the Crisis Caused by the Pandemic (*reCOVery-LV*) of the national research programme For *Mitigation of COVID-19 Consequences*, the researchers have concluded that from 2019 to 2020 63% of the companies surveyed in the course of preparation of the report (37 companies from all regions of Latvia) have introduced at least one product or business process innovation, or have carried out an innovative activity that is still ongoing. The result of such an alternative survey, although based on a small sample, shows that more targeted work on raising awareness of businesses may lead to a larger number of innovative companies appearing in statistics.

## INVESTMENT IN RESEARCH AND DEVELOPMENT

Total expenses of Latvia on research and development (R&D) in 2021 amounted to 248 million euro or 0.74% of GDP. They rose by 12.2%, compared to 2020. Investment of businesses in R&D activities has increased by 15.4 million euro or 19.4% since 2020. Such results were supposedly achieved due to the measures implemented for the promotion of innovation in state-owned enterprises as well as measures to promote innovation in SMEs. Overall, the financing of R&D by businesses amounted to 92.79 million euro in 2021 or 37.2% of total R&D funding in the Latvian economy. This indicator lags behind the achievements of EU Member States, where businesses provide more than half of total R&D investments (2020: EU-27 – 65.8%; Latvia – 37.2%). Low activity and capacity of Latvian businesses in R&D are largely affected by the existing economy and business structure – a low share of high and medium high-tech businesses in the Latvian economy.

The total amount of R&D investments is affected by investments from all sectors, but it should be noted that large state-owned enterprises (SOEs) have a significant influence in fostering R&D. SOE's assets account for 13.1% (2021) of the assets of all capital companies. Approximately half of them are formed by three state-owned enterprises. here is a discrepancy between the national targets in promoting R&D in SOEs and the existing regulation, the shortcomings of which create obstacles to holders of capital shares or boards of directors in setting R&D targets in SOEs, thus delaying the achievement of the R&D target value set by the state. Differences in the regulatory framework in Latvia from trends in other countries show that SOEs play a key role in achieving the country's R&D targets.

## IMPLEMENTATION OF THE INNOVATION GOVERNANCE REFORM

In 2023, the implementation of the innovation institutional governance and *Smart Specialisation Strategy* (RIS3) governance model continued. The reform provides for the involvement of the LIAA in the coordination of RIS3 areas, leading the work of the five RIS3 management groups and envisaging a long-term strategy and action plan for each RIS3 area. Similarly, within the framework of the reform for the approximation of innovation and research policies, including the supervision of RIS3, an Innovation and Research Governance Council (IRGC) has been established, where the Minister of Economics, Minister of Education and Science, as well as officials of the LIAA and Latvian Council of Science cooperate.

At the beginning of 2023, a cooperation project between the LIAA and the OECD on the development of a methodology for working with innovation ecosystems was completed, defining new systems, working with existing ones, and defining the role of the LIAA in the development of ecosystems. The OECD recommends improving cooperation between policymakers and policy implementers by developing a common understanding of the nature of functioning of "ecosystems", as well as of the necessary investments and return on "ecosystems" for both building a better business environment and creating and implementing business projects.

## CREATING INNOVATION DEMAND IN THE PUBLIC SECTOR

The public sector may play a crucial role in fostering innovation and research activities forming demand for innovation. Public procurement for innovation is increasingly being used for this purpose in Europe and plays an important role in promoting economic growth, business development and increasing the country's competitiveness. For example, EU Member States spend an average of 19% of GDP on public procurement, while Latvia, according to publicly available data, uses only an average of 11% of GDP. 4298.8 million euro were spent on public procurement in 2022, which demonstrates the great potential of public procurement to drive development across sectors, help stimulate the future market and address societal challenges.

By developing the innovation procurement culture, it is possible to promote innovative procurements of goods and services, improve public services, and also to create a market for innovative solutions. In 2023, the MoE joined the *PPI4Cities* project of *the Interreg* Baltic Sea Region (BJR) programme to promote innovation procurement. The project brings together partners from Lithuania, Finland, Estonia, Germany, Denmark and Latvia (MoE). The project aims to support municipalities of the BJR region in the use of public procurement for innovation for the development of smart city solutions. Both physical and digital tools that will support selected BJR municipalities are intended to be developed for the achievement of this objective to create an environment in which they can test how to apply new business models needed to successfully implement public procurement for innovation.

In November 2023, the CM approved support for the improvement of the technology transfer system (1.2.1.4 "Support for the improvement of the technology transfer system"). The support will be available to undertakings for new products to be developed within the framework of innovation procurement and their commercialisation. State support will be available to undertakings who have been awarded contract rights as a result of the innovation partnership procedure with a public buyer to implement the following activities: 1) experimental development; 2) product or technology certification and testing services. State support is provided in the form of grants – within the framework of one application, support to an undertaking for the implementation of one of the abovementioned activities is available in the amount of 50% of the contract price with the contracting authority (public buyer), but not more than 50,000 euro. However, the remaining part of the contract price shall be covered by the contracting party.

On 27 June 2023, CM Regulations No. 350 governing the implementation of activity *5.1.1.4 Smart municipalities* (hereinafter referred to as the activity) were approved. The activity aims to promote the development of smart municipalities by introducing smart solutions for ensuring the fulfilment of autonomous functions of local governments and the administrative tasks arising therefrom. Local governments and other applicants for support may choose to organise public procurement for innovation for smart solutions. The primary beneficiaries of the support and the parties involved in the activity are local governments, local government institutions, capital companies, planning regions, scientific institutions, digital innovation hubs and other stakeholders.

## NATIONAL RESEARCH PROGRAMME *INNOVATION FUNDS – SECTORAL RESEARCH PROGRAMME*

In 2023, the implementation of the national research programme *Innovation Funds – Sectoral Research Programme* (hereinafter – Programme) was still ongoing aiming to promote scientific research and foster technology transfer, the development of innovative and commercialisable products and technologies in two RIS3 areas: *Biomedicine, medical technologies, pharmacy* and *Photonics, smart materials, technologies and engineering systems*.

According to the tender results of 2022, two projects of the Programme are supported and implemented, each amounting to 5.7 million euro with the implementation period until 2024.

1. Programme Project *Biomedicine, Medical Technologies, and Pharmacy*, applicant Latvian Institute of Organic Synthesis, cooperation partners – Rīga Stradiņš University, University of Latvia, Latvian Biomedical Research and Study Centre, Riga Technical University, Institute of Food Safety, Animal Health and Environment *BIOR*. The objective of the project is to support the state biomedicine research platform to solve public health problems in the RIS3 area *Biomedicine, medical appliances, bio-pharmacy and bio-technology.*
2. Programme Project *Ecosystem of Smart Materials, Photonics, Technology and Engineering*, applicant Institute of Solid State Physics of the University of Latvia, cooperation partners – University of Latvia, Riga Technical University, Rezekne Academy of Technologies, Institute of Electronics and Computer Science, Latvian Biomedical Research and Study Centre, Latvian State Institute of Wood Chemistry, Institute of Mathematics and Computer Science of the University of Latvia. The objective of the project is to create a co-creation research "ecosystem" to promote development in the RIS3 field of photonics, smart materials, related technologies and engineering systems, based on scientific discoveries and commercialization of research in Latvia.

At the same time, the MoE is working on amendments to CM Regulations No. 560 of 4 September 2018 *Procedures for the Implementation of State Research Programme Projects*, in order to create a public procurement for scientific research within the framework of national research programmes, introducing a research project selection approach in the existing regulation, which would ensure the possibility to create cooperation platforms (hereinafter – platforms) created by research organisations, select platform projects on platforms and use flexibility in the monitoring of platform projects. The model would enable platforms to plan their work in the long term.

## SPACE INDUSTRY

Aware that the global space industry is developing rapidly and that the Latvian space industry has inherited large and high value added infrastructure (instruments, radio telescopes, equipment, etc.), and modern space technologies contributing to international space missions, as well as satellite data processing competences, Latvia is competitive in the international space industry.

Currently, the Latvian space ecosystem is maintained by the status of an Associate Member of the European Space Agency (since 2020), the EU Space Programme, EC innovation support programmes, as well as bilateral international cooperation projects and national support instruments. The potential of the Latvian space industry is, however, not fully exploited. The hindering factors are the shortage of human resources and limited access to infrastructure maintenance and modernisation financing opportunities.

The Latvian space industry (like that of other countries) needs to ensure development to the stage of commercialization of technology to make a full contribution to the global space industry and benefit from the opportunities provided by the global space industry. In addition, space business development capabilities need to be promoted. Therefore, the establishment of the Business Incubation Centre of the European Space Agency in Latvia has commenced. MoE, in close cooperation with other institutions, is actively raising awareness of the Latvian space industry, related industries and the general public about national, European and global level space industry opportunities and promoting active participation in them. Particular attention is paid to internationalisation and the involvement of non-space businesses, as the space industry offers versatile opportunities for commercialisation, export and technological development.

The MoE and the LIAA have organised several space-themed events to position Latvia as an active player in the global space industry and provide valuable networking opportunities, and they also provide the necessary support for the Latvian space industry to be represented at major industry conferences and exhibitions across the world (e.g. the International Astronautical Congress), as well as in committees of international organisations such as the European Space Agency, the European Union Agency for the Space Programme (EUSPA), the United Nations, etc., thus facilitating both the launch of new bilateral cooperation projects and the visibility of Latvia within and outside the EU.

## ESTABLISHMENT OF A KNOWLEDGE TRANSFER SYSTEM SUPPORTING INNOVATION

The LIAA, which at the same time ensures the functions of a Single Technology Transfer Centre, is a central element, and a mediator in the ecosystem of innovations in Latvia, which fosters cooperation between research organisations and industries along with competence centres. The LIAA also develops the awareness and development of technology transfer in public research organisations, improves their industrial property management policy, promotes the takeover of international knowledge and skills for the organisation of technology transfer processes and ensures the 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 was 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 knowledge and technology transfer system needs to be improved to develop cooperation skills of the research and business sectors, foster a 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 the market of the research results. Moreover, the purpose of *the Technology Transfer Programme* is to help Latvia achieve RIS3 goals, foster commercialisation of state-funded research results available to research organisations in Latvia and abroad, as well as 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 or technology development.

So far, *the Technology Transfer Programme* has supported 101 projects for commercialisation of ideas, as well as 400 innovation voucher agreements have been concluded. The activities of the programme fostering operations of business and research organisations are planned to continue until the end of 2023. Then they will continue within Activity 1.2.1.4 *Support for the improvement of Technology Transfer System of specific objective* 1.2.1 *Strengthening research and innovation capacity and introducing progressive technologies in businesses* of the EU Cohesion Policy programme for 2021-2027. At least 200 businesses are planned to be supported. At least 38 of them will cooperate with research organisations.

## CREATION OF START-UPS

The objectives set out in *the National Industrial Policy Guidelines 2021-2027* provide for building a new economic model based on knowledge and innovation, focusing on strengthening innovation capacity, improving the quality of the institutional environment and increasing business dynamism. Start-ups play an important role in the overall innovation “ecosystem” providing an inflow of innovative business ideas and contributing to a faster shift in the economic paradigm towards the knowledge economy.

The Latvian start-up “ecosystem” consists of at least 626 start-ups, of which 447 are registered in the database of the Latvian Start-up Association. More than half of them are active in information and communication, and more than 20% in manufacturing and professional, scientific and technical activities. In 2022, Latvian start-ups raised 93 million euro in investment and provided more than 3,200 jobs, contributing to the influx of innovative business ideas into the start-up “ecosystem”, the development of high value added products and services, the attraction of investment and the transition of the economy to a modern and innovative economy.

One of the priority tasks of the MoE is not only to strengthen cooperation with representatives of the start-up environment and their representative organisations but to create an environment supporting entrepreneurship through a joint strategy in which start-ups can form and develop their innovation thereby creating preconditions for the growth of the Latvian economy. On 7 September 2022, the MoE, LIAA, Altum, *TechChill* Foundation, *Latvian Private and Venture Capital Association*, Latvian Startup Association, Riga Technical University, *TechHub* Foundation and *Business Angel Network Association* signed a Memorandum of Cooperation *On the Latvian Start-up* “Ecosystem” *Development Strategy 2022-2025*, which sets out several activities aimed at promoting strong and unified development of the start-up “ecosystem” and attracting talent to start-ups. It should be noted that these non-governmental organisations representing Latvian start-ups bring together more than 250 members. *The Latvian Start-up* “Ecosystem” *Development Strategy 2022-2025* envisages not only planned activities but also the results to be achieved by 2025, and they are:

- to promote the attraction of investment of 300 million euro to start-ups;
- to increase the number of employees in start-ups by 1500.

In order to implement the directions and activities specified in the Strategy, in 2023, the MoE concluded 6 agreements with the Latvian Startup Association, Latvian Business Angel Network, *TechChill*, *TechHub*, Riga Technical University and Latvian Private and Venture Capital Association for a funding of 200 thousand euro from the state budget. Within the framework of the agreements, organisations carried out activities promoting the activities of the start-up “ecosystem”, which were attended by around 1500 visitors, including representatives of the organisation representing start-ups, start-ups, investors and authors of business ideas from different countries, for example, ensured the development of the *startin.lv* database, organised investment sessions, consultations, masterclasses for start-ups and investors; organised an international conference *TechChill 2023*, as well as a *Start-up* Day, during which awards were presented to the best Latvian start-ups in 2023 for the first time. The awards were presented in the following categories: *Breakthrough, Newcomer, Scaleup, Impact, Hardware, Digital, Founder-Hero.*

In 2023, the MoE has developed amendments to the *Law on Aid for the Activities of Start-up Companies*, which provides for permanent delegation of the legislator to promote activities of the start-up "ecosystem" and attract investment, i.e. enabling the MoE to enter into cooperation agreements with non-governmental organisations specified in CM Regulations in order to continue promoting the activities supporting start-ups and attraction of investment.

In support of the abovementioned organisations representing the Latvian start-up environment, which have developed a common approach or strategy to promote the development of the Latvian start-up "ecosystem", the state reinforced its clear position regarding the role of the start-up "ecosystem" in the development of the national economy and continued working on both local and international level to promote the image of Latvia as a country favourable to start-ups and attracting investment.

