

**MINISTRY OF ECONOMICS
REPUBLIC OF LATVIA**

**ECONOMIC
DEVELOPMENT
OF LATVIA
REPORT**

**December
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RIGA

**Ministry of Economics
Republic of Latvia**

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Dear reader,

We would like to deliver the new Report on the Economic Development of Latvia prepared by the experts of the Ministry of Economics for your evaluation. The first Report was issued in September 1994, whereas the following ones since 1995 – twice a year traditionally, in June and December. It has become a tradition that we assess the economic situation of Latvia in this report, as well as forecast the prospects of economic development.

In recent years, our country has experienced one of the most rapid growths in the European Union. The average growth rate of GDP was 4.4% in 2011-2014. Despite the geopolitical instability and its consequences, the GDP of Latvia continued to grow in 2015. According to the evaluation by the experts of the Ministry of Economics, GDP grew by 2.8% in 2015.

Development of the economy of Latvia is closely linked to the global trends. Economic situation is improving gradually in the most important export market for Latvia – the EU. At the same time, the exporters who mainly focus on Eastern markets are affected by the poor economic situation in Russia. Despite the fact that the consequences of geopolitical problems are hindering the growth of Latvia's economy, the experts of the Ministry of Economics forecast that GDP growth in 2016 could be more rapid than a year before and it could reach 3.2 per cent.

To improve the competitiveness of Latvian companies more rapidly, it is important to find the most efficient ways of strengthening the development of knowledge-based economy, improving the competitiveness of companies in the exporting industries, increasing productivity and innovation capacity, as well as continuing the reforms to improve the business environment, ensuring a low electricity price for companies, as well as ensuring timely acquisition of EU funds.

The new programming period of the EU funds gives us the opportunity of investing 4.4 billion euro in the growth and development of Latvia. It should be noted that the most important planned funding objectives of the EU funds include increasing the financial flow in research and development, facilitating the attraction of private investment, and activating the cooperation of research institutions and entrepreneurs. Significant investments are also planned for the improvements of the information and communication technology, and transport infrastructure that directly affect economic productivity and is the basis for creating new, well-paying jobs and increasing the quality of life.

Approximately 770 million euro will be available in the activities of the Ministry of Economics for targeted investments in the modernisation and industrialisation of the economy of Latvia. A significant increase in the funding of the EU funds is intended for the promotion of energy efficiency, investing more than 280 million euro to improve energy efficiency in apartment buildings,

public and industrial buildings within the framework of the programming period. In 2016, the following EU funds activities will be continued or commenced: *Introduction of New Products in Production* (support for acquisition of equipment), *Promotion of International Competitiveness* (national stands, including entering into external markets (participation in exhibitions)), *Training of the Employed, Competence Centres, Business Incubators and Heat Insulation of Apartment Buildings*.

The new board of *Attīstības Finanšu Institūcija* (AFI) began its work in October 2015 with an aim of ensuring more active operations of AFI, carrying out activities related to guarantees, loans, venture capital and energy efficiency. AFI has to work hard to help entrepreneurs in preparing applications to the European Fund for Strategic Investments.

For economic operators to invest in development of new, more profitable products and services, it is important to maintain the existing tax incentives and develop new ones. Corporate income tax allowances are currently available to economic operators for investment in acquisition or creation of new production equipment, research and development, and large investment projects. It has to be noted that on 19 May 2015, following the suggestion of the Ministry of Economics, the Cabinet of Ministers approved the new version of the *Procedure for Approving and Implementing the Project of Investment to be Supported*, which gives the right to continue providing state support to large investors until 1 October 2020.

In 2016, it is planned to draft a *Law on support of business start-ups for introduction of a special simplified tax regime for business start-ups at the initial stage of their operations*, as well as amendments to the laws and regulations on introduction of a specialised simplified tax regime for small and micro enterprises with a small annual turnover.

One of the priorities of the Ministry of Economics is the improvement of the business environment. In the latest *Doing Business 2016* study of the World Bank, Latvia ranked 22nd among 189 countries or 10th among the EU member states. The World Bank has recognized Latvia as one of the TOP 30 leaders, who have implemented significant reforms for improving the business.

Latvia has improved its performance in such fields as business start-ups, meeting of contractual obligations, and registration of real estate. However, in order to improve the quality of the Latvian business environment more rapidly, it is important to continue the reforms in the justice system, in particular in the consideration of commercial disputes and simplification of the insolvency process. At the same time, targeted reduction of the bureaucratic burden on the tax administration is required, reducing the number of procedures and the time needed to carry them out. Future competitiveness of the business environment and economy of Latvia will depend on the quality and speed of implementation of the reforms. Our goal – to be among the world's TOP 20 countries in terms of business-friendly environment.

In order to strengthen consumer protection, the amendments to *Unfair Commercial Practice Prohibition Law* and *Advertising Law* entered into force on 1 July 2015, extending the powers of the Consumer Rights Protection Centre and other supervisory authorities in cases of unfair commercial practices, as well as increasing the maximum amount of the fine for unfair commercial practices. Whereas on 1 January 2016, the amendments to the *Consumer Rights Protection Law* will enter into force, providing for stricter conditions regarding the granting of “quick loan”.

In order to make the implementation of the *Competition Law* more efficient and protect the interests of honest entrepreneurs, the amendments to the *Competition Law* were passed for consideration to the Saeima in the third reading, providing for possibility for the Competition Council to consider the most severe infringement cases as the priority, extending the institution’s powers of investigation and the possibilities for companies to obtain an exemption from a penalty, improving the rules of merger control, as well as facilitating victims’ right to adjustment of damages caused by a distortion of competition.

In the field of construction, all the subordinate laws and regulations of the new *Construction Law* were drafted in 2015, work was continued on reviewing the construction standards of Latvia, and the *Enurocode standards* were adapted in the legal framework regulating construction. At the same time, the National Construction Control Bureau commenced its operation, improving the supervisory control of construction. The Standardisation Bureau in collaboration with the Ministry of Economics created service *Library of Standards* for the construction merchants registered in the Register of Construction Merchants – remote access to more than 3000 construction standards.

Integration of the energy market of Latvia in Europe continues. After complete opening of the electricity market, first year in conditions of free competition has been passed successfully. To compensate for the increase in electricity prices, which occurred when cancelling subsidized tariffs, low-income users of electricity, as well as large families may get electricity at a regulated price. In 2015, the circle was extended to families caring for a disabled child and persons with a disability of group I. The amount users pay for electricity in Latvia could decrease in the future, since new transmission capacities were constructed between Lithuania and Sweden (*Nordbalt*), as well as between Lithuania and Poland (*Litpollink1*) at the end of 2015, thus ensuring access to cheaper electricity from Scandinavian countries. The Ministry of Economics has implemented complex measures, in order to limit further increase in the component of mandatory procurement of electricity in the total price of electricity by 2017, keeping it at the level of 2013.

The Cabinet of Ministers has reviewed the draft law *Energy Efficiency Law* aimed at cost-effective energy efficiency in generation, transmission, and consumption

of energy. Energy efficiency can be seen as the greatest energy source, and its implementation is a method that has to be used successfully to increase security of energy supply and reduce greenhouse gas emissions.

Currently, further liberalisation of the natural gas market is also on the agenda. The Cabinet of Ministers has reviewed the draft law *Amendments to the Energy Law*, planned to be approved at the Saeima at the beginning of 2016.

In addition to improvement of the legislative conditions of the energy market of Latvia, active work is carried out on the development of electricity and gas infrastructure, to strengthen national energy security and diversification of energy supplies.

The main objective in the field of energy by 2020 is to strengthen energy independence of Latvia, to increase security of energy supplies, to facilitate energy sustainability, and to ensure a competitive energy price to consumers.

Work is continued on accession to the OECD, for Latvia to become a full-fledged member state of the OECD. OECD membership will grant Latvia a certain “seal of quality”, contribute to recognisability of the country, and build a positive image of Latvia for investments. In 2015, an in-depth report was prepared regarding the compliance of Latvia with the OECD guidelines for the management of public capital, as well as the Latvian Economy Report and Consumer Policy Report on Latvia. The Ministry of Economics is working actively on developing the policy of its areas of competence according to the OECD guidelines and recommendations.

To achieve the objectives set, we are actively creating a dialogue with entrepreneurs, non-governmental organizations, and other members of the public.

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, including the use of EU funds.

Not all the issues discussed in the Report were assessed by the Cabinet of Ministers, therefore, a number 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.

December 2015



Dana Reizniece-Ozola,
Minister of Economics

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ABBREVIATIONS, MEASUREMENT UNITS AND SYMBOLS

Abbreviations

CC	Competition Council	HGP	Heat-electric generating plant
CF	Cohesion Fund	HPP	Hydroelectric Power Plant
CIF	Price of goods created by the value of goods inclusive of freight and insurance costs till the border of the importing country	ICT	Information and Communication Technologies
CIS	Commonwealth of Independent States	IDAL	Investment and Development Agency of Latvia
CLC	Central Land Commission	IGC	Intergovernmental commission
CoM	Cabinet of Ministers	IMF	International Monetary Fund
CPI	Consumer Price Index	JSC	Joint Stock Company
CRPC	Consumer Rights Protection Centre	LGA	Latvian Guarantee Agency
CSB	Central Statistical Bureau	LLC	Limited Liability Company
EAGGF	European Agricultural Guidance and Guarantee Fund	LNAB	Latvian National Accreditation Bureau
EC	European Commission	LTDA	Latvian Tourism Development Agency
ECC	The European Consumer Centre of Latvia	LVS	Latvian Standard
ERDF	European Regional Development Fund	MSS	Meeting of the State Secretaries
ESF	European Social Fund	NEC	National Economy Council of the Ministry of Economics
EU	European Union	NPP	Nuclear Power Plant
EU-15	European Union Member States before the enlargement on May 1, 2004	OP	Operational Programme
EU-27	European Union Member States after the enlargement on January 1, 2007	PJ	Petajoule
FDI	Foreign Direct Investment	SEA	State Employment Agency
FIFG	Financial Instrument for Fisheries Guidance	SMEs	Small and Medium-Sized Enterprises
FOB	Price of the goods, including value, and transport and insurance costs to the border of the exporting country	SMM	Small and Medium-Sized Merchants
FTA	Free Trade Agreement	SOLVIT	EU Internal Market Problem Solving System
GDP	Gross Domestic Product	SRS	State Revenue Service
		TPI	Trade Protection Instruments
		TWh	Terawatt hour
		USA	The United States of America
		WTO	World Trade Organization

Country Abbreviations

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

1. ECONOMIC SITUATION: BRIEF OVERVIEW

From 2005 to 2007, a huge inflow of foreign capital stimulated significant growth of private consumption and investment in Latvia. The average annual growth rate of GDP exceeded 10%. In 2008 and 2009, recession set in as the inflow of foreign capital stopped due to the global financial crisis. During the crisis, GDP fell by ¼, external debt almost doubled, the number of the employed decreased by 16%, while the real wages of the employed fell by 12 per cent.

As of the end of 2010, the recession was stopped in Latvia, and growth has resumed. From 2011 to 2013, GDP increased by 4.4% a year on average, which was one of the fastest growths in the EU. In 2014, GDP grew by 2.4%, while in the first three quarters of 2015 – by 2.7%. The slowdown of growth in the last two years

was determined by the trends in the external environment – slower growth in the EU than expected, as well as weakening of the economic situation in Russia. Even though the economy of Latvia has been growing in recent years, GDP is still by 7.5% lower than before the crisis, in 2007.

In 2015, domestic demand, which was by 3.5% higher in the first three quarters than in the corresponding period a year ago, contributed more to the growth. At the same time, export volumes increased by 2.2% during the same period. **The experts of the Ministry of Economics estimate that, in total, the GDP growth rate was within 2.8% in 2015.**

Table 1.1

Latvia: Key Figures of Economic Development									
	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
Gross domestic product (at current prices, billion euro)	24.3	18.8	17.9	20.2	21.8	22.8	23.6	24.5	25.6
increase compared to the previous year, per cent									
Gross domestic product	-3.6	-14.3	-3.8	6.2	4.0	3.0	2.4	2.8	3.2
Private consumption	-7.9	-16.1	2.8	3.0	3.2	5.1	2.3	4.0	3.6
National consumption	2.4	-10.7	-8.1	3.0	0.3	1.6	4.9	3.4	2.8
Formation of the total fixed capital	-9.2	-33.3	-19.8	24.1	14.4	-6.0	0.5	3.4	2.0
Export	2.4	-12.9	13.4	12.0	9.8	1.1	3.1	1.9	2.5
Import	-10.7	-31.7	12.4	22.0	5.4	-0.2	0.8	3.0	2.4
Consumption prices	15.4	3.5	-1.1	4.4	2.3	0.0	0.6	0.2	1.0
as a percentage in relation to the GDP, unless indicated otherwise									
General government sector balance	-4.0	-9.0	-8.1	-3.4	-0.8	-0.9	-1.6	-1.4	-1.0
General government debt	18.7	36.6	47.5	42.8	41.4	39.1	40.6	36.0	37.0
Export-import balance	-12.9	-1.6	-1.5	-5.0	-4.5	-3.2	-2.2	-2.0	-1.7
Changes to the number of the employed (15-74 years of age, % compared to the previous year)	-0.2	-13.9	-6.4	1.3	1.6	2.1	-1.0*	1.0	0.9
Employment rate	62.0	54.3	52.0	54.0	56.1	58.2	59.1	60.7	62.1
Unemployment rate (jobseekers, % of the economically active population, 15-74 years of age)	7.7	17.5	19.5	16.2	15.0	11.9	10.8	9.8	8.7
f – forecast									
* As of 2014, changes are 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									

Since 2010, the exports of Latvian goods and services have grown very quickly, and it is the main drive of economic development. Currently, export volumes exceed the pre-crisis level by more than 25%. However, in recent years, the low demand in external markets has affected the export dynamics, and it has

become more moderate. Export volumes grew by 3.1% in 2014. The growth in 2014 was primarily driven by an increase in export of goods, while the volumes of services exports decreased.

Exports grew by 4.6% in Q1 2015, compared to the corresponding period in 2014, while in Q2 and Q3 – by

0.8% and 1.4%, respectively. Economic problems in Russia have affected the Latvian export opportunities – in eleven months of 2015, exports of goods at current prices to Russia was by 25.6% lower than a year ago. At the same time, with the economic situation improving in the EU, Latvian exports to these countries increased by 2.8%. By contrast, exports of goods to other countries grew by 15%, which suggests that Latvian producers are able to diversify their markets. Volumes of services exports also grew in 2015.

Further export development opportunities will be affected not only by changes in external demand, but also the competitiveness of Latvian producers. It should be noted that, until now, the improvement of competitiveness of Latvia was primarily driven by reducing labour costs, but, from now on, a crucial role will be played by the ability to increase productivity.

During the crisis, with the domestic demand decreasing, import volumes fell sharply. With the economic activities in the internal market increasing, the demand for imports is growing. However, since mid-2012, import dynamics have become more moderate. In 2014, imports grew by only 0.8%, while in the three quarters of 2015 – by 3 per cent.

The current account deficit in 2014 was 3.1% of GDP, while in three quarters of 2015 – 2.2%. It should be noted that **the current account deficit has remained low in Latvia since 2010, which gives proof of the external balance of the Latvian economy.**

An increase in employment and a gradual increase in wage contribute to growth in private consumption. Private consumption grew by 2.3% in 2014. By contrast, in three quarters of 2015, private consumption was by 3.6% higher than a year before. In 2015, compared to 2014, the growth rates of private consumption became faster, which was facilitated by a low inflation in addition to the above mentioned factors.

With the budget situation improving, public consumption increases. It grew by 4.9% in 2014. Similar growth rates were observed in 2015 – an increase of 3.5% over three quarters.

Investment dynamics in Latvia have been quite unstable in recent years. During the crisis – in 2008-2009, investment decreased significantly, but from 2011 to 2012 it increased considerably. In 2013, the amount of investment in the Latvian economy fell again – by 6%. In 2014, investment dynamics were moderate, and investment volumes were only by 0.5% higher than a year before. Investment decreased by 1% in Q1 2015, compared to the corresponding period in the previous year, while in Q2 and Q3 it increased – by 2.9% and 6%, respectively. Investment level is still significantly lower than during the pre-crisis years. The relatively slow growth of investments is affected by the entrepreneurs' hesitant attitude in relation to the increased uncertainty in the external environment. Also, the cautious crediting policies of banks continue to be one of the factors limiting investment. It should be noted that the state

plays an essential role in the investment process – in weak crediting conditions, the state provides significant support to private investment through the co-funding of EU structural funds.

In recent years, the weak demand in export markets has been hindering the growth of the manufacturing industry. During the post-crisis years, the manufacturing industry was the main driver of economic growth. From 2009 to the end of 2012, production volumes in the manufacturing industry increased by 24%. In 2013, production volumes in the manufacturing industry decreased by 1.2%. In 2013, discontinued operations of *Liepājas Metalurģis AS* also had a significant impact on industrial production volume, resulting in a significant decline in the volumes of metal production. Also, in 2014, production volumes were close to the previous year's level.

In three quarters of 2015, output volumes of the manufacturing industry were by 4.8% higher than a year before. Metalworking industry, which is affected by the resumed operations of one of the largest industrial enterprises *KVV Liepājas Metalurģis*, contributed significantly to the total growth of manufacturing industry in 2015. Similarly, wood-processing, computers, electrical and optical equipment, as well as machinery and equipment manufacturing industries also had a large positive impact on the growth of manufacturing industry. Output volumes in the food industry are much lower than a year ago. Russia–European Union economic relations have a significant impact on the development of the industry. Production volumes are also decreasing in light industry, production of non-metallic mineral products, paper manufacturing, and printing and publishing industry.

Domestic demand-oriented industries contributed the most to the GDP growth in recent years. After an extensive recession during the crisis, growth has resumed in the construction industry, which is largely facilitated by public procurements and EU funds projects. Construction volumes grew by 8.1% in 2014. The growth was largely driven by the rapid increase in construction volumes of the buildings in the first half of the year. Since the second half of 2014, the industry growth rate has been slowing down, while in the first half of 2015, construction volumes even fell. However, in Q3 2015, they were by 4.9% larger than a year before, largely due to a rapid increase in the construction of civil engineering structures.

Volumes of the industries of commercial services grew by 1.6% in 2014. By contrast, they grew by 1.9% in three quarters of 2015, and their increase was mainly facilitated by the growth in the arts, entertainment and recreation services industry, real estate operations, and information and communication services.

With the government expenditure increasing, a steady growth is observed in the public services sectors, in 2014 – by 3.3%. In three quarters of 2015, the volume of

services provided in the public services sectors was by 3.5% higher than a year before.

Production volumes are fluctuating in the rest of the industry. In 2014, they fell by 3.1%, which was mainly due to the weather, as smaller volumes of electricity and heat were produced, compared to the previous periods. By contrast, in three quarters of 2015, production volumes in this industry were by 1.3% higher than a year before.

The volume of services provided in the trade sector (including accommodation and catering services) grew by 2.3% in 2014. In three quarters of 2015, the volumes in this sector were by 5.6% higher than a year before. Trade sector was positively influenced by an increase in private consumption and retail turnover. Weak foreign trade activities, in their turn, hinder growth of the wholesale industry.

The volume of services provided in the transport sector in 2014 was by 3.2% higher than a year before. The growth of this sector in 2014 was largely facilitated by successful operations of ports and an increase in the volume of freight transport by road. In 2015, the volumes of services provided in the transport sector fell – by 1.3% in the first three quarters. The decrease is largely due to the drop in cargo turnover at ports and railway.

A moderate inflation can be observed in Latvia in recent years. The average inflation in 2014 was 0.6%. A very moderate increase in prices continued in also 2015, largely influenced by global oil and food price dynamics. Prices increased by 0.3% in 2015 (12-month inflation). During this period, the consumer prices were mainly increased by a rise in the prices of electricity, services, alcoholic beverages and tobacco. By contrast, prices for fuel, heating, and food fell.

In total, the average inflation in 2015 was 0.2%. It is expected that the average annual inflation could be around 1% in 2016, which will be influenced both by supply factors (tax increase) and demand (increase in activities and wages). At the same time, inflation will still largely depend on global oil and food price fluctuations.

After the financial market turmoil at the end of 2008 and the beginning of 2009, **monetary indicators of Latvia are gradually stabilising** – quality of the credit portfolio is improving and the volume of deposits attracted by banks is increasing. In Q3 2015, the amount of overdue loans in the total bank loan portfolio was 12.9%, which is one of the lowest indicators since late 2008. The improvement of the quality of bank loan portfolio is largely related to the writing off of bad debts.

The amount of residents' deposits attracted by banks continues to grow. Along with the upcoming introduction of the euro, deposits grew particularly rapidly at the end of 2013. At the end of September 2015, the amount of deposits grew by 8.8% compared to the relevant period of 2014.

However, outstanding credits continue to shrink, even though the negative rates decrease. This is mainly due to the repayment of previously issued credits and

writing off of bad credits. As at the end of September 2015, they shrank by 3.5% compared to the relevant period of the year before. Outstanding mortgage and commercial credits shrank more rapidly. At the same time, the outstanding consumer credits grew a bit.

Significant improvements have been achieved in the fiscal position. In 2014, the general government budget deficit was 1.6% of GDP or 366 million euro, which was by 0.4 percentage points more than planned in the *Latvia's Stability Programme* of the previous cycle. Such deviations were mainly caused by a one-time capital transfer for execution of liabilities of the central government towards the European Bank for Reconstruction and Development.

The Saeima adopted the state budget for 2015 with a deficit of 1% of GDP. According to the latest forecasts of the Ministry of Finance, the general government budget deficit is projected to be 1.4% of GDP in 2015.

On 30 November 2015, the Saeima approved the Law on State Budget for 2016 at the final reading, where the permissible budget deficit of 1% of GDP is established, and it corresponds to the permissible budget deficit amount arising from the specific target of the structural balance. Strengthening of the country's internal and external security, improvement of access to health care, as well as improving the quality of education are set as the budget priorities in 2016.

Since the adoption of the *Fiscal Discipline Law* (FDL) at the beginning of 2013, the course of national fiscal policy is based on the concept providing for ensuring a balanced budget in the economic cycle, i.e., the amount of structural balance of the general government budget, which does not exceed -0.5% of GDP, as prescribed in the FDL. Latvia reached the structural deficit of 0.5% of GDP in 2012. Consequently, the task in subsequent years is no longer to reduce the structural deficit, but to preserve it at the level of the medium-term goal.

Increasing economic activity has a positive impact on the labour market situation – high unemployment rate caused by the crisis is falling, and the employment rate is rising. At the same time, the improvement of the situation is less felt by some population groups, especially people with low level of education and qualification, older people, as well as young people.

In 2014, the situation in the labour market continued to improve, but more slowly than before. The unemployment rate fell to 10.8%, which was by 1.1 percentage point less than in 2013, but employment rate rose by 0.9 percentage points – to 59.1 per cent.

In three quarters of 2015 the number of employed population increased by 1%, compared to the respective period of the year before. The unemployment rate fell by 0.9 percentage points to 9.7% in Q3 2015, compared to the respective period in 2014.

The registered unemployment rate also continues to fall – it was 8.7% at the end of December 2015. 81.8 thousand unemployed people were registered, which

was by 247 less than in December 2014. The highest unemployment rate remains in Latgale region (18.5%), while the lowest rate – in Riga (5%). Almost a third of the total number of registered unemployed was long-term unemployed (out of work for more than a year).

The comparatively high unemployment rate is mainly related to cyclical factors; however, a high structural unemployment risk also remains. Some of the unemployed may have lasting problems finding a job, since the new jobs are not the same that were lost during the crisis.

Overall, the number of employed could increase by 1% in 2015, while the unemployment rate will be slightly below 10%. It is expected that the situation in the labour market will continue to improve in 2016.

During the crisis, taking into account the volumes of economic decline, wage adjustment was relatively moderate, most of the economic decline was compensated by the decrease in the number of employed population. With the economic situation becoming more stable, **wage growth has resumed since the end of 2010.**

The average gross wage grew by 6.8% in 2014, reaching 765 euro. A rapid increase in wages was also observed in 2015. In the third quarter, the average gross wage increased by 7.3% in annual terms and amounted to 829 euro.

Since 2010, wages have increased in both the private and public sector. It should be noted that the average gross wage in the public sector in Q3 2015 was for 5.9% higher than in Q3 in 2008, while in the private sector it exceeded the level of 2008 by almost 28 per cent.

Along with an increase in the nominal wage, real wages are also increasing gradually. As of 2013, the increase in real wages has become more rapid. In 2013, real wages grew by 5.6%, and by 8% in 2014. Real wages grew by 8.3% in Q3 2015. Since 2013, the increase in real wages has been primarily driven by the rapid rise in nominal wages, as well as the slow increase in consumer prices.

Further development of the Latvian economy will still be closely linked to export opportunities, **therefore the main risk for growth of Latvia is related to the global economic development.**

Development dynamics of the EU's common economic space, as well as improvement of the geopolitical situation caused by the Ukrainian crisis are of particular importance. The economic benefits of Latvia in the medium term will be mostly based on the macroeconomic stability achieved, resulting in improved credit ratings of Latvia, as well as on the efficiency of the planned structural funds support programmes and improvement in the business environment.

Scenario of a more rapid growth provides for resumed growth in the main export markets of Latvia, and the benefits of the Latvian economic competitiveness are mainly based on technological factors, improvement of production efficiency, and innovation, to a lesser extent on cheap labour and low resource prices. **In the medium term, growth rates of Latvia could reach an increase of 4-5% a year.** By contrast, in the scenario of a weaker growth, with weak growth resuming in Europe and the geopolitical situation not improving, the economic growth rate of Latvia could be much slower.

2. GLOBAL ECONOMIC ENVIRONMENT¹

The growth of the global economy has been moderate in the last years, increasing in the developed countries and slowing down slightly in the developing countries. Despite slower growth, contribution of the developing countries to the global growth was still very significant. Global growth is promoted by the gradual recovery of demand, decrease in oil prices, measures of monetary expansion etc. At the same time, the geopolitical tension in different regions, as well as such fundamental factors as slowing down of potential growth and ageing of society are still significant obstacles for growth.

The latest forecasts of the EC show that the growth of the global economy in 2015 was weaker than in 2014, while the growth rate in 2016 will rise to 3.5%. A similar growth of the global economy is also forecasted by the International Monetary Fund.

A relatively stable growth was observed in the US economy in 2014. It remained stable in 2015, despite weaker indicators at the beginning of the year. Growth was mainly driven by private consumption, investment

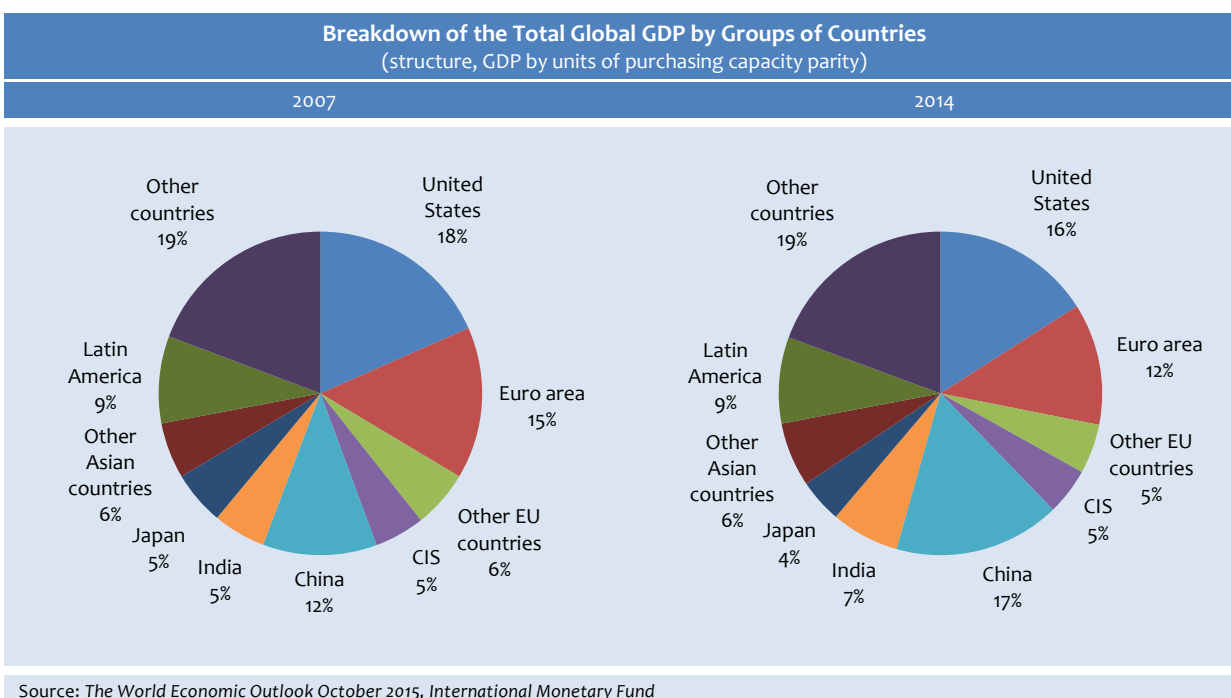
and government expenditure. Strengthening of the dollar and an unfavourable external environment hinder an export development.