## SME INNOVATION SUPPORT AND BUSINESS INCUBATION

The following activities of the business incubator programme started in 2016 – activity *3.1.1.6 Regional business incubators and creative industries incubator* of specific objective *3.1.1 To foster creation and development of SMEs, in particular in manufacturing and in RIS3 priority sectors* and activity *13.1.1.4 Recovery measures in the economic sector – Regional business incubators and creative industries incubator* of specific objective *13.1.1 Recovery measures in the economic sector of the Operational Programme Growth and Employment*. Throughout Latvia there are 11 regional business incubators and 9 support units, as well as a Creative Industries Incubator in Riga specialising in providing support to creative industries. By 30 September 2023, 675 businesses received grants, 1055 businesses received non-financial support, while employment growth in supported companies is 2502.59 full-time equivalents. The number of pre-incubation beneficiaries receiving non-financial support is 3173.

In continuing the activities motivating to start business and business incubation across Latvia and foreign market entering activities, on 13 July 2023, the CM approved *Implementing Regulations of activity 1.2.3.1 "Support for innovative SME business development" of specific objective 1.2.3 "To promote sustainable growth, competitiveness and job creation for SMEs, including through productive investments" of the EU Cohesion Policy Programme for 2021-2027* proposed by the MoE, which provides for channelling 73.3 million euro by the end of 2029. One of the support activities within the SME aid programme is support for business incubation, which includes grants for services for business development, rental of premises and workplaces, prototyping and development of technologies, purchase of production equipment, purchase of raw materials, as well as one minimum monthly wage and mandatory state social insurance contributions for one employee once in a 12-month period only for an innovative business. A total of 22 LIAA representations are planned throughout the territory of Latvia, which also provide advisory support to Latvian entrepreneurs regarding aid possibilities. Support for business development and promotion measures, such as seminars, consultations, mentoring, as well as grant support to promote international competitiveness (participation in exhibitions, marketing activities for arranging conferences and other activities), will also be provided within the SME aid programme. Within the framework of the SME aid programme, LIAA must establish close cooperation with local governments to ensure the effective implementation of the programme. A total of 2000 companies developing their business projects are planned to be supported within the activity, of which at least 600 will be authors of new ideas, and at least 300 new products will be created. Based on the estimates of the responsible authority, the turnover of the companies supported by the activity and LIAA is planned to grow and exports are planned to increase by 20% (between 2024 and 2029). 700 exporting companies would also be supported and 1000 new jobs would be created, thus it could be ensured within the activity that supported businesses will pay 150 million euro in taxes annually.

## COMPETENCE CENTRE PROGRAMME

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 the 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* is to increase the 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 the active involvement of beneficiaries of funding in the creation of international and intersectoral platforms. 10 competence centres received support as a result of the selection of projects within the Competence Centre Programme. The total funding of the programme is 78.7 million euro, including ERDF funding of 63.2 million euro.

421 research projects will be carried out, 610 new products will be created, 322 businesses will be supported, 1149 new jobs will be created, 418 co-publications of businesses and research organisations will be prepared within the competence centre programme. 52.05 million euro of co-financing will be raised as a result of the programme. The turnover in supported businesses has grown by 254.8 million euro, from 2015 to 2021 the companies involved showed an increase in exports by 134% and paid 36.78 million euro in employment taxes.

Continuing the introduction of smart specialisation in Latvia, on 5 July 2022, the CM approved *Implementing Regulations of investment 5.1.1.2.i "Instrument to support the development of innovation clusters" of reform 5.1.1.r "Innovation system governance and private research & development investment motivation" of reform and investment direction 5.1.r "Increasing productivity by increasing investment in R&D" of Latvia's Recovery and Resilience Facility Plan* proposed by the MoE to ensure transitional financing of competence centres. The total aid is estimated at 25 million euro allocated to 8 projects to support the development of new products and technologies and knowledge transfer to the economy. Investment in research and the development of new products or technologies, which are planned to continue until the end of 2023, will be of greater importance to increase competitiveness, allocating a total of 108 million euro from the financing of the Recovery and Resilience Facility Plan and 36.4 million euro from the EU Funds programming period 2021-2027. Overall, more than 480 businesses are planned to be supported.

## DEVELOPMENT OF STRATEGIC "ECOSYSTEMS"

In early 2023, the results of the project implemented by the LIAA in cooperation with the OECD and the Observatory of Public Sector Innovation since 2021 to develop a new innovation management model were presented. They emphasise the need to promote Latvia's priority economic sectors through innovations.

The priority sectors of the national economy of Latvia include those sectors which have been included in the smart specialisation strategy of Latvia: knowledge-intensive bio-economy; smart energy and mobility; biomedicine, medical technology and pharmacy; photonics and smart materials, technologies and engineering systems; ICT.

It has been concluded in the course of the study that Latvia should make the most effective use of the resources at its disposal because the opportunities for science-intensive sectors to develop fully on the basis of business are limited. This is due to the overall capacity of sectors to develop large production facilities with many thousands of employees. One of the most important findings of the project is that Latvian companies have to seize opportunities in the early stages of value chains, which in turn requires the ability to predict and spot early signals and technology trends. In particular, Latvia can generate the greatest added value precisely at the beginning of introducing innovation, which does not require very large investments in the development of production capacity. Different niche products and services have a greater perspective. At the same time, the OECD recommends improving cooperation between policymakers and policy implementers by developing a common understanding of the nature of functioning of "ecosystems", as well as of the necessary investments and return on "ecosystems" for both building a better business environment and creating and implementing business projects.

## FOSTERING INTERNATIONAL COOPERATION

The Latvian Innovation and Technology Representation *Lat.Tech*, established in Brussels in April 2021, continues its activities also in 2023. This is the first representation under the auspices of the LIAA that focuses on technology. *Lat.Tech* aims to strengthen the position of Latvian enterprises and research institutes in cooperation projects of international organisations. The representation acts as a bridge between Latvian enterprises and research organisations to facilitate their participation in *Horizon Europe*, for example, to engage in international consortia of projects and initiatives. A significant task of the representation is to belong to a family of similar offices of other countries, as well as to highlight Latvia's excellence in smart specialisation in the lobbying and decision-making environment of Brussels.

In October 2023, the LIAA Innovation and Technology Representation started functioning in Geneva. Its task will be to support Latvia's progress towards the status of a fully-fledged Member State of the European Organization for Nuclear Research (CERN) and to work in one of the most important science laboratories in the world to increase the R&D capacity of Latvian enterprises through industry procurement in CERN and closer involvement in the organisation's technology transfer projects. Latvia has been an Associate Member State of CERN since 2021 and Latvia intends to become a full member of this organisation in the next few years. CERN can potentially provide Latvia with new opportunities for the development of both science and business.

# 12. PROMOTING PRODUCTIVE INVESTMENTS AND EXPORTS

## 12.1. PROMOTION OF ACCESS TO FINANCE

The purpose of the implementation of financial instruments is to reduce market failures and to promote the creation of new economic operators and the growth of existing ones, ensuring access to funding to make possible the implementation of prospective and viable business projects for 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 ERDF funding of 161 million euro was channelled to financial instruments in the 2014-2020 programming period of EU funds. In addition, Altum raised its funding or used repaid funding of the funds growing its portfolio to 1 billion euro during the period. Overall, more than 1500 companies were supported and private funding of 327 million euro was raised for the implementation of different business projects – from starting a business to entering foreign markets.

Ensuring the continuous availability of funding to SMEs, aid programmes will continue in the form of financial instruments in the new EU funds programming period 2021-2027, providing loans to business starters and guarantees, as well as facilitating the availability of venture capital instruments, while ensuring that these programmes and activities planned by the *InvestEU* programme complement each other. Overall, EU CF financing of 506 million euro is planned to be channelled to financial instruments: 231 million euro to productivity activities and 275 million euro to energy efficiency. In total, 2000 companies are planned to be supported and private funding of 800 million euro is planned to be raised.

### INVESTMENT FUND

To ensure access to finance for large investment projects aimed at economic recovery following the COVID-19 crisis, on 6 July 2021, the CM approved Regulations No. 503 *Regulations regarding Loans with Capital Rebate for Investment Projects for Merchants for Promotion of Competitiveness* (hereinafter – Investment Fund), approving the state budget support of 152 million euro. The objective of the Investment Fund is to stimulate an influx of new investments to expand entrepreneurship by stimulating entrepreneurs to make new investments and thus create a value-added chain throughout the economy.

The application for the new support programme for large investment projects started in 2022. The programme is planned for development projects from 10 million euro. When achieving the objectives of the project and fulfilling certain criteria, a company can qualify for a loan with a capital rebate of 30% or repayment of the portion of the loan granted by Altum. In total, 37 large investment projects have been approved by the LIAA in the support programme and will be further evaluated by Altum. By November 2023, Altum has taken 11 positive decisions to grant support for total eligible costs of 249.3 million euro and with a capital rebate of 66.6 million euro, including an agreement has been concluded with eight of them (amount of capital rebate applied for – 48 million euro). In view of the withdrawn and rejected projects, Altum continues the evaluation of 11 large investment projects for total eligible costs of the investment project of 233.8 million euro and the applied capital discount of 67.6 million euro. It is planned that the programme will help to create more than 1000 new jobs with remuneration above average, ensure exports of 207 million euro per year and investment in research and development of at least 14 million euro. Moreover, additional funding of 30.5 million has been allocated in October 2023 enabling entrepreneurs to apply for additional expenses up to 30 million euro (excluding the amount of the capital rebate).

In 2023, the government allocated a total of 70 million euro to sustain the operation of the Investment Fund. This funding is intended for investments in the development of large, export-oriented projects deemed crucial for the economy. The conditions for implementing a new selection round of the loan program are currently being coordinated with relevant institutions, with plans to commence no later than the first months of 2024. It is projected that by investing 70 million euro in the form of support, entrepreneurs will invest at least 200 million euro annually, creating a minimum of 600 new jobs per year with above-average remuneration, ensuring a yearly increase in exports starting from 2026 worth at least 130 million euro, and repaying the amount invested by the state in the form of taxes within 10 years.

## SUPPORT TO MITIGATE THE CONSEQUENCES OF RUSSIAN MILITARY AGGRESSION

The Russian Federation's military aggression against Ukraine has caused significant economic and financial disruptions, particularly in commodity markets, as prices for oil, gas, wheat, fertilizer and seeds have rapidly increased. The extent of the economic impact of the aggression is highly unclear and will depend on the duration of the war and political reactions. However, there is no doubt that global growth will be significantly hampered and inflationary pressures will rise. To mitigate the impact of war and the resulting consequences related to market reorientation, access to raw materials and the establishment of new supply chains, the LIAA is carrying out important work in advising entrepreneurs on current crisis solutions and potential support tools. It acts as a single point of contact for market reorientation, also looking for options to replace exports and imports.

In a situation where economic operators are experiencing the effects of the Ukrainian war, such as supply chain disruptions, market shock, uncertainty, inflation, etc., in 2022, the MoE has developed solutions to overcome the crisis and stabilise the market by offering various financial instrument programmes:

- At the CM meeting of 14 June 2022, a loan programme with a financing of 21.5 million euro was approved to reduce the economic consequences of the Russian military aggression against Ukraine. The beneficiaries are small (micro), medium-sized and large enterprises capable of demonstrating that they need the loan to mitigate the negative impact on the economic activity of economic operators and that the performer of economic activity is economically viable. 48 businesses received support of 14.09 million euro within the programme;
- At the CM meeting of 11 October 2022, a programme was approved to compensate processing industry merchants for the increase in energy and natural gas costs resulting from the consequences of the Russian military aggression. This compensation covers the period from 1 February 2022 to 31 December 2022. 134 merchants were supported in total with a combined funding of 25.5 million euro.

## PORTFOLIO GUARANTEES

On 12 September 2017, a state aid programme, portfolio guarantees, was approved. It provides entrepreneurs with the opportunity to receive investment and working capital loans and financial leasing with a term ranging from 1 to 10 years up to a volume of 250 thousand euro. The aid programme is implemented by Altum, which in the process of open selection has selected and concluded agreements with six credit institutions, which are now able to grant loans within the scope of available funding with a state guarantee to companies without direct involvement of Altum. 11.2 million euro of repaid public funding are available for issuing of the guarantees. Since the start of the programme from 2018 to 30 September 2023, 1165 guarantees for 62.7 million euro have been issued within its framework providing financial services to companies.

To continue the support in the form of guarantees started in the EU Funds programming period 2014-2020, on 5 September 2023, the CM decided at its meeting that the support programme should continue – portfolio guarantees for the 2021-2027 programming period granting financing of 9.8 million euro. This additional funding is planned to support 235 companies and raise private investments of 110 million euro.

## VENTURE CAPITAL

Support in the form of acceleration, seed capital, initial capital and growth capital provided by Altum was provided within specific objective *3.1.2 To increase the number of start-ups* of the Operational Programme *Growth and Employment* of the 2014-2020 programming period of EU funds:

- Activity *3.1.2.2 Technology accelerator* provided support to economic operators in the form of quasi-equity investments or equity investments. Altum performed a selection and concluded agreements with three financial intermediaries (fund managers) within a public procurement process. Each financial intermediary manages one pre-seed investment fund and one seed money investment fund. The public funding available for implementing the activity is 16.62 million euro;
- From the beginning of 2022 to 30 September 2023, 28 new agreements were concluded and ERDF funding of 1,941 thousand euro was paid. By 30 September 2023, a total of 157 agreements were concluded and ERDF financing of 12.5 million euro was paid;
- Within activity *3.1.2.1 Venture capital*, economic operators can receive support in the form of quasi-equity investments or equity investments. Altum performed a selection and concluded agreements with three financial intermediaries (fund managers) within a public procurement process. One of them manages a seed capital fund and an initial capital fund, and two financial intermediaries manage one growth capital fund each. From the beginning of 2022 to 30 September 2023, 9 new agreements were concluded and ERDF funding of 5.196 million euro was paid.

By 30 September 2023, a total of 33 agreements were concluded and ERDF financing of 28.516 million euro was paid.

To continue the support to start-ups started and provided in the 2014-2020 programming period providing for venture capital investments, on 15 August 2023, CM approved at its meeting a new EU Structural Funds support programme for venture capital investments in business with total financing of 93 million euro. About 50 million euro are expected to be invested and private investments of at least 31.6 million euro are expected to be raised within the activity. 400 companies (of which at least 300 are start-ups) are planned to be supported and 300 new jobs are planned to be created during the implementation of the activity. The support of the companies will result in at least 12 million euro paid in taxes every year and exports for at least 20 million euro every year.

## MICROCREDITING

*The Start Loan Programme* in the 2014-2020 programming period of EU funds is implemented within the framework of activity *3.1.1.4 Microcrediting and loans to starters* 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*. Starters can receive loans in the form of direct financial instruments. The Start Loan Programme is an important type of state aid for companies at an early stage.