Table 2.1

Growth of Gross Domestic Product (percentage compared to the year before)				
	2013	2014	2015f	2016f
World	3.2	3.3	3.1	3.5
including:				
USA	1.5	2.4	2.6	2.8
Japan	1.6	-0.1	0.7	1.1
EU	0.2	1.4	1.9	2.0
including:				
Euro area	-0.3	0.9	1.6	1.8
Russia	1.3	0.6	-3.7	-0.5
China	8.0	7.4	6.8	6.5

Source: European Commission – European Economic Forecast, Autumn 2015; f – forecast

Figure 2.1



¹ The following publications have been used in preparation of this section: European Commission – European Economic Forecast, Autumn 2015; International Monetary Fund – World Economic Outlook, October 2015, Regional Economic Outlook Update: Asia and Pacific, October 2015, Regional Economic Issues – Central, Eastern, and Southern Europe, November 2015

The growth of the US economy in 2016 is projected faster than in 2015. It will be determined by factors such as low oil prices, favourable monetary and fiscal policies, as well as improvement of the housing market. At the same time, the growth of net exports will remain negative.

Economic development of **Asian countries** depends directly on the largest countries of the region. Due to growth rates slowing down in China, they were slightly

slower in the region as a whole in 2014 compared to previous years. A decrease in demand in China negatively influenced the growth of export of Asia. At the beginning of 2015, growth in the region was weaker than expected due to the weak external demand. In some countries of the region, private consumption was also weaker, while domestic demand is stable. Labour market conditions in the region remain positive.

Table 2.2

Main Macroeconomic Indicators of the EU Member States (percentage)									
	GDP growth			Consumption prices			Unemployment		
	2014	2015f	2016f	2014	2015f	2016f	2014	2015f	2016f
European Union	1.4	1.9	2.0	0.6	0.0	1.1	10.2	9.5	9.2
Austria	0.4	0.6	1.5	1.5	0.9	1.8	5.6	6.1	6.1
Belgium	1.3	1.3	1.3	0.5	0.6	1.7	8.5	8.6	8.4
Bulgaria	1.5	1.7	1.5	-1.6	-0.8	0.7	11.4	10.1	9.4
The Czech Republic	2.0	4.3	2.2	0.4	0.4	1.0	6.1	5.2	5.0
Denmark	1.1	1.6	2.0	0.3	0.4	1.5	6.6	6.1	5.8
France	0.2	1.1	1.4	0.6	0.1	0.9	10.3	10.4	10.4
Greece	0.7	-1.4	-1.3	-1.4	-1.0	1.0	26.5	25.7	25.8
Croatia	-0.4	1.1	1.4	0.2	-0.1	0.9	17.3	16.2	15.6
Estonia	2.9	1.9	2.6	0.5	0.1	1.8	7.4	6.5	6.5
Italy	-0.4	0.9	1.5	0.2	0.2	1.0	12.7	12.2	11.8
Ireland	5.2	6.0	4.5	0.3	0.3	1.4	11.3	9.5	8.7
Cyprus	-2.5	1.2	1.4	-0.3	-1.6	0.6	16.1	15.6	14.6
Latvia	2.8	2.4	3.0	0.7	0.2	1.4	10.8	10.1	9.5
Great Britain	2.9	2.5	2.4	1.5	0.1	1.5	6.1	5.4	5.4
Lithuania	3.0	1.7	2.9	0.2	-0.8	0.6	10.7	9.4	8.6
Luxembourg	4.1	3.1	3.2	0.7	0.3	1.7	6.0	5.9	5.8
Malta	3.5	4.3	3.6	0.8	1.1	1.8	5.9	5.8	5.7
The Netherlands	1.0	2.0	2.1	0.3	0.2	1.2	7.4	6.9	6.6
Poland	3.3	3.5	3.5	0.1	-0.6	1.4	9.0	7.6	7.2
Portugal	0.9	1.7	1.7	-0.2	0.5	1.1	14.1	12.6	11.7
Romania	2.8	3.5	4.1	1.4	-0.4	-0.3	6.8	6.7	6.6
Slovakia	2.5	3.2	2.9	-0.1	-0.2	1.0	13.2	11.6	10.5
Slovenia	3.0	2.6	1.9	0.4	-0.6	0.8	9.7	9.4	9.2
Finland	-0.4	0.3	0.7	1.2	-0.2	0.6	8.7	9.6	9.5
Spain	1.4	3.1	2.7	-0.2	-0.5	0.7	24.5	22.3	20.5
Hungary	3.7	2.9	2.2	0.0	0.1	1.9	7.7	7.1	6.7
Germany	1.6	1.7	1.9	0.8	0.2	1.0	5.0	4.7	4.9
Sweden	2.3	3.0	2.8	0.2	0.8	1.5	7.9	7.7	7.7

Source: European Commission – European Economic Forecast, Autumn 2015
f – forecast

All in all, stable growth is expected in Asian countries in 2016, the region preserving its leading position in terms of global growth. The growth will be supported by a relatively strong labour market and growth in the disposable income. In most of the major Asian economies, consumption will be stimulated by lower commodity prices. The negative risks of growth are related to the slowdown of China's economic growth. In addition, further strengthening of the US dollar contributes to tighter global financial conditions, weaker growth in Japan, as well as a weaker potential growth in the region.

Although growth in China in 2015 is weaker than previously expected, it will remain slightly below 7%. The rate of China's economic growth will continue slowing down in the coming years.

In 2015, growth in Japan was slow due to a weak domestic demand and an adverse external environment. By contrast, in 2016, it is projected to be slightly above 1%, driven by an increase in demand before the planned increase in consumption taxes and favourable investment conditions.

Growth continues in India. It is supported by domestic demand, industrial development, and investment. With the pace remaining above 7%, the economy of India will be the regional leader in 2015 and 2016 in terms of growth.

Growth in Russia and the **CIS countries** in 2014 and the first half of 2015 remained explicitly negative. It was due to international sanctions against Russia, low oil prices, as well as structural shortcomings. The recession in Ukraine intensified, which was influenced by a decrease in economic activities in the eastern conflict

zone and the implemented macroeconomic adjustments. The economic recession of Russia negatively affected the development of other CIS countries – reduced amounts of trade and cash transfers, as well as reduced consumption and investment.

In general, the region's economy in 2015 will decrease by 2.7%. A small positive growth in the CIS countries is forecasted for 2016.

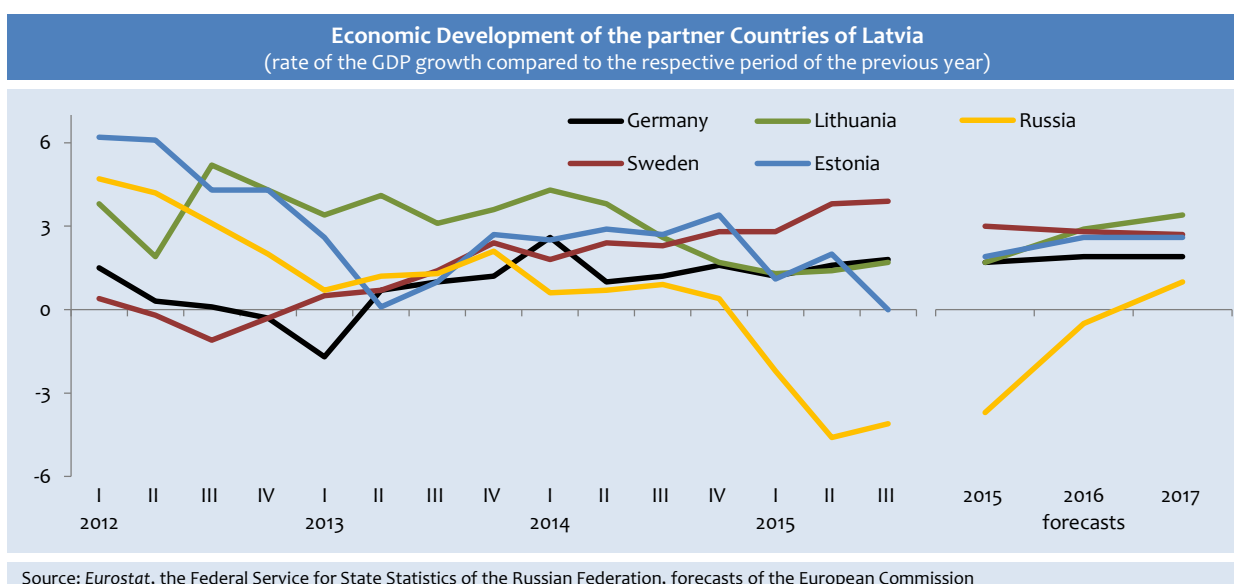
Russia's economy fell significantly in 2015. In 2016, it will decline slightly. Similar trends are forecasted for Ukraine.

Elsewhere in the region, particularly in the Caucasus and Central Asia, growth will be affected by low prices of goods, the Russian crisis (through trade, FDI, and cash transfers in particular), as well as the existing structural imbalances.

The economic recovery in the **European Union** and the euro area will continue at a moderate pace, supported by low oil prices, a relatively weak euro exchange rate, monetary policy measures, and neutral fiscal policy. These factors have so far been strong enough to compensate for new challenges arising from weaker development of the global economy, especially in China and other emerging economies.

Low oil prices, supportive monetary policy and favourable euro exchange rate will remain the main determinants of growth in the near future. At the same time, potential growth remains relatively weak, due to consequences of the crisis, demographic trends, and total productivity of factors of production. External economic environment is mentioned as the risk of growth, while inflation risk is evaluated as balanced.

Figure 2.2



Although the growth in **the Baltic States** remains relatively strong, it is weaker than previously forecasted. This is due to the economic recession in Russia and other CIS countries.

The economic growth of **Lithuania** in the first half of 2015 was significantly lower than expected. Although the domestic demand increased more than in 2014, the overall growth was limited by a significant reduction in exports to Russia. As a result, moderate growth was in 2015. The growth in private consumption is supported by a significant increase in real wage, affected by the situation in the labour market and low inflation. Thanks to the payments of EU structural funds, investment continues to increase.

It is projected that the growth of real GDP will increase in 2016 and 2017. Increase in nominal wage will be the basis for growth of private consumption, which will be the main driver of growth.

The growth of **Estonia's** GDP in 2015, in general, was slightly slower than forecasted previously. This was due to a weaker growth in the first half of the year. At the beginning of 2015, growth was promoted by private consumption, based on a strong increase in wages and a low consumer price inflation. After completion of the major investment projects, investment activity fell, especially in the transport and ICT sectors. Successful acquisition of new export markets and low demand for imports contributed to an increase in net exports, which had a positive impact on growth.

The growth of real GDP in Estonia in 2016 is forecasted to be more rapid than in 2015. It will be supported by the positive base effect from the first half of 2015. A moderate private consumption is forecasted, affected by a slowdown in the real income growth and the rising inflation. At the same time, growth will be promoted by an increase in investment.

In the first half of 2015, growth in **Germany** was comparatively weak. In the first quarter, growth was promoted by private consumption and investment, while in the second quarter – by net exports. The growth rates improved in the second half of the year. In the third quarter, economic growth was mainly driven by the increase of both household and government expenditure.

Favourable labour market and funding conditions, as well as additional government expenditure on reception and integration of asylum seekers will promote growth in Germany in 2016.

Overall, the growth of **Sweden's** real GDP in 2015 was more rapid than a year before and was above the potential growth rate. Although domestic demand is still the main driver of growth, the export recovery will also provide further impetus for growth, which is based on the EU's economic recovery.

Also, the economic growth of Sweden will be stable in 2016, and domestic demand will remain the key factor of growth. Unemployment is likely to fall only slightly.

3. GROWTH

3.1 Gross Domestic Product and Aggregate Demand

3.1.1 Development Trends

Since 2011, economic growth has been one of the most rapid ones in the EU. From 2011 to 2013, economic growth reached 4.4% per year on average. During the first years after the crisis, economic growth was largely based on an increase in export volumes. Since 2013, the unfavourable situation in the external environment has been restricting export opportunities. Private consumption facilitated by a gradual increase in employment and wages has been growing more rapidly.

In 2014, the trends of economic development were influenced by the external situation – growth in the EU that was slower than previously expected, as well as weakening of the economic situation in Russia. In total, GDP grew by 2.4% in 2014. At the same time, growth was still more rapid than the average growth in the EU. However, despite the relatively rapid economic growth in the post-crisis years, GDP was by 7.5% lower than in 2007.

Even though the geopolitical situation in the region was tense, the Latvian economy continued to grow in 2015. Since Q2 2015, the growth rate has been increasing, and the GDP growth in Q3 reached 3.3% in annual

terms. In total, GDP was by 2.7% higher in three quarters of 2015 than a year before, which was a higher growth than previously forecasted.

Figure 3.1

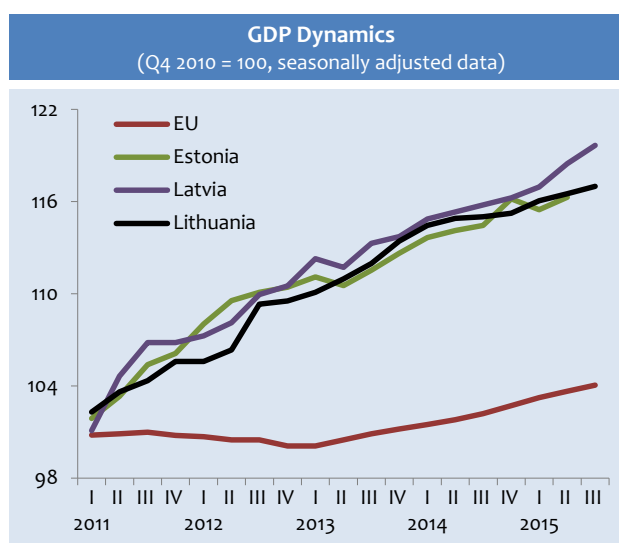


Table 3.1

GDP by Expenditure Items (changes compared to the previous year, percentage)							
	2008	2009	2010	2011	2012	2013	2014
GDP	-3.6	-14.3	-3.8	6.2	4.0	3.0	2.4
Private consumption	-7.9	-16.1	2.8	3.0	3.2	5.1	2.3
Public consumption	2.4	-10.7	-8.1	3.0	0.3	1.6	4.9
Gross fixed capital formation	-9.2	-33.3	-19.8	24.1	14.4	-6.0	0.5
Exports	2.4	-12.9	13.4	12.0	9.8	1.1	3.1
Imports	-10.7	-31.7	12.4	22.0	5.4	-0.2	0.8

Since 2010, the export of Latvian goods and services has grown very rapidly, and it was the main drive of economic development; however, as of 2013, in relation to the low demand in foreign markets, export dynamics have become more moderate.

In 2014, the volumes of goods and services exports grew by 3.1% – export of goods grew by 5.2%, while the export of services dropped by 2.2 per cent.

In 2015, despite a decrease in the volume of exports to Russia, the overall volumes of exports of Latvian producers grew. Volumes of goods and services exports

grew by 2.2% in the first three quarters of 2015, compared to the corresponding period of the year before. The export of services grew more rapidly in 2015, while the export of goods increased at a more moderate rate.

Domestic demand grew by 2.3% in 2014. Even though domestic demand in 2014 was by 17.1% higher than during the lowest point of the crisis in 2010, it was still by 16.4% lower than in the pre-crisis level in 2007.

Domestic demand continued to grow in 2015 – it grew by 3.5% in three quarters of the year, compared to the corresponding period of the year before.

Just like export, import dynamics have also been very moderate since mid-2012.

Goods and services imports grew by 0.8% in 2014. A slower growth in imports was influenced by a decline in volumes in certain product categories, such as mineral products, agricultural and food products, and vehicles.

In 2015, an increase in domestic demand facilitated growth of imports. The volumes of goods and services imports in Q3 2015 were by 5.3% higher than a year before, which was the sharpest increase in imports in annual terms since 2012. In three quarters of 2015, imports increased by 3 per cent.

Table 3.2

GDP by Expenditure Items by Quarters (% change compared to the corresponding period of the year before)												
	2013				2014				2015			
	I	II	III	IV	I	II	III	IV	I	II	III	
GDP	2.2	3.3	3.7	2.8	2.7	2.3	2.3	2.1	1.8	2.7	3.3	
Private consumption	4.4	7.3	7.1	1.4	2.9	2.1	2.2	2.0	3.1	2.4	5.2	
Public consumption	4.9	-0.1	2.4	0.2	5.3	5.7	3.2	5.4	3.4	3.3	3.7	
Gross fixed capital formation	-16.2	-2.3	-4.6	-3.6	2.3	1.2	-0.8	0.1	-1.0	2.9	6.0	
Exports	3.1	1.9	-0.7	0.5	4.0	2.8	1.4	4.2	4.6	0.8	1.4	
Imports	2.0	-1.8	0.2	-1.0	0.8	1.2	-1.9	3.0	0.8	2.6	5.3	

The export-import balance of Latvia improved significantly during the crisis. Even in 2007, the export-import balance exceeded -20% of GDP, but the export-import balance has been improving since 2009.

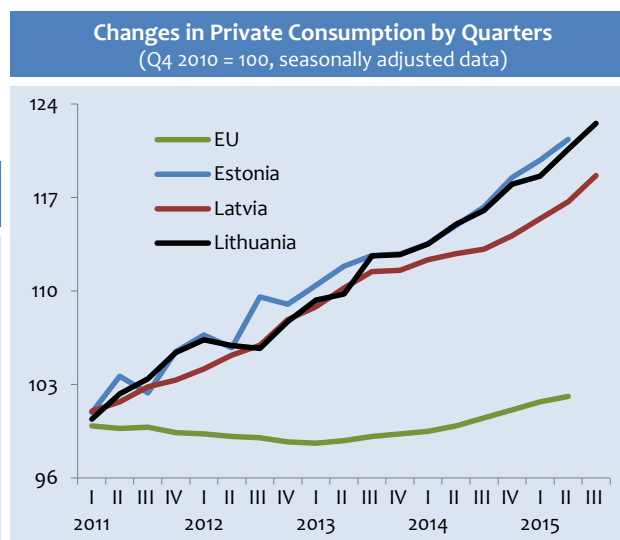
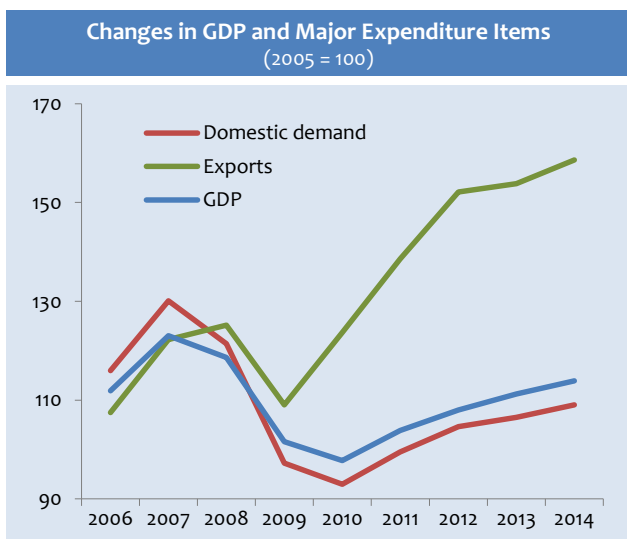
In 2013, the export-import balance was -3.2% of GDP, but in 2014 – -2.2% of GDP.

The export-import balance continued to improve in 2015, and it was -2.3% of GDP in three quarters of the year.

Private consumption continued to grow in 2014; however, just like the overall economic growth, the rate of private consumption was more moderate than in 2013. In total, private consumption grew by 2.3% over the year.

Figure 3.3

Figure 3.2



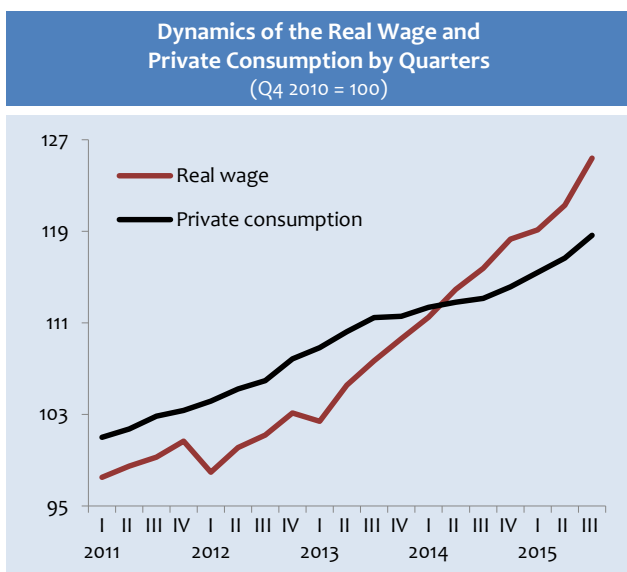
3.1.2 Private and Public Consumption

In recent years, the increase in private consumption has been facilitated by a gradual increase in employment and wages. Private consumption grew by 3.2% in 2012, while in 2013 – by 5.1 per cent.

Household expenditure on food grew by 4% in 2014, on transport – by 2%, on leisure and culture – by 4%. By contrast, expenditure on housing maintenance decreased by 1 per cent.

In three quarters of 2015, private consumption grew by 3.6%, and it was largely facilitated by the improved situation in the labour market, as well as the low inflation, thus the disposable income of households increased.

Figure 3.4



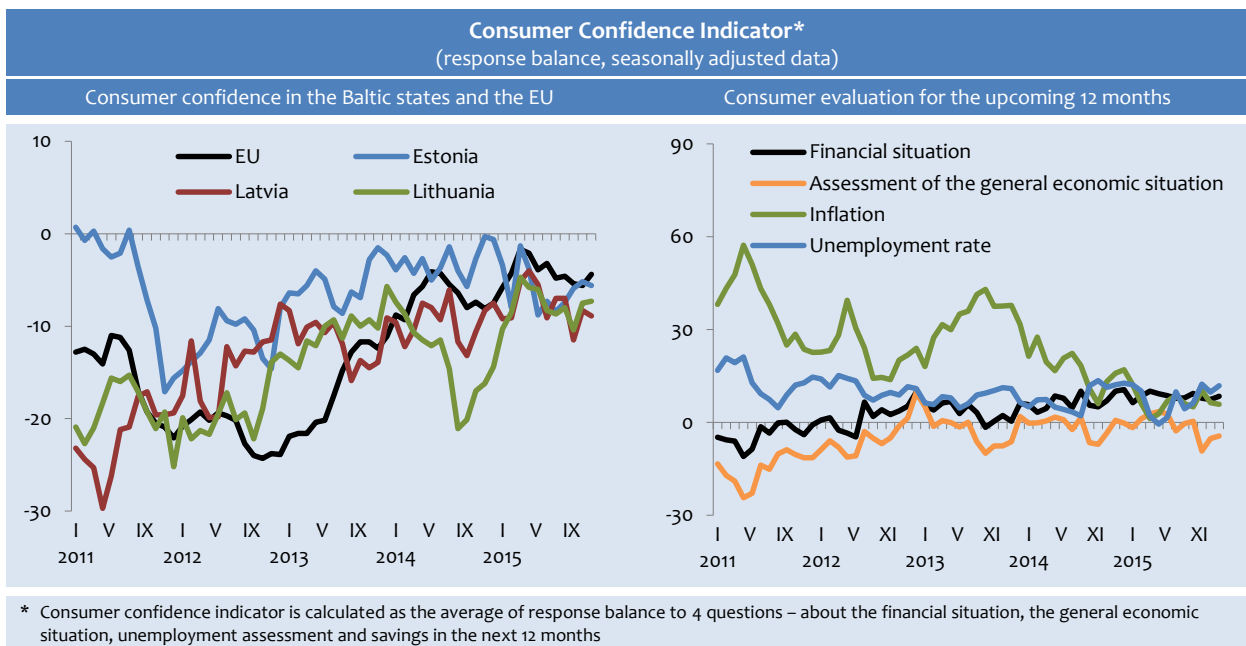
From 2011 to 2012, consumer confidence improved sharply. However, no significant changes have been observed in consumer mood since 2012, and it is still negative. It should be noted that consumer confidence was also negative during the years of rapid growth (2005-2007).

Since mid-2012, consumer optimism about the family’s financial situation has been largely improving.

Consumer’s assessment of the overall situation in the country has been very cyclical since 2013, but it has not changed essentially.

Unemployment expectations have been decreasing since the end of 2011, except for a slight rise at the end of 2014, while inflation expectations have been very cyclical since 2011, but, in general, they have a trend to decrease since mid-2013. Cyclicity of mood is driven by consumer reaction to various changes, such as the introduction of the euro or opening of the electricity market.

Figure 3.5



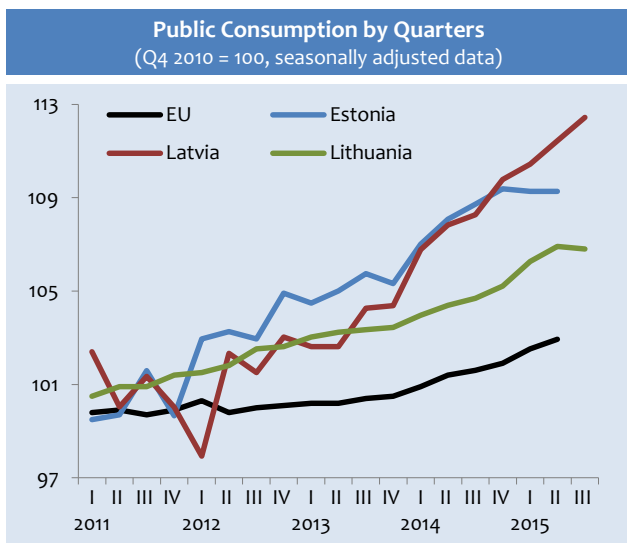
* Consumer confidence indicator is calculated as the average of response balance to 4 questions – about the financial situation, the general economic situation, unemployment assessment and savings in the next 12 months

Public consumption or the volumes of public services fell sharply during the crisis. In 2011, public consumption was by 13.4% lower than in 2007. The reduction was due to the implementation of budget consolidation measures. As a result, the share of public consumption in GDP also decreased. In 2008, public consumption constituted 20% of GDP. In 2012, public consumption constituted only 17% of GDP. Although the economic situation improved, the government’s

commitment to continue reducing the national budget deficit in 2012 held back a rapid increase in expenditure. Since 2013, with the budget revenue growing, public consumption has been increasing gradually. The volumes of public consumption grew by 1.6% in 2013, but in 2014 – by 4.9 per cent.

Government consumption continued to grow in 2015 – it grew by 3.5% in the first three quarters, compared to the corresponding period of 2014.

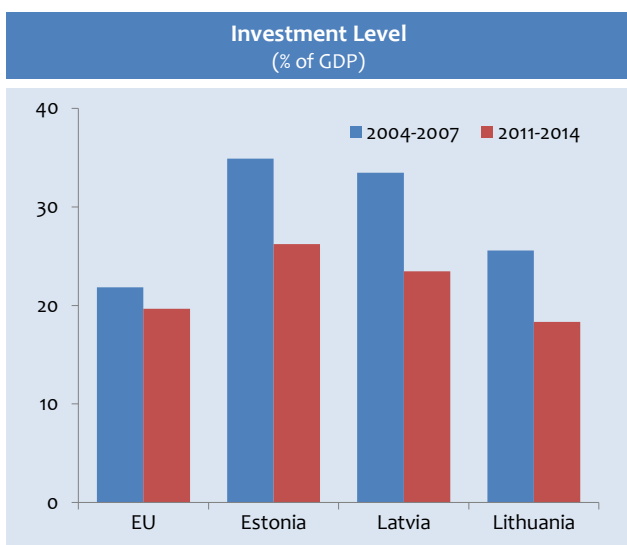
Figure 3.6



3.1.3 Investments

In recent years, investment activities have been quite moderate, and investment volumes still have not reached the pre-crisis level. The rapid decrease in investment volume during the global financial crisis and the slow recovery can be observed in almost all EU member states. The low level and weak dynamics of investment are greatly affected by the weak crediting, relatively low demand, relatively high level of debt commitment of private and public sectors, as well as the uncertainty of economic and political situation in the external environment. Low levels of investment hinder renewal and modernization of fixed assets, which may undermine the country’s competitiveness and growth potential.

Figure 3.7



In 2014, investment volume in the EU states in total decreased by almost 12.3% compared to 2007, and it was

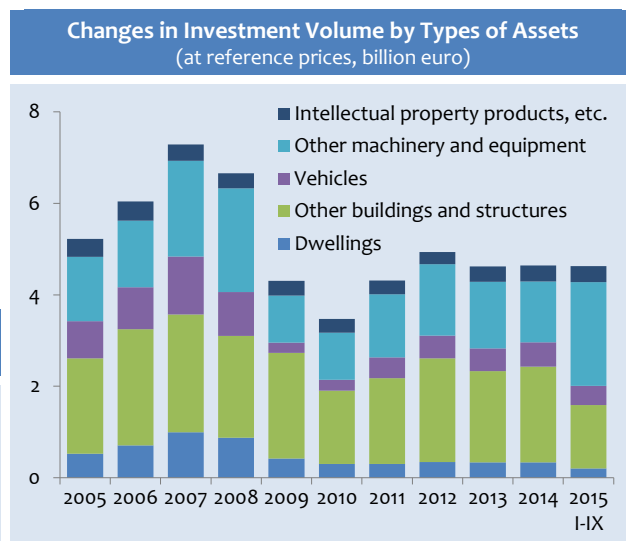
19.4% of GDP, i.e., for almost 2.5 percentage points lower than on average in 2004-2007.

In some EU member states, the decrease in investment volume was even more dramatic, for example, in Greece – by 65%, in Cyprus – by 55%, in Italy, Portugal, and Spain – by nearly 35%. At the same time, it should be noted that investment volumes in Germany, Poland, and Sweden in 2014 exceeded the level of 2007.

Decrease in investment in the Baltic States during the crisis was almost four times higher than on average in the EU, and it was by 63% lower in 2010 than prior to the crisis. With the economy becoming more stable, investments grew, while the investment volume in the Baltic States in total was by 26% lower in 2014 than the pre-crisis level.

Since 2008, investments in Latvia have been rather fluctuating. During the years of rapid recession, investments fell by almost a half. Positive investment dynamics recovered as of the end of 2010, and investment volume in 2011 exceeded the level of 2010 by 24.1%. A sharp rise in investment was largely related to the low base effect. Therefore, investment growth rates were almost twice slower in 2012 (they rose by 14.4%), whereas in 2013 investment in the national economy of Latvia fell by 6%, compared to 2012, mainly due to a lower investment volume in the industries.

Figure 3.8



In 2014, investment in the national economy of Latvia grew by only 0.5%. Investment process was also very moderate at the beginning of 2015. Investment decreased by 1% in Q1 2015 compared to the corresponding period of the year before, while in Q2 and Q3 the investment volume grew by 2.9% and 6% respectively. In the nine months of 2015, investment in the national economy of Latvia exceeded the level of the year before by 3.2% and constituted 21% of GDP. It was mainly influenced by an increase in the investment in machinery and equipment, as well as intellectual property

products. It is expected that investments in the national economy of Latvia will continue to grow moderately.

The structure of investment assets has also changed since 2007. It was mainly due to a significant drop in investment in dwellings, as well as in machinery and equipment during the years of rapid recession. In 2010, compared to 2007, investment in dwellings fell by 70.2%, while in machinery and equipment – by 62.4%, including in vehicles – by 81.3%. In the following years, investments in machinery and equipment increased slightly; however, in 2014, investment volumes were twice as low as in 2007. By contrast, investments in dwellings basically did not rise and constituted 34% of the pre-crisis level in 2014.

Investments in other buildings and structures were relatively more stable during the crisis. They decreased by 37.5% in 2010, compared to 2007. In the following three years, the investment in these assets grew quite rapidly – by 42.3%, mainly due to the significant public investment

in infrastructure projects. In 2014, investment volumes in buildings and structures was almost at the pre-crisis level and accounted for 45% of total investments in the national economy of Latvia.

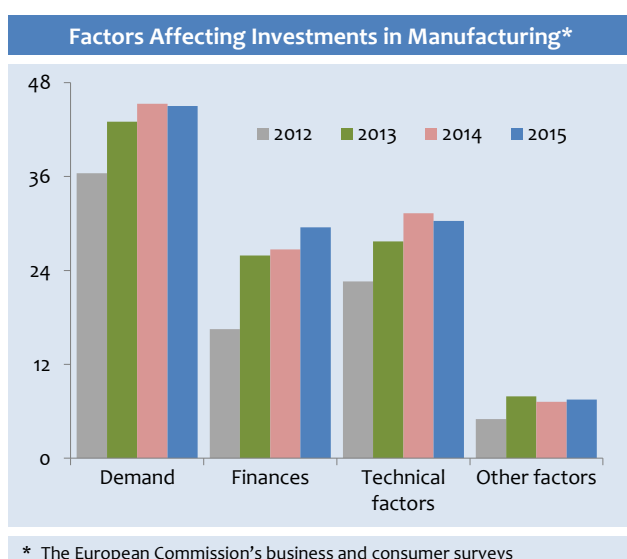
In 2014, investment in dwellings and vehicles grew most rapidly, by 13.3% and 16.7% respectively, while investments in production equipment decreased by 15.2%. By contrast, in the first nine months of 2015, the investments in the construction of dwellings, other buildings and structures were by 2.8% less than a year before, but investments in machinery and equipment grew by 7.6%, and investments in intellectual property products grew by almost 20 per cent.

In recent years, the role of government in the investment process has increased. In the weak crediting conditions, the state provides significant support to private investment through the co-funding of EU structural funds.

Table 3.3

Gross Capital Formation						
	annual average 2008-2010	2011	2012	2013	2014	2015 I-IX
changes in per cent						
GDP	-7.2	6.2	4.0	3.0	2.4	2.7
Gross Capital Formation	-25.1	48.7	-1.1	-4.3	-5.5	1.3
– gross fixed capital formation	-20.8	24.1	14.4	-6.0	0.5	3.2
% of GDP						
Gross Capital Formation	25.6	25.2	26.1	24.1	23.4	21.9
– gross fixed capital formation	24.7	22.2	25.5	23.2	22.9	21.9
– changes in inventories	0.9	2.9	0.7	0.8	0.6	0.0

Figure 3.9



During the economic recession, public investments were quite steady. In 2010, the share of public investment reached 24% of the total investments, due to private investment decreasing twice as fast as public investment. In 2011, public investment grew by 15%, constituting 2/3 of the total increase in investments. However, since 2012, the volume of public investment has remained almost unaffected, while the volume of private investments grows by 4% a year on average. In 2014, public investments constituted 19.3% of the total investment volume, while in 2007 – 16.1 per cent.

Results of the business managers survey show that the most significant factor encouraging investments is the increase in demand. Since 2013, the role of the factors of access to finance in stimulation of investment has increased significantly. Financial conditions are estimated as an important supportive factor for investment also in 2015, equivalent to the factors of technical nature, such as technological development, availability of skilled labour, etc. It should be noted that, in recent years, technical factors are identified as the main incentives for investment in the EU countries, followed by demand.

Since early 2010, capacity utilization rate has been growing gradually in the manufacturing industry. At the end of 2015, the rate reached 72%, which was by only 1.7 percentage points less than at the end of 2007. Low investment activity at a relatively high capacity utilization indicates the reserved mood of investors. The increase in demand, as well as the positive vision of the future of entrepreneurs can contribute not only to an increase in capacity utilization, but also to an increase in investments. Positive trends in the investment process will be also largely determined by the availability of the credit resources and other external sources of funding, and the wish to strengthen one's position in the foreign and domestic markets, including by technological renewal of the existing production capacity.

Structure of investment sectors.¹ Due to the financial crisis, investment fell in all sectors. A particularly large drop in the investment volumes was observed in the construction. In 2010, investments in the construction were by 78% lower than in 2008. A similarly large decrease was observed in the trade, accommodation and catering services sectors. Investments fell rather moderately in such sectors as information and communication services, health and social care, mining and energy industries.

Positive investment dynamics recovered in some sectors as of the end of 2010, and they were very rapid in

2011. Investments in the commodity production industries in 2011 were by 49.4% higher than a year before, largely due to large investments in the energy sector and the manufacturing industry. By contrast, investment in service sectors grew by 12% and accounted for almost 60% of the total investment in the national economy of Latvia.

The dynamics of investments in service sectors increased slightly faster in 2012 than a year before – by 18.9%, mainly due to the substantial investments in the transport and storage sector, as well as operations with real estate. The investment dynamics in production sectors, in their turn, were more moderate (by 6.6%), which was largely influenced by the decrease in investments in the construction. In 2013, investment volumes in services sectors remained at the level of 2012, while the total investments in the commodity production industries were by 14.4% lower than a year before. Investment slowdown in services sectors was mainly influenced by a decrease in investment in the trade, transport and storage sectors. By contrast, the decrease in investment volumes in the commodity production industries was due to a decrease in the manufacturing industry (by 30.6%) and energy sector (by 21%). It was partly compensated by growth in investments in construction, as well as sewage, waste management and remediation activities.

Table 3.4

Dynamics and Structure of Investments by Sectors*								
(per cent)								
	growth rates				structure			
	2012	2013	2014	2015 I-III	2012	2013	2014	2015 I-IX
Agriculture and forestry	7.0	2.6	-14.9	-7.9	7.0	7.5	6.2	4.5
Manufacturing	7.6	-30.6	46.2	-0.9	13.4	9.7	13.7	13.5
Construction	-29.1	6.1	5.0	36.5	3.0	3.3	3.3	3.2
Trade	19.9	-4.6	3.5	6.7	8.5	8.5	8.5	7.3
Transport and communications	31.1	-5.5	7.6	33.3	15.7	15.6	16.1	20.3
Other commercial services	34.1	7.1	1.4	21.9	20.7	23.3	22.7	18.1
Public services	-3.9	4.3	6.9	-6.1	16.3	17.9	18.4	21.6
Other industries	16.6	-12.0	-18.2	-20.4	15.4	14.2	11.2	11.3
Total	14.4	-6.0	0.5	3.2	100	100	100	100

* 2014 – provisional data; 2015 – estimated using the quarterly data

According to preliminary data, total investment in the Latvian economy in 2014 slightly exceeded the level of the year before. However, investment dynamics were rather different in certain sectors. Investment volumes in service sectors increased by 4.7%, largely due to a significant increase in investment in education, health and social protection sectors, by 45% and 38.2% respectively, as well as in information and telecommunication services

– by 16.4%, and transport and storage sector – by 7.6%. By contrast, investment volume in almost all commodity production industries was lower than a year before, except for the manufacturing industry. According to the provisional data in 2014, investments in the manufacturing industry grew almost 1.5 times, compared to 2013.

Evaluation of the investment volume using the quarterly data shows that, in the first nine months of 2015, investments in service sectors were by 12% higher than in the corresponding period of the year before.

¹ Investments by industry are examined according to the non-financial investment statistics.

Increase in the investments in the transport and storage sector (an increase of 33.3%) and operations with real estate (an increase of 93.7%) contributed the most. By contrast, in the first nine months of 2015, the investment volume in the commodity production industries in total was by 7.3% lower than a year before. This was largely due to a decrease in investments in the energy sector – by 23.3 per cent.

Investment processes in the manufacturing industry are uneven with explicitly large fluctuations in recent years. During the years of rapid economic recession, investment volumes in the said industry fell almost three times, reaching the lowest point in 2009. This was largely due to a decrease in investment in the production of consumer goods (including the food industry – by 44%), as well as the intermediate goods production sectors (including woodworking – by 88%, and production of chemicals and chemical products – by 77%).

Positive dynamics resumed in the sector as of 2010. In 2010, investments in the manufacturing industry

exceeded the level of the year before by 5.5%. The most rapid increase was in the sectors of production of consumer non-durables and investment goods. Woodworking industry, paper manufacturing and publishing industry, as well as pharmaceutical products industries contributed the most to the increase in investments in the manufacturing industry.

Investment activities grew rapidly in the manufacturing industry in 2011. Investment volumes in the industry grew by 37.5%, compared to 2010. More than a half of the investments in the manufacturing industry were in the sectors of woodworking and metal production. Investments in the manufacturing industry continued to grow in 2012, although slower than the year before, largely due to a lower level of investment in the woodworking and metal production industries. By contrast, the investment volume in the manufacturing industry in 2013 was by 30% lower than a year before and constituted 13.7% of the total investment volume in the national economy of Latvia.

Table 3.5

Dynamics and Structure of Investments in Manufacturing* (per cent)								
	growth rates				structure			
	2012	2013	2014	2015 I-III	2012	2013	2014	2015 I-III
Food industry	46.7	-39.6	2.5	-4.0	27.9	25.1	21.1	19.4
Light industry	-19.2	-7.6	41.2	-4.7	1.4	1.9	2.2	2.1
Wood processing	-28.2	-26.9	56.9	-34.4	23.9	26.0	33.4	23.0
Paper industry and publishing	0.3	16.4	-10.3	154.2	3.2	5.5	4.1	9.7
Chemical industry and related industries	-33.6	-19.1	3.5	-14.5	7.5	9.0	7.6	7.4
Production of other non-metallic mineral products**	43.2	-18.6	20.1	6.5	7.5	9.0	8.9	9.8
Production of metals and metal articles**	-33.4	-68.7	6.7	11.7	14.2	6.6	5.8	6.6
Production of machinery and equipment	5.1	-35.8	45.3	3.0	1.5	1.5	1.8	2.0
Production of electrical and optical equipment	66.6	-30.8	54.3	33.5	3.3	3.3	4.2	5.1
Production of vehicles	22.1	-40.7	33.9	42.3	5.7	5.0	5.5	7.9
Other industries	-6.6	18.8	-6.6	53.5	4.0	7.1	5.4	7.1

* 2013 – provisional data; 2014 – estimated using the quarterly data
** evaluation by the Ministry of Economics

According to the preliminary data, investment in the manufacturing industry in 2014 was by 46.2% higher than a year before and accounted for almost 13.5% of the total investment in the national economy. Increase in investments was mainly driven by investments in the wood-processing industry and production of non-metallic mineral products, while investment activity in the rest of the manufacturing sectors in 2014 was rather moderate.

In 2015, investment in the manufacturing industry remained at the level of the previous year. The drop in investment volumes in the wood-processing industry was almost completely compensated by investment growth in sectors such as the manufacturing of vehicles, electrical

and optical equipment, as well as paper manufacturing and printing industries.

Investor survey data shows that the investment structure in the industry mainly remains the same. In 2015, investments in the industry were mainly related to the replacement of discarded equipment and machinery and increasing the production capacity – 38.5% and 25.8% of the total investment in the industry, respectively. In recent years, investments aimed at streamlining the production process have been growing. In 2015, they constituted 21% of the total investments in the industry sectors.

In the near future, investment volumes in the national economy of Latvia will grow moderately. However,

investment process dynamics will be largely based on growth in demand, availability of financial resources, as well as the improvement of the situation in the external environment.

3.1.4 Exports and Imports

Exports and Imports of Goods

Latvian exports of goods grew very sharply from 2010 to 2012, with the growth rate at current prices exceeding the average of 20% a year. By contrast, with the external demand falling and the cost competitiveness advantages gained during the crisis decreasing, export rates started to decrease significantly in 2013, but they remained positive.

In 2014, similarly as in 2013, exports of goods at current prices grew moderately – by 2.3%, while at constant prices – by 3.8 per cent.

Figure 3.10



Similarly to exports, Latvian imports of goods also grew very sharply from 2010 to 2012, but the growth rate slowed down to 1% at current prices in 2013.

In 2014, Latvian imports of goods at current prices grew only by 0.2%, while at constant prices – by 0.7 percent.

In 2012-2014, trade deficit decreased, while the exports grew a bit more rapidly than the imports. In 2013, exports constituted 11.5% of the foreign trade volume, while in 2014 – 10.5%. The trade deficit continued to decrease in 2015, and it was below 10% in January-November. It should be noted that during the years of rapid growth (2007-2008) deficit constituted more than a fourth of the total volume of foreign trade.

Figure 3.11



During the post-crisis period, in 2010-2011, development of Latvian exports to the EU countries was equally determined by an increase in the competitiveness of the Latvian companies and a stable foreign demand. In 2012-2013, with the growth in the EU becoming weaker, external demand fell significantly, and export growth was mainly driven by an increase in competitiveness. Improvement of the competitiveness of the Latvian producers in the post-crisis years was mainly driven by a decrease in labour costs. At the same time, an increase in the exports of goods in 2014-2015 was mainly driven by external demand, and the role of competitiveness in the growth of exports is becoming less significant.

Figure 3.12

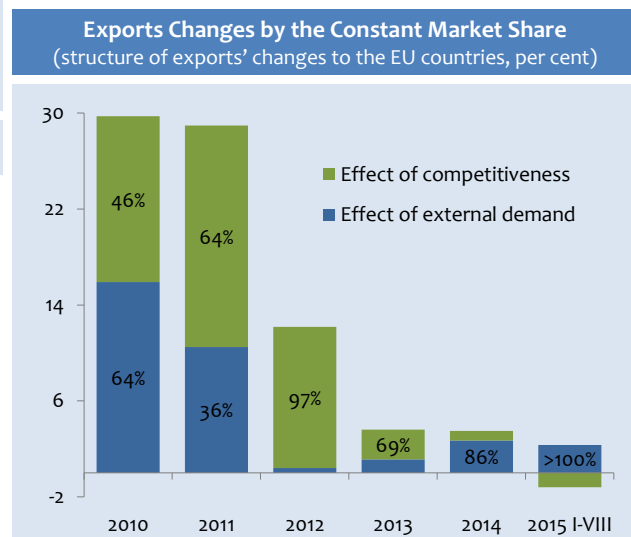


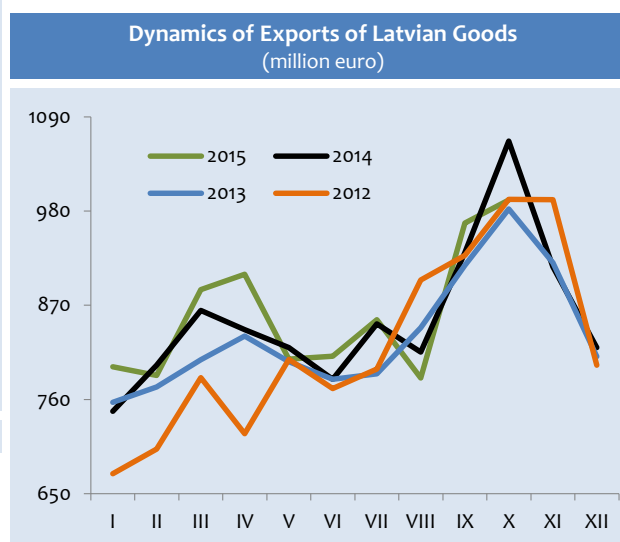
Figure 3.13



In recent years, the level of diversification of the Latvian exports of goods has also been improving. In the years of rapid growth, some of the major groups of export goods, such as wood and wood products, and metals, dominated the growth of exports. During the crisis, export volumes decreased in all product groups, while the volumes of the major groups of export goods shrank more rapidly, which led to an improvement in the diversification index. During the post-crisis period, with

the growth resuming, increases in export volumes in terms of product groups were more similar, which points to a higher level of export diversification. It should be noted that the index in Latvia in recent years corresponds to the average level of EU-15 countries.

Figure 3.14



In 2014, with the export prices decreasing faster than import prices (-1.4% and -0.5% respectively), the terms of trade became slightly worse. By contrast, in eleven months of 2015, with the export prices rising a bit (by 0.2%) and the import prices decreasing (by 1.7%), the terms of trade improved.

Table 3.6

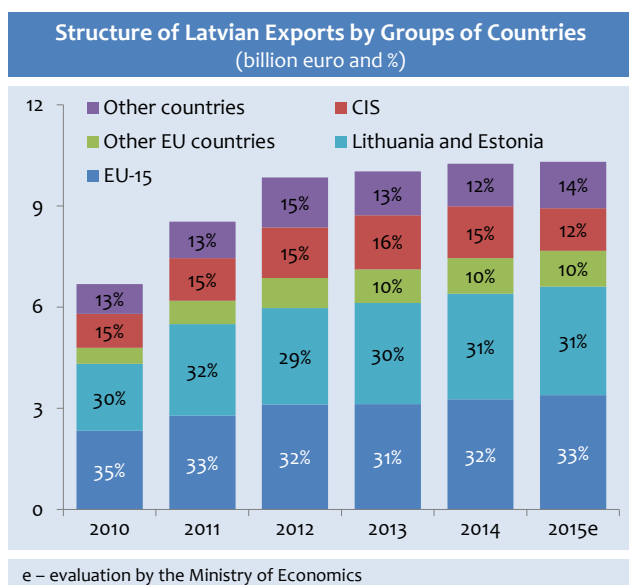
Exports by the Main Commodity Goods (%, at current FOB prices)				
	2014		2015 I-XI	
	structure	changes	changes compared to the corresponding period of the previous year	contribution to the changes in volumes
Total	100	2.3	1.2	1.2
including:				
agriculture and food products	19.3	-3.3	-3.3	-0.6
mineral products	8.3	-2.7	-12.9	-1.1
production of the chemical industry and related industries; plastics	10.0	4.4	4.7	0.5
light industry products	4.7	-2.2	-7.1	-0.3
wood and wood products	16.6	6.7	2.4	0.4
metal and metal articles	9.0	-12.0	-2.1	-0.2
machinery products	16.8	10.5	13.3	2.2
vehicles	5.2	16.8	-8.7	-0.5
other goods	10.1	6.9	7.2	0.7

In 2014, the growth of exports was still negatively affected by a decrease in the export volumes of metals

and metal products. The exports of agricultural and food products, mineral products, as well as products of the

light industry fell slightly. At the same time, growth of exports was positively influenced by an increase in the volumes of exports of machinery, appliances and electrical equipment, as well as wood and wood products. The exports of transport vehicles and products of chemical industry grew more moderately.

Figure 3.15



In January-November 2015, exports were positively influenced by an increase in the volumes of exports of machinery, appliances and electrical equipment, production of chemical industry, as well as wood and wood products. At the same time, the export value of agricultural and food products, and mineral products fell

due to a significant drop in prices. The exports of transport vehicles, products of light industry, as well as metals and metal products also fell.

The amount of exports to the EU countries grew by 4.6% in 2014. A large part of the increase was due to the growth of export groups of machinery, appliances and electrical equipment, as well as transport vehicles. The amount of exports to the EU countries continued to grow also in January-November 2015 – by 2.3%. Increase in the value of agricultural and food products contributed the most to the growth of exports to the EU countries. The exports of products of chemical industry, machines, appliances and electrical equipment also grew.

Figure 3.16

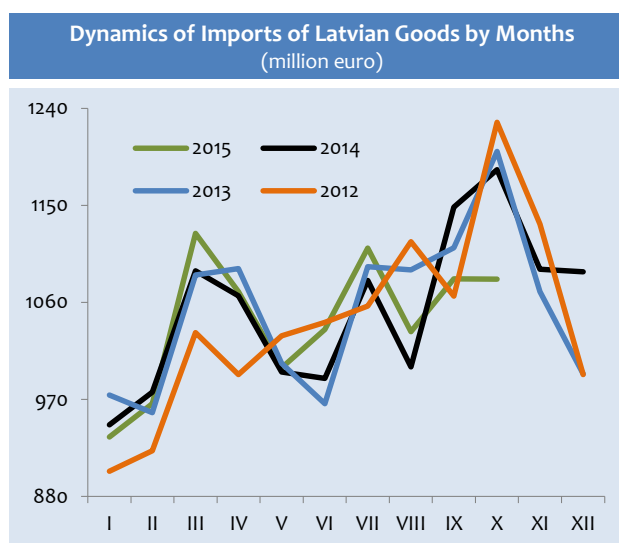


Table 3.7

Imports by the Main Commodity Groups (%, at current CIF prices)				
	2014		2015 I-XI	
	structure	changes	changes compared to the corresponding period of the year before	contribution to the changes in volumes
Total	100	0.2	-0.5	-0.5
including:				
agriculture and food products	15.8	-0.4	-3.4	-0.5
mineral products	14.5	-15.2	-19.1	-2.8
production of the chemical industry and related industries; plastics	15.3	2.3	4.8	0.7
light industry products	6.0	-1.4	-8.8	-0.5
wood and wood products	2.6	33.3	13.8	0.4
metal and metal articles	8.3	-4.5	-3.6	-0.3
machinery products	20.1	9.1	10.1	2.0
vehicles	7.7	0.8	5.5	0.4
other goods	9.8	6.1	1.4	0.1

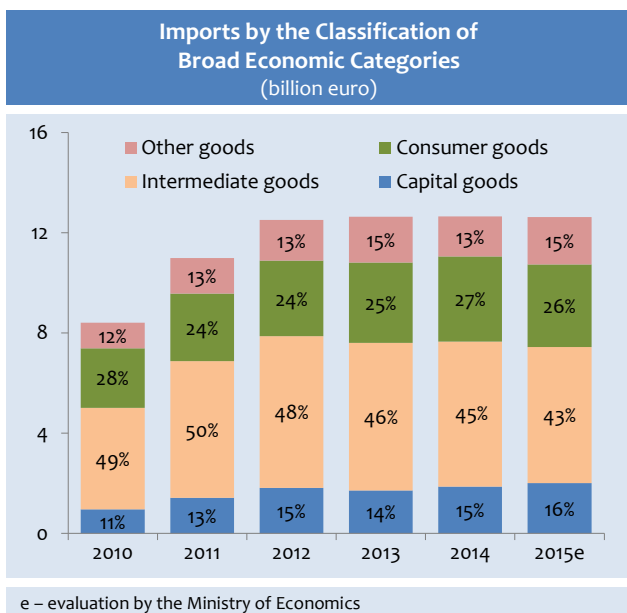
In 2014, the exports of goods to CIS countries fell by 5%, and significantly faster in January-November 2015 – by 20.4%. This was due to the significant decrease in exports to Russia (by 25.5%). This decline was driven mainly by a significant reduction in value of the Russian currency, as well as the sanctions introduced on imports of certain food products. The exports of products of chemical industry, wood and its products also fell. During this period, exports to CIS countries grew only in the group of machines, appliances and electrical equipment.

The small increase in imports of goods in 2014 was positively influenced by the growth of imports of machinery, appliances and electrical equipment, wood and its products, as well as production of the chemical industry, but negatively affected mainly by a decrease in the imports of mineral products. In eleven months of 2015, imports of goods were positively influenced by the same groups of goods as in 2014. By contrast, the imports of mineral products and agricultural and food products fell significantly during the said period. It was mainly due to the significant drop in the prices of oil and food products.

In 2014, imports from the EU countries increased along with the total imports, but it fell by 1.7% in January-November 2015.

In 2014, imports from CIS countries fell (by 3.2%) due to a significant decrease in the value of imports of mineral products. A similar trend remained in eleven months of 2015, when the imports of goods from CIS countries fell by 1 per cent.

Figure 3.17

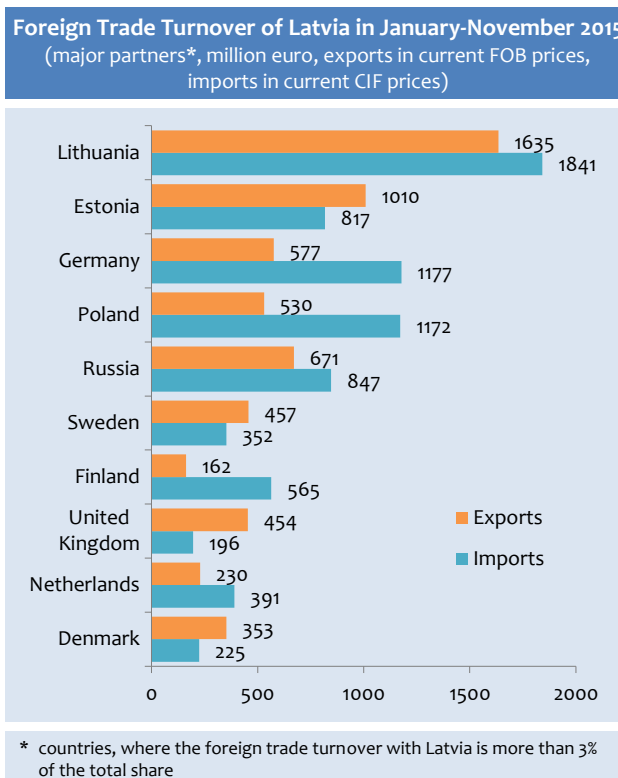


Until 2009, with the investment volume decreasing, the share of imports of capital goods also decreased, while the share of imports of consumer goods decreased from 2009 to 2012. Over the last three years, the share of capital goods in the imports structure has increased a bit, while the share of intermediate goods has been

decreasing. The share of consumer and other goods in Latvian imports does not change significantly.

The major **trade partners** of Latvia in January-November 2015 were Lithuania – 18% of the total foreign trade turnover, Estonia – 10%, Germany and Poland – 9% each, Russia – 8%, Sweden and Finland – 4% each, and the United Kingdom, the Netherlands and Denmark – 3% each.

Figure 3.18

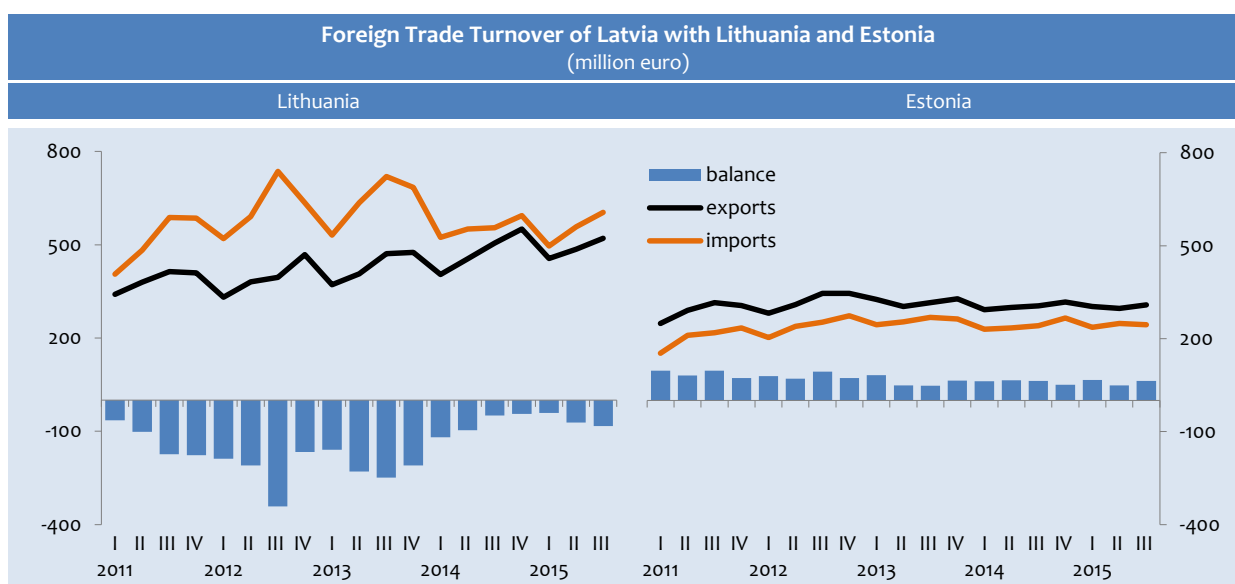


The neighbouring countries of Latvia – **Lithuania and Estonia** – have traditionally been the major trading partners of Latvia. During the years of rapid growth, with the imports growing significantly, trade balances of Latvia became explicitly worse with both countries. In the second half of 2008, the balance with Lithuania and Estonia began to improve gradually.