Since June 2016 start loans can also be received for the implementation of viable business projects – for investments and working capital. The loans are issued to economic operators, which are registered in the Commercial Register, are not older than five years (of their establishment), and the maximum loan amount is 150 thousand euro. Start loans play a pivotal role for business starters, granting them access to the necessary funding for prospective and viable projects. This is particularly beneficial for economic operators who, due to factors such as insufficient security, a limited history of economic activity, credit history, net income flow, or existing credit obligations, face challenges securing funding from traditional financial market participants like commercial banks or private investors.

750 start loans for 18.3 million euro and 227 microloans for 3.1 million euro have been issued by 30 September 2023. To ensure the continuity of support, the support programme *Start and growth loans* (hereinafter – activity 1.2.3.3) is also foreseen for the EU programming period 2021-2027. On 19 September 2023, the CM approved amendments to CM Regulations No. 328 of 31 May 2016 *Regulations Regarding Micro-Loans, Start and Growth Loans*, which aim to continue providing support for investments and current assets. The maximum amount of the loan is 250 thousand euro with a loan maturity of up to 15 years. It is planned that at least 290 new companies could be supported under activity 1.2.3.3.

## LOAN GUARANTEE PROGRAMMES

Loan guarantee support activities for starting business and development in situations, when own funds of the company are not sufficient to attract the necessary funding from commercial banks or the company is classified as too risky.

ERDF funding of 49.8 million euro for the support of small and medium-sized enterprises and 3.51 million euro of repaid funding of the previous EU funds periods for the support of large enterprises is available in the support programme from the 2014-2020 programming period of the EU funds.

The programme has been functioning since June 2016 and by 30 September 2023 879 guarantees were issued, totalling 221 million euro, guaranteeing financial services for at least 263 million euro, which evidences of constantly high demand for such financial instruments.

The loan guarantee programme is intended to be continued also in the 2021-2027 planning period with an allocation of 29.6 million euro in funding. On 5 September 2023, the CM approved amendments to CM Regulations No. 383 to ensure the continuation of the programme. Within the 2021-2027 planning period the programme will provide support for 310 companies, attracting private investments totalling 130 million euro.

## 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 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 implemented in the form of direct financial instruments.

The availability of parallel loans makes it possible to receive funding for 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 the crediting policies of commercial banks (for example, the ratio of undertaken obligations to net income, insufficient equity). The parallel loan instrument allows resolving 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 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, therefore the part of the loan from Altum can be considered technically subordinated.

These opportunities make the use of the product more understandable from the point of view of the credit policy of commercial banks. Furthermore, for a customer or entrepreneur a parallel loan means a way to reduce the participation of the customer itself, which is rather difficult to accumulate for companies. The programme has been functioning since June 2016 and by 30 September 2023 20 parallel loans of 12.2 million euro have been funded from the ERDF, and 6 parallel loans of 2.2 million euro have been issued in addition co-financed from repayments of previous periods of structural funds.

## EXPORT CREDIT GUARANTEES

The MoE continues the export support measures initiated in the previous years. Altum short-term export credit guarantees are a significant support for exports. From the beginning of the current export credit guarantee programme in 2017 until 30 September 2023, export credit guarantees have been issued for 325 million euro (declared export amount – around 166.5 million euro) and 133 companies have been supported (unique). On 19 September 2023, the EC provided coordination for the extension of the term of issuance of export credit guarantees to EU and developed OECD countries, thus Latvian undertakings will be able to receive short-term export credit guarantees until 31 December 2028 regardless of the size of the exporting company and the (buyer's) debtor's country.

## SME LOANS

In the SME loan programme, since the end of 2021, activity *3.1.1.7 Loans for the development of micro, small and medium-sized economic operators* and activity *13.1.1.1 Loans to promote the development of micro, small and medium-sized economic* operators provide financing for loans for the implementation of SME projects, incl. providing loans for sustainability of companies. By 30 September 2023, 209 applications for 54.1 million euro have been approved. To continue support for the sustainability of companies started and provided in the 2014-2020 programming period, the activity will also be implemented in the 2021-2027 programming period, and at least 150 economic operators receiving financial support are planned to be supported.

## CAPITAL MARKET DEVELOPMENT SUPPORT

To move towards increased access to financing for businesses and promote the development of the capital market, on 17 October 2023, the CM approved the support programme of the new FU Funds programming period 2021-2027 *Support for Participation of Enterprises in Capital Markets*, which provides support to entrepreneurs for inclusion of stocks and debt securities in a trading place – costs of attracting consultants and services, not exceeding 50% of the eligible costs of the project. SMEs and small midcaps will be supported. 10 businesses are planned to be supported and private financing of 2 million is planned to be raised.

On 13 June 2023, the CM supported the creation of an initial public offering fund for SMEs in the Baltics (IPOs), thus providing financing for the initial listing and inclusion of SMEs in the Baltic stock market (both on the regulated market and the alternative market of the multilateral trading facility (MTF) on the *Nasdaq* Baltic stock exchange). The fund will act as a specialised financial intermediary and will focus on profitable SMEs. An average of 2-3 million euro is expected to be invested in one company. Altum and Lithuanian Development Finance Institution *INVEGA* are expected to participate in the creation of the fund contributing 20 million euro each. In early 2024, work is planned to begin on the creation of the fund and the selection of the manager.

## 12.2. PROMOTING ENERGY EFFICIENCY

By approving *Latvia's National Energy and Climate Plan 2021-2030* (National Energy and Climate Plan 2030) by CM Order No. 46 of 4 February 2020, the Latvian government has set energy efficiency targets to be reached by 2030:

- total indicative national energy efficiency – total primary energy consumption not more than 165 – 170 PJ and final energy consumption not more than 145 – 149 PJ;
- annual final energy consumption saving of 0.8% – final energy saving of 1.76 Mtoe (20,472.02 GWh) accumulated in 2021 – 2030;
- annual renovation of 3% of the state-owned building area (maximum estimates – 500 thousand m$^2$).

**Support Programmes for Improvement of Energy Efficiency (as of 20 November 2023)**

Several programmes supervised by the MoE are currently being implemented to support energy efficiency projects.

*Recovery and Resilience Facility* support programme

Improving the energy performance of multi-apartment houses:
- funding has been reserved for 21 projects for the total Recovery Fund financing of 7.9 million euro and detailed documentation is being prepared for these projects to be able to close agreements on the implementation of projects.

Improving the energy performance of public sector buildings, including historical buildings:
- funding has been reserved for 9 projects for the total Recovery Fund financing of 23.956 million euro and detailed documentation is being developed for these projects to be able to close agreements on the implementation of projects.

Increasing energy efficiency in business:
- funding has been reserved for 151 projects for the total Recovery Fund financing of 16.4 million euro;
- planned $CO_2$ reduced per year for the applied projects – 4.1 thousand tons.

Support programmes implemented from funds that are not EU support

Energy efficiency programme for private houses:
- 969 projects requesting funding of 4.1 million euro were approved by Altum;
- the implementation of the projects will increase the energy efficiency class of the private house at least to class C and reduce heating consumption at least by 20%.

Repair fund:
- Altum has granted 76 loans amounting to 3.1 million euro for repair and improvement of multi-apartment residential houses;

Indicators achieved in the EU funds programming period 2014-2020

Energy efficiency programme for multi-apartment houses:

Altum supported 627 projects for the requested ERDF funding of 158 million euro which achieved the following indicators:
- the average energy consumption reduction in homes – 55%;
- the annual average energy consumption for a renewed house – 56 kWh/m$^2$;
- annual CO2 reduction – 26.6 thousand tons.

Energy efficiency programme for public buildings:

131 projects for the requested ERDF funding of 88.3 million euro were supported which achieved the following indicators:
- the total area of state-owned buildings, which will be renewed within projects – 112,583 m$^2$;
- the annual average energy consumption of the buildings after a year of implementation of the project – 110 kWh/m$^2$.

Energy efficiency programme for production buildings:

73 projects for the CF funding of 20.20 million euro were supported which achieved the following indicators:
- annual energy savings – 169.6 GWh;
- installed capacity of renewable energy sources (heating boilers + solar collectors) – 9.5 MW;
- annual CO2 reduction – 22.5 thousand tons.

Energy efficiency programme for the district heating system:

158 projects for the CF funding of 93.79 million euro were supported which achieved the following indicators:
- additional installed capacity of renewable energy sources – 219.31 MW;
- reconstructed production capacity– 217.82 MW;
- reconstructed heating networks – 61.86 km;
- annual reduction in heating energy losses in reconstructed heating networks – 47.75 GWh;
- annual $CO_2$ reduction – 163.03 thousand tons.

The main task of introducing energy efficiency improvement measures is to limit the increase in consumption of primary energy sources and final energy consumption and to reduce overall energy consumption. Energy savings for end consumers are obtained through financial support programmes for undertakings (economic operators), households (residential houses) and the public sector.

The measures taken by the parties responsible for the energy efficiency obligation scheme and the measures stated in mandatory energy audits and introduced by companies have also contributed to progress towards state energy efficiency targets. Energy efficiency improvements in enterprises are an important element in facilitating EU competitiveness, therefore, since 2015 all large enterprises in the EU are obliged to conduct regular energy audits.

The *Energy Efficiency Law* provides that large companies and companies with annual electricity consumption above 500 MWh (two calendar years in a row) every four years conduct an energy audit or introduce and maintain a certified energy management system, obliging them to implement energy efficiency measures with the highest energy saving potential or economic return.

According to the latest data, these requirements generally apply to 276 large enterprises and 1086 large electricity consumers. As a result of the audit, the companies identify the possibilities for improvement of their buildings, introducing energy-efficient lighting, production equipment and transport. Effective use of energy will save companies' costs, as well as will help Latvia to reach its energy efficiency targets.

## 12.3. SUPPORTING ACCESS TO FOREIGN MARKETS

Intergovernmental agreements on economic cooperation are concluded with the aim to strengthen and extend economic, industrial, scientific, and technical cooperation, while fostering favourable conditions for cooperation among economic operators. In June 2023, the Minister of Economics visited Saudi Arabia and signed an agreement on economic cooperation between the governments of the Republic of Latvia and the Kingdom of Saudi Arabia. At present, Latvia has concluded and maintains agreements on economic cooperation with the United Arab Emirates, Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Kuwait, China, Moldova, Saudi Arabia, Tajikistan, Turkey, Turkmenistan, Ukraine, and Uzbekistan.

In 2022, based on a CM decision, the previously concluded agreements on economic cooperation with Russia and Belarus were suspended in response to hostilities in Ukraine conducted by Russia and backed by Belarus and because of the sanctions imposed against Russia and Belarus.

Intergovernmental Commissions or Joint Committees have been established to implement these intergovernmental agreements on economic cooperation. The agenda of their meetings includes issues of bilateral economic cooperation, which are important for contracting countries at the level of governments and businesses in various areas: industry, tourism, transport, pharmacy, agriculture, financial services, communication, professional training, investment attraction, technology and innovation. In March 2023, the 9th session of the Latvian-Ukraine Intergovernmental Commission for economic, scientific and technical cooperation matters was held in Riga.

In 2023 a series of meetings and visits were conducted to explore opportunities for Latvia to extend its cooperation with Lithuania, Estonia, Poland, France, Germany, Malta, Luxembourg, Ukraine, Saudi Arabia, Japan, South Korea, and other countries, as part of the ongoing intergovernmental dialogue.

### LATVIA'S FOREIGN ECONOMIC REPRESENTATIONS

LIAA representations operate in several countries of the world to solve economic issues and support Latvian businesses. They organise national stands at international trade shows abroad, organise trade missions, provide advice on foreign markets and organise meetings with potential business partners.

In 2023, Latvia's foreign economic representations provided support in 19 representations: United States (San Francisco and Boston), the United Arab Emirates, Austria, Denmark, South Korea, France, Italy, Japan, Canada, the United Kingdom, the Netherlands, Norway, Finland, Ukraine, Germany and Sweden. In addition, two representations in Norway and Sweden have a representative working exclusively on investment matters. Given the current global and geopolitical challenges to expand companies' opportunities to seek partners in new markets, representations were opened in Australia and Uzbekistan. In 2023, 3 Latvia's external economic representations were established in Brussels, Geneva and Israel, whose main tasks are to seek cooperation and projects in the field of innovation and technology, as well as to represent Latvia's interests in the European Organization for Nuclear Research (CERN). Representations in Russia and Belarus were closed because of Russia's war against Ukraine. Having assessed the geopolitical situation, the representation in China was also closed.

LIAA also offers economic operators the services of the Enterprise Europe Network (EEN) – assistance in searching for international partners, preparation of market information, consultations on legislation and business aspects, consultations on access to finance (*Horizon 2020*, *Erasmus*, *Creative Europe*, *Interreg*, etc.) and other consultations. EEN successfully complements the services provided by the LIAA – providing advice to economic operators regardless of the industry, access to information in 69 countries around the world and specific resources developed by the EC. The EEN project is implemented in cooperation with the Latvian Technological Centre and the Latvian Chamber of Commerce and Industry.

During the 9 months of 2023, 939 consultations on foreign markets and other business-related matters were provided, 29 broker activities and foreign trade missions were organised and information activities were organised in the framework of the EEN project involving 267 participants. 13 innovation and technology audits were conducted in companies. The mandatory "customer path" model introduced by the EC has been successfully used in the day-to-day work with companies, i.e. an evaluation of the company has been carried out and an action plan has been developed based on a questionnaire in line with EC requirements, which is an agreement between EEN and the company on the provision of a successful service. In 9 months, this business evaluation has been carried out for 50 companies. 27 partnership achievements have been registered with other companies and research institutions, and 18 business, technology and research cooperation agreements have been concluded.

## NATIONAL PLATFORM FOR BUSINESS DEVELOPMENT

To improve the awareness of potential and existing economic operators of business developments, enhance LIAA's customer service processes, and simplify obtaining information and communication, LIAA has developed a national platform for business development *business.gov.lv*, which contributes to the digitisation of services and the development of e-services.

The platform *business.gov.lv* has been set up as a *web*-based customer self-service platform for the acquisition of personalised information and communication, where an economic operator can create its profile, indicating industries of interest, topics and other criteria for receiving personalised information, can apply electronically to the services provided by LIAA, including the possibility to submit forms, payment requests and other documents electronically. The platform provides in one place information about industry news, news abroad, and different events addressed to economic operators. The creation of the content of the portal is supported by the sectoral ministries, the CSB, Altum, the Latvian Chamber of Commerce and Industry, the Bank of Latvia and other commercial banks and institutions.

To ensure further development of the platform, on 10 May 2023, the CM approved Order No. 265 "On the approval of the passport and centralised function or shared services development plan of investment project *2.1.2.1.i Digital Services Platform for Promotion of Business Development*, which is planning to invest 1.68 million euro in the platform by 31 December 2025 within the framework of the EU Recovery and Resilience Facility providing it as a single platform for entrepreneurs and a single digital gateway for cooperation of entrepreneurs with the state.

## EXPORT MARKETING ACTIVITIES

Against the backdrop of the COVID-19 pandemic and geopolitical turmoil, companies' interest in finding new markets has grown more than ever, as a result, companies' motivation to use state and other support tools more effectively has also risen.

Support is provided by the state within the scope of the ERDF project *Promoting international competitiveness* (hereinafter – PIC project). In the nine months of 2023, support (in the form of grants) was provided to the project target group 2358 times for participation in both on-site and digital exhibitions, conferences, seminars, contact fairs, trade missions or visits of senior Latvian public officials, as well as participation in international digital industry platforms, adaptation of products or services to foreign markets, brand or product/service publicity in foreign specialised industry printed and digital media, telemarketing services and participation in international industry associations, the development of website and online stores, the involvement of a foreign industry expert. Support (in the form of grants) was provided to companies 132 times to evaluate compliance of production facilities and products of the PIC target group.

In 2023, the LIAA proposed a comprehensive programme for participation in the national stands organised by the LIAA and funded by the PIC project for companies to continue strengthening in existing markets or find partners in new markets. In the nine months of 2023, LIAA provided 1300 consultations on foreign markets to Latvian companies and 561 in-depth consultations. 493 export requests of foreign companies have been processed, including 109 in RIS3 areas, 31 trade missions have been organised, in which 87 representatives of Latvian companies participated, more than 745 contacts have been obtained, 91 agreements or letters of intent have been concluded.

Trade missions within foreign visits of state officials are considered as the most important: 1) the visit of the Minister of Economics to Saudi Arabia, followed by a response visit to Latvia with a large Saudi Arabia delegation; 2) the visit of the President of Latvia to Portugal; 3) the visit of the Minister of Foreign Affairs to the Republics of Ghana and Benin; 4) the visit of the Minister of Economics to France; 4) the participation of the President of Latvia in the three Seas Initiative Summit and Business Forum in Bucharest (Romania) together with a delegation of entrepreneurs; 5) Latvian days in South Korea, which were held from October 25 to 29 in Seoul, the capital of the Republic of Korea, and gathered a wide range of stakeholders.

17 seminars were organised on various foreign trade missions and were attended by 1278 visitors.

Also, activities are planned in the new EU programming period 2021-2027 for entrepreneurs to promote exports, providing support for participation in exhibitions, conferences, and contact fairs, ensure export consultations, the development/registration of trademarks and designs, the adaptation of products/services to foreign markets, installation/transportation of stands, as well as organisation of international conferences and exhibitions in Latvia in the field of RIS3. Support will be provided to businesses starting from December 2023.

## DEVELOPMENT OF INNOVATIVE BUSINESS OF SME

The ERDF project *Business Development Support for SMEs* by the LIAA (hereinafter – SME project) was approved on 26 September 2023 to ensure the availability of financing for the implementation of a business idea and the development of business, promoting activities aimed at increasing the proportion of innovative entrepreneurs in the economy and promoting business aimed at creating high added value in the field of medium-high and high-tech and creative industries, and promoting export growth in supported companies, thus contributing to the achievement of the objectives of the *Smart Specialisation Strategy*.

The project is expected to commence at the end of November 2023. Within the scope of the available support, the SME project is planned to be implemented until 31 December 2029. The total eligible costs of the project application are 73.3 million euro, including ERDF funding of 62.3 million euro.

In the project, the LIAA will implement activities covering the full support of the business development cycle – from the idea of creating a new technologically intensive company to a stable, competitive, growth-oriented business with high added value. Within the framework of the project, financial and non-financial support will be provided to the target group for innovation and motivation, business incubation and export promotion activities. Within the framework of the project, the LIAA will carry out activities such as consultations of foreign economic representations of Latvia, implementation of educational and training programmes directed towards the development of business and innovations, organisation of measures for promotion of innovation and business export, including providing support in the form of grants, awarding of prizes and money prizes to the winners of business idea competitions, cooperation with organisations and institutions, etc.

To support enterprises entering foreign markets, as part of the SME project support will be provided both in the form of grants and by offering participation in export promotion activities organised by the LIAA such as national stands in international exhibitions, trade missions, etc.

## SUPPORT TO THE PRODUCTION OF FOREIGN FILMS IN LATVIA

On 15 March 2022, the CM approved a new support programme for the production of foreign films in Latvia – *Procedure by which state budget co-financing is granted for the production of foreign films in Latvia*. The total annual state funding of the support programme until 2025 constitutes 850 million euro. The amount of co-financing available for one project is 20% of the total amount of eligible expenditure indicated in the co-financing agreement, while for eligible remuneration cost items the amount of co-financing is 30%.

To be able to grant national co-financing for the production of foreign films, the LIAA organises open competitions for the selection of project applications during a calendar year. Seven project applications were received in the first selection round in 2023, requesting the necessary co-financing of 1.994 million euro. On 8 June 2023, the CM approved an increase in appropriations for 1.994 million euro to ensure state budget co-financing for the production of foreign films in Latvia, thus supporting the projects submitted in the first selection round.

## 12.4. POLICY FOR ATTRACTION OF FOREIGN INVESTMENT

The LIAA plays a significant role in the attraction of foreign investment in Latvia. The strategy of the LIAA for attraction of investment is oriented towards qualitative servicing of incoming investment projects and active operation in attracting investment projects by addressing potential investors. Attraction and promotion of FDI are broken down into four main processes such as strategy and planning (creation of the national level 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 (aftercare and improvement, monitoring of services).

In 2023, LIAA continued active attraction of investment in RIS3 areas, purposefully promoting the growth of FDI in knowledge-intensive sectors with high added value. In 2023, it is planned to achieve 85% of FDI projects implemented in RIS3 areas.

As a result of the war initiated by the Russian Federation against Ukraine and their joint hybrid war with Belarus against EU and NATO countries, several foreign investors demonstrate a wait-and-see attitude before making a final decision on investments in Latvia. Nevertheless, the number of attracted investments and newly created jobs has increased compared to 2022. Investment volumes in the field of smart energy are growing, thus strengthening Latvia's and the region's independence from the energy sources of the Russian Federation, and investments and the number of newly created jobs in ICT and global business services (GBS) sectors are growing as well.

The export promotion and foreign investment attraction policy is enshrined in the *National Industrial Policy Guidelines for 2021-2027*. FDI attraction policy is aimed at raising the competitiveness of Latvia as an attractive investment environment, considering the most important aspects 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 in the economy structure in favour of external demand-oriented sectors, especially those that are defined as medium-high and high technology sectors. The priority in the FDI attraction process must be geographically closest neighbouring countries where Latvia is recognized and no extensive additional resources have to be invested for informative activities; also it has to be oriented towards economically stable and developed countries where the development potential and needs of economy sectors are appropriate for Latvian perspective cooperation opportunities; and countries with Latvian foreign economic representations.

The process of improvement of the FDI attraction policy has been taking place in close cooperation with the FICIL. On 2 and 3 November 2023, the twenty-seventh high level meeting between the Latvian government and the FICIL was held, where government representatives and investors discussed human capital, data-driven decisions, good governance, and sustainable procurement in the public sector.

The *Large Investment Loan with a Capital Discount* programme plays an important role in the attraction of foreign investment, which provides a capital discount of up to 10 million euro for strong and large investment projects. The support programme in question has given rise to a high level of interest among entrepreneurs and shows that this programme needs to be continued, ensuring the continuity of access to finance.

To contribute to the faster recovery of the Latvian economy from the COVID-19 crisis and the improvement of the economic situation by accelerating the attraction of investment and increasing Latvia's competitiveness, in February 2021, the CM approved a MoE's and LIAA's offer to create a *green corridor* to accelerate the bureaucracy and administrative processes for high value added investment projects. The *green corridor* is designed for investment projects in priority industries covering RIS3, international business services centres, as well as construction, transportation and logistics if the implementation of these ideas is linked to priority industries. It is an opportunity for the companies registered in Latvia, which are planning to implement investment projects and meet the set criteria (size of investments, number of jobs created, volume of exports and investments in R&D), to receive public administration services provided in the field of construction, spatial planning or migration using an accelerated procedure, i.e. reducing the time for receiving specific public services by half.

24 investment projects for a total planned investment amount of 582 million euro were approved from the introduction of the *green corridor* regulation until 1 November 2023. Seven projects have already received this status this year and are planning to invest 299 million euro.

In addition to the abovementioned initiatives, investment marketing activities are also being implemented, covering both the organisation of events abroad, for example, the Business Forum in Lisbon (as part of President Levits' visit), the *Spotlight Latvia* conference, Latvian days in Korea, and the provision of meetings for investors at events organised in Latvia. Events like *DeepTech Atelier*, *5G Techritory*, and the Precision Medicine Networking Forum are worth mentioning, within the framework of which separate events were organised for foreign investors representing the sector to present Latvia's cooperation offers.

The LIAA is actively informing foreign investors about Latvia's investment environment also through Latvia's external economic representations abroad.

## 12.5. DIGITAL TRANSFORMATION

Investment in the development of the digital transformation of businesses is one of the priorities for promoting productive business. To achieve these objectives, until 2029 companies have access to support for digitisation of business processes, improvement of digital skills, development of new products and services, as well as testing and purchasing of technological equipment.

The MoE is planning to invest 183.5 million euro in digital transformation support programmes within the EU CF for 2021-2027 and Latvia's Recovery and Resilience Facility Plan.

Two European Digital Innovation Hubs (EDIH) have been approved to help entrepreneurs better identify their needs in digital transformation. They will provide consultations, mentoring, technological services, first and second digital maturity tests, digital development roadmap and report development services.

### SUPPORT OF EUROPEAN DIGITAL INNOVATION HUB

On 13 September 2022, by Regulations No. 577 *Implementing Regulations of Investment 2.2.1.1.i. "Support for creation of Digital innovation hubs and regional contact points" of 2.2.1.r. "Establishment of full cycle support for digital transformation of entrepreneurship with regional scope" of reform and investment direction 2.2 "Digital transformation and innovations of enterprises" of component 2 "Digital Transformation" of Latvia's Recovery and Resilience Facility Plan* the CM approved the support programme forwarded by the MoE, which aims to promote the competitiveness of businesses through the introduction of digital technologies, as well as digital and innovative public administration, which uses technologies as advanced as in the private sector, to promote the introduction of solutions in conjunction with the *Smart Specialisation Strategy*, to raise the awareness of businesses regarding the advantages provided by digital technologies, as well as to ensure access to support for digital transformation processes throughout the territory of the Republic of Latvia and to ensure full involvement of Latvia in the joint EDIH network.

Target groups or final beneficiaries of the programme are the micro, small, medium-sized enterprises and large enterprises, associations and foundations, which unite several merchants or represent their interests, public persons or institutions, capital companies of public entities, research and knowledge distribution organisations, farms, cooperative societies, that carries out economic activity. As part of the support, any interested person can receive consultations and fill digital maturity test, to evaluate degree of digitisation of their company or institution, a digital development road map for identifying priority investments and mentoring on how to digitise the processes of the company or institution. The total investment funding is 10 million euro. According to the plan, 3500 companies will be able to receive support by the middle of 2026.[6]

### GRANTS FOR DIGITALISATION OF SERVICES AND PRODUCTION PROCESSES OF COMPANIES

On 10 January 2023, by Regulations No. 10 *Implementing Regulations of Investment 2.2.1.2.i. "Support for digitisation of processes in commercial activities" of 2.2.1.r. "Establishment of full cycle support for digital transformation of entrepreneurship with regional scope" of reform and investment direction 2.2 "Digital transformation and innovations of enterprises" of component 2 "Digital Transformation" of Latvia's Recovery and Resilience Facility Plan* the CM approved the support programme proposed by the MoE, which aims to issue grants for the development or introduction of digital products,

[6] More information on available EDIH support is available on the websites of the Latvian IT Cluster and the Latvian Digital Accelerator and on the MoE website: https://www.em.gov.lv/lv/edic-un-regionalo-centru-izveide.

services and applications or acceptance of digital solutions to transform their existing services, products or processes to improve business processes and increase productivity.

Not only micro, small, medium-sized and large enterprises, including a foreign branch of a legal entity, farms, cooperative societies, but also associations and foundations, which unite several merchants or represent their interests, as well as research and knowledge distribution organisations and capital companies of public entities will be eligible for support within the programme. To receive the grant, an EDIH will have to evaluate digital l and innovation maturity of the merchant after the second test and of the compliance with the digital development roadmap and that the acquisition of the specific equipment or software has contributed to the digitisation of the processes. The total investment funding is 40 million euro. According to the plan, 3000 companies will be able to receive support until the middle of 2026.

## LOANS WITH A CAPITAL DISCOUNT FOR DIGITALISATION AND AUTOMATION OF COMPANIES

On 5 July 2022, by Regulations No. 421 *Implementing Regulations of investment 2.2.1.4.i "Financial instruments for promotion of digital transformation of businesses" of reform and investment direction 2.2 "Digital transformation and innovations of enterprises" of the European Union Recovery and Resilience Facility Plan*, the CM approved the support programme proposed by the MoE in the form of a financial instrument. The objective of the investment is to promote the digital transformation of businesses, development of businesses and increase turnover by supporting investments in tools for digital transformation of business aimed at productivity growth. Within the framework of the RRF investment, support can be received as a loan with a capital discount of up to 35% of the total amount of the investment project, but not more than 1 million euro.

It is planned as an Altum loan with a capital discount if no other financer is involved in financing the project and the Altum loan amounts at least to the capital discount. Similarly, a parallel loan with a capital discount is possible within the framework of an investment if the project is co-financed together with one or more other financers. The parallel loan in the Altum part amounts at least to the capital discount. Micro, small, medium-sized and large enterprises will be eligible for the support. To apply for the Altum loan capital discount, an EDIH report will have to be submitted, which is an assessment of digital and innovation maturity after the second test and of the compliance of the investments made with the Digital Development Roadmap, as a confirmation that the Digital Development Roadmap has been fulfilled and that the specific investment has contributed to the digitisation of the processes. The RRF funding available for the investment is 45.1 million euro. According to the plan, 133 companies will be able to receive support until 30 June 2026 raising at least 37 million euro of private funding.