In recent years, foreign trade balance with Estonia remained above 10% of the total trade turnover, while the balance with Lithuania became slightly worse in 2012-2013 mainly due to more rapid imports of mineral products and agricultural and food products. In 2014, due to reduced prices of oil and food products around the world, the value of imports of these groups fell sharply, and the negative trade balance with Lithuania decreased significantly in 2014-2015.

The main groups of products for the foreign trade with both Baltic States in 2015 were machinery, appliances and electrical equipment, agricultural and food products, products of chemical industry, and mineral products.

Figure 3.19



Exports and imports of services

During the crisis, exports of services decreased less than exports of goods. In 2011-2012, exports of services grew in a stable manner, as well as exports of goods. The positive balance of services in 2012 covered 64% of the

negative balance of trade in goods, but in 2013 – 70%, due to the trade balance improving significantly. This trend continued in 2014, when the positive balance of services covered 77% of the negative balance of trade in goods, but in three quarters of 2015 – 76 per cent.

Table 3.8

Exports and Imports of Services (per cent)									
	2014				2015 I-IX				
	structure		changes		structure		changes compared to the corresponding period of the year before		
	export	import	export	import	export	import	export	import	
Total	100	100	-1.2	-0.9	100	100	5.1	8.5	
Transport services, including:	43.1	30.7	-4.9	4.6	40.2	32.8	0.5	9.0	
– sea transport	11.0	7.0	-6.1	0.0	10.9	6.3	8.3	-8.5	
– air transport	6.8	10.4	-9.2	4.6	6.7	12.7	7.2	24.6	
– rail transport	10.7	3.9	0.7	7.9	10.5	4.5	0.3	17.4	
– road transport	13.5	9.0	-8.3	6.6	10.9	8.8	-9.0	0.3	
– other transport	1.2	0.5	19.1	5.9	1.3	0.5	-4.4	16.4	
Travel	16.7	25.3	10.6	-0.3	20.1	24.6	12.5	2.3	
Other services, including:	40.2	44.0	-2.2	-5.1	39.7	42.6	6.4	11.9	
– construction services	3.1	3.1	5.6	-11.7	2.1	1.8	-32.8	-28.8	
– financial and insurance services	9.9	9.8	8.6	-18.9	11.5	9.5	14.1	29.9	
– communication services	2.5	3.4	-2.2	-2.8	2.5	3.6	10.8	22.0	
– information and computer services	4.7	4.8	6.7	-8.1	6.2	4.8	30.5	16.2	
– other commercial services	18.7	21.3	-11.6	2.4	16.2	21.5	1.9	8.7	
– other services	1.2	1.5	0.3	-5.4	1.2	1.4	0.5	1.7	

Slightly less than a half of the exports of services generally consist of income from transportation. Year 2014 was not very successful for transport services – the volume of this export group fell by 4.9%. The exports of road transport and sea transport fell, and they were compensated a little by an increase in carriage by rail and exports of other transport services. In three quarters of 2015, the volumes of exports of transport services remained at the level of the year before.

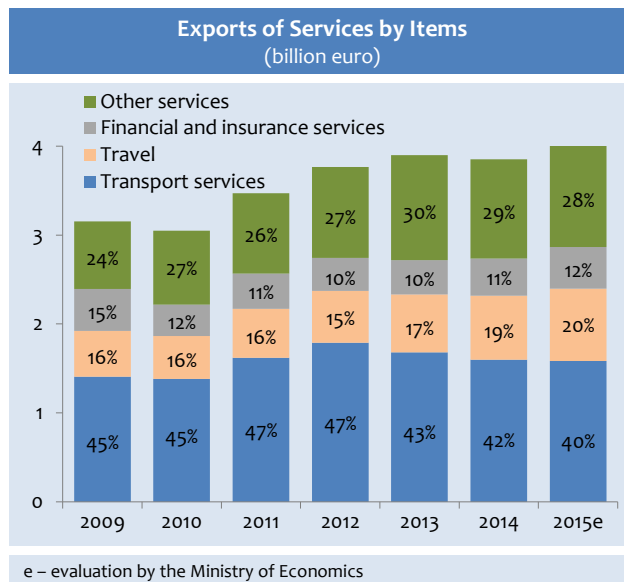
Both in 2014 and January-September 2015, the income from foreign tourists grew in a stable manner, as usual.

A half of the total exports of the Latvian services are related to the EU countries. The amount of exports to the EU countries decreased a little in 2014, but in three quarters of 2015, it grew by 10.3%. Travel and transport services by road and sea constitute the largest share of exports of services to the EU countries.

The volume of services exports to CIS countries constitute a little more than 10% of the total services exports. In 2013, the services exports to CIS countries grew sharply. By contrast, with the volume of exports of transport services decreasing in 2014, the total services exports also decreased a little. It was partially compensated by an increase in the income from tourists travelling from CIS countries. In three quarters of 2015, similarly to 2014, the volumes of exports of transport services decreased. The income from tourists from CIS

countries also shrank. It was compensated by exports of other commercial services (exports of finance and insurance, communications and information technology). In total, the exports of services to CIS countries grew by 6.3% in three quarters of 2015.

Figure 3.20



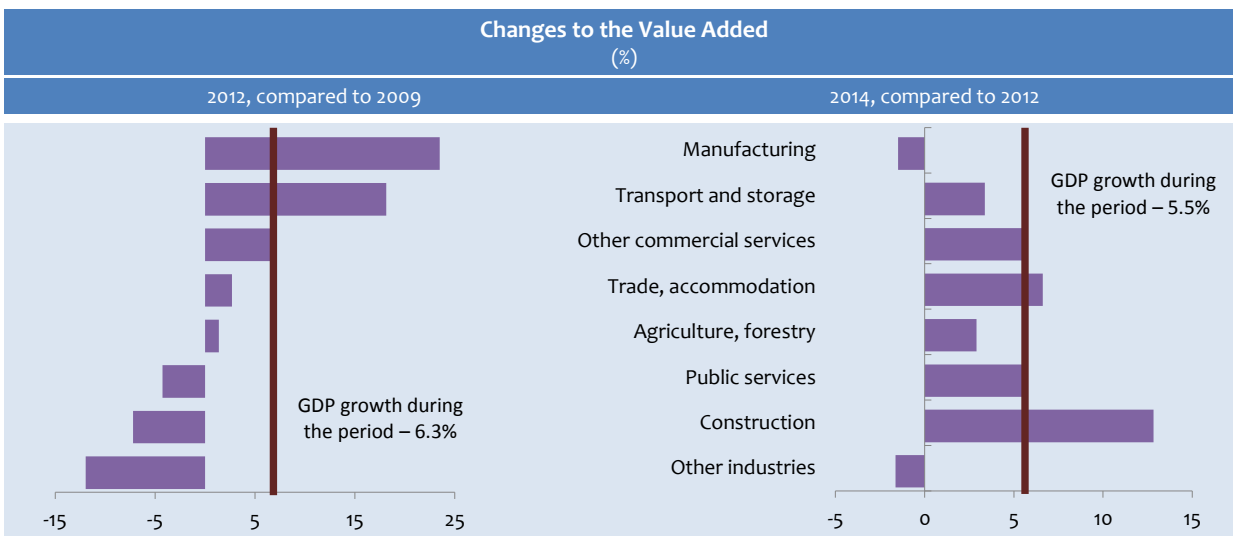
3.2 Contribution of Sectors

3.2.1 Development Trends of Sectors

After a significant decrease in the volume during the crisis, tradeable sectors recovered first due to competitiveness improvements and export opportunities. In 2012, production volumes in the manufacturing – the

main sector of exports – exceeded the level of 2009 by 23.5%. In the manufacturing, growth rates were significantly faster than the overall economic growth, and manufacturing became the main driver of economic growth.

Figure 3.21



Growth of tradeable sectors and an increase in earnings from export gradually facilitated an increase in

domestic demand and, respectively, growth of domestic market-oriented industries.

Table 3.9

Structure of the Economy (by value added, %)							
	2000	2005	2009	2011	2012	2013	2014
Agriculture, forestry	5.1	4.3	3.3	4.4	3.7	3.4	3.3
Manufacturing	15.4	13.0	10.8	13.4	13.0	12.6	12.2
Other industries	4.2	3.2	3.6	5.4	4.7	4.6	4.4
Construction	7.0	6.7	10.0	5.0	6.4	6.5	6.8
Trade, accommodation	15.4	18.0	15.7	17.2	15.8	15.8	15.8
Transportation and storage	11.9	12.3	9.3	10.5	10.5	10.2	10.1
Other commercial services	23.9	27.3	30.4	28.2	30.9	31.7	32.2
Public services	17.1	15.1	16.9	15.9	15.0	15.2	15.3
Total	100	100	100	100	100	100	100

In recent years, due to a gradual decline in the cost competitive advantages acquired during the crisis, as well as due to the geopolitical situation, export growth slowed down, resulting in slower growth of tradable sectors. Domestic market-oriented sectors – trade and commercial services – have contributed more to the

growth. From 2011 to 2014, relatively fast growth rates were observed in the construction, which experienced the biggest drop during the crisis. With the national budget expenditure growing, the volume of public services is also increasing.

Table 3.10

Dynamics of GDP (changes compared to the corresponding period of the year before, %)						
	2009	2010	2011	2012	2013	2014
Agriculture, forestry	12.7	-3.9	-1.7	7.4	1.2	1.6
Manufacturing	-22.1	14.2	3.7	4.3	-1.2	-0.3
Other industries	6.8	-1.5	-5.2	-5.7	1.6	-3.1
Construction	-38.3	-34.4	29.9	8.9	4.4	8.1
Trade, accommodation	-16.3	-1.6	2.9	1.3	4.2	2.3
Transportation and storage	-22.4	-4.9	17.9	5.5	0.2	3.2
Other commercial services	-6.7	-3.9	6.1	5.1	3.9	1.6
Public services	-9.9	-6.9	3.0	-0.2	2.4	3.3
GDP	-14.3	-3.8	6.2	4.0	3.0	2.4

A moderate growth has been observed in **agriculture and forestry** in recent years. Year 2014 started on a positive note in agriculture and forestry, and production volumes grew in the industry in the first half of the year. In the second half of 2014, the agriculture industry was affected by Russia's restrictions on food import. In total, production volumes in this industry grew by 1.6% in 2014. The volumes of crop production grew by 0.4% in 2014, whereas the volumes of livestock production – by 4.8%. The volumes of cut wood also grew a little in 2014.

In 2015, despite Russia's restrictions on food imports, growth continued in agriculture and forestry industries. Even though the production volumes in agriculture and forestry in Q1 2015 were by 7% lower than a year before,

the production volumes in the first three quarters in total were by 1.6% higher than a year before. The fall in Q1 was mostly due to the situation in the forestry. The relatively warm weather at the beginning of the year restricted the possibility of taking timber out from felling areas. By contrast, growth was observed in the sector in the following quarters. It was largely facilitated by a record-high yield of grain, as well as the growth of the wood processing sector and the steady demand for timber.

In 2014 and 2015, the weak demand in export markets continued to slow down the growth of the **manufacturing**. In 2014, production volumes were by 0.3% lower than a year before. In ten months of 2015,

output volumes of the manufacturing were by 3.9% higher than in the corresponding period of 2014. Wood-processing, manufacture of basic metals, production of

computers, electrical and optical equipment, as well as machinery and equipment had the greatest positive contribution to the growth of the manufacturing.

Table 3.11

GDP by Quarters (change compared to the corresponding period of the year before, %)												
	2013				2014				2015			
	I	II	III	IV	I	II	III	IV	I	II	III	
Agriculture, forestry	2.1	0.5	-0.3	4.2	8.8	5.2	-6.4	3.3	-7.0	4.2	4.9	
Manufacturing	-5.8	-1.9	1.1	1.3	1.2	0.1	-0.6	-1.7	4.4	6.2	3.7	
Other industries	3.6	6.4	0.6	-3.7	-7.4	-5.2	-1.6	2.3	-4.1	4.2	5.9	
Construction	6.3	2.3	8.5	0.9	24.6	15.8	0.6	4.4	-0.1	-3.4	4.9	
Trade, accommodation	5.7	5.3	4.7	1.7	2.6	2.1	2.5	2.0	0.6	4.3	6.0	
Transportation and storage	0.3	-0.8	-0.4	1.8	5.1	2.2	2.3	3.1	-1.5	-4.3	1.7	
Other commercial services	2.7	4.3	5.1	3.5	1.8	-0.1	4.0	0.9	1.6	3.5	0.5	
Public services	-0.2	2.6	3.4	3.1	3.3	3.4	3.3	3.3	3.9	3.2	3.4	
GDP	2.2	3.3	3.7	2.8	2.7	2.3	2.3	2.1	1.8	2.7	3.3	

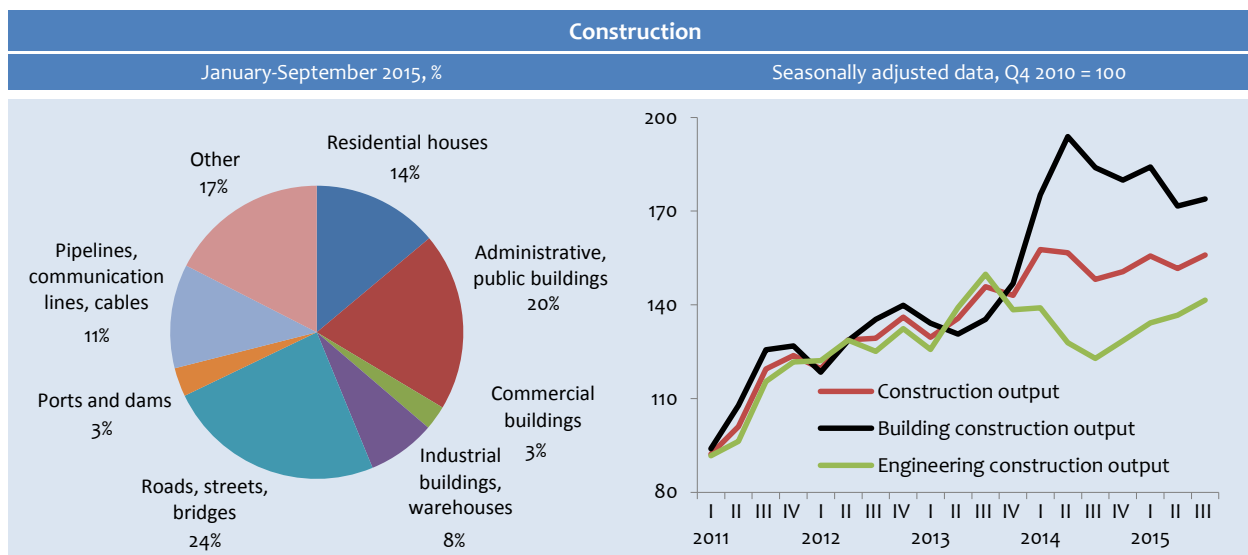
Production volumes in **other industries** (mining and quarrying, electricity, gas supply, heat supply, water supply, sewerage, waste management and remediation activities) dropped by 3.1% in 2014. This was mainly due to the weather, resulting in smaller volumes of electricity and heat produced.

By contrast, growth was observed in other industries in 2015. After a drop in volumes in early 2015, production volumes in other industries grew considerably

in Q2 and Q3, and, in total, growth in other industries reached 1.3% in three quarters of the year.

Growth of **construction** is largely related to public procurements and projects of EU funds. After a rapid increase in construction volumes in the first half of 2014, growth rate of the sector slowed down at the end of the year. In total, growth of construction reached 8.1% in 2014.

Figure 3.22



The construction volumes of both residential and non-residential buildings had an equally rapid increase in 2014 (31.1% and 34.6% respectively). In the category of non-residential buildings, the construction volumes of hotels and buildings of similar usage experienced the most rapid increase. In 2014, a moderate increase in

volumes could be observed in the construction of industrial buildings and warehouses. Construction volumes of duplexes experienced the most rapid growth in the category of residential housing.

Civil engineering construction volumes decreased by 10.4% in 2014. The most rapid decrease was observed in

construction of ports and dams, as well as bridges and tunnels, while construction volumes of industrial complex buildings increased.

In the first half of 2015, growth of construction was weak. In the third quarter, construction volumes grew by 4.9% in annual terms, and, in total, construction volumes in three quarters of 2015 were by 1.1% higher than a year before.

Contrary to the trends in 2014, growth of construction in 2015 was mainly ensured by civil engineering construction volumes that were by almost 10% higher in the first three quarters of 2015 than a year before. An increase in the volume of road construction contributed the most to the growth, while the construction volumes of bridges, main pipelines, and communication lines decreased.

In three quarters of 2015, the volumes of building construction were by 5.8% lower than a year before. In the category of residential buildings, the construction volumes of single-apartment houses grew in 2015, while the volume of construction of apartment houses decreased significantly. By contrast, in the construction of non-residential buildings, reduction in the volume was mainly driven by a decrease in construction volumes of wholesale and retail trade buildings, educational institutions, as well as administrative buildings, partly compensated by an increase in construction volumes of

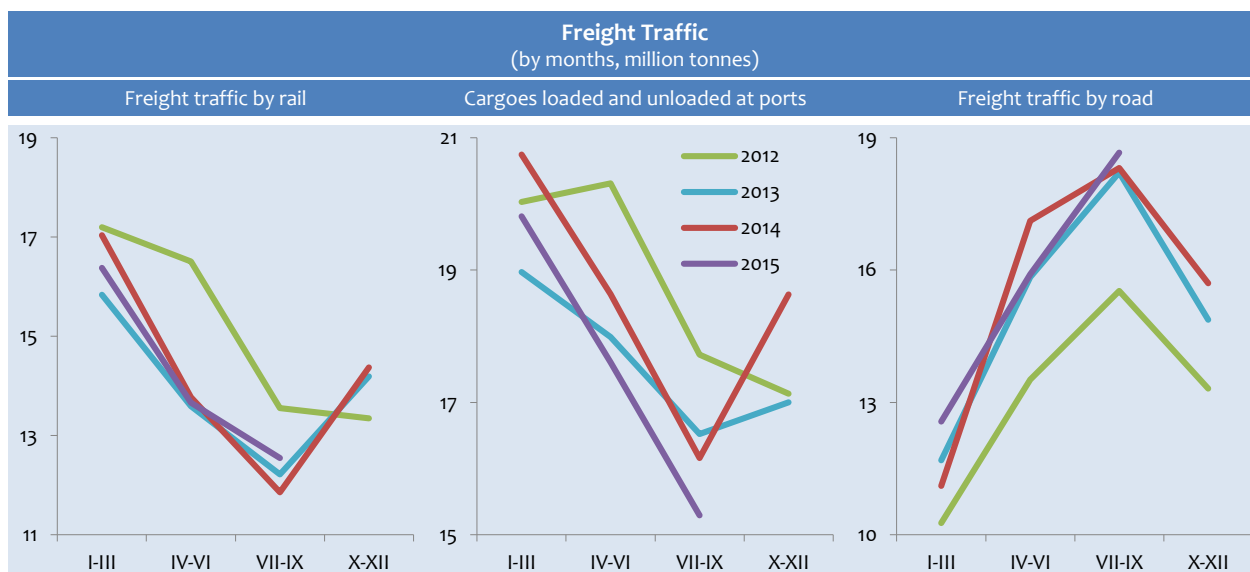
hotels, sports facilities, museums, as well as industrial buildings and warehouses.

It should be noted that, after a significant decline at the end of 2014 and in early 2015, the number of building permits issued has resumed growing over the last few quarters. In Q3 2015, 1362 building permits were issued. The majority (63%) of the building permits issued were issued for construction of new buildings (mainly construction of single-apartment houses and other non-residential buildings).

The volumes of services provided in the **transportation and storage** sector grew by 3.2% in 2014. The growth of the transportation and storage in 2014 was largely facilitated by successful operations of ports – the volumes of freight shipped to/from ports increased by 5.2%. At the same time, the volumes of rail freight increased by 2.2%, while the volumes of freight transport by road – by 2.7 per cent.

Year 2015 was not as successful for the transportation and storage industry. In three quarters of 2015, the volumes of services provided in the transportation industry were by 1.3% lower than a year before. The drop was largely driven by a decline in the freight turnover by rail and in ports. In the first ten months of 2015, the volume of freight transport by rail and in ports was by 5.2% and 0.6% lower, respectively, than a year before.

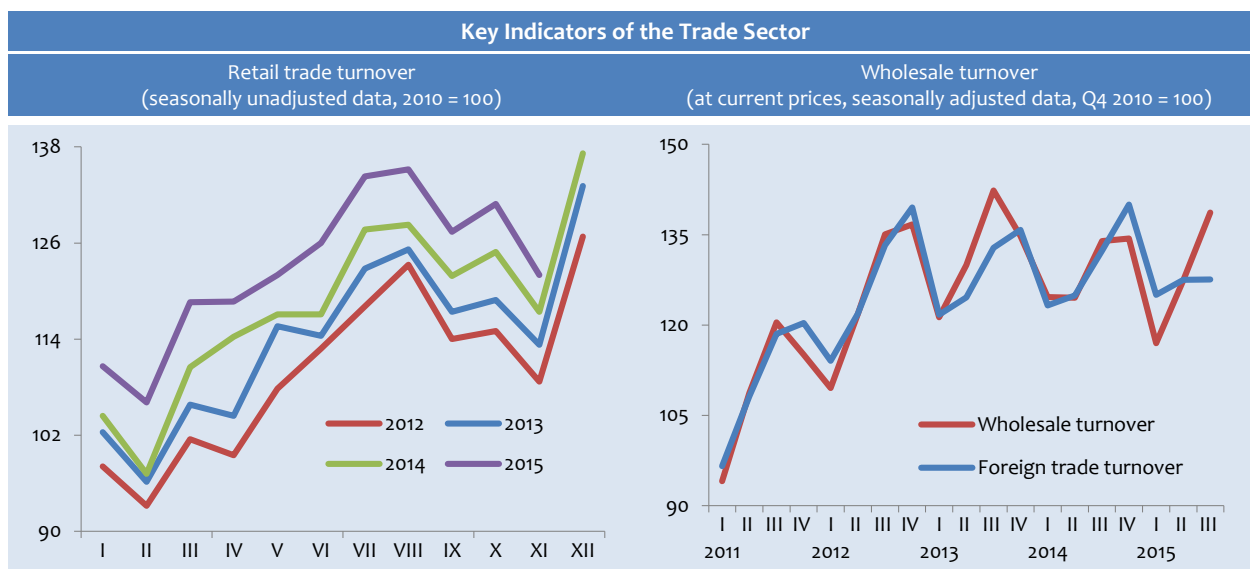
Figure 3.23



The volume of services provided in the **trade** sector continues to grow. The growth of the trade sector (including accommodation and catering services) reached 2.3% in 2014. By contrast, the volumes of services provided in the sector in the first three quarters of 2015 were by 3.9% higher than a year before. Trade sector was positively influenced by an increase in private consumption and retail turnover. Weak foreign trade activities, in their turn, affect the wholesale.

Retail trade turnover grew by 3.6% in 2014. Non-food retail sales increased by 2.8% during this period. Increase in the sales of clothing, footwear, and household appliances, as well as retail sales via mail and online stores contributed the most to the growth. Food retail grew by 3.4% in 2014. Retail sales of automotive fuel, in its turn, increased in 2014 after a reduction in 2013, especially at the end of the year, when retail prices of fuel decreased due to global oil price cuts. In total, fuel retail sales grew by 5.8% in 2014.

Figure 3.24



A rapid increase in retail sales was also observed in 2015. In eleven months of the year, total retail turnover was by 5.2% higher than a year before. During this period, retail sales in the non-food products group increased by 5.9%. Increase in retail sales of electronics and electrical goods contributed the most to the growth. Retail trade via mail or online stores also had a major contribution to the growth.

Increase in the automotive fuel retail sales is still stimulated by relatively low fuel prices. In the first eleven months of 2015, automotive fuel retail sales were by 9.2% higher than a year before. This accounted for more than a quarter of the total retail sales growth.

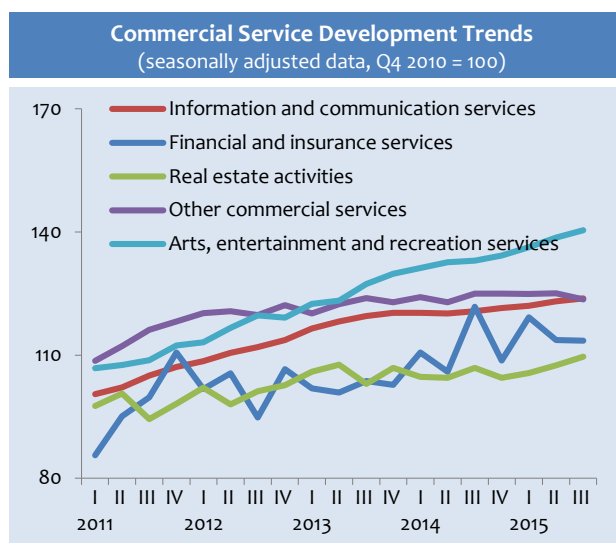
Retail sales of food grew slower in January-November 2015 – by 2.8%, compared to the corresponding period of the year before.

Development trends of the wholesale industry were greatly affected by foreign trade activities. With the export and import growth rates slowing down, the turnover dynamics of wholesale companies are moderate. Wholesale turnover at current prices decreased by 2.1% in 2014. Increasing economic activity in 2015 had a positive impact on the wholesale sector, where the volumes of services provided in the third quarter at current prices was by 3.6% higher than in the corresponding period of 2014. However, taking into account the huge decrease in wholesale turnover in Q1 2015, the total wholesale turnover in the first three quarters of 2015 was essentially at the level of the corresponding period of the year before.

Growth in the sectors of **commercial services** was more moderate in 2014 than on average from 2011 to 2013. Service volumes in the sectors of commercial services grew by 1.6% in 2014. The rise was mainly facilitated by the growth in financial and insurance activities (an increase of 9.2%), as well as arts, entertainment and recreation industry (an increase of 5.6%). At the same time, moderate growth was observed

in the information and communication services sector, while a small decline could be observed in real estate activities.

Figure 3.25



In the three quarters of 2015, the volumes of commercial services were by almost 2% higher than a year before. The increase was primarily based on a more rapid growth in arts, entertainment and recreation industry. In 2015, service volumes increased steadily also in financial and insurance activities, operations with real estate, and information and communication services.

With the national general budget expenditure growing, the volume of services provided in the sectors of **public services** is also increasing. They grew by 3.4% in 2014. The volumes of services provided in the sector continued to grow in 2015, and in the first three quarters they were by 3.5% higher than in the corresponding period of 2014.

3.2.2 Manufacturing

During the crisis, with the costs going down, the competitiveness of the Latvian producers improved. This facilitated the development of the manufacturing industry. From 2010 to late 2012, the output of the industry experienced a rapid increase, and the manufacturing contributed significantly to the total development of the economy.

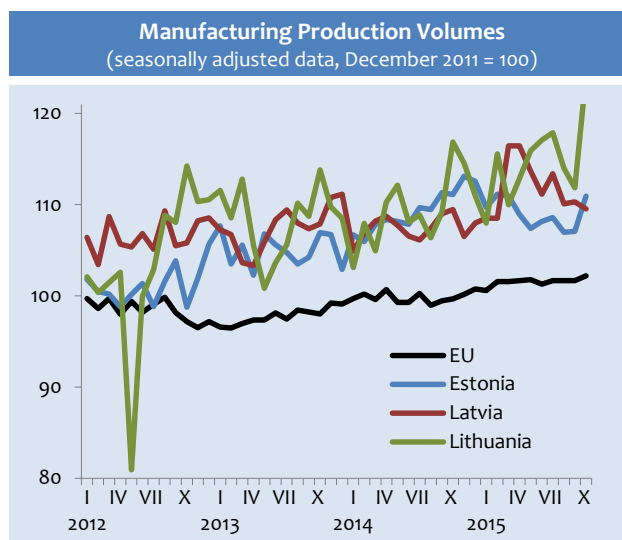
Reduction of the competitive advantages acquired during the crisis, as well as the weak demand in export markets have slowed down the growth of the manufacturing. In 2013, production volumes in the manufacturing increased only by 0.1%. The manufacturing was significantly affected by cessation of operations of Liepājas Metalurģis JSC.

In 2014, production output volumes of the manufacturing were by 0.3% lower than a year before. The growth of the sector was still affected by trends in the foreign markets – slower than expected economic growth in the EU, as well as the weak economic situation in Russia.

At the same time, development trends in the sub-sectors of manufacturing differ considerably. Production volumes in one of the largest sectors of manufacturing – wood-processing – grew steadily in 2014, and the output of this sector was by 6.9% higher than a year before.

Export volumes and domestic demand for production of the said sector grow steadily.

Figure 3.26



The sharpest increase in production volumes in 2014 was in the production of electrical and optical equipment. A moderate growth in 2014 was observed in the production of non-metallic mineral products, as well as manufacturing of machinery and equipment.

Table 3.12

Structure of the Manufacturing in 2015*			
	Structure of the Manufacturing in 2015* (%)		
	By output	By the number of occupied posts	Share of exports in the sales of the sector
Manufacturing – total	100	100	64.0
Food and beverage production	23.5	20.7	34.4
Light industry	3.9	10.1	86.8
Wood processing	27.1	21.1	74.7
Paper industry and publishing	4.3	4.1	61.5
Chemical industry and related industries	7.5	7.1	76.1
Production of other non-metallic mineral products	6.1	4.5	47.6
Production of metals and metal articles	9.1	10.2	67.8
Production of electrical and optical equipment	7.1	3.8	90.9
Production of machinery and equipment	2.3	2.9	85.2
Production of vehicles	3.6	3.3	88.6
Other manufacturing industries	5.5	12.2	58.5

* – evaluation by the Ministry of Economics

The production volumes in the production of food and beverages in 2014 were by 0.1% higher than a year before. After a successful beginning of the year, the food industry at the end of the year was affected by the Russian embargo on imports of food. In 2014, a decrease in production volumes was observed in the light industry,

chemical industry, vehicle manufacturing, as well as metalworking, affected by the downtime at Liepājas Metalurģis JSC.

In 2014, the total turnover of the manufacturing decreased by 1.4%. Turnover of products sold in the domestic market decreased by 1.2%, while the turnover

of exported products – by 1.5%. The total turnover of the manufacturing was positively influenced by the sharp increase in the turnover of woodworking (by 9.7%). In general, a small increase in 2014 was observed in the production of food and beverages, and production of

non-metallic minerals. By contrast, decrease was mostly due to the drop in metalworking turnover that was related to ceasing the operation of KVV Liepājas Metalurģs JSC.

Table 3.13

Changes in the Production Volumes of the Manufacturing (%, compared to the corresponding period of the year before)						
	2010	2011	2012	2013	2014	2015 I-XI
Manufacturing – total	16.5	11.7	9.3	0.1	-0.3	4.1
Food and beverage production	-0.1	-0.2	2.5	6.0	0.1	-5.0
Light industry	19.4	19.4	3.0	1.4	-13.6	-15.2
Wood processing	33.0	12.6	5.4	2.7	6.9	6.3
Paper industry and publishing	19.8	-0.5	10.1	5.6	-0.6	-0.8
Chemical industry and related industries	5.2	4.4	8.3	-8.7	-2.6	-5.8
Production of other non-metallic mineral products	17.6	24.2	8.6	4.6	1.2	-8.7
Production of metals and metal articles	24.2	28.3	16.3	-17.6	-10.5	..*
Production of electrical and optical equipment	33.2	29.6	19.9	18.4	32.3	16.0
Production of machinery and equipment	17.8	37.1	8.7	1.4	2.4	9.8
Production of vehicles	59.0	37.0	15.8	3.0	-15.2	4.4
Other manufacturing industries	-4.9	9.5	26.1	-7.6	-12.0	2.5
* – confidential data						

In the eleven months of 2015, output volumes of the manufacturing were by 4.1% higher than in the corresponding period of 2014. Wood-processing, manufacture of basic metals, production of computers, electrical and optical equipment, as well as machinery and equipment manufacturing had the greatest positive contribution to the growth of the manufacturing.

Production volumes are growing steadily in the largest industrial sector – wood-processing. In the eleven months of 2015, production volumes were by 6.3% higher than a year before. Metalworking, which is affected by the resumed operations of one of the largest industrial enterprise KVV Liepājas Metalurģs, contributed significantly to the total growth of the manufacturing in 2015.

In 2015, a sharp increase in production volumes continued in the manufacturing of computers, electrical and optical equipment – an increase of 16% in January-November compared to the corresponding period a year before. Over the year, production volumes have also grown in the manufacturing of machinery and equipment, as well as manufacturing of vehicles.

In January-November 2015, output volumes in the food industry were by 5% lower than a year before. Development of the industry is substantially affected by Russia's sanctions imposed on imports of certain food products.

In the first eleven months of 2015, production volumes were lower than a year before also in the light industry, production of non-metallic mineral products,

chemical industry, paper manufacturing, and printing and publishing industry.

With the producer prices remaining low in 2015, increase in the turnover of the manufacturing was moderate. In total, the turnover of the manufacturing in the first eleven months of 2015 basically remained at the level of the corresponding period of the year before. Turnover of products sold in the domestic market decreased by 5.5% during the said period, while the turnover of exported products increased by 3.5%. Woodworking, manufacturing of electrical and optical equipment, as well as metalworking had the largest positive impact on the increase in the total turnover. By contrast, production of non-metallic mineral products, where the turnover in eleven months was by 7.7% lower than a year before, had the largest negative impact.

In the eleven months of 2015, 64% of the production of the manufacturing was exported. Almost $\frac{3}{4}$ of the total exported production was sold in the EU markets. Exports to CIS countries, in their turn, constituted 11% of the total exports of production of the manufacturing in the first eleven months of 2015, which was significantly less than in 2014. A decrease in exports to Russia and other CIS countries was due to the weak economic situation in Russia and Russia's restrictions on food imports set in August 2014. The share of third countries in the export structure of the production of the manufacturing has increased compared to 2014, which indicates that Latvian producers are able to find new markets.

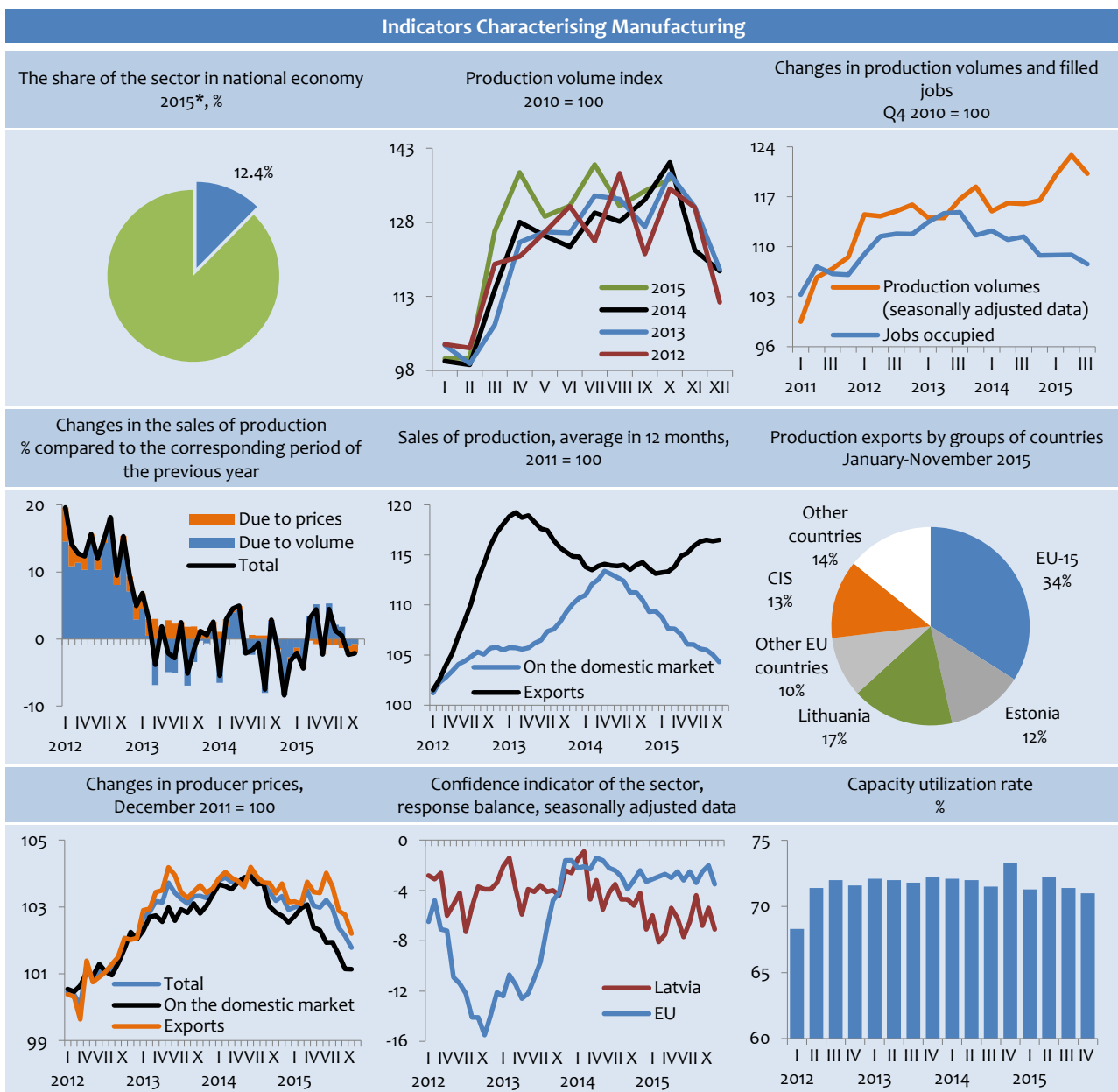
During the post-crisis years, manufacturing contributed significantly to job creation in the economy – in 2011 and 2012, the sector accounted for almost a fifth of all new jobs. At the same time, the increase in the number of people employed in the sector was significantly slower than the increase in production volumes, which indicated increase in productivity.

Since 2013, with the growth of the sector slowing down, the demand for labour has fallen. In 2014, the number of jobs occupied in the manufacturing was by 2.5% lower than a year before. This was most significantly affected by the reduced number of jobs in metalworking, light industry, and food and beverage production. At the same time, an increase in the number of occupied jobs in 2014 was observed in woodworking, chemical industry, manufacturing of electrical and optical

equipment, as well as production of non-metallic minerals. By contrast, the number of jobs occupied in the manufacturing continued to decrease in 2015 – in the third quarter, it was by 3.5% lower than a year before.

Since mid-2012, production capacity utilization rate in the manufacturing has remained relatively high – 71-73%. The capacity utilization rate was 72.2% in Q4 2015. By contrast, the confidence evaluation of Latvian producers became worse as of March 2014 after a period of certain stability in 2011-2013, reaching the lowest level at the end of 2014 and the beginning of 2015. This was largely due to the developments in Ukraine and the economic situation in Russia becoming worse. Since the spring of 2015, the evaluation of manufacturing companies in relation to their future prospects has not become significantly worse.

Figure 3.27



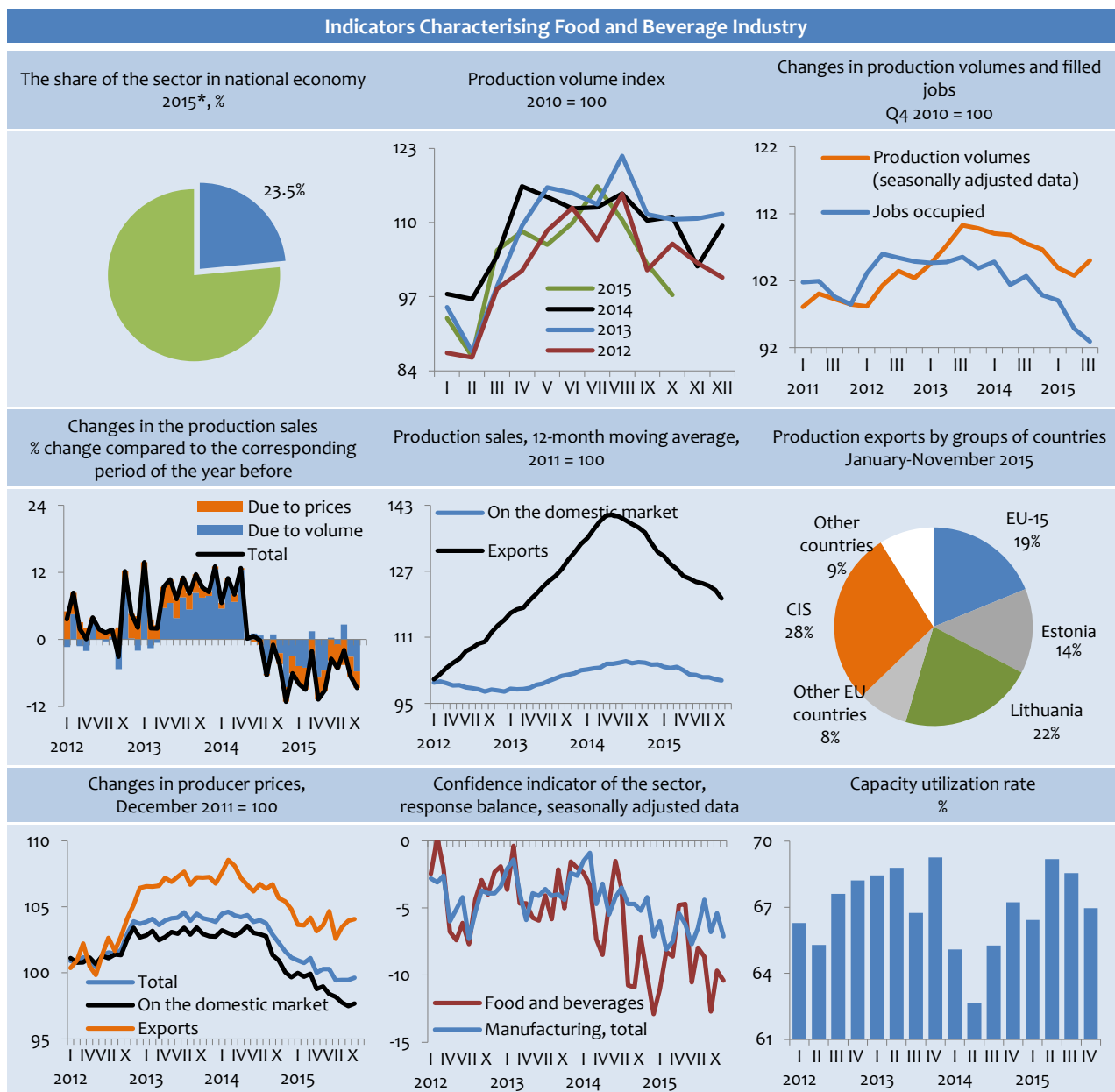
Food and beverages production is the second largest sector of the manufacturing in terms of both the output and the number of jobs occupied. The sector sells more than a third of its production in external markets. Russia's economic problems, as well as Russia's embargo on food products have had a significant impact on development of the sector. In 2014, 41.2% of all exported production was sold in CIS markets, while in the first eleven months of 2015 – only 28.3 per cent.

Due to a more rapid increase at the beginning of the year, the output of the food and beverages production industry in 2014 was by 0.1% higher than a year before. By contrast, in the eleven months of 2015, production volumes were by 4,8% lower than a year before.

A drop in prices of food producers and a decrease in output have significantly affected the industry's turnover. The total turnover grew by 0.3% in 2014, while the turnover of exported production fell by 1.5%. In the first eleven months of 2015, industry turnover was by 6.1% lower than a year before, whereas the turnover of exported production decreased by 9.5 per cent.

Decrease in the production volumes affects the number of people employed in the industry. The number of jobs occupied decreased by 2.4% in 2014, while in the first three quarters of 2015, it was by 7.1% lower than a year before.

Figure 3.28



Production volumes have been falling in the **light industry** in recent years. Development of the industry is closely related to changes in demand and competitiveness in the external markets.

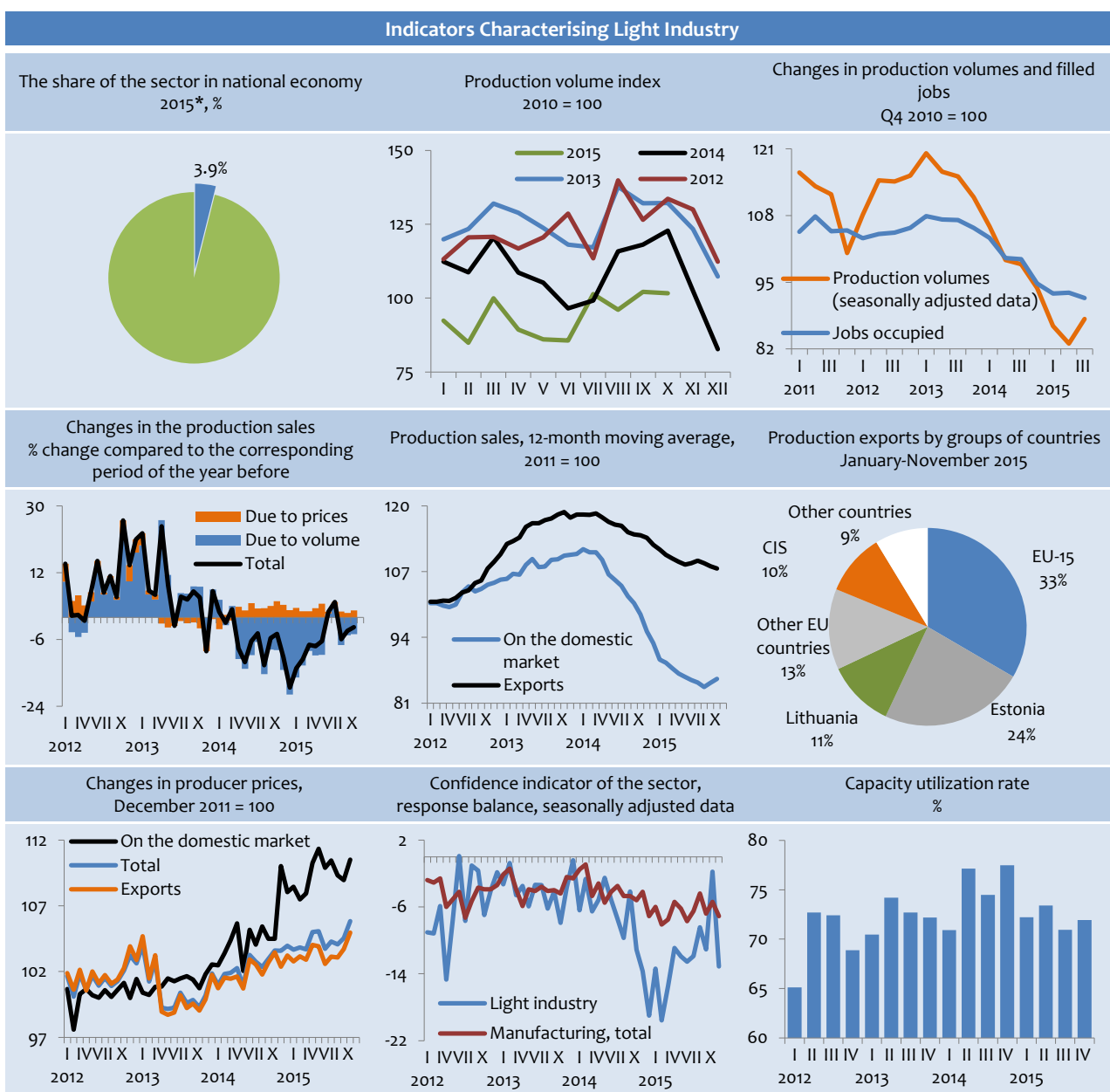
In 2014, production volumes in the light industry decreased by 13.6%. In 2015, production volumes continued to fall – in the eleven months of the year, they were by 14.2% lower than a year before. Production volumes are falling in the manufacturing of both clothing and textiles.

Due to the rise in producer prices, the industry’s turnover decreases at a slower pace than the output volumes. In 2014, turnover in the light industry decreased by 6.7%. Sales of exported production decreased by 5%,

while the turnover of production sold on the domestic market – by almost 15.9%. The industry’s turnover continued to decrease in 2015. In the eleven months of 2015, the turnover was by 4.1% lower than a year ago. During the said period, the turnover of exported production decreased by 4.8%, while the turnover of production sold on the domestic market – by 6.2%.

During the post-crisis years, the growth of the industry was largely ensured by an increase in productivity, while the number of jobs has been decreasing since 2013. The number of jobs occupied in the industry decreased by 7.1% in 2014, while in the first three quarters of 2015, the number of jobs in the light industry was by 8.3% lower than a year before.

Figure 3.29



Due to a steady growth in recent years, **wood processing** has become the largest sector of the manufacturing in terms of both the production volumes and the number of jobs. Approximately 75% of the production is exported. The largest export market is the EU-15 countries.

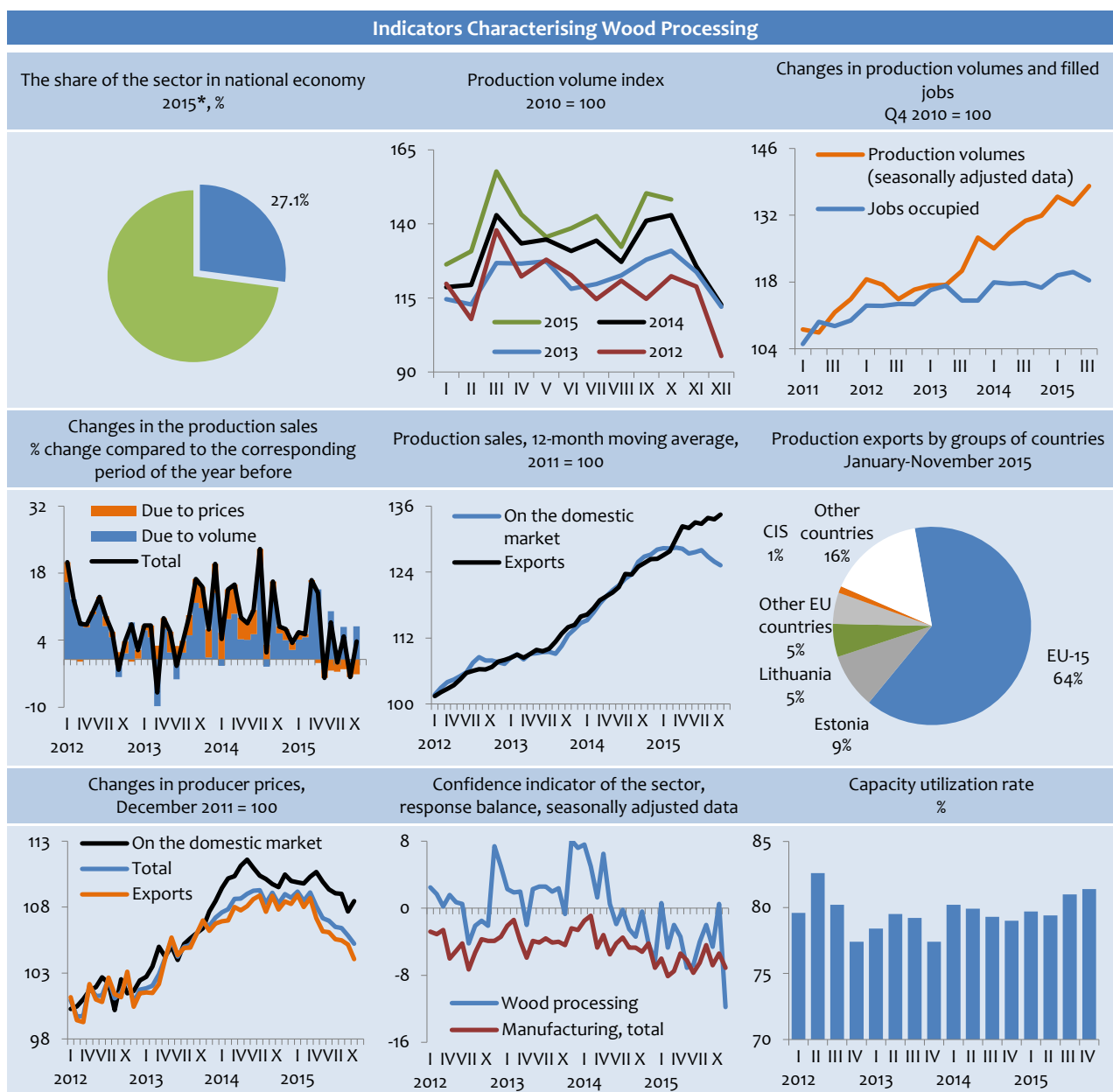
In 2014, production volumes were by 6.9% higher than a year before, while in the eleven months of 2015, production volumes were by 6.3% higher than a year before. The industry accounts for 27% of the total manufacturing output.

In 2014, the turnover of the wood-processing industry grew by 9.7%. Sales volumes in the domestic

market and export markets grew at a similar pace. In 2015, a drop in producer prices affected the industry's turnover. In January-November, the turnover of the woodworking industry was by 4.7% higher than a year before. At the same time, turnover of the exported production increased by 7.3%. By contrast, sales volumes in the domestic market decreased by 2.4 per cent.

Compared to the increase in production, the number of jobs in the industry is growing at a considerably more moderate rate, indicating an increase in productivity. The number of jobs occupied increased by 1.8% in 2014, whereas in the first three quarters of 2015, the number of jobs occupied was by 1.3% higher than a year before.

Figure 3.30



During the post-crisis years, *the paper industry and publishing* successfully reoriented from the domestic market to export markets. In 2015, more than 60% of the production was exported.

At the end of 2012, production volumes reached the pre-crisis level, and a steady growth remained in the industry in 2013. By contrast, production volumes decreased by 0.6% in 2014. It was due to a decrease in production volumes in paper industry (by 4.7%), while the production volumes in the publishing increased by 2.1%. Similar trends were also observed in 2015. In the first eleven months of the year, the total output remained at the level of the previous year. During the said period, the volumes of paper industry fell by 3.7%, while the publishing output increased by 1.8 per cent.

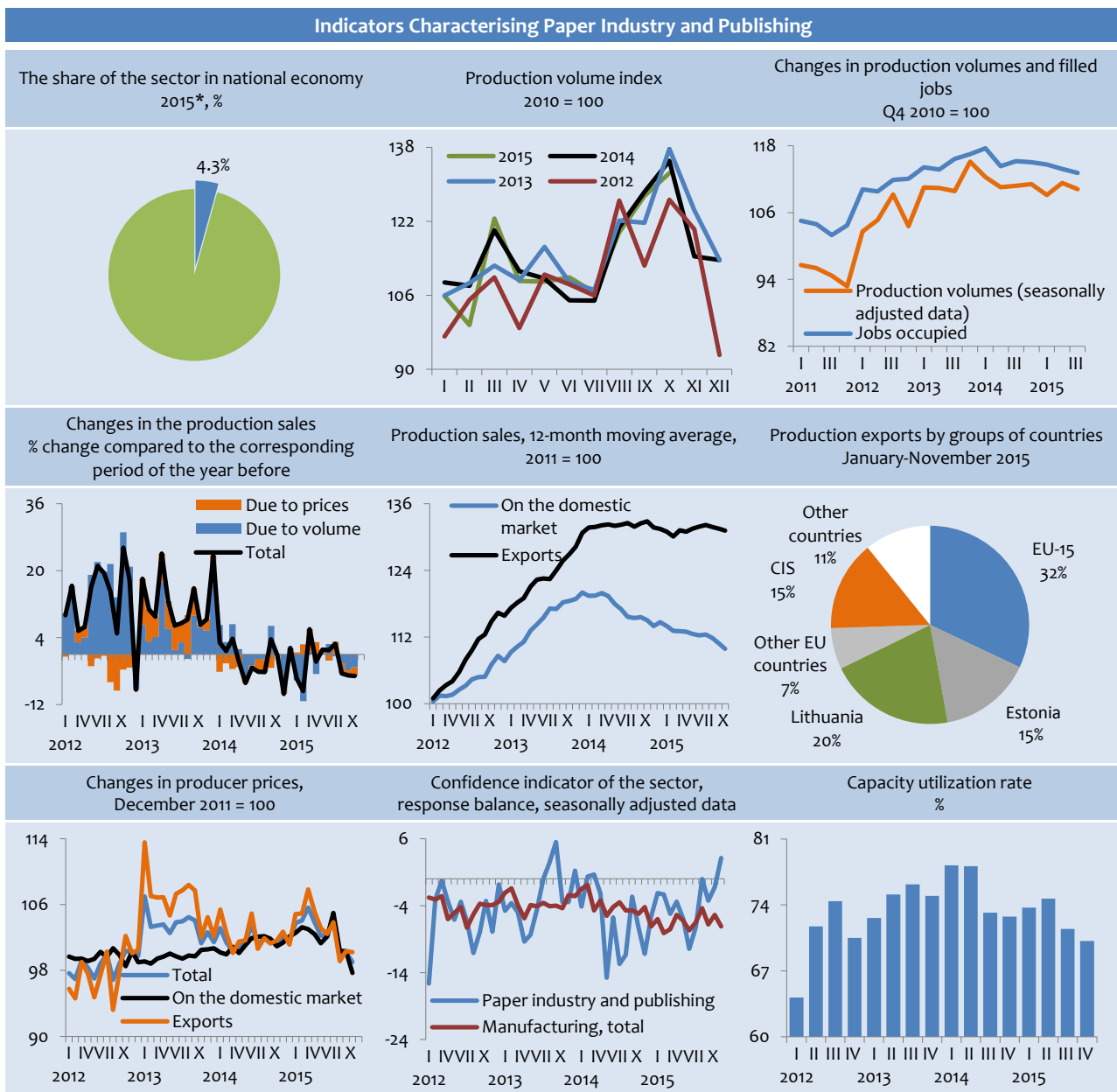
Decrease in the production volumes affects the turnover of the sector. The industry's turnover decreased by 1.5% in 2014, whereas in January-November 2015, it was by 1.4% lower than a year ago.

The drop in turnover is largely due to the decline in turnover of production sold on the domestic market.

In the first eleven months of 2015, the turnover of production sold in the domestic market decreased by 4.4%, while the turnover of exported production basically remained the same during this period the year ago.

With the industry growth slowing down, the number of jobs occupied in the industry increased moderately in 2014 – by 0.5%, whereas in the first three quarters of 2015, the number of occupied jobs was by 1.6% lower than a year ago.