## IMPROVEMENT OF DIGITAL SKILLS

To provide Latvian micro, small, medium-sized and large enterprises with digital skills, including skills that contribute to export promotion, basic high-level digital management skills at the level of enterprise management and skills for the use of digital technologies in different business processes, support in the form of grants and non-financial support is planned within the RRF. The RRF financing available for the investment is 20 million euro, and support will be provided by EDIH or industry organisations representing entrepreneurs.

## DEVELOPMENT OF NEW DIGITAL PRODUCTS AND SERVICES

Within the framework of the RRF, support is planned for the creation of new digital products and services, which would help the Latvian economy recover from the crisis and promote competitiveness in the future with the introduction of state-of-the-art automation, robotics and labour control tools in the manufacturing facility, as well as support the introduction of personalised e-commerce solutions tailored for the company into sales processes.

The support will be available in the form of grants and the support intensity may reach 25%-80% depending on the type of research project (industrial research, experimental development or feasibility study) and the size of its implementer, at the same time, the maximum available funding from the RRF for one research project implementer is 1 million euro. As part of the investment, priority will be given to the implementers of the research project, who, upon starting the implementation of the research project, will conduct a digital maturity test and develop a digital development roadmap After the implementation of the research project, its implementer can submit a second digital maturity test, checking the usefulness of the investment, at the same time, the second maturity test is not considered a prerequisite for receiving funding. The RRF financing available for the investment is 24.3 million euro, which will be available from 2024.

# 13. CONSTRUCTION POLICY

In 2023, the MoE continued working on the improvement of construction processes; solutions have been found to improve and simplify the administrative process of construction while maintaining a high level of protection of the public interest and contributing to the safety of construction. In 2023, the MoE, in cooperation with representatives of the construction industry and real estate developers, launched an audit of the real estate development process, including the process of implementing the construction concept, from the point of view of bureaucratic burdens, paying particular attention to digitisation matters.

In 2023, the annual Shadow Economy Index of Stockholm School of Economics in Riga shows that the worst situation is still in the construction sector, where the shadow economy ratio has increased by another 3.3 percentage points compared to 2021, reaching 34.5%. Considering that the situation is deteriorating, the MoE, in cooperation with MoF and construction industry organisations, has developed proposals for shadow economy restriction measures, which were submitted to MoF for further forwarding.

Compared to 2022, fewer construction cases (construction applications, explanatory notices, notices) have been proposed in the Building Information System in Q1-Q3 2023.

Overall, construction cases on construction boards are processed quicker than in 2022. In Q1-Q3 2023, the average:

- period for examination of a construction application is 21.451 days (28.663 days in 2022), in accordance with the requirements of regulatory enactments the period for examination of a construction application is 30 days;
- period for examination of an explanatory note is 14.204 days (15.816 days – in 2022), the period specified in regulatory enactments is 10 working days;
- period for evaluation of the conditions for commencement of construction work is 3.967 days (5.472 days in 2022), the period specified in regulatory enactments is 5 working days;
- period for issuance of technical regulations is 10.601 days (12.716 days – in 2022), the period specified in regulatory enactments is 20 days;
- the period for coordination of a building design by issuers of technical regulations is 11.86 days (in 2022 – 11.703 days), the period specified in regulatory enactments is 30 days.

Data from the Building Information System indicate that the periods specified in regulatory enactments for coordination and acceptance of the construction concept are generally observed, however, in some cases significantly longer execution times are observed in practice. The available statistics on the issue of technical regulations and the coordinators of building designs from the issuers of these regulations show that deadlines for issuance and coordination are most often delayed by those who issue such regulations less often.

## IMPROVEMENT OF REAL ESTATE DEVELOPMENT PROCESSES

Improvement of real estate development (RED) processes is one of the priorities defined by the CM headed by Prime Minister Evika Siliņa. Tackling disproportionate bureaucracy and reducing bureaucratic burdens is a commitment reflected both in the government declaration and later in specific government tasks.

It should be noted that the construction process or implementation of a construction concept is only a small part of RED, as the construction-related processes have the same effect during planning and preparation of investments, and deficiencies in them may make construction impossible or ineffective. As a result of these deficiencies, the investor often decides to abandon investments or abandon them in Latvia, looking for alternative options in neighbouring countries.

The MoE has defined the need to simplify RED processes, from spatial planning to the registration of immovable property in the Land Register, to promote uniform application of the construction regulation throughout the territory of Latvia, as well as to improve and accelerate building commissioning processes.

RED is a complex measure consisting of several processes: spatial planning defining the prospects of RED; environmental protection issues – environmental impact assessment; preparation of construction process – geodetics, another type of feasibility study; construction process – initiation of construction until the commissioning of the building; registration of the building and corroboration of ownership rights.

To assess the current situation and to make meaningful proposals to improve the RED process, a working group was set up to identify with the social partners legislative gaps and administrative barriers to RED. On this basis, a plan of RED simplification measures was developed, bringing together complex and comprehensive measures to improve the RED process. Given that the problems identified and the solutions proposed concern, among other things, the matters of competence of the MoEPRD, MoJ, MoA, Ministry of Transport and Ministry of Culture, special attention was paid to interdepartmental cooperation.

To promote the introduction of faster and more efficient solutions, on 6 November 2023, a task of the Prime Minister was received for the MoE, in cooperation with other involved institutions, to submit by 1 February 2024 proposals for the reduction of administrative burden in the field of real estate development, including, but not limited to, local level spatial development planning, land survey, construction, cadastral survey, environmental impact assessment and deforestation. The coordinating role is entrusted to the State Chancellery. To fulfil the task assigned by the Prime Minister, the MoE, in cooperation with the State Chancellery, has set up an interdepartmental working group representing all parties involved, including representatives of real estate developers, as well as 4 working groups at the expert level, which, based on the developments of the MoW, continue to develop an action plan to reduce bureaucracy in the field of RED.

In parallel, the MoE is implementing the solutions within its competence. Having assessed the identified obstacles, within the scope of its competence, the MoE has prioritised a single and successive building construction and registration process, within the framework of which it is necessary to ensure receipt of the data about the building required by the Real Estate State Cadastre Information System from the Building Information System not to delay commissioning of buildings. In this regard, the MoJ, in cooperation with the MoE, has prepared a draft informative report *On Solutions for the Introduction of a Single Building Registration Process*. In addition, work on the improvement of the RED process continues in cooperation with other state and local government institutions.

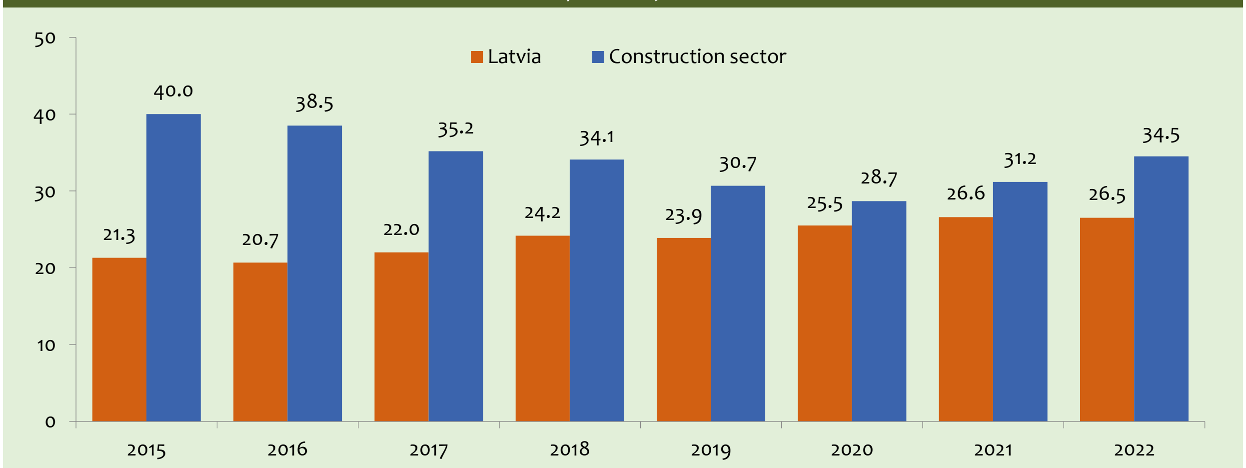
Along with the wider review of the RED process, amendments to the laws and regulations in the field of construction were developed in 2023 to reduce the administrative burden for participants in the construction process and improve the investment environment. The building design expert examination regulation was improved, reducing the time during which it is necessary to suspend construction work in case of changes in the construction concept, and the construction commencement regulation, reducing the need to initiate several construction cases for the implementation of one concept. In addition, the administrative process of building construction has been reviewed, ensuring that similar construction works will have similar requirements, as well as amendments have been made to the regulation on construction works on municipal streets and roads, providing that local governments can restore their streets more efficiently and with less administrative burden.

## RESTRICTION OF SHADOW ECONOMY

According to the *Shadow Economy Index for the Baltic Countries 2009–2022*, a study conducted by researchers of the Centre for Sustainable Business of Stockholm School of Economics in Riga A. Sauka, T. Putniņš, the share of the shadow economy in the construction sector was 40% in 2016, then gradually decreased until 2020, until it rose again to 31.2% in 2021 and by another 3.3% in 2022, reaching 34.5% (see Figure 13.1).

Figure 13.1

**Shadow economy index for Latvia and construction sector**
*as per cent of GDP*



While the growth of the shadow economy in recent years has been rapid, there are also objective reasons for this.

The growth of the shadow economy was fuelled by major turbulence and a sharp rise in costs, initially caused by the global impact of the COVID-19 pandemic and later the Russian military aggression in Ukraine. As the sector stabilises and businesses regain stability, the share of the shadow economy will naturally decrease as well. However, to achieve an appropriate and vitally important reduction of the shadow economy for the competitiveness of the sector, the functioning of existing measures should be improved and additional measures should be introduced in segments which are not covered by the measures previously introduced or where they are unable to produce an appropriate effect.

CM order No. 178 *On the Development of the Plan for the Limitation of the Shadow Economy for 2023-2025* approved on 30 March 2023, identifies three priority economic sectors for the reduction of the shadow economy, including construction – construction of buildings, civil engineering, specialised construction activities. A working group was set up in line with the order, which, together with the social partners, has drawn up proposals to curb the shadow economy in the construction sector, which have been submitted to the MoF for further forwarding. The measures are aimed at reducing the risk of the shadow economy in the construction sector, the potential fiscal impact of the introduction of measures on the state budget, as well as the administrative burden have been estimated.

It should be noted that targeted measures to reduce the shadow economy in the construction sector have been consistently introduced since 2016, with the participation of the construction sector itself where it made a significant contribution to improving the business environment of the sector. The members of the working group led by the MoE concluded that effective measures have been put in place in the construction sector to curb the shadow economy, but individual improvements would be needed for them to function fully. The measures introduced so far in the construction sector were basically targeted at larger sites. Meanwhile, more effective shadow economy restriction measures should be taken, which can be applied to construction sites of different sizes by construction processes. An offer has been made in the working group for such segmentation of the construction sector – construction sites in which only a construction merchant is entitled to perform construction work within the framework of the construction process; construction sites in which a builder is entitled to perform construction work within the framework of the construction process (a natural person or a farm can build the structures specified in special construction regulations for their own needs); home repairs. The proposals developed under the leadership of MoE envisage both the improvement of the previously introduced measures covering a wider segment of the sector and the introduction of new measures targeting the segment of the sector that was not previously covered.

## DIGITALISATION THE CONSTRUCTION SECTOR

In 2023, the implementation of the ERDF project *Construction Process and Information System Development (round 2)* continued. The project aims to increase the efficiency of the construction process, the productivity of the sector and to promote the use of information and communication technologies in the management of the construction process and the lifecycle of the building, which will improve the availability of public administration services and ensure the re-use of the data available to the state. At the same time, the administrative burden, the costs associated with the organisation of the construction process and the time needed to prepare the documentation will be reduced. In addition, priority activities have been implemented in 2023, focusing on improvements in the usability and performance of the Building Information System, automation, integration of shared solutions and data exchange with other information systems, as well as other improvements have been implemented to the Building Information System within the framework of maintenance.

**Implementation of the Building Information System (BIS) in 2023**

In 2023, interfaces with information systems of construction initiators, developers of the building design and performers of construction work have been developed, and, at the same time, various improvements were introduced in the processes of construction intent creation, building design coordination and completion of the construction work log, the *WSO2 API Manager* platform for management of interfaces has been introduced, a workplace for an expert has been developed for ensuring the process of management of the building design expert examination and the Single Electronic Time Recording Database has been supplemented with information regarding the payments performed within the framework of construction contracts.

In 2023, within the framework of priority measures relating to the usability of BIS, a new website with content administration possibilities has been introduced, data monitoring in building operation files and house files has been developed, the registration process of residential house managers and the process of management of independent practice of construction specialists has been improved, the demonstration of results of the public consultation process has been developed, the summary of the coordinations of the building design and the presentation of comments has been improved, the mobile application has been supplemented with building operation files and house files, automatic display of building file data to new owners has been ensured, the notification and warning functionality has been improved, functionality of requests of technical regulations has been improved and a structured e-signature has been introduced.

With regard to performance, the archiving of technical regulations has been developed, the process of archiving and grouping of construction files has been introduced, the e-address usage process has been improved, the download of the construction work log has been redesigned and software was migrated to newer versions. With regard to automation, the automatic determination of the belonging of a construction file has been improved and functionality has been established allowing one institution to transfer a document that does not belong to it to another institution, a system signature has been incorporated.

**Box continued**

For e-services of the Register of Construction Merchants and Register of Construction Specialists, part 2 of the principle of tacit consent has been developed, the functionality has been adapted in accordance with the regulations for a cadastral survey and registration of buildings, the annex to the construction permit has been supplemented with alternate responsible construction specialists, the link of construction specialists to construction merchants has been created, the Register of Construction Merchants and its e-services have been improved in conformity with amendments to the Regulations Regarding the Registration of Construction Merchants and the process for determination belonging and the process of exchange of documents has been automated. Finally, for the integration of sharing solutions and the exchange of data with other information systems, the BIS-SLS (State Land Service) data exchange has been migrated to the data distribution network, the BIS-SUCLR (State Unified Computerised Land Register) data exchange has been improved, the BIS-EPS (Electronic Procurement System) interface and the SRS (State Revenue Service)-BIS interface have been migrated from VISS to the API manager, the transfer of data of the Energy Efficiency Calculation Information System from BIS to EECIS (Energy Efficiency Calculation Information System) and eIDAS authentication have been ensured.