Figure 3.31



Chemical industry and its related industries constitute almost 8% of the total output of the manufacturing and ensure more than 7% of the jobs. Approximately ¾ of the production of the chemical industry is exported.

Since 2014, the industry has been negatively affected by the weaker economic situation in Russia, which is one of the major markets. Production volumes in the industry decreased by 2.6% in 2014. Production volumes in pharmacy fell, while a moderate growth remained in the production of chemicals and chemical products, as well as the manufacturing of rubber products.

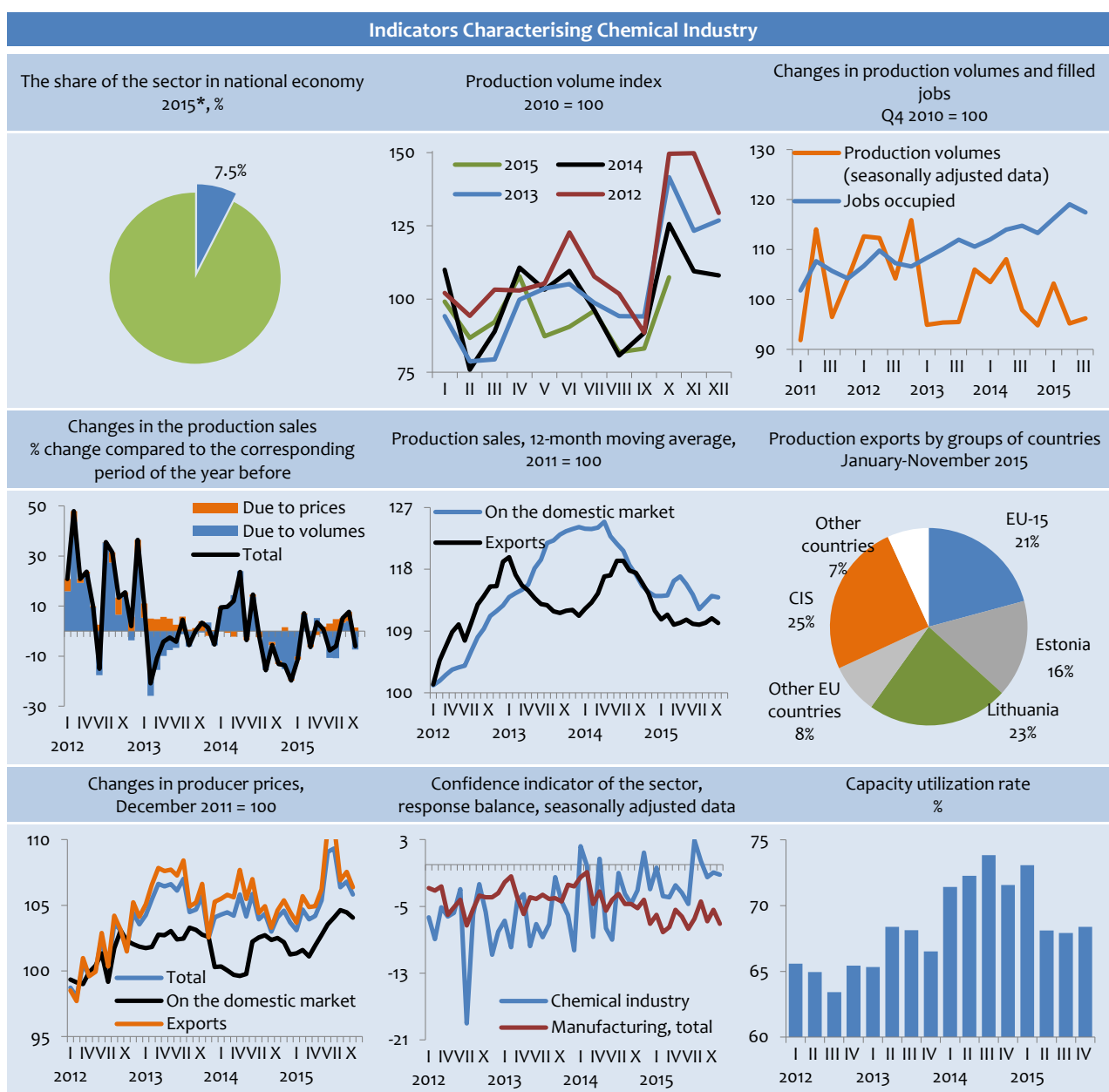
In total, the production volumes in the chemical industry in the first eleven months of 2015 were by 4% lower than a year before. Development trends observed in 2014 remained in the sub-sectors.

Decrease in the production volumes is partially compensated by an increase in producer prices, especially for the exported production. The industry's turnover decreased by 1.5% in 2014, while the turnover of production sold as exports remained at the level of 2013.

In the eleven months of 2015, the industry's turnover was by 0.4% higher than a year ago. Income from the production sold on the domestic market decreased by 0.3%, while the turnover of the exported production was by 0.2% higher than a year ago.

Despite the difficulties, the number of occupied jobs in the industry continues to grow. The number of occupied jobs increased by 3% in 2014, whereas in the first three quarters of 2015, the number of occupied jobs was by 3.5% higher than a year before.

Figure 3.32



Recovery of *the production of other non-metallic minerals* after the crisis was facilitated by the growth of the construction, as well as reorientation towards foreign markets – mostly to the EU countries. In 2015, the industry exported half of the total production on average. For comparison – in 2007, the industry exported only 18% of the production.

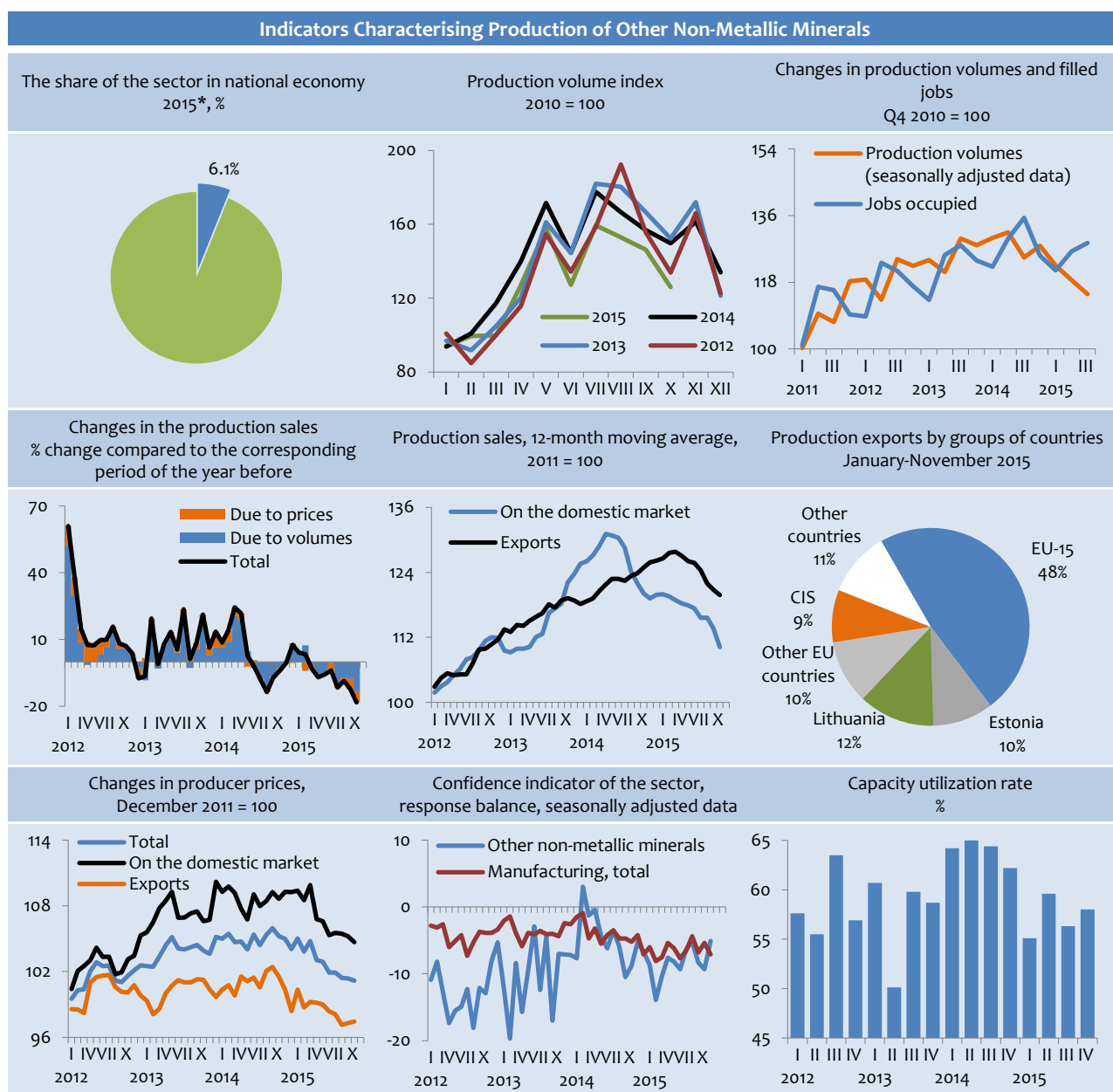
Since the second half of 2014, growth of the construction has slowed down, which is reflected in the performance indicators of the production of other non-metallic minerals. In 2014, the industry's production volume grew by only 1.2%, while the output in the eleven months of 2015 was by 8.7% lower than a year ago.

With the demand and producer prices falling, the industry's turnover grew by only 0.4% in 2014. At the same time, the turnover of the exported production increased by 6.8%, while the turnover in the domestic market fell by 4.6%.

In the eleven months of 2015, the industry's total turnover was by 7.8% lower than a year ago. The turnover of production both exported and sold on the domestic market decreased.

Despite a decrease in the production volumes at the end of the year, the number of jobs occupied in the industry increased by 4.5% in 2014. By contrast, in the first three quarters of 2015, the number of jobs decreased by 2.9 per cent.

Figure 3.33



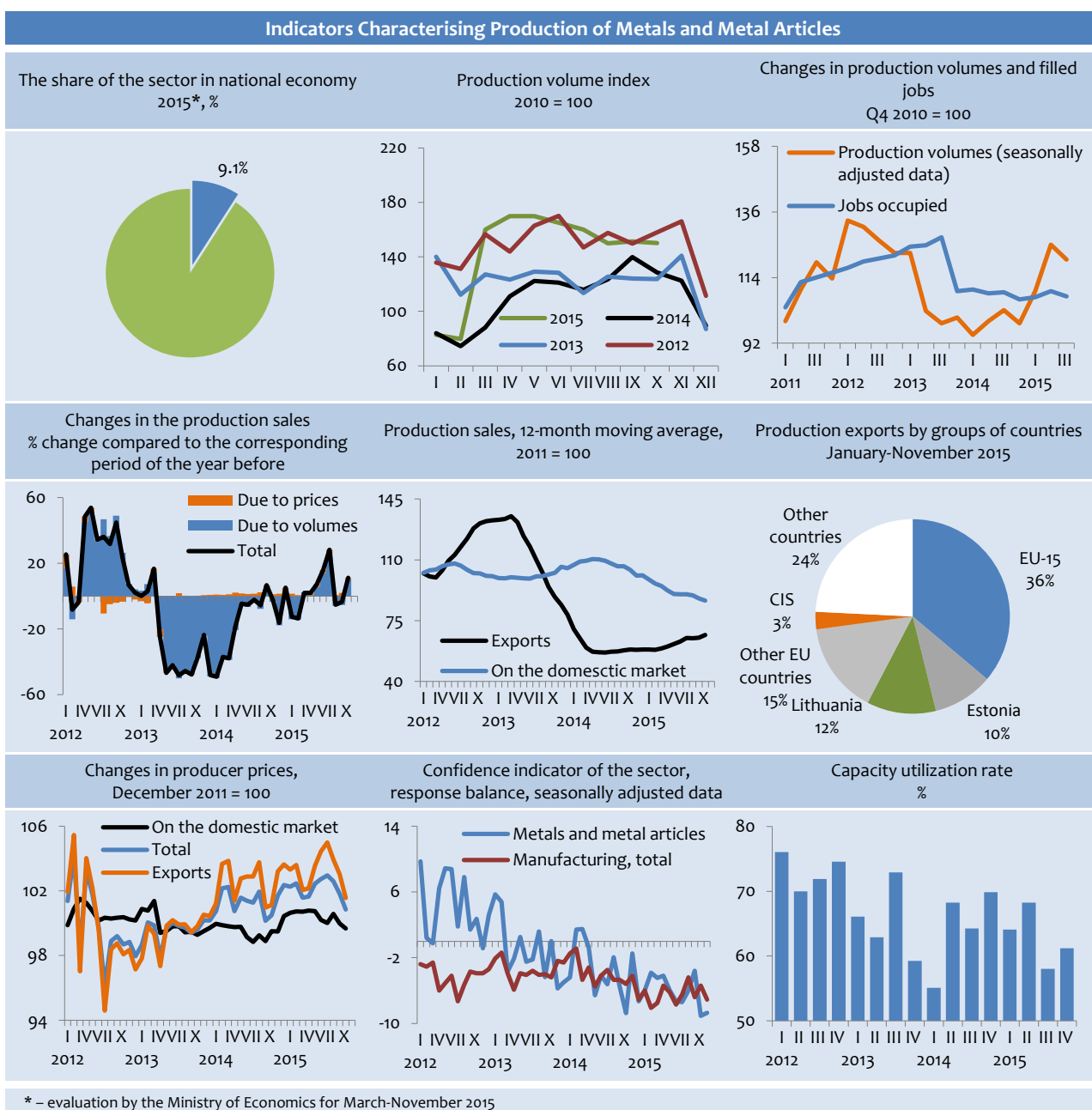
During the post-crisis years, *the production of metals and metal articles* contributed significantly to the total growth of the manufacturing. In 2012, the output was by almost 40% higher than prior to the crisis.

In 2013, the industry was significantly affected by ceasing of the operation of Liepājas Metalurģs JSC. The volumes of production of metals dropped by half in 2013. The downtime at Liepājas Metalurģs JSC affected the industry indicators significantly also in 2014. In 2014, metalworking output was by 10.5% lower than a year before. KVV Liepājas Metalurģs has taken over the insolvent company's assets and, since March 2015, has resumed its operation, which positively influences the entire metalworking industry.

Along with a decrease in the output in 2014, the industry's turnover also decreased (by 18%). In the first eleven months of 2015, due to an increase in exports, the industry's total turnover was higher than in the corresponding period of 2014.

At the end of 2013, when the operations of Liepājas Metalurģs JSC were ceased, employees constituting approximately one tenth of the total number of employees in the industry were laid off. The number of jobs occupied in the industry decreased by 10.7% in 2014. In the first three quarters of 2015, the number of jobs in the industry was by 1% lower than a year before. The drop was affected by a decrease in the number of jobs in the production of fabricated metal products.

Figure 3.34



Since 2010, *the production of electrical and optical equipment* has been the fastest growing sector of the manufacturing, the share of which in the total output of the manufacturing has increased from 3.7% in 2009 to 7.1% in 2015. More than 90% of the production of the said industry is exported.

The industry's output grew by 32.3% in 2014. Manufacturing of computers, electronic and optical equipment contributed more to the growth of the industry. Rapid growth remained in the industry also in 2015 – in the first eleven months, production volumes were by 15.6% higher than a year before.

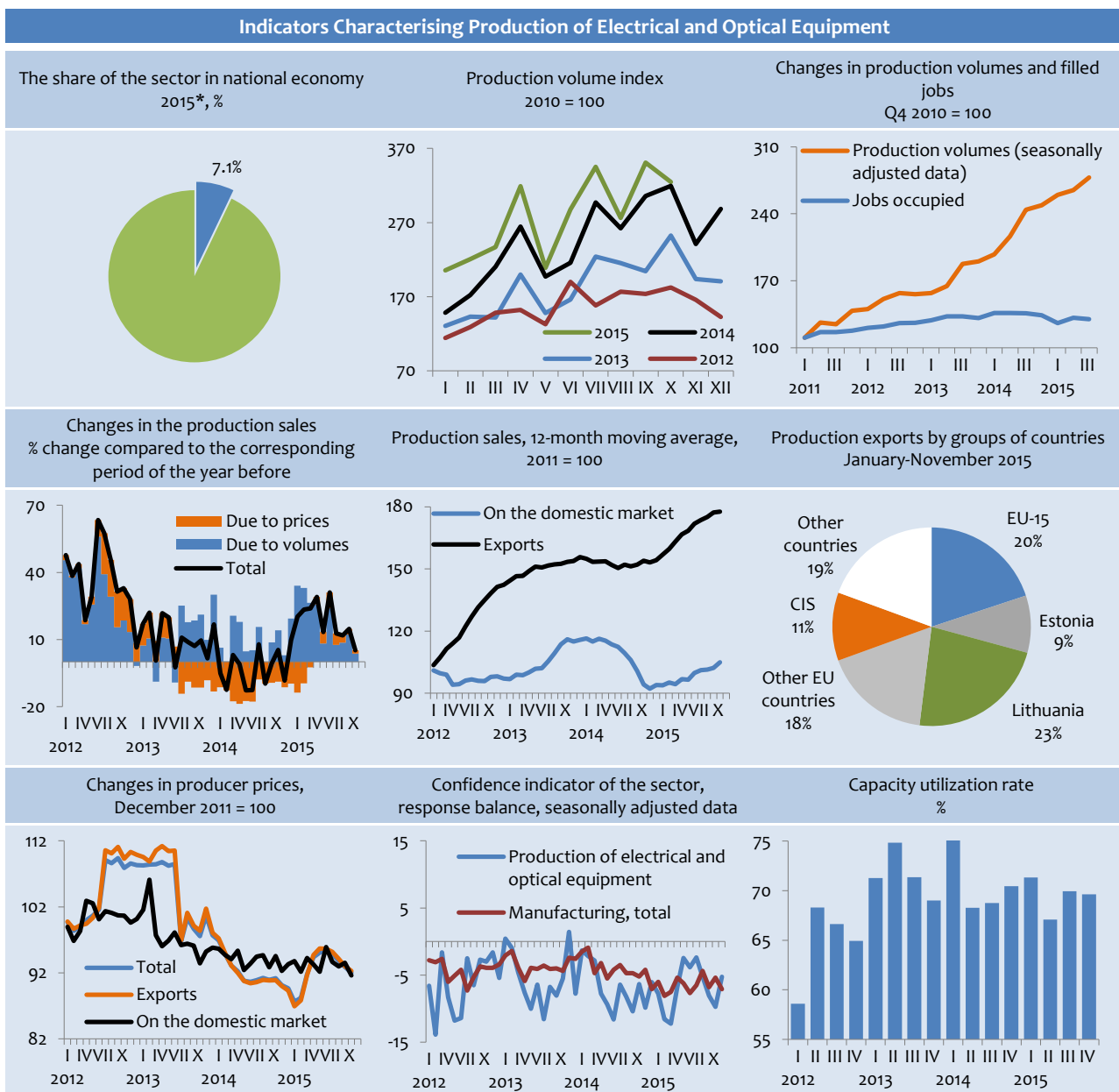
In 2014, despite the significant increase in the industry's output, the industry's turnover was by 3.1% lower than a year before. Turnover of the exported production decreased by 1%, while the turnover of

production sold on the domestic market – by 18.8%. Decrease in the turnover was affected by a significant drop in producer prices.

In the first eleven months of 2015, the industry's turnover was by 18% higher than a year before. The turnover of the exported production increased by 18.7% during the said period, while the turnover in the domestic market increased by 13.1 per cent.

Most of the industry's growth is ensured by a rise in productivity, while the increase in the number of jobs is moderate. The number of jobs in the production of electrical and optical equipment increased by 3.3% in 2014. By contrast, in the first three quarters of 2015, despite the successful growth rates, the number of jobs in the industry was by 5.3% lower than a year before.

Figure 3.35



Machinery and equipment industry exports 80% of its production. The EU-15 countries, Lithuania, and Estonia are major export markets. The markets of CIS countries also play an important role.

In 2013, the rates of the industry's growth were moderate (an increase of 1.4%), and the growth of the machinery and equipment industry was also slow in 2014 (an increase of 2.4%). Growth was stimulated by an increase in the growth rates of the EU countries, as well as the ability to sell production in CIS countries despite the economic difficulties.

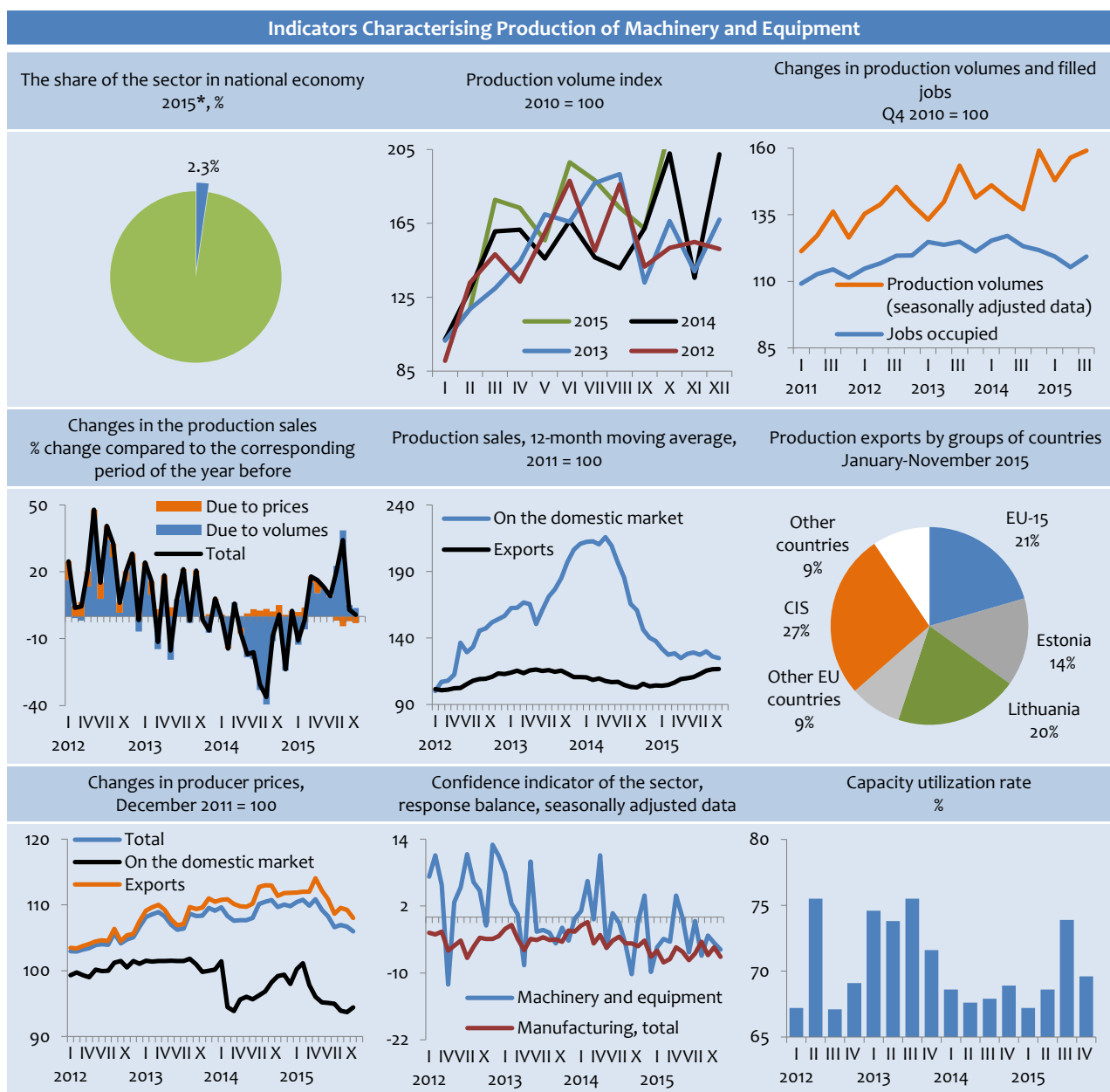
The industry's turnover decreased by 13% in 2014. During the period, turnover of the exported production

decreased by 5.7%, while the turnover of production sold on the domestic market – almost by a third.

Even though the turnover of production sold on the domestic market continued to decrease in 2015, the industry's total turnover in the first eleven months of the year was by 10.1% higher than a year before due to an increase in the export turnover.

Along with a more moderate growth of the industry in 2014, the number of occupied jobs in the industry increased by only 0.5%. By contrast, in the three quarters of 2015, the number of occupied jobs in the industry was by 5.8% lower than a year before.

Figure 3.36



Production of vehicles is mainly focused on external markets – 90% of the production of the industry on average is exported. Since the industry largely depends on new orders, it is characterized by very pronounced fluctuations in production volumes.

Orders finished over the previous years and the weak demand in foreign markets in 2013 and 2014 affected the industry's growth. Production volumes in the industry decreased by 15.2% in 2014. The situation in the industry slightly improved in 2015 – production volumes in January-November were by 3.5% higher than a year ago.

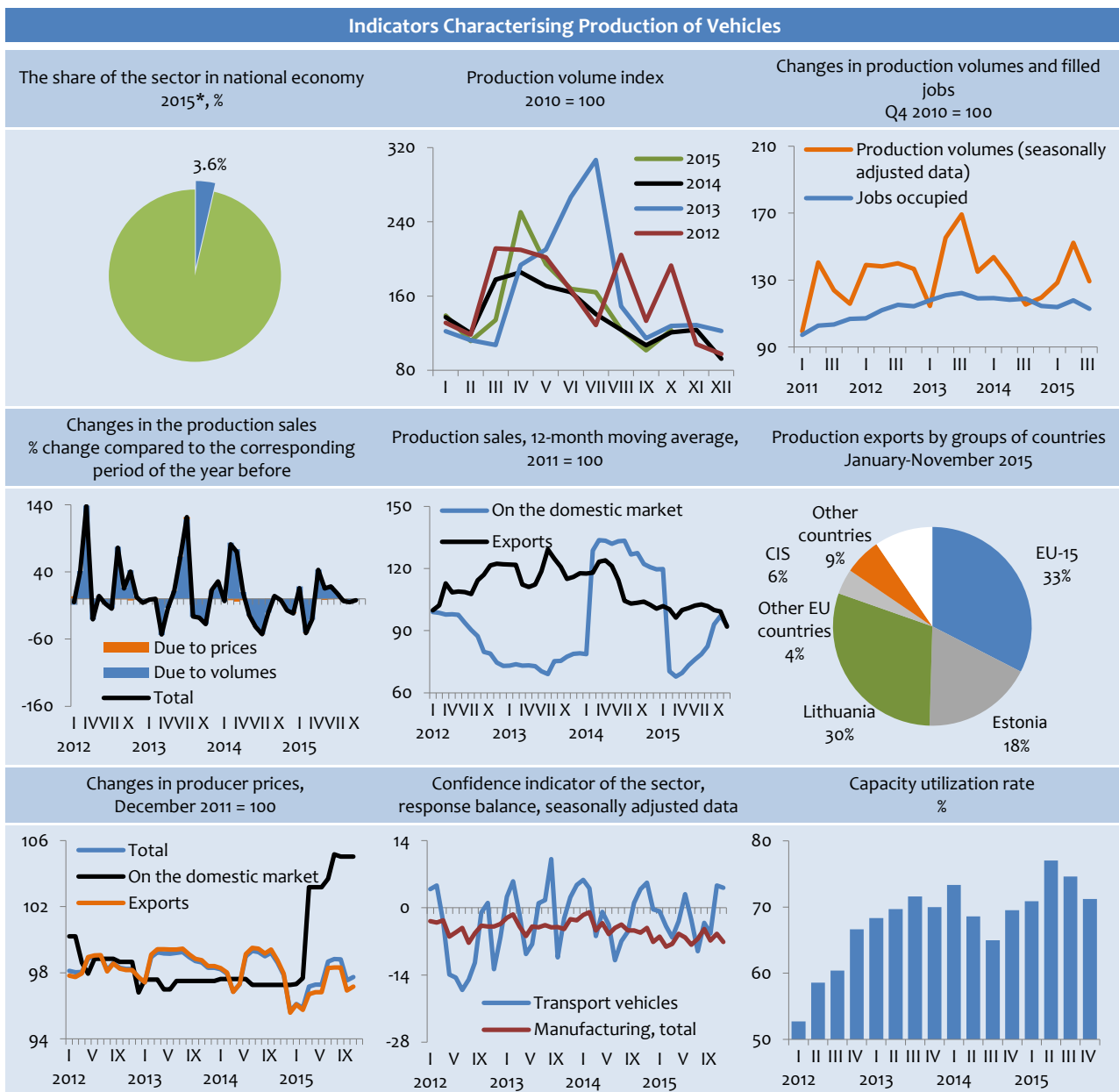
The industry's turnover decreased by 9.3% in 2014. A huge increase was observed in the income from products

sold on the domestic market, which increased by more than 50% in the period. By contrast, the turnover of exported production decreased by 14.5% in 2014.

In the eleven months of 2015, the industry's turnover was by 3.2% lower than a year ago, mainly due to the small turnover of products sold on the domestic market.

Pronounced fluctuations in the industry's production volumes affect the number of people employed in the industry. The number of occupied jobs in the industry decreased by 1.9% in 2014, while in the first three quarters of 2015, the number of occupied jobs was by 3.3% lower than a year before.

Figure 3.37



3.3 Forecasts

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

Economic development in 2016

The latest forecasts of the EC show that the growth rates of global economy in 2016 will rise to 3.5% (the global increase in 2015 was assessed as 3%). The IMF also forecasts a similar development of global economy. Growth of the EU in 2016 is projected at 2%, which is only by 0.1 percentage point higher than the assessed dynamics in 2015.