By continuing work on the introduction of building information modelling (BIM) in Latvia, amendments to CM Regulations No. 529 of 2 September 2014 *Construction Regulations for Buildings* have been drafted providing that the building information model in third group buildings financed from the resources of a legal person governed by public law is part of the building design for architecture, building structures and internal engineering systems. The requirement will apply from 1 January 2025.

## EVALUATION OF COMPETENCE OF CONSTRUCTION SPECIALISTS AND SUPERVISION OF INDEPENDENT PRACTICE

On 29 May 2023, amendments to the *Construction Law* came into force, which combine the specialities of construction work management and construction supervision, providing that from 1 January 2024 supervision of construction work will be the competence of the construction work management speciality. Thus, the administrative burden for construction specialists, who have construction practice certificates in both the specialities of construction work management and construction supervision, has greatly reduced, because it will no longer be necessary to maintain several certificates as both construction work management and construction supervision work will be able to be performed with a construction practice certificate in construction work management. In addition, an in-depth inspection is introduced in the regulatory framework as part of the supervision of construction specialists, within which construction specialists will be selected based on risk analysis and the quality of the services provided by these construction specialists will be examined.

The regulatory framework has been supplemented by introducing a new regulated area – fire safety – in construction and design. Since the area is created to promote the quality of construction design reducing the risks of non-compliance with fire safety requirements and reducing the fragmentation of liability in the construction process by designating one person responsible for the development and compliance with fire safety requirements, the competence of a fire safety construction specialist will include the development of a report of fire safety solutions and fire safety measures of the building design.

## RAISING COMPETENCE

In 2023, the MoE continued its tradition from the previous years – the organisation of free-of-charge online training seminars for construction specialists, architects, as well as construction initiators, representatives of state and local government institutions. Two training seminars were organised: *Design of Smoke Protection Systems for Buildings*, where construction specialists and other stakeholders were given an idea of the importance of smoke protection systems for the protection of people, were presented the latest studies in the design of smoke protection systems and the control of natural smoke, and *Design of Prefabricated Reinforced Concrete Structures*. Overall, 660 construction specialists participated in free seminars organised by the MoE in 2023. Video recordings and presentations of seminars with translation into Latvian have been published and are available on the website of the Building Information System[7].

In 2023, the MoE, in cooperation with LLC *Latvijas standarts*, provided practical training for construction specialists on BIM modelling, BIM management, BIM coordination, BIM implementation in enterprises, 3D scanning and other topics. More than 500 people attended the seminars. Consultations were provided to public contracting authorities on the application of the BIM guidelines in public procurement and more than 80 persons participated in these events. Seminars were also organised for construction specialists on various topics related to the use of wood in construction, including practical tasks *(Timber products for construction — production, characteristics and quality criteria; Characteristics and essential requirements of wooden building structures*; *Design of wooden buildings*). More than 300 people attended the seminars.

[7] Video recordings of training seminars are available at: https://bis.gov.lv/apmacibas/apmacibu-video-arhivs/citas-notikusas-apmacibas.

# 14. HOUSING POLICY

Housing affordability is an important element in economic development. It affects not only the level of welfare of households but also their access to economic growth opportunities enabling them to participate or preventing them from actively participating in the labour market and the economy as a whole.

Providing affordable and quality housing for everyone is an important challenge in Latvia. Long-term low purchasing power and low-income levels of the population have led to housing quality problems in the country. Although disposable income of households is growing year-on-year, it has not been sufficient to create significant savings for the purchase or rental of housing meeting contemporary needs, as well as poses challenges in maintaining and renovating the existing housing stock.

The MoE has developed several support programmes and continues working on new projects to address the issue of the availability of quality housing in Latvia. Particular emphasis in the programmes is placed on regional development.

To promote housing affordability, at its meeting of 7 November 2023 the CM approved *Housing Affordability Guidelines 2023-2027*. The guidelines include directions of action, policy indicators and a set of tasks, providing solutions for providing housing affordability to households of different income levels, including the lowest-income households, as well as investing in improving the existing housing stock and encouraging investment in the development of new housing stock.

## SUPPORT FOR THE CONSTRUCTION OF LOW-RENT HOUSING AND ESTABLISHMENT OF A LONG-TERM HOUSING AFFORDABILITY FUND

Given the existing housing affordability problems, particularly in regions, and the OECD recommendations, support programmes for the construction of low-rent housing are among the priorities of MoE in 2023.

Since 22 November 2022, real estate developers may start applying for a new Altum state support programme for the construction of low-rent housing in the regions of Latvia. The total funding of the programme is 42.9 million euro and it is financed from the EU Recovery Fund.

With the support of this programme, it is planned to promote the construction of around 700 new apartments by 2026, thus contributing to entrepreneurial activity and the availability of low-rent housing for residents in regions. Affordable modern housing will be rented out to households unable to buy apartments on market terms while boosting labour availability and economic activity in the regions.

## HOUSING SUPPORT PROGRAMME

The housing support programme has been highly appreciated by the population so far simplifying for families with children payment of the first instalment for the loan for purchase or construction of housing. Since its inception in 2015, the programme has helped over 26 thousand families with 39 thousand children to get housing of appropriate size. Throughout the programme, the total amount of guarantees exceeded 214 million euro. Since 2018, when the programme was extended providing that also persons under the age of 35 and having higher or vocational education can get a guarantee for the first instalment for the loan for purchase or construction of housing. In 2020, an additional support programme named *Balsts* was created, which provides large families with the possibility of obtaining a non-repayable state subsidy for the purchase or construction of housing. The amount of the subsidy, according to the number of children in the family, is between 8 and 12 thousand euro. The subsidy was increased by 2 thousand euro if the housing meets the energy efficiency requirements for nearly zero-energy buildings. Since the programme started, more than 1140 families with more than 3500 thousand children have received subsidies and a total of 9.6 million euro have been granted in subsidies.

## RENOVATION OF SOCIAL HOUSING AND CONSTRUCTION OF NEW SOCIAL HOUSING

Both the EC and the OECD have stated in their evaluation that social housing in Latvia is insufficient and in bad technical condition. At the same time, due to lack of funding, the local governments do not supplement the residential fund or improve its technical condition. As a result, the most vulnerable households, even if they qualify for limited housing assistance until local governments rent them an apartment, may have to wait in line for years.

On 19 September 2023, a new EU Structural Funds support programme for the renovation of social housing and the construction of new social housing was approved, which will bring significant improvement of the social housing stock of municipalities and reduction of lines in municipalities for rental and social apartments.

The support is intended in the form of grants for local governments, their institutions or capital companies to renovate or rebuild separate groups of premises (apartments) or buildings owned by local governments and not rented out, as well as for the completion of buildings not previously commissioned and the new construction of residential houses. The conditions of the programme provide that the homes created as a result of it will have to be rented out by local governments to persons in accordance with the regulation of the *Law on Assistance in Solving Apartment Matters*, moreover, to the most vulnerable categories of persons specified in this law, such as low-income persons who are evicted from apartments, children left without parental care after the age of majority, special categories of low-income persons (persons with disabilities, persons reaching retirement age), etc., as well as to the categories of persons specified in the binding regulations of local governments.

The total funding planned for the support programme is 60.9 million euro, including ERDF funding of 51.8 million euro, and local government budget co-financing of 9.1 million euro. With the support of the programme, it is planned that, by 31 December 2029, local governments will be able to provide a place of residence to at least 1,865 newly built or upgraded social homes, including at least 200 persons by 31 December 2024. It is planned that with the support granted at least 1,200 homes will be created by renovating individual homes already owned by local governments, and at least 665 dwellings could be created by constructing new houses or rebuilding existing houses.

# 15. TOURISM POLICY

In 2023, the tourism industry is gradually recovering from the consequences of the COVID-19 pandemic, and hotels and cafés previously closed and newly created are opening, as well as new tourism infrastructure development projects are planned both in Riga and outside Riga. The average level of guests' ability to pay has also increased in certain tourism segments.

**Tourism development trends in Latvia**

**Inbound tourism**

In January-October 2023, Latvian travel accommodation establishments served 2.1 million foreign and local guests, which is 11.9% more than in January-October 2022. However, this is down 14.9% from January-October 2019, i.e. before the pandemic.

In January-October 2023, 1.2 million guests served in tourist accommodation establishments were foreign visitors, which is 22% more than in January-October 2022, but 29% less than in January-October 2019. Nights spent by foreign guests increased by 23% in January-October 2023, compared to January-October 2022, and was 2.2 million nights. The average duration of overnight stays of guests in tourist accommodation establishments was 2 nights.

In January-October 2023, most foreign visitors were welcomed from Lithuania (221 thousand), Estonia (159 thousand), Germany (115 thousand), Finland (94.9 thousand), the United Kingdom (74.9 thousand), Poland (54.4 thousand) and the United States (50.2 thousand). Most foreign visitors were received in Riga – 68.9%, Jurmala – 9,7%, Marupe Municipality – 3%, Liepaja – 2.9%, Sigulda Municipality – 2%, Ventspils – 1.5%, and Cesis Municipality– 1.4%.

**Domestic tourism**

In January-October 2023, 907,882 thousand Latvian guests were served in tourist accommodations, which is 0.4% more than in January-October 2022, but 13.7% less than in January-October 2019. Local guests spent 1.5 million nights in tourist accommodations in January-October 2023.

**Tourism exports**

The foreign payment card data, collected by the Bank of Latvia, shows that in January-October 2023 the expenditure of foreign tourists in Latvia was 825.94 million euro. Most was spent on positions such as hotels and other accommodation, financial institutions – automated cash payout, catering places and restaurants, as well as supermarkets. Travelers from the United Kingdom, Lithuania, Estonia, Ireland and Germany spent the most in Latvia.

Industry growth rates continue to be hampered by Russian hostilities in Ukraine. Firstly, it should be noted that before the war in Ukraine, approximately 30% of tourists visiting Latvia came from Russia, Belarus and Ukraine. To return to the figures of 2019 in terms of tourists attracted, this number has to be offset by guests from other countries such as Germany, Finland, Sweden, Norway, and the United Kingdom. Second, the geopolitical situation negatively affects neighbouring countries of the countries involved in the war, including Baltic States, threatening the reputation of the Baltics as a safe tourist destination. The third important aspect of Russia's hostilities in Ukraine hindering the development of the tourism industry is the rapidly rising energy costs and inflation, which pose a particular threat to the viability of businesses in the hospitality and catering sector.

However, for Latvia to become a competitive and attractive tourism destination, it is necessary to think about the development and digitalisation of the sector to have the opportunity to offer a contemporary service at a competitive price. In 2023, the MoE, in cooperation with the Latvian Tourism Advisory Council, developed the *Latvian Tourism and Event Export Promotion Strategy 2023-2027* to ensure the introduction of a new tourism sector development policy paradigm, putting export capacity as the most important component in the tourism sector development, while making the tourism sector more innovative, sustainable and efficient.

At present, it is essential to ensure that the growth rate of the tourism sector in 2023-2027 is equivalent to the average growth rate in 2014-2019, i.e. growth of 4.2% per year. The tourism policy aims to increase Latvian tourism exports to 1.52 billion euros in 2027.

To achieve the objective set, the *Latvian Tourism and Event Export Promotion Strategy 2023-2027* sets four main priorities or strategic directions: 1) development of products and destinations; 2) promotion of demand; 3) data-based management; 4) improvement of the business environment in the field of tourism and arrangement of the regulatory framework in the field of tourism. Horizontal components – digitisation and environmental, social and economic sustainability – dominate in the implementation of these priorities.

To address the main competitiveness challenges – fragmentation of tourism supply and high share of small enterprises in the tourism sector – on 22 August 2023, the CM approved the *Tourism Product Development Programme* with a total financing of 6.4 million euro for the development of new tourism products. The objective of the support programme is to promote that the competitive advantage of businesses is based on unions of businesses to create joint, more competitive tourism products. In early 2024, the selection round of applications for the cooperation network project is planned to be launched.

As part of the mentioned support programme, 20 new tourism products are planned to be developed. By implementing the programme, the amount of foreign tourist expenditure in Latvia is planned to increase by 1.36%, compared to 2022 (or increase by 14 million euro). Tourist expenditure on developed tourism products will rise to 5.6 million euro, a 10% increase in turnover of participants in cooperation networks is expected, and additional expenses of foreign tourists outside tourism products are planned to increase to 8.4 million euro. Within the framework of the measure, it is expected that 15 million euro will be collected annually in labour taxes (employing around 2000 employees).

In addition, to ensure Latvia's competitiveness at the level of the Baltic States as well as the Baltic Sea region, it is important to promote the attraction of international investments in the development of strategically important tourism products and organisation of very large, internationally visible events (major events) in Latvia. The organisation of very large, international events has not only a significant impact on the state budget but also on the funds or spending attracted by foreign participants and visitors in Latvia. Exports of tourism and events provide jobs and income not only in classic tourism-related areas but also promote the export income flow in the country indirectly, such as entertainment and cultural services, financial and insurance services, medical services, environmental improvement, transport, retail, etc. Furthermore, the organisation of events at this level has a fiscally invaluable impact on the country's international profile and national image.

One of the biggest challenges at the international level is also arranging the short-term rental housing market. Considering the possibilities of improving the regulatory framework in the field of tourism to reduce the risks of provision of illegal tourism services, as well as having read the draft regulation of the European Parliament on data collection and sharing relating to short-term accommodation rental services and the approach of EU Member States in the development of the regulation on short-term rental services, it should be concluded that a register of short-term rental accommodation should be established in Latvia while defining the specificity of short-term rental accommodation and specific requirements for its operation.

Several major events have taken place in the tourism sector in 2023:

- The world-renowned tourism guide publisher *Lonely Planet* has included Latvia in its latest guide *Best In Travel 2024*. It is known that the Baltic country hiking trail network *Baltic Trails* is included in the *Sustainability* category. Next year, the *Best In Travel* edition will have its 50th anniversary, and Latvia will be among the destinations included in the guide for the first time;
- Latvia is included in the *Michelin Guide* of restaurants. Inspectors of the *Michelin* Guide have carried out a thorough study of Latvia's gastronomic offer and visited not only the capital Riga but also several other places in Latvia. When assessing Latvian restaurants, *Michelin* inspectors visited the Kurzeme coast, Jurmala, Valmiera, Cesis, Ligatne, Tervete and other places, which is a great success and a stepping stone for the growth of the sector. 22 restaurants were included in the *Michelin Guide* of restaurants. The restaurant *Pavāru māja* (Ligatne) acquired the *Michelin* Green Star. One Latvian restaurant received the special *Michelin* award – *Michelin* star – *Max Cekot Kitchen* (Riga).