Development of the national economy of Latvia is closely related to the opportunities for expansion of exports. In 2016, export dynamics will be limited by the weak demand in the CIS markets. No significant changes in the development dynamics are expected for the largest market of Latvia – EU, which does not allow to hope for a noticeable increase in exports. Therefore, third countries are an important direction for export development.

Investments are important for further development of economy. Dynamics of private investments are still very slow. They are affected by the entrepreneurs' hesitant attitude in relation to the increased uncertainty in the external environment, as well as the cautious crediting policies of banks. By contrast, investments of the public sector are closely related to the cyclical nature of acquisition of the EU structural funds.

Changes in private consumption in 2016 will be influenced by a rise in employment and remuneration, as well as inflation dynamics. A moderate rise in consumer prices is expected in 2016, since the global prices will not change significantly, and changes in tax rates will have a greater influence on consumer prices in Latvia (in total, they could increase by approximately 1%).

Private consumption growth will contribute to the growth of retail trade and other – domestic-market oriented sectors. The current positive trends will remain in the manufacturing, and production volumes will continue to grow. It will be facilitated by a gradual increase in demand in the EU and third country markets.

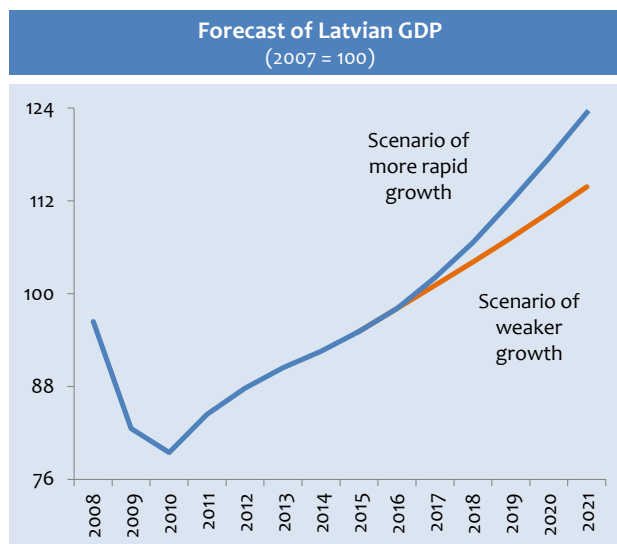
By contrast, the development of the construction sector will be moderate. Development of the sector is closely related to the EU funds projects, therefore a more rapid growth of the sector is expected after intense commencement of activities of the new EU funds programming period. Growth will also be slow in the transport sector. Development of the sector will largely depend on the geopolitical situation in the region.

The Ministry of Economics forecasts that, in total, GDP growth rate will be 3.2% in 2016.

Development Perspectives for 2017-2021

Scenarios of slower and more rapid growth are developed for the medium term until 2021. Basic assumptions of the scenarios are based on different trends of global economic developments over the medium term.

Figure 3.38



The growth of Latvia – a small open economy with a relatively high degree of market liberalisation – is affected significantly by the global economic development and maintenance of stable competitiveness. Development dynamics of the EU's common economic space, as well as opportunities for expanding and diversifying markets in third countries are of particular importance.

The economic benefits of Latvia in the medium term will be mostly based on the macroeconomic stability achieved, resulting in improved credit ratings of Latvia, as well as on the efficiency of the planned support programmes of structural funds and improvements in the business environment.

Labour costs in Latvia are significantly lower than in the old EU member states. Both the cheap labour and the relatively high profitability are weak incentives for a change in the business model and creation of other competitive advantages. At the same time, an increase in labour costs is inevitable due to growth and open labour market. It means that by not implementing appropriate structural policy measures Latvia could lose competitiveness in the low-cost segments sooner than acquire advantages in the manufacturing of products with higher added value.

The weaker growth scenario is based on the assumption that the global economic development is uneven, the EU's recovery from the crisis is slow, and the geopolitical situation caused by the Ukrainian crisis does not improve. This means that the annual export growth

rate during this period will not reach 4% in the scenario of weaker growth. Private consumption and investments will grow slowly. By contrast, GDP growth rates on

average from 2017-2021 are estimated to be within 3 per cent per year.

Table 3.14

Forecast of Latvian GDP by Expenditure Items					
	2013	2014	2015	2016	2017-2021 (on average a year)*
	Fact	Forecasts			
growth rates, % compared to the previous year					
Gross domestic product	3.0	2.4	2.8	3.2	3.0 .. 4.7
Private consumption	5.1	2.3	4.0	3.6	2.2 .. 4.7
Public consumption	1.6	4.9	3.4	2.8	3.2 .. 4.2
Gross fixed capital formation	-6.0	0.5	3.4	2.0	2.9 .. 5.5
Exports	1.1	3.1	1.9	2.5	3.0 .. 4.5
Imports	-0.2	0.8	3.0	2.4	3.0 .. 4.6
structure, %					
Gross domestic product	100	100	100	100	100
Private consumption	61.5	61.2	61.5	61.7	61.4 .. 61.4
Public consumption	17.7	17.6	18.0	17.9	17.4 .. 17.6
Gross fixed capital formation	23.2	22.9	22.8	22.5	22.0 .. 22.7
Changes in inventories	0.8	0.6	-0.3	-0.5	1.2 .. -0.1
Exports	60.4	59.5	58.8	58.0	57.5 .. 57.4
Imports	63.6	61.8	60.8	59.7	59.4 .. 59.1
Export-import balance	-3.2	-2.2	-2.0	-1.7	-1.9 .. -1.7

* structure at the end of the period

The scenario of more rapid growth envisages that growth will resume in the key export markets of Latvia and the advantages of the Latvian economy competitiveness will be primarily based on technological factors, improvement of production efficiency, and innovation, to a lesser extent on cheap labour and low

prices of resources. In the scenario of more rapid growth, exports and processing industry retain a relatively fast growth rate in the medium term, based on both the competitiveness of Latvian producers and growing external demand. In this scenario, GDP growth rates in the medium term may reach 5 per cent per year.

Table 3.15

Forecast of Latvian GDP by Sectors (real growth, % in compared with the previous year)					
	2013	2014	2015	2016	2017-2021 (on average a year)
	Fact	Forecasts			
Gross domestic product	3.0	2.4	2.8	3.2	3.0 .. 4.7
Agriculture, forestry	1.2	1.6	2.1	3.5	2.7 .. 3.2
Manufacturing	-1.2	-0.3	4.1	3.0	3.7 .. 4.8
Other industry	1.6	-3.1	2.2	3.6	2.2 .. 3.2
Construction	4.4	8.1	1.8	1.8	2.9 .. 6.0
Trade, accommodation	4.2	2.3	4.5	4.5	2.9 .. 5.2
Transport and storage	0.2	3.2	-0.9	0.5	2.1 .. 3.7
Other commercial services	3.9	1.6	1.9	3.5	3.2 .. 4.9
Public services	2.4	3.3	3.5	3.2	3.1 .. 4.6

4. MACROECONOMIC STABILITY

4.1 Public Finances

4.1.1 Fiscal Policy and Public Debt

Table 4.1.

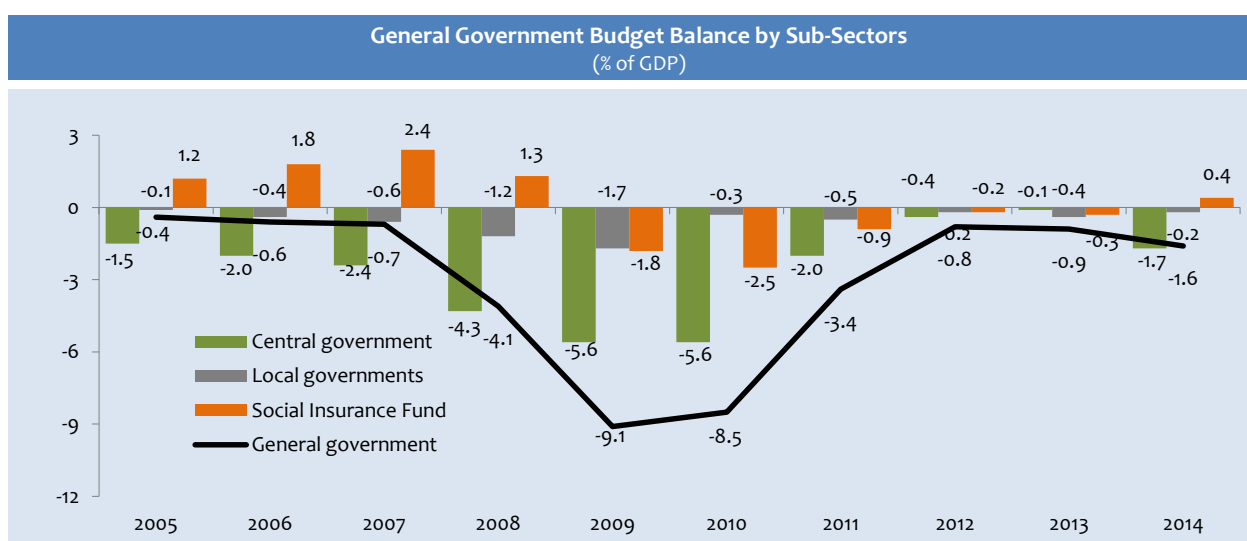
The fiscal policy of Latvia is focused on ensuring sustainable economic growth and implementation of a responsible fiscal policy in line with the conditions of the fiscal discipline.

Since 2011, Latvia has returned to growth, and significant improvements have been achieved in the fiscal position (see Table 4.1). However, the negative impacts of the economic crisis can be observed in a number of key sectors of the economy. The lack of funding has accumulated problems that could lead to irreversible processes if they are not solved. Therefore, the following years are also characterized in the course of the country's fiscal policy as a post-crisis period, during which it is necessary to restore adequate funding for the implementation of state functions, while fully respecting the conditions of the fiscal discipline.

General Government Budget				
	2011	2012	2013	2014
Income (million euro)	7213.8	7885.4	8187.2	8436.2
(% of GDP)	35.6	36.2	36.0	35.8
Expenditures (million euro)	7896.0	8064.6	8390.7	8802.3
(% of GDP)	39.0	37.0	36.9	37.3
Balance (million euro)	-682.2	-179.2	-203.4	-366.1
(% of GDP)	-3.4	-0.8	-0.9	-1.6

In 2011-2013, deficit of the general government budget consisted of the deficit both in the budget of the central government and the budget of local governments, as well as the Social Insurance Fund (see Figure 4.1).

Figure 4.1



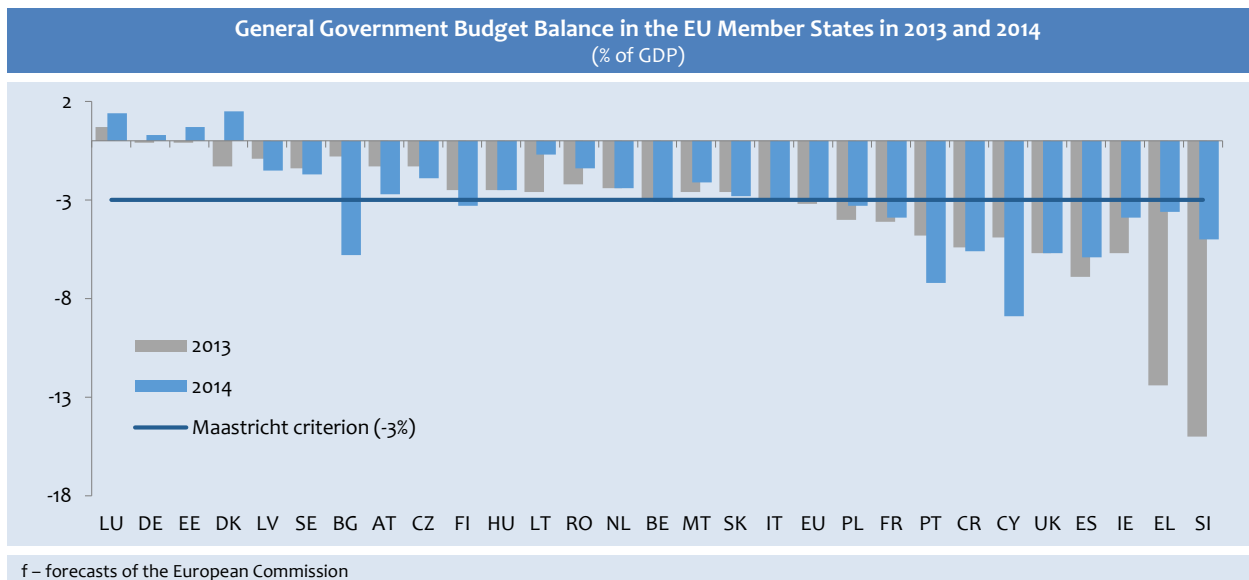
In 2014, budget deficit of the central government increased significantly, which was related to the single capital transfer for the fulfilment of central government obligations towards the EBRD, as well as an increase in expenditure on remuneration and social benefits. In its

turn, decrease of the budget deficit developed in the two other sub-sectors of the general government, especially in the sub-sector of the Social Insurance Fund, where even a small surplus was observed.

As shown in Figure 4.2, the overall situation of the EU in the budget is improving. The average level of budget deficit of the EU in 2014 was 3% of GDP (in 2013 – 3.3% of GDP, in 2012 – 4.3% of GDP). In 14 EU member states (in 2013 – 10 member states, in 2012 – 17), national budget in 2014 was equal to or exceeded the Maastricht criteria, which is 3% of GDP. The highest

general government budget deficit to GDP in 2014 was detected in Cyprus, Portugal, Spain, Bulgaria, the United Kingdom, Croatia, and Slovenia. The budget deficit in these countries exceeded 5% of GDP. There was a budget surplus in Denmark, Luxembourg, Estonia, and Germany.

Figure 4.2



According to the forecasts of the EC announced in the autumn of 2015, the budget situation in the EU will continue to improve in 2015 and 2016. The average level of budget deficit in the EU in 2015 is expected to be 2.5% of GDP, while in 2016 – 2%. The highest budget deficit in 2015, which may exceed 4% of GDP, is expected in Croatia, Spain, Greece, and the United Kingdom.

The Saeima adopted the national budget for 2015 with a deficit of 1% of GDP. According to the forecasts of the Ministry of Finance, the general government budget deficit is projected to be 1.4% of GDP in 2015.

On November 30, the Saeima approved the Law on State Budget for 2016 at the final reading, where the permissible budget deficit of 1% of GDP is established, and it corresponds to the permissible budget deficit amount arising from the specific target of the structural balance. Strengthening of the country’s internal and external security, improvement of access to health care, as well as improving the quality of education are set as the budget priorities for 2016.

Along with the adoption of the *Fiscal Discipline Law* (FDL) at the beginning of year 2013, the state fiscal policy has been based on the concept, which provides for ensuring a balanced budget in the economic cycle, i.e., the amount of structural balance of the general government budget, which does not exceed -0.5% of GDP, as stipulated in the FDL. Latvia reached the structural deficit of 0.5% of GDP in 2012. Consequently, the task

for the subsequent years is no longer to reduce the structural deficit, but to preserve it at the level of the medium-term goal.

While developing the goals for medium-term structural balance, a multi-stage approach is applied, which allows to ensure that the respective goals of structural balance are in compliance not only with the national approach, but also with the conditions of the *Stability and Growth Pact*, also recalculating the difference of outputs according to the EC standardised methodology. The following goals of structural balance of the general government budget are defined for the medium term: -0.9% of GDP in 2016, -1% of GDP in 2017, and -0.8% of GDP in 2018.

A significant aspect is not only the development and approval of the fiscal discipline framework, but also operation of such instruments that actually introduce the framework of fiscal discipline in the process of budget formation and monitoring. The body responsible for compliance with the requirements of fiscal discipline both during the budget planning process and in the execution stage is the Fiscal Discipline Council, which was established in 2014.

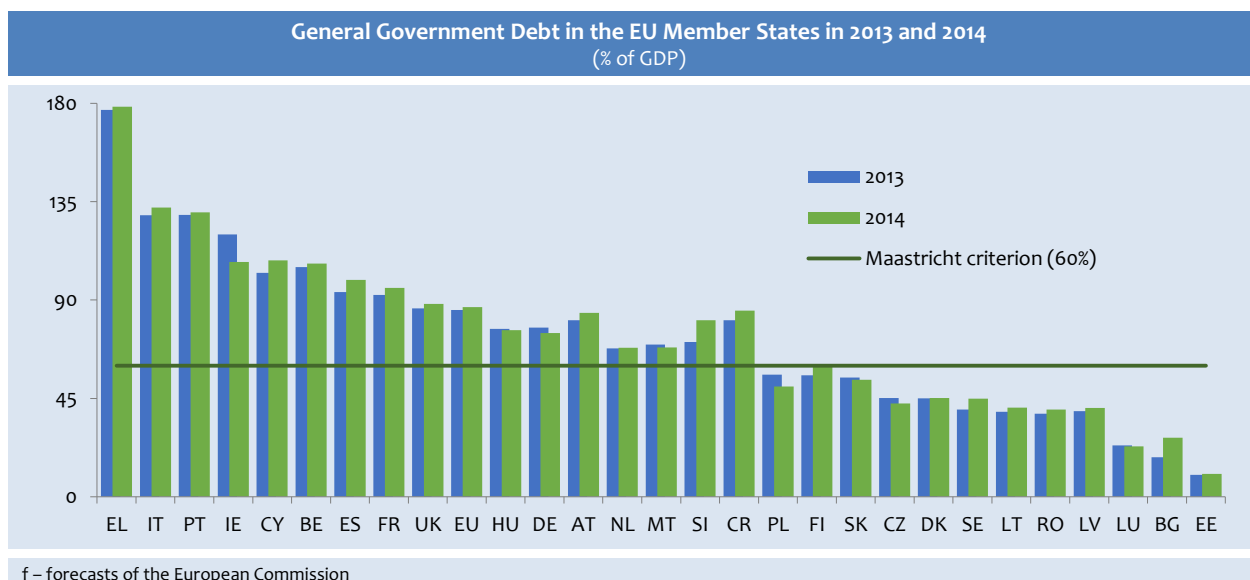
The general government debt in Latvia is still one of the lowest in the EU (see Figure 4.3).

The average level of public debt in the EU in 2014 was 86.8% of GDP (in 2013 – 85.5% of GDP, in 2012 – 83.8% of GDP). In 16 EU member states (in 2013 – 16 member states, in 2012 – 14), the public debt in 2014 exceeded the Maastricht criteria, which is 60% of GDP.

The highest public debt to GDP in 2014 was detected in Greece, Italy, Portugal, Cyprus, Ireland, and Belgium, whereas the lowest general government debt to GDP was registered in Estonia, Luxembourg, and Bulgaria. As

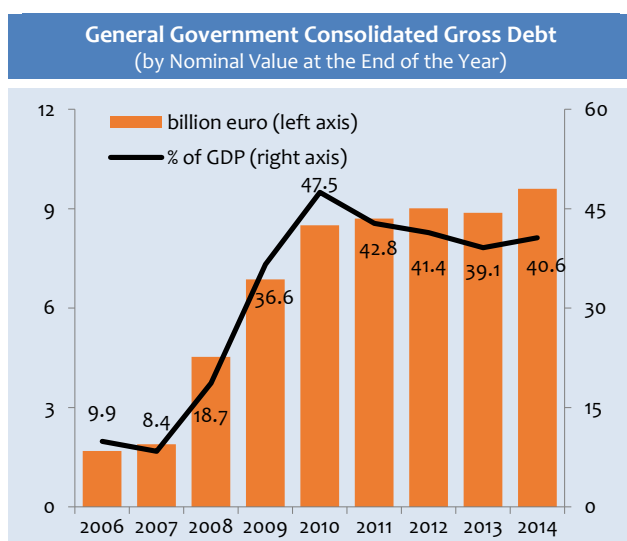
indicated by the forecasts of the EC for autumn 2015, the average level of public debt in the EU will slightly decrease in 2015 and 2016.

Figure 4.3



The general government debt in Latvia increased moderately until 2007. In order to provide funding for performance of financial liabilities, the general government debt started to grow rapidly starting from 2008, and it reached 8,509 million euro or 47.5% of GDP at the end of 2010. Since the end of 2011, the general government debt to GDP has been decreasing (see Figure 4.4). The debt slightly increased at the end of 2014 and reached 9,626 million euro or 40.8% of GDP.

Figure 4.4



It has to be noted that a three-year international loan programme was successfully concluded at the end of 2011. The amount of loan for Latvia was planned to constitute 7.5 billion euro. Taking into consideration that the economic and financial situation in the country improved, it was not necessary for Latvia to take the available loan in full amount. Latvia has used 4.4 billion euro.

After a successful completion of the international loan programme, Latvia has repeatedly proved its ability to attract finances on international financial markets under favourable conditions, through organising public issuance of public debt securities.

In January 2015, a loan in the amount of 1.2 billion euro from the EC principal amount was repaid. Thereby, in 2015, it is planned to decrease the amount of public debt by 5% to GDP.

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

4.1.2 Budget Revenue¹

With the economic situation improving, the budget revenue has been increasing in recent years. In 2014, **general government consolidated budget revenues** amounted to 8535.9 million euro or for 1.9% more than in 2013. Increase in the revenues was largely ensured by an increase in tax revenues.

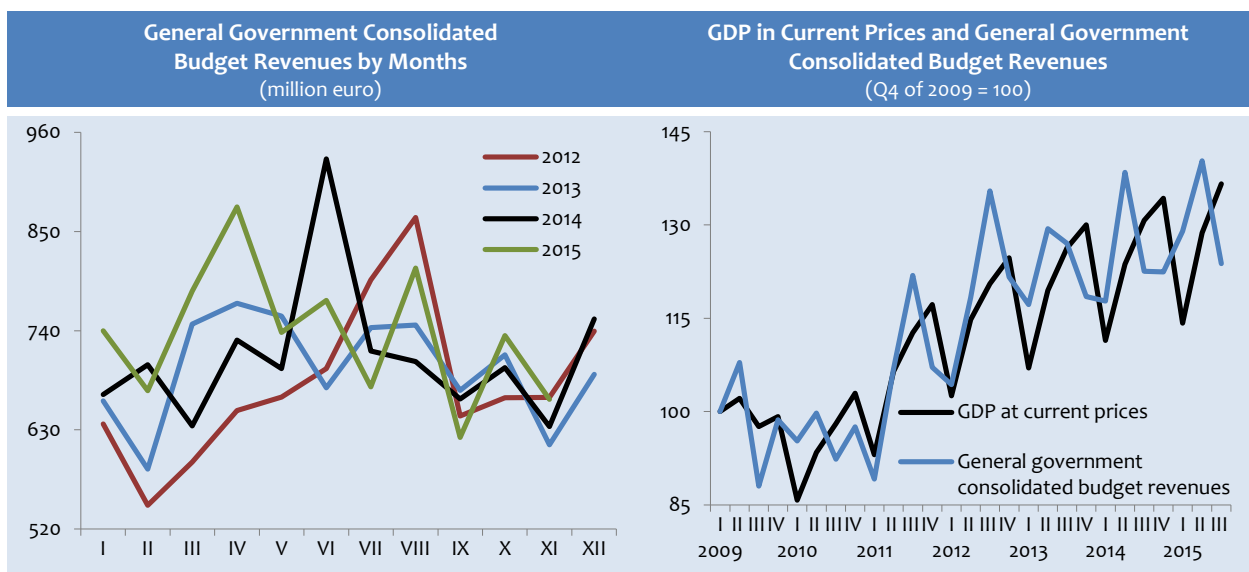
In 2014, tax revenues amounted to 6675.9 million euro, which is for 3.9% more than a year earlier. The increase in the employment tax revenue had the most important contribution, which was facilitated by an

increase in remuneration, as well as an increase in retail trade turnover that increased the revenue from value added tax.

In the first eleven months of 2015, general government consolidated budget revenues were 8093 million euro, which was for 4% more compared to January-November 2014.

Approximately 3/4 of all budget revenues consist of tax revenues. The remaining budget revenue consists of non-tax revenue and revenue from foreign financial assistance.

Figure 4.5



In the eleven months of 2015, taking into account a more rapid economic growth than previously expected, tax revenues grew by 5% compared to January-November 2014 and reached 6398.3 million euro.

Tax revenue plan in the general government consolidated budget was fulfilled by 100.1% in the first 11 months of 2015.

Employment taxes account for almost a half of all tax revenues.

In 2014, with the average wage in the country and the number of the employed continuing to increase, **employment tax** revenues increased by 1.4% compared to 2013.

In the eleven months of 2015, employment tax revenues were for 3.8% higher than a year earlier.

In 2014, personal income tax revenues amounted to 1385.2 million euro and grew by 3.9% compared to 2013.

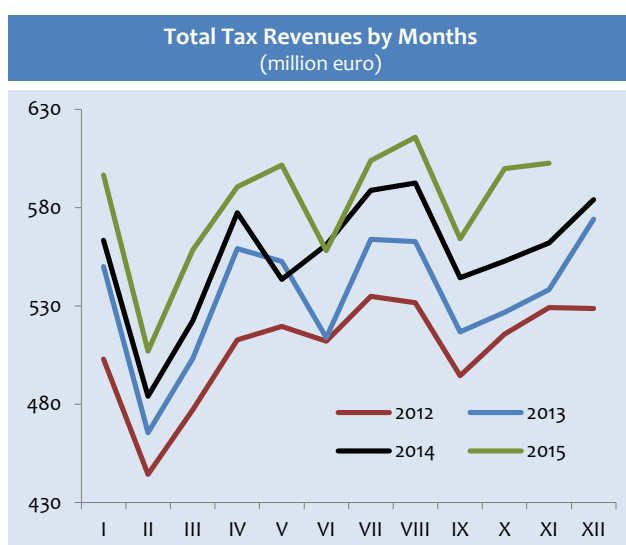
As of 1 January 2014, personal income tax rate is reduced to 24%. The non-taxable minimum was increased from 64 euro to 75 euro, allowance for dependent persons was increased from 100 euro to 165 euro, while the minimum wage was increased to 320 euro.

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

Table 4.2

Budget Income (% of GDP)								
	2008	2009	2010	2011	2012	2013	2014	2015 III
General government consolidated budget revenues	33.5	35.7	36.6	35.8	37.5	36.8	36.2	37.4
I Tax revenues	27.7	26.6	27.1	27.3	28.0	28.2	28.3	29.0
1. Indirect taxes	9.9	10.0	10.3	10.3	10.7	10.7	11.0	11.3
– value-added tax	6.5	6.0	6.6	6.7	7.3	7.3	7.6	7.9
– excise tax	3.2	3.8	3.6	3.4	3.2	3.2	3.2	3.3
– customs duty	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2
2. Income taxes and property taxes	9.4	7.6	7.9	7.7	8.0	8.2	8.2	8.4
– corporate income tax	2.9	1.5	0.9	1.4	1.6	1.6	1.5	1.6
– personal income tax	6.0	5.5	6.3	5.6	5.7	5.9	5.9	5.9
– real estate tax	0.4	0.6	0.7	0.8	0.8	0.8	0.8	0.9
3. Social insurance contributions	8.2	8.8	8.7	8.6	8.6	8.7	8.4	8.5
4. Other taxes	0.3	0.2	0.2	0.6	0.6	0.7	0.8	0.8
II Other revenues	5.8	9.1	9.5	8.5	9.5	8.6	7.9	8.4

Figure 4.6



In January-November 2015, personal income tax revenues amounted to 1293.4 million euro and grew by 3.8% compared to the relevant period of 2014.

As of 1 January 2015, personal income tax rate is reduced to 23%. The minimum wage was also increased – from 320 euro to 360 euro.

It is planned to introduce the differentiated non-taxable minimum in the field of personal income tax in 2016 (thus differentiated rather than equal non-taxable minimum will be applied to all persons in the future, the amount of which will vary depending on the amount of the taxpayer's taxable income), to narrow the circle of persons for which the taxpayer is entitled to apply an allowance for dependents, and other changes. It is also planned to increase the minimum wage from 360 euro to 370 euro.