## LIAA TOURISM PROMOTION AND SUPPORT MEASURES

In 2023, the LIAA continued to actively promote Latvia's tourism offer in Latvia and abroad. A marketing campaign *Home Cafe Days 2023* has been implemented for the third time, with 65 thousand visitors in over 450 cafes in 42 destinations as part of the campaign from July to September.

The LIAA *uses Latvia's Tourism Marketing Strategy 2021–2027* for the coordination of foreign tourism marketing activities. Tourism industry organisations and businesses are involved in the marketing activity planning, and the work is organised in the Marketing and Product Development Sub-Group of the Latvian Tourism Advisory Council.

LIAA implements cooperation among the countries of the Baltic Sea region in the fields of joint tourism products and marketing, ensuring regular communication with the national tourism organisations of the Baltic States within the framework of the Joint Tourism Committee of Baltic States. LIAA is involved in the European Travel Commission ensuring the efficient use of resources from international organisations. As part of the project *Promoting Latvia's International Competitiveness in Tourism*, support is provided for activities to promote the competitiveness of tourism industry operators in external markets, as well as Latvian tourism marketing activities are implemented in the local and foreign markets. In Q1-Q3 2023:

- a national stand at 4 international tourist fairs were organised, support in the form of grants was provided 222 times;
- tourism marketing campaigns were implemented in Germany, Lithuania, campaign activities were launched in Estonia and Norway;
- the content of latvia.travel, Latvian Tourism Portal, was updated, activities on social networks were implemented;
- 30 Latvian tourism publicity and foreign specialised tourism promotion activities abroad were implemented;

- 36 foreign media visits to Latvia were organised;
- 17 visits to Latvia by foreign tour operators, agents and event organisers were organised;
- 3 events to promote business tourism were organised;
- 5 events were implemented to attract tourists to Latvian municipalities;
- 4 events were implemented to develop health tourism.

Within the framework of the project *Promoting International Competitiveness in Tourism*, the LIAA provides support in the form of grants for individual marketing activities performed by tourism entrepreneurs, local governments, foundations and associations in foreign markets. Support is also provided to organisers of international conferences, major cultural and sporting events and international exhibitions in Latvia.

In 2023, a training cycle was implemented for restaurant managers and chefs for the development and quality improvement of gastronomy tourism, cooperation with the international restaurant guide *Michelin Guide* has been initiated.

Conferences in four historical lands of Latvia were organised to promote regional tourism, experience exchange seminars were implemented for tourism entrepreneurs and specialists of historical lands.

# 16. 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. To ensure their observation and to protect consumers' economic interests, it is important to ensure the implementation of the consumer rights protection policy in different directions. Moreover, consumer rights protection requirements should be considered, also when developing and implementing other policies.

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 the goods and services they need and want on the basis of clear, accurate and consistent information. Considering the dynamics under the influence of the rapid development of globalisation, digitalisation and technologies, also the consumer rights protection policy is made as flexible as possible to respond to the changes operatively.

Over the past year, the market situation has been affected both by Russia's war against Ukraine and by the global energy crisis, which also directly affects commodity prices and increases the cost of living. At this difficult time, consumer rights still need to be protected. In particular, the issue of cost increases has been pressing and service providers and traders must act in accordance with the principles of fair commercial practices. The consumer rights protection system in Latvia is constantly being developed to ensure effective market surveillance and consumer rights protection. The MoE is working to improve the existing framework and ensure a high level of consumer rights protection. There is also active participation in shaping of the international consumer protection policy, research and adoption of good practices of other countries.

In the field of consumer protection, the MoE is working closely with the Consumer Rights Protection Centre (CRPC). The CRPC is the main coordinating authority in surveillance of laws and regulations on consumer protection, and the goal of its operations is to ensure the efficient protection of consumer rights and interests. To perform the entrusted functions, the CRPC implements different activities related to the monitoring of consumer rights protection, considers consumer complaints, informs and advises consumers and entrepreneurs, implements monitoring activities to prevent unfair commercial practices, controls e-commerce and advertising, licences non-bank credit providers and extrajudicial debt recovery service providers, takes measures on the safety and compliance of goods and services, carries out the national metrological supervision, supervision of dangerous equipment and investigations of dangerous equipment accidents.

**Activities of the Consumer Rights Protection Centre (CRPC) in 2023**

In January-September 2023, the CRPC received 2732 written applications. 230 or 8.41% more applications were received in 2023 compared to the same period of 2022 (2502 applications). Compared to previous years, when most applications were received about failure to deliver goods and services (409 applications in 2022; 536 applications in 2021), in 2023, most applications were received about non-conformity of goods with the provisions of the contract (489). 462 applications were received about violations of the Flight Regulation and other passenger rights. 411 applications were received about violations of commercial practices, advertising and e-commerce. 365 applications were received about failure to deliver goods and services. 296 applications were received about invoices issued to consumers by sellers/service providers.

While consumers continue to actively buy goods and services online, in 2023, the CRPC did not receive much information about undertakings that abused consumer confidence and failed to comply with their contractual obligations, resulting in a decrease in the number of applications received about failure to deliver goods and services. In 2023, most applications were received about the non-conformity of goods with the provisions of the contract. It is also apparent from the applications that consumers resumed travel because the number of applications received about violations of the Flight Regulation and other passenger rights increased in 2023, compared to 2022 when 320 applications were received, and compared to 2021 when 137 applications were received. Violations of commercial practices, advertising and e-commerce were also stated in consumer applications. It follows from the applications that consumers most often purchased electric goods (142), footwear (113), mobile phones (56), computer equipment (50), clothing (49), vehicles (43), and furniture (41). Consumers make claims about purchased second-hand vehicles and defects found after purchase. Most applications about services were received in the following areas: 128 applications about entertainment, sports and leisure services; 75 – about electronic communications; 69 applications – about parking services; 22 – about tourism services. The matter of the procedure for the free use of paid car parks and the behaviour of undertakings in imposing contractual penalties for various infringements, such as failure to enter the car registration number in the registration terminal, incorrect parking, etc., remains a concern for consumers.

20,730 consultations were provided in January-September 2023. 890 consultations or 4% fewer were provided in 2023, compared to the same period of 2022. The number of telephone consultations decreased (15,858 consultations in 2023, 17,279 consultations in 2022), while the number of e-mail consultations increased (4,522 consultations in 2023, 4,129 consultations in 2022). The total number of consultations provided in January-September 2023 has decreased.

Given that the number of consultations provided directly by phone has decreased, it can be concluded that consumers independently obtained the information they were interested in. The increase in e-mail consultations indicates that consumers are becoming more eager to use electronic means of communication. Due to the extensive information available on the CRPC website on consumer rights, consumers obtain this information independently. It should also be noted that there were no major shocks in 2023, which would be the basis for more consumer calls to the CRPC.

**Box continued**

Several important decisions were taken on unfair commercial practices in cases where the public and consumers were harmed, namely, unordered subscription services paid and the use of misleading models, unfair practices in the advertising of food supplements as part of network marketing, as well as a decision against a consumer credit service provider was taken having stated violations of the prohibition of credit advertising to circumvent it. At the same time, using the *Consult First* principle, the CRPC has achieved several written commitments in the field of debt recovery and consumer lending, with service providers committing to compensate consumers for the losses caused.

The CRPC actively engaged in solving various obstacles and problem situations, the disbursement of money to Latvian consumers from the funds of the sanctioned LLC *TT Baltics* has completed. However, the reimbursement of money to consumers in Lithuania and Estonia is still ongoing. Considering the information submitted by LLC *TT Baltics* regarding the reimbursement of cash, approximately 185 thousand euro still have to be disbursed.

The CRPC concluded several assessments relevant to society: 1) with regard to the action of LLC *Rīgas namu pārvaldnieks* in relation to the calculation of thermal energy, if allocator-like thermal energy accounting devices were installed for individual apartments in the house, as well as took a decision against an Estonian undertaking with a prohibition to place such devices on the market; 2) concluded an evaluation of the commercial practice implemented in summer and autumn 2022 by JSC *Latvijas Gāze* in relation to the communication and unreachability of the undertaking when the payment procedures for natural gas changed, providing several recommendations for improvement of the practice.

Work has been completed on the development of Guidelines for the indication of prices of goods and services, including the implementation of fair commercial practices, approving them on 5 September 2023. Different industry operators as well as their associations were involved in drafting the guidelines.

Support and information to consumers in cases of bad **EU cross-border purchases** is still provided by the European Consumer Centre (ECC Latvia). ECC Latvia is a member of the European Consumer Centres Network (ECC-NET) that operates within the framework of CRPC with the EC's support. In January-September 2023, consumers and businesses received 774 consultations and more than 415 complaints about cross-border problems within the EU have been dealt with. 86.5% of complaints received were about online purchases (household goods, clothing, footwear and various other goods) showing that consumers continue to actively make cross-border purchases online even after the COVID-19 pandemic. Main problems arising from online purchases: failure to deliver goods, goods that do not comply with the terms and conditions of the contract, right of withdrawal. 18% of complaints were received in the field of air services, 7% – cultural and entertainment events, 7% – car rental, 3% – hotels.

The following priority directions were set by the CRPC for **market surveillance** in 2023: improvement of safety and conformity of goods and services in fields such as construction products, electrical appliances, machinery, explosive equipment, toys, pleasure boats, vehicles and their components, radio and telecommunication terminal units, unmanned aircraft, as well as ecodesign and energy labelling inspections. Additional inspections are planned also for surveillance of smart goods and accessibility requirements.

Projects for the inspection of dangerous equipment in the fields of surveillance of elevators and vertical lifting platforms are implemented. Supervision projects in state metrological supervision are implemented in priority areas like non-automatic weighing instruments, water meters and heating meters, as well as control of pre-packaged products in manufacturing, distribution and importing companies in product groups affected by inflation the most (oil, cereal products, pre-packaged fuel).

In January-September of the year, the CRPC inspected 1070 goods through market surveillance. The highest number of inspections – 535 – were related to the labelling of electrical goods (non-conformities have been detected in 84% of cases). At the same time, 142 toys (non-conformities detected in 73% of cases), 78 transportable pressure vessels (gas cylinders) were inspected, and non-conformities were detected in 33% of cases. 73 radio equipment units (non-conformities detected in 40% of cases) and 59 electrical appliances (non-conformities – 58%) were inspected.

In January-September 2023, 47 inspections of construction products were carried out – 133 inspections of models of construction products, including 34 of them underwent expert examination of construction product samples in testing laboratories. 62 models of construction products were inadequate (47% of cases), including 8 models of construction products that were subjected to expert examination.

The CRPC inspected 35 unmanned aircrafts, with non-conformities found in 24 models. Five samples of unmanned aircraft were taken for the expert examination and the expert examination found one of them to be non-conforming. Ship equipment was subjected to 7 inspections, with 28 models of goods inspected.

In January-September 2022, 37 inspections were also carried out to control pre-packaged goods, examining 133 batches of pre-packaged goods, and non-conformities were found in 17 or 13% of batches.

In January-September 2023, 66 inspections of dangerous equipment were carried out, 194 dangerous equipment units were inspected and 107 (55%) were found to be non-conforming. Most of the non-conformities were found in elevators – 73 units, of which 53 did not undergo technical inspection.

In January-September 2023, 63 inspections were carried out for surveillance of measuring instruments. The CPPC paid most attention to the surveillance of non-automatic weighing instruments, water meters and heat meters. 622 measuring instruments were inspected in market surveillance, of which 146 or 23% were non-conforming.

In January-September 2023, 148 samples were taken. 96 samples of products were taken in various areas of consumption and technical products (including five samples of unmanned aircraft and 5 samples of electrical products to check conformity to ecodesign requirements), 34 samples were taken in the field of construction products and 18 samples in the field of measuring instruments.

Taking into account the current economic situation in the world and the tense geopolitical situation in neighbouring countries, as well as the rapid pace of innovation and digitalisation, not only the adaptation of supervisory work to new market conditions is taking place, but also the regulatory framework is being updated and European regulation is being transposed into national regulatory enactments.

On 12 June 2023, work on a proposal for a General Product Safety Regulation was completed. The new proposal replaces the current Directive 2001/95/EC of the European Parliament and of the Council on General Product Safety. The proposal aims to update and modernise the general framework for the safety of non-food consumer products while maintaining the function of the consumer safety net currently carried out by the General Safety Directive. This proposal incorporates solutions to the various market surveillance challenges posed by new technologies and online sales. The introduction of uniform requirements for non-food consumer products ensures a level playing field for businesses. The proposal for a Regulation lays down the general requirement that consumer goods should be safe, defines certain obligations for businesses and includes the conditions for the development of standards necessary to implement the general safety requirement.

On 12 September 2023, the European Parliament adopted the new Directive on consumer credit, which provides for a revision of the Directive of 2008. The Directive ensures a consistently high level of consumer protection, the suitability of the rules for the digital age, and a clearer and more coherent legal framework for businesses. The general objectives are to reduce damage and risks to customers associated with taking loans in a volatile market, to facilitate cross-border issuance of consumer credits and to increase the competitiveness of the internal market. The main amendments to the new Directive are to improve the quality of information in advertising and pre-contractual information forms for the consumer. The Directive also covers professional ethics rules and the obligations of credit providers to ensure that employees have the appropriate skills and knowledge. Strengthening the customer solvency assessment requirements by reducing the possibility of granting a loan to a person who will not be able to repay the loan is vital. The proposal also incorporates the obligation of Member States to promote financial education and improve access to debt advisory services.

The MoE has drafted amendments to the *Consumer Rights Protection Law* and the *Civil Procedure Law* setting out the requirements applicable to the collective remedy framework (collective actions) in line with the directive adopted by the EU. Collective actions will be an efficient and effective procedural means to prevent breaches of consumer rights and to enable consumers to obtain compensation for inflicted damage through collective action.

Discussions are currently underway in the EU on the development of various new laws and regulations that Member States will have to transpose in their legislation. Member States are discussing the proposal for a directive on empowering consumers for the *green* transition designed to provide better protection of consumers against unfair practices and better information. The regulation aims to strengthen consumer rights and promote sustainable consumption and a *green* circular economy in the EU: if consumers can make informed purchase decisions, they will be able to choose sustainable consumption, also using information that indicates whether the product can be repaired and its longevity in comparison with other goods.

Discussions are ongoing on the proposal for a directive on liability for defective products, providing that liability regulations reflect the nature and risks of the digital age and circular economy products. The proposal aims to ease the burden of proof on injured parties in complex cases and to reduce the restrictions on bringing actions while striking a fair balance between the general legitimate interests of manufacturers, affected persons and consumers.

The EC adopted a proposal to revise the alternative dispute resolution (ADR) regulation. The proposal published on 17 October 2023 aims to modernise and simplify out-of-court dispute resolution rules to adapt them to digital markets. This proposal will broaden the range of matters that can be resolved out of court through the Alternative Dispute Resolution Directive, including matters related to misleading advertising, access to services and unjustified geographical blocking. To make this process more accessible to consumers, designated authorities, such as the European Consumer Centres Network, will help consumers understand alternative dispute resolution procedures and facilitate access.

The new proposal for a toy safety regulation revises the current regulations on the protection of children from the risks posed by non-compliant toys. Toys placed on the EU market are among the safest in the world. The rules proposed on 28 July 2023 will further strengthen this protection, in particular against harmful chemicals. These rules aim to reduce the large number of unsafe toys still sold in the EU, especially online, and this will contribute to a more level playing field for EU-made toys and toys imported while ensuring the free movement of toys within the single market.

# 17. COMPETITION POLICY

The provision of a fair competitive environment is also considered to be an essential element in promoting competitiveness in the country. A pressing topic in the competition policy is to keep supervising that companies do not breach the law and act fairly within *Competition Law*, as well as fostering equal and non-discriminating competition between public persons (for example, state or local government capital companies) and the private sector.

Free and fair competition stimulates the development of businesses and 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 restrictions, incl. unjustified involvement of public administrative bodies in business.

The Competition Council (CC) is responsible for the implementation of the competition policy in the country. The CC investigates and prevents infringements of the *Competition Law*, controls market concentration, monitors that state and municipal regulatory enactments do not create unjustified obstacles for free and fair competition among companies, and educates society, thereby promoting understanding of the *Competition Law* and contributing to intolerance towards distortion of competition. 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 surveillance to be effective, the CC has the right to set priorities in its activities to prevent above all severe violations of the *Competition Law*. When a smaller potential violation is identified, the CC uses alternative methods, incl. the c*onsult first* public administration principle allowing to preventively improve the competition environment in national economy sectors.

In 2023, the CC set for itself several priority tasks:

- monitoring fair competition in public procurement;
- monitoring the involvement of state and local governments in the market and the principle of neutrality;
- monitoring unfair trade practices, digital markets and other markets with significant economic impact;
- developing the IT capacity for more effective antitrust investigations;
- effectively creating a culture of competition in the interests of the Latvian economy.

According to the CC's practices and the results of the last opinion poll conducted in 2022, Latvia has two important issues in the field of competition: bid rigging and distortions of competition caused by state and local governments or public administrative bodies, which often take the form of creating uneven conditions of competition, discrimination of entrepreneurs or pushing them out of the market.

In 2023, the CC devoted significant resources to combating prohibited agreements, including discovered four high-priority violation cases and warned 71 market player about potential smaller violations. Public administrative bodies have been particularly topical on the CC's agenda since 2020, when amendments to the *Competition Law* came into force, which gave the CC broader powers to confront competition distortions caused by public administrative bodies. To prevent violations of competition neutrality, it is essential to ensure immediate changes in the conduct of public administrative bodies, which also provides immediate benefits to the public, so the CC uses negotiation procedures as the most effective tool for preventing possible violations.

The CC has started to prepare summaries by sector or industry, emphasising the most important conclusions and challenges arising from the state and local government shareholding self-assessment in capital companies, the involvement of public administrative bodies in various markets, for example, in the fields of health, public transport, house management, etc.

To identify barriers to free and fair competition promptly, in 2023 the CC focused on sectors with significant influence in the national economy and consumer welfare, and on markets where rapid development is taking place or innovations are being introduced. The institution pays particular attention to digital markets, as well as to the waste market, health services and accommodation services, as well as to the retail sector with widespread resonance in society due to regular complaints about high food prices.

In underperforming markets, the CC monitors and confronts abuses of dominant market position and prevents harmful concentrations of markets.

The CC needs to implement extensive communication activities both at national level and in the international environment to make entrepreneurs understand the benefits of fair and free competition and also to act in good faith. The CC has defined the education of market participants on fair competition as one of the CC's main priorities.

**Activities of the Competition Council (CC) in 2023**

Four high-priority violation cases were completed in 2023 to ensure the **identification of significant competition violations and market distortions**. The CC has detected bid ridding between three undertakings in procurements organised by SLLC *Autotransporta direkcija* regarding the provision of public transport services by bus on routes of regional significance for ten years. Public transport carriers – LCC *Liepājas autobusu parks*, *LLC Latvijas Sabiedriskais Autobuss* and JSC *Nordeka* – were fined 1,974,923.81 euro for participating in the cartel. A settlement has been concluded with one of the sanctioned persons – *Liepājas autobusu parks*, and an agreement has been reached regarding payment of the fine imposed and the termination of proceedings. The CC has also detected bid ridding between three market participants in the road construction sector; road construction companies – JSC *A.C.B.*, JSC *Ceļu pārvalde* and LLC *STRABAG* – a total penalty of 4,451,649.77 euro was imposed for bid ridding in public procurements organised by LLC *Latvijas Valsts ceļi* for construction of roads in Latvia. In Q4 2023, bid ridding was detected in the activities of LLC *AKE LOĢISTIKA*, LLC *LATGALES MULČA* and LLC *MG Auto LTD*. They exchanged commercially sensitive information regarding the conditions of participation in five procurements of JSC *Latvijas valsts meži* regarding the provision of energy timber supply, chipping, storage and transportation services. A fine of 163,630 euro was imposed for bid ridding between companies. At the same time, in 2023, the CC found in an in-depth study that several criteria applied by the *Latvian Association of Performers and Producers* (LaIPA) for the calculation of remuneration fee tariffs for playing music in hotel rooms were not considered justified. LaIPA took note of the call of the CC and, in cooperation with the *Latvian Hotel and Restaurant Association*, agreed on the transition to a new, justified procedure for the application of the remuneration fee.

Using the ***Consult First*** principle, 21 preventive activities were implemented in cases of small market participants and minor potential violations, with a total of 71 legal persons warned about possible violations of the *Competition Law*. During this period, in addition to organising a negotiation procedure with public parties, five complaints regarding alleged violations of competition neutrality have also been eliminated where public persons discriminated against private market players by their conduct, created unequal rules for different market players or reduced competition through excessive requirements and rules.

The CC has been able to ensure an **evaluation of merger** in 24 cases. In 2023, an in-depth investigation was conducted in three merger cases. In one case, the CC allowed LLC *Latvijas Mobilais Telefons* to acquire sole decisive influence over several companies providing repair services of household and electrical appliances. In the second case, the CC allowed JSC *AQUA MARINA*, the parent company of LLC *KOOL LATVIJA*, to expand and take over more than 50 petrol stations. All 14 mergers examined in 2023 were permitted without objections because no significant negative risks to competition were identified.

In 2023, significant resources were devoted to the **representation of the CC in courts.** In 2023, applications for 23 decisions of the CC were examined in different instances. During the reporting period, the court proceedings were initiated regarding the discovered cartel between public transport carriers with buses. At the same time, there were 13 court hearings in the so-called *Construction companies' cartel* case and 8 court hearings regarding the use of the dominant position stated by the CC in the case of LDZ *CARGO* and *Latvijas Dzelzceļš,* as well as other court proceedings. In 2023, seven legal proceedings were completed, and all the CC decisions were upheld. The decision of the Supreme Court has rejected the ancillary complaint by JSC *LNK Industries* regarding the imposition of the obligation on the CC to provide the settlement entered into between the CC and *VELVE*, as well as *Alpha Baltic Media* concluded a settlement with the CC in the court proceedings regarding termination of the legal dispute and payment of the fine for the stated cartel agreement, as well as, on 28.06.2023, the Administrative Regional Court decided to terminate the legal dispute between the CC and LLC *Corvus Company*, because the applicant has withdrawn its application submitted to the court regarding the action of the CC not to initiate a violation case. In Q3, the proceedings in the case of abuse of a dominant position in the practice of applying Latvian and also EU competition law were completed with a positive result for the institution after 10-year-long proceedings. By judgment of September 29, the Senate of the Republic of Latvia dismissed the cassation complaint and upheld the decision of the CC of 2013 by which the CC found that the *Copyright and Communication Consulting Agency/ Latvian Authors Association (AKKA/LAA)* had abused its monopoly position by imposing on small and medium-sized shops and service providers a significantly higher tariff for playing music in premises intended for visitors than in Lithuania and Estonia, as well as in most other EU Member States. The court proceedings with *Liepājas autobusu parks* were also dropped and the company agreed to pay the fine imposed. The judgment of the Senate of the Republic of Latvia to leave unchanged the judgement of the previous instance – Administrative Regional Court – upheld the decision of the CC of 2017 on the cartel of distributors of professional video, sound, lighting equipment and stage equipment.

The CC implemented several measures to integrate the **principle of competitive neutrality** among public administrative bodies. In 2023, the CC received 138 different applications regarding the behaviour of public administrative bodies mostly related to discriminatory behaviour of public administrative bodies, for example when organising procurements. At the same time, in 2023, 36 public administrative bodies received assessments regarding shareholding in capital companies, which results from Section 88 of the *State Administration Structure Law*, at least once in five years to reassess their shareholding in capital companies, and a report should be submitted to the CC, and a total of 64 reports submitted not only in 2023 but also in late 2022 have been evaluated. During the reporting period, a negotiation procedure for solving possible competition neutrality discrepancies was used in five cases – with the Jelgava State City Local Government, the National Heritage Administration, LLC *Rīgas meži*, JSC *Latvenergo* and the Smiltene Municipality Local Government.

**To promote understanding of fair competition among market participants,** in 2023 the CC participated in 50 educational events (seminars, webinars, conferences), where the *Competition Law* was presented to entrepreneurs and contracting authorities, as well as society as a whole. For example, in 2023, a large cycle of educational seminars was organised with the Procurement Monitoring Bureau (PMC) for contracting authorities on fair procurement and the exclusion of suppliers from procurement due to possible competition violations. Nearly 1200 procurement specialists from state and local government institutions have been educated in six seminars. Also in 2023, active work has been carried out on developing seminar content for enterprises in so called *Competition Council Seminar School* to educate them on vertical agreements, prohibited agreements, unfair trade, abuse of dominant position, mergers and other topics.

The CC continues to develop tools that encourage entrepreneurs and public administrative bodies to control their actions and participate in the prevention of competition violations, for example, by developing easy-to-use self-assessment tools. One of the plans for the future is to develop an automated cartel screening tool and start developing a digital merger reporting tool for entrepreneurs.

The CC also participates in the identification and elimination of undue restrictions of competition from laws and other regulatory enactments, as well as in the process of improvement of the regulatory framework of *Competition Law*.

The CC continues to systematically demonstrate its effectiveness and public benefit from the implementation of a fair competition policy. The authority's priority objective is not to penalise companies, but to raise awareness of fair competition among market participants and to prevent potential infringements. It is the benefit of society from competing markets that is one of the efficiency indicators of the CC, which the CC focuses on when carrying out both investigative, supervisory and educational activities. Apart from the fines imposed by the institution on market players, the average public benefit calculated by the CC from the implementation of competition policy in Latvia from 2020 to 2022 exceeds 51.5 million euro per year. If we compared the public benefit to the institution's budget during this period, it can be concluded that each euro allocated to the institution brings an average public benefit of 26.73 euro. At the same time, in 2023, companies have already paid more than 1 million euro into the state budget for violations of *Competition law*. Thus, the CC has confirmed its usefulness and contribution to the Latvian economy both in terms of public benefit and in terms of the fines paid by companies into the state budget.

The CC's work has been appreciated also internationally. In 2023, the CC maintained its high three-star rating in the international *Global Competition Review* (GCR) ranking for the ninth consecutive year, ranking among the world's 33 leading competition authorities. Competition authorities of Singapore, Switzerland, Belgium, Lithuania, Poland and other countries are ranked the same as Latvia's. More than 140 countries of the world have competition authorities, but only 33 of them are included in the GCR rating. At the same time, in 2023, the CC received the main award in the Competition Advocacy Contest of the International Competition Network (ICN) and World Bank Group for the market surveillance performed in the woodchips market, which was initiated due to the rapid price increase.

In 2023, the CC strengthened its information technology capacity by setting up an IT laboratory and organising training for employees so that they can use state-of-the-art IT technical equipment for more efficient acquisition and processing of electronic evidence, paying particular attention to the development of an automated cartel screening tool. Additional resources are devoted to strengthening the institution's economic analysis capacity, which will ensure deeper and more economically accurate investigation of mergers, market surveillance, abuse of dominant position cases, etc., paying more attention to the economic assessment of the impact on competition.

In 2023, the CC Advisory Council was established to organise closer and more efficient cooperation with partners in matters of development and application of competition policy, for example, by providing the competition supervisory authority with recommendations regarding the operational strategy, competition supervision directions and possibilities for improvement of work, as well as opinions regarding the guidelines prepared by it, the case prioritisation strategy, priorities of operation of the CC and the activity report. Six meetings of the CC Advisory Council were organised in 2023.

Proposals for improvement of the *Competition Law* related to the liability of officials for violations of *Competition Law*, have been prepared within the framework of the improvement of the regulatory framework in 2023 and are in the process of coordination. The CC's cooperation with the MoE and the Ministry of Justice will continue in 2024 to introduce responsibility for the most serious violations of *Competition Law* not only for legal persons but also for officials of market players. These amendments will encourage officials to take active action to prevent violations of *Competition Law* in their companies or, in the case of violations already committed, motivate the officials to cooperate in their discovery.

At the same time, amendments to the *Competition Law* are in preparation related to the implementation of the *Digital Markets Act* adopted by the European Parliament and the Council in 2022, which provides for the involvement of the CC in the supervision of digital platforms and further cooperation in the field of EC digital market surveillance. The regulatory framework is also amended in the context of Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market.

Currently, within the framework of the information report developed in cooperation with the MoE, solutions are being sought to promote the damage compensation process, which public contracting authorities can use as a tool for recovering losses caused from infringers of *Competition Law*. It aims to provide as much methodological support as possible for public contracting authorities in the damage compensation process. Namely, the proposal included in the informative report provides that the CC will provide consultations to public contracting authorities in the calculation of the assessment of losses and in the selection of the calculation method, as well as provide support in the calculation of the losses caused to the public contracting authority for the submission of the application to the court. To prevent potential risks of conflict of interest, it is planned to separate these new functions from the investigation of violations of *Competition Law* carried out within the framework of the administrative procedure. At the same time, the necessary changes to the *Competition Law* are discussed.