Figure 4.7

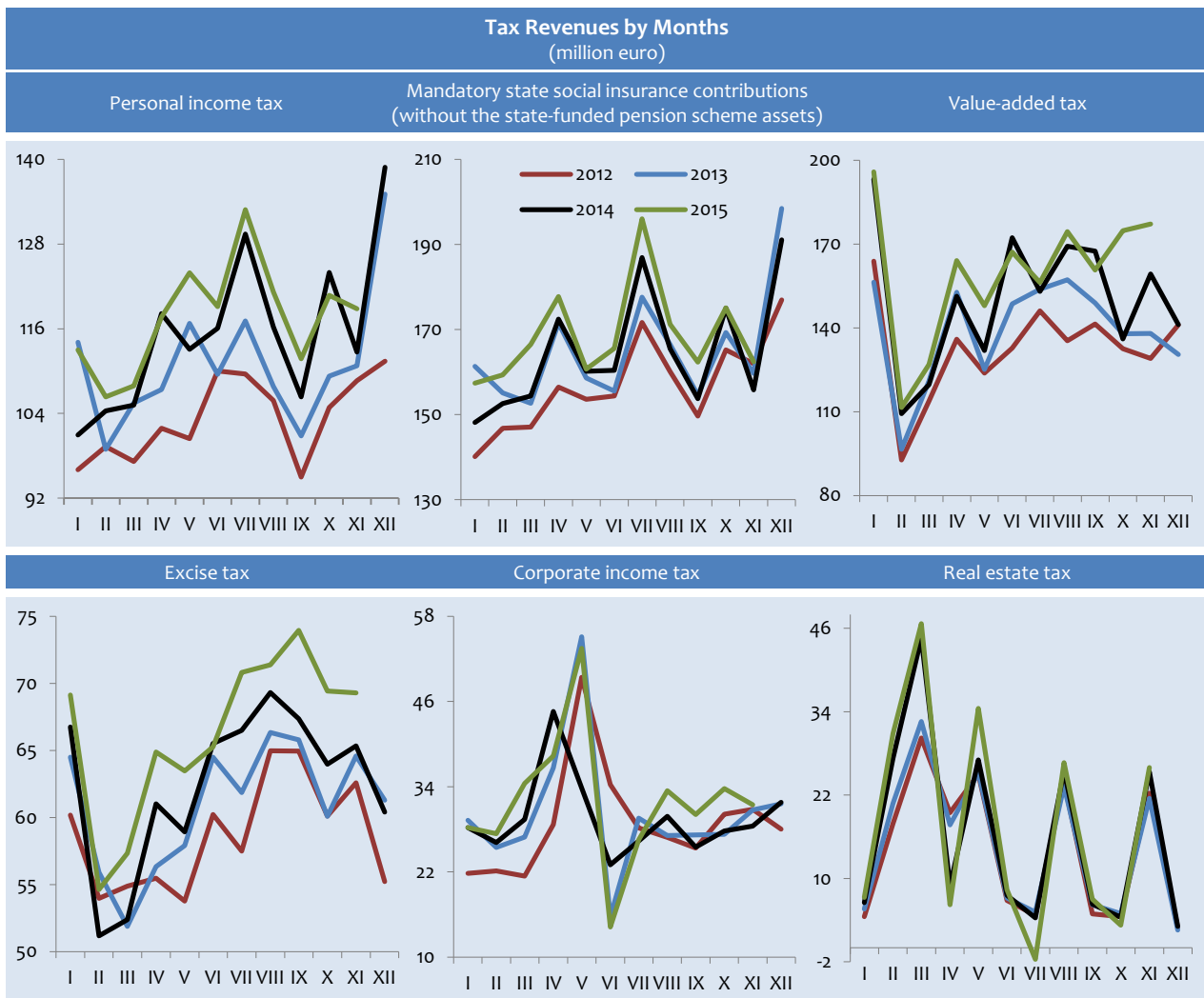


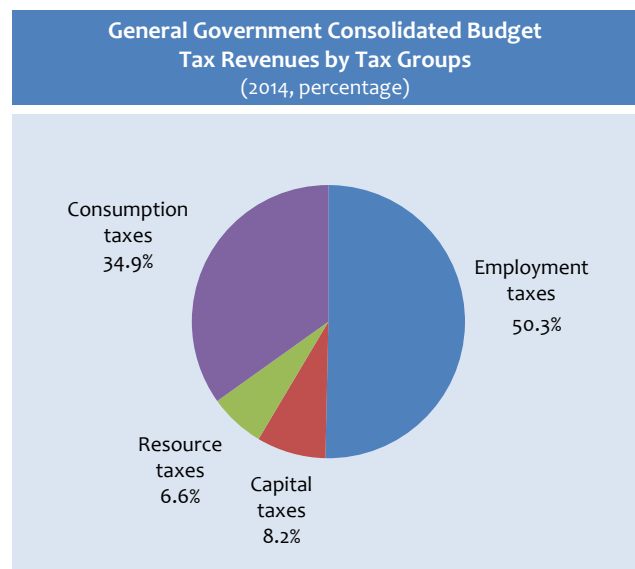
Figure 4.8

In 2014, revenue from the mandatory state social insurance contributions amounted to 1976.1 million euro, which is for 0.2% less than in 2013.

Reduction in the collected amount was affected by changes in the rate of the mandatory state social insurance contribution. On 1 January 2014, the rate of state social insurance was reduced by 1 percentage point to 34.09%, 23.59% of which are paid by the employer and 10.5% – by the employee.

In the first eleven months of 2015, revenue from the mandatory state social insurance contributions increased to 1,854.3 million euro, which is for 3.9% more compared to the corresponding period in 2014.

To reduce tax regressivity for employees and self-employed with a higher income level, the *Law on Solidarity Tax* was adopted. As of 2016, the solidarity tax will be applied to personal income part that exceeded the maximum amount of mandatory state social insurance contributions over the calendar year.



Consumption tax revenues constitute a third of all tax revenues. As a result of private consumption growth and, consequently, an increase in the retail sales turnover, consumption tax revenues in the national budget increased by 8.6% in 2014.

In the first eleven months of 2015, consumption tax revenues were for 5.9% higher than in the corresponding period of 2014.

In 2014, value-added tax revenues amounted to 1,803.7 million euro and grew by 8.2% compared to 2013.

Since 1 January 2014, several restrictions on the deduction of input VAT were lifted in the field of VAT, changes were made in the application of VAT in real estate transactions, and VAT liens were introduced in transactions with petroleum products etc.

In the first eleven months of 2015, value-added tax revenues were 1,756.8 million euro, which is for 5.7% more than in the corresponding period of 2014.

Since 1 January 2015, changes have been made in the field of value-added tax, for example, specific value-added tax calculation and payment modes were introduced for the electronic communication, broadcasting and electronically supplied services, changes were made in the enforcement procedures of the value-added tax law, etc.

Changes in the field of value-added tax are also planned for 2016:

- as of July 1, VAT standard rate of 21% will be applied to the residential house management service;
- as of January 1, the VAT reverse charge mechanism will be supplemented with a variety of types of timber, and it will be established that the input tax deduction limit for passenger car acquisition and related maintenance costs is 50%;
- as of April 1, VAT reverse charge mechanism will be introduced for mobile phones, laptops, tablets, and other devices along with other changes.

Revenue of the consumption share (alcoholic beverages, tobacco, and other excise goods) of the excise duty increased in 2014. In 2014, excise duty revenues amounted to 330 million euro, which is for 3.8% more than in 2013.

Changes to the consumption share of the excise duty on tobacco products were introduced as of 1 January 2014 by increasing the excise duty on cigarettes, cigars, and smoking tobacco. It is established that the excise duty on this product group shall be increased annually by 2018.

In the first eleven months of 2015, revenue of the consumption share of the excise duty increased by 4.7% compared to the corresponding period of 2014.

As of 1 January 2015, excise duty was established on tobacco leaves at the same rate as the excise duty on smoking tobacco.

Changes in the field of excise duty are also planned for 2016:

- as of January 1, excise duty rate on smoking tobacco and tobacco leaves will be increased;
- as of March 1, the rate on alcoholic beverages will be increased, and a tax on heated tobacco will be introduced;
- as of July 1, a tax on liquids for electronic cigarettes will be introduced.

Capital tax share in the total tax revenues was 8.2% in 2014. Capital tax revenues increased by 2% in 2014 compared to 2013.

In the first eleven months of 2015, capital tax revenues increased by 6.9% compared to the corresponding period of 2014.

Revenues from corporate income tax decreased by 2.1% in 2014. This is mainly due to a reduction in payments and an increase in the amount repaid. Repaid amounts increased by 3 million euro or 4.2% compared to 2013. At the same time, corporate income tax payments decreased by 4.7 million euro or 1.1 per cent.

Changes have been made in the field of corporate income tax as of 1 January 2014, aimed at encouraging investments in R&D, such as a prolonged opportunity to apply tax relief on new production equipment, extended terms for application of tax allowances for investments made in projects to be supported, etc. Changes have been also made in the field of micro-enterprise tax.

In the first eleven months of 2015, corporate income tax revenues increased by 8.8% compared to January-November 2014.

Amendments to the *Micro-enterprise Tax Law* provides for maintaining a 9% micro-enterprise tax rate in 2016 on all micro-enterprise turnover of up to 100 thousand euro a year.

Real estate tax revenues increased by 10.5% to 190.9 million euro in 2014.

As of 1 January 2014, changes have been made in the field of real estate tax, for example, tax exemptions for state-protected monuments were cancelled, the procedure for establishing a tax payer for national or municipal real estate was changed, etc.

In the first eleven months of 2015, real estate tax revenues increased by 3.8% to 195 million euro compared to January-November 2013.

As of 1 January 2015, it is established in the field of real estate tax that the real estate exemption period of 12 months as of the commissioning of the building will no longer apply to newly constructed or reconstructed buildings intended for carrying out economic activities.

It is planned to use two types of tax base for calculation of real estate tax from 2016 to 2025 – the cadastral value of real estate (in general) and the special value (for rural land with an area of more than 3 ha).

Resource taxes are the smallest group of taxes, which composed 6.6% of all tax revenues in 2014. Resource tax revenues increased by 1.5% in 2014, compared to 2013.

In the first eleven months of 2015, resource tax revenues were for 7.1% higher than a year earlier.

Natural resource tax revenues increased by 5% in 2014, compared to 2013.

As of 1 January 2014, several changes were introduced in the field of natural resource tax, for example, rates of new subjects of natural resource tax were introduced and natural resource tax rate was increased (for extraction of natural resources, waste disposal, air and water pollution, environmentally harmful goods, etc.).

In the first eleven months of 2015, natural resource tax revenues increased by 8.1%.

In 2014, revenue from the excise duty on oil products and natural gas amounted to 418.6 million euro, which is for 1.3% more than in 2013.

As of 1 January 2014, the rate of excise duty on natural gas used in industrial production was reduced and the excise duty on petroleum gases and other gaseous hydrocarbons was increased.

In the first eleven months of 2015, revenue from the excise duty on oil products and natural gas increased by 7.1% compared to January-November 2014.

As of 1 January 2015, changes were introduced in the field of excise duty that repealed the reduced rates of excise duty on certain fuel, specified rules on application of the excise duty exemption for natural gas used for heating of greenhouses, and established changes as regards the application of the excise duty relief on diesel fuel for agricultural purposes.

As of 1 January 2016, it is planned to increase excise duty rates on unleaded petrol, diesel, kerosene, LPG and a mixture of unleaded gasoline and ethanol.

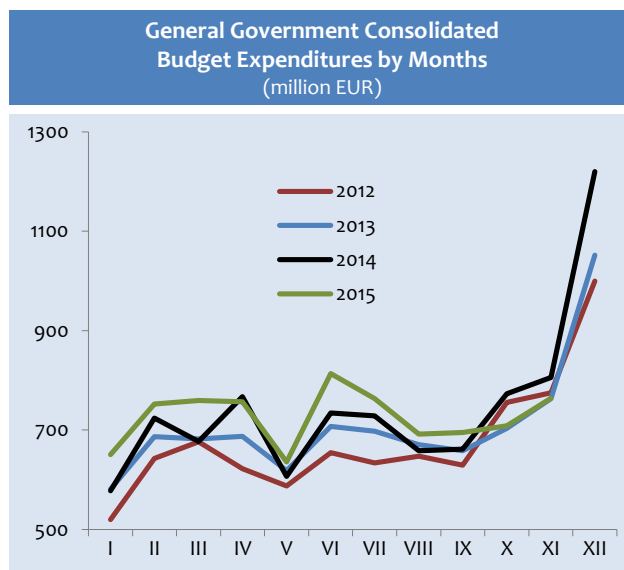
4.1.3 Budget Expenditure

After an extensive cutting down of expenditure during the economic crisis, the **general government consolidated budget expenditure** has been gradually increasing since 2011.

General government consolidated budget expenditure increased by 5% to 8934.9 million euro in 2014.

In the first eleven months of 2015, general government consolidated budget expenditure continued to increase, and it has increased by 3.6% to 7,991.6 million euro compared to the corresponding period in 2014.

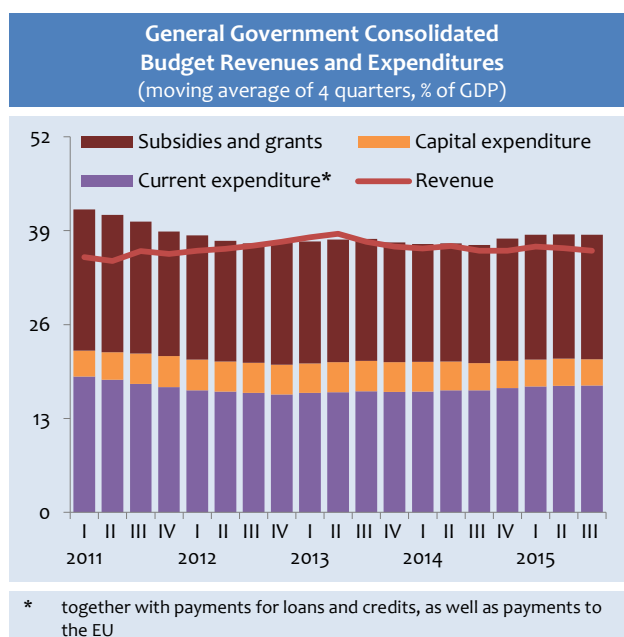
Figure 4.9



In 2014, **expenditure on subsidies and grants** increased by 7.4%. The sharp increase was largely due to higher cost of acquisition of EU fund projects in the transport sector, entrepreneurship and innovation, as well as for direct payments to farmers. The increase was also stimulated by the grants for health care, as well as support to milk producers, whose activities were adversely affected by the sanctions of Russia.

It should be noted that expenditure on subsidies and grants also increased during the economic crisis. It was largely due to the growing number of unemployed and paid unemployment benefits, payments of severance pay for the employees released from employment in the public sector, as well as social benefits.

Figure 4.10



* together with payments for loans and credits, as well as payments to the EU

In total, expenditure on subsidies and grants amounted to 44.7% of the total budget expenditure in 2014.

In the first eleven months of 2015, expenditure on subsidies and grants increased by 2.6% compared to January-November 2014.

When cutting the budget expenditure during the crisis, **capital expenditure** was one of the first to be limited. Already in 2008, capital expenditure was lower than a year earlier, and it was substantially reduced in 2009 and 2010. Capital expenditure increased in 2011-2013 in connection with active acquisition of the EU funds' assets.

Capital expenditure decreased by 4% in 2014.

The share of capital expenditure in the total expenditure constituted almost 10% of the total national budget expenditure in 2014.

In the eleven months of 2015, capital expenditure decreased by 6% compared to the corresponding period in 2014.

Current expenditure was reduced most significantly during the crisis. To reduce the national consolidated general budget expenditure, certain areas of public administration were optimised – cutting the number of employees and wages in ministries and public authorities, as well as reducing the number of state agencies and hospitals. These expenditures were reduced the most during the crisis. In 2008, current expenditure constituted more than a half of the total budget expenditure, while its share in 2014 constituted only 45.4 percent.

Both in 2011 and 2012, current expenditure basically did not increase, but it has been increasing since 2013.

Current expenditure grew by 8.7% in 2014. Such a rapid increase was largely due to an increase in the minimum wage and levelling of wages of the public sector employees.

In the first eleven months of 2015, current expenditure grew by 4.8% compared to the corresponding period of the previous year.

Table 4.3

Expenditures of the General Government Consolidated Budget by Functions (percentage)										
	structure					of GDP				
	2011	2012	2013	2014	2015 III	2011	2012	2013	2014	2015 III
Total expenditure	100	100	100	100	100	38.9	37.3	37.4	37.1	36.4
General government services	12.1	13.3	12.8	13.2	13.5	4.7	5.0	4.8	4.9	4.9
Defence	2.3	2.1	2.2	2.1	2.2	0.9	0.8	0.8	0.8	0.8
Public order and security	4.4	4.5	4.8	4.9	4.9	1.7	1.7	1.8	1.8	1.8
Economic activity	19.0	18.6	18.7	18.1	15.3	7.4	7.0	7.0	6.7	5.6
Environmental protection	2.5	2.3	2.4	2.4	2.2	1.0	0.9	0.9	0.9	0.8
Management of municipal territories and housing	3.0	3.0	3.0	2.6	2.4	1.2	1.1	1.1	1.0	0.9
Health	7.8	7.8	7.6	7.4	7.6	3.0	2.9	2.8	2.8	2.8
Recreation, culture and religion	3.2	3.5	3.6	3.4	3.4	1.3	1.3	1.4	1.3	1.3
Education	17.1	16.6	16.4	16.7	17.1	6.6	6.2	6.1	6.2	6.2
Social protection	28.5	28.2	28.4	29.1	31.3	11.1	10.5	10.6	10.8	11.4

According to the budget expenditure by functional categories, social protection, education, general government services and economic activity contributed the most to the increase in expenditure in 2014. At the same time, expenditure on management of municipal territories decreased.

Similar trends in expenditure dynamics remain also in 2015.

Public demand consists of national consumption or public services, the value of which is determined by the volume of public services, as well as public investment, which is capital investment from the budget.

Public demand fell sharply during the crisis. It began to rise again in 2011, driven by a rapid increase in the

national budget expenditure on investment and an increase in local government expenditure.

By contrast, public demand decreased by 0.4% and 0.1% in 2012 and 2013, respectively. The decrease was largely driven by reduction of the central government budget expenditure, as well as a decrease in the national budget expenditure on investments.

Public demand resumed growth in 2014 – by 4.4%. It was determined by a more rapid increase in central government budget expenditure – by 8%, as well as increase in the amount of central government budget expenditure on investments – 13.4%. At the same time, local government expenditure decreased, driven by reduced local government budget expenditure on investments – by 8.3 percent.

Table 4.4

	Public Demand (percentage)									
	of GDP					changes				
	2010	2011	2012	2013	2014	2010	2011	2012	2013	2014
Public demand	23.1	23.3	22.2	22.0	22.0	-8.5	5.5	-0.4	-0.1	4.4
National consumption	18.4	18.3	17.4	17.6	17.6	-8.1	3.0	0.3	1.6	4.9
– central government*	10.4	10.1	9.4	9.3	9.6	-2.9	0.4	-1.8	-0.1	8.0
– local governments	8.0	8.2	8.0	8.3	8.0	-14.2	6.5	2.8	3.7	1.5
Gross fixed capital formation	4.7	5.0	4.9	4.4	4.4	-9.8	15.0	-3.0	-6.3	2.1
– central government*	2.1	2.6	2.6	2.1	2.4	-8.6	30.7	-0.2	-14.7	13.4
– local governments	2.6	2.4	2.3	2.3	2.1	-10.8	2.2	-5.9	2.9	-8.3

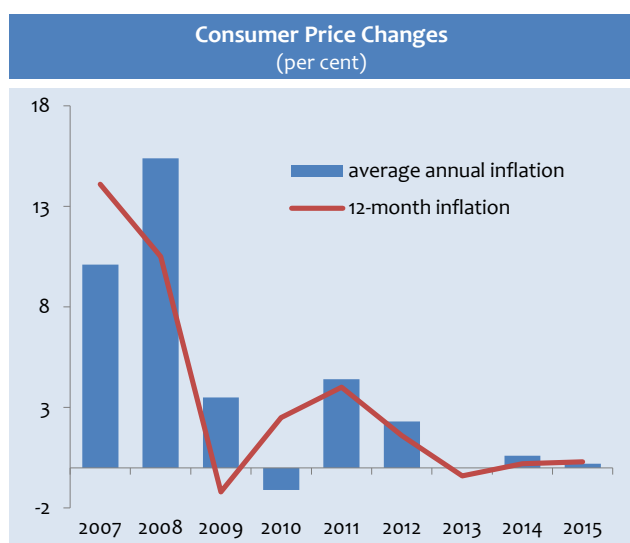
* together with the Social Insurance Fund

4.2 Prices

4.2.1 Consumer Prices

After the deflation caused by the crisis, when the 12-month consumer price inflation fell to -4.2% in February 2010, prices started to rise again. In 2011, the 12-month consumer price inflation was 4%, in 2012 – 1.6%, while in 2013, consumer prices fell by 0.4%. There was a moderate rise in prices in 2014, and it was more rapid than the year before – consumer prices rose by 0.2%, but the price changes were lower than the traditional seasonal fluctuations. Price changes in 2014 were mainly due to an increase in prices of tobacco and services, as well as a reduction of expenses on transport (fuel) and food. Global dynamics of food and oil prices had a great influence.

Figure 4.11



A moderate price increase continued in 2015, and it was lower than the year before, despite the sharpest increase in prices over the last four years that was observed at the beginning of the year. In 2015 the average inflation was 0.2 percent.

Table 4.5

Consumer Price Changes by Months (per cent)				
		compared to the previous month	compared to the respective month of the previous year	annual average
2014	July	-0.4	0.6	0.2
	August	-0.6	0.8	0.3
	September	0.5	1.0	0.4
	October	0.0	0.7	0.5
	November	-0.3	0.9	0.6
	December	-0.6	0.2	0.6
2015	January	0.1	-0.4	0.6
	February	0.3	-0.1	0.5
	March	0.8	0.4	0.5
	April	0.6	0.5	0.5
	May	0.6	1.2	0.6
	June	-0.2	0.6	0.5
	July	-1.0	0.0	0.5
	August	-0.5	0.1	0.4
	September	-0.1	-0.5	0.3
	October	0.3	-0.2	0.2
	November	0.0	0.0	0.2
	December	-0.3	0.3	0.2

In December 2015, compared to December of the year before, consumer prices rose by 0.3 per cent.

The main factors affecting prices in 2015:

- An increase in electricity price due to the opening of the electricity market as of 1 January 2015 had the greatest impact on the increase in prices. Electricity prices rose by an average of 27.6%, which increased the overall level of consumer prices by 0.9 percentage points. In the housing group, the prices of water supply and other housing-related services rose by 1.7%. This was partly compensated by a fall in prices of heat energy by 12.7% and gas – by 9.5%, which together lowered the total level of consumer prices by 0.65 percentage points. In total, the prices in the housing maintenance group rose by 1.7%, which increased the overall level of consumer prices by 0.3 percentage points.
- A drop in oil prices all over the world. Despite the global rise in oil prices in February-May, there has been a sharper drop in oil prices since June, with the prices dropping by almost 40% in total over the year. In connection with the news on a significant increase in oil stocks in the US, as well as the OPEC's decision not to reduce oil production quotas, the price of crude oil in December dropped to the lowest level since December 2008 – USD 35 per barrel. In Latvia, the drop in fuel prices over the year had the greatest impact on the reduction in prices, although the decline in oil prices was not as sharp as the drop in global oil prices. A more rapid drop in fuel prices is prevented by the strong US dollar to euro foreign exchange rate. Over the year, the fuel prices in Latvia decreased by 11% and reduced the overall price level by 0.65 percentage points. This was partly compensated by an increase in the prices of transport services that increased by 9.1%. In total, the prices in the transport group decreased by 2.3%, which decreased the overall level of consumer prices by 0.3 percentage points;
- A rise in prices of alcoholic beverages and tobacco due to an increase in the excise tax rate. Prices of alcoholic beverages grew by 5.7%, while the price of tobacco grew by 1.8%, which together increased the total level of prices by 0.4 percentage points;
- Prices of food decreased by 0.8%, which decreased the overall level of consumer prices by 0.2 percentage points. The drop in prices of milk and dairy products had the most significant impact. The drop in prices of milk and milk products was the sharpest since 1997 (except for 2009), which was still affected by Russia's embargo as of August 2014. Changes in food

prices are largely determined by the global price fluctuations. Global food prices in 2015 continued to decline for the fourth year in a row. In December 2015, compared to December of the 2014, prices dropped by 17%, which was affected by a drop in prices in all major food groups. Extensive supply together with the weak demand and the high value of the US dollar were the main causes of the drop in global food prices. The prices of meat and cereals decreased most rapidly in relation to a higher yield than expected in the product exporting countries. Global drop in food prices was also due to sluggish trading activity and expectations of deflation, with the buyers hoping for even lower prices in the following months. Prices of dairy products saw a sharp decrease in the middle of the year due to Russia's embargo, removal of the milk quota system in the EU, as well as uncertainty about China's purchases of dairy products in 2015. In September-December, prices of sugar rose sharply in relation to the bad weather in the key exporting countries, but, in general, the prices decreased over the year, thanks to a decrease in prices in the first half of the year.

A moderate inflation is expected in 2016, but it will be higher than in 2015. It will be influenced by various supply factors related to the increased tax rates, as well as the rise in demand, stimulated by the growth of economic activities and wages. At the same time, inflation will still largely depend on global oil and food price fluctuations. The Ministry of Economics projects that the overall average annual inflation may be around 1% if the global oil and food prices will maintain a moderate dynamics and no rapid changes in prices are expected.

Figure 4.12

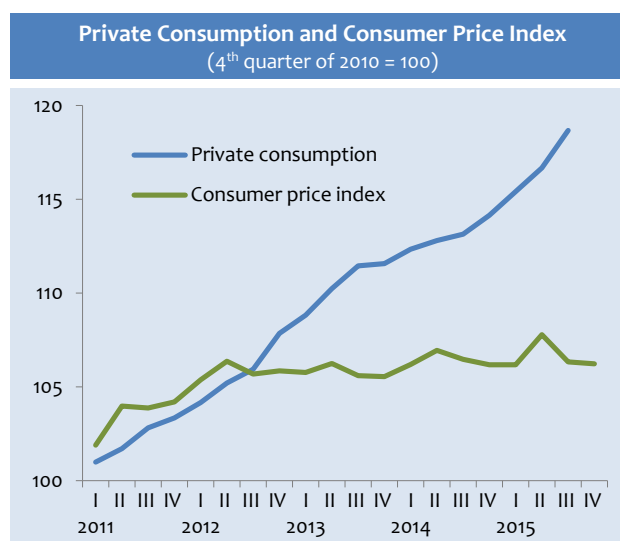
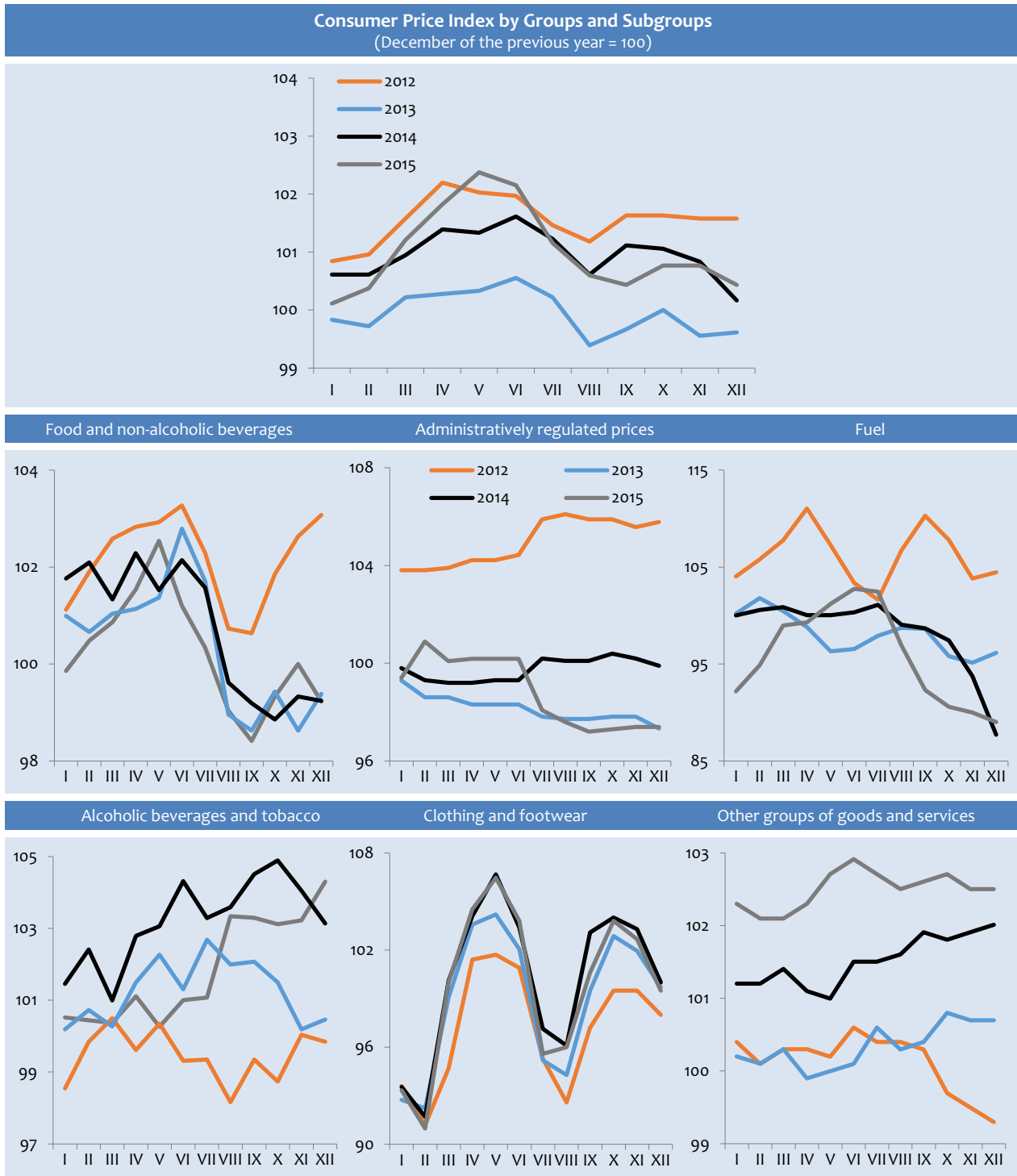


Figure 4.13



The average **inflation in the EU** was 0.6% in 2014. It was mainly due to an increase in prices of services.

In December 2015, compared to December 2014, the price level grew by 0.2% in the EU countries as a whole as well as in the Eurozone. Inflation increased most rapidly in Greece, Belgium, Hungary, and Luxembourg, but prices fell more rapidly in Romania and Finland. The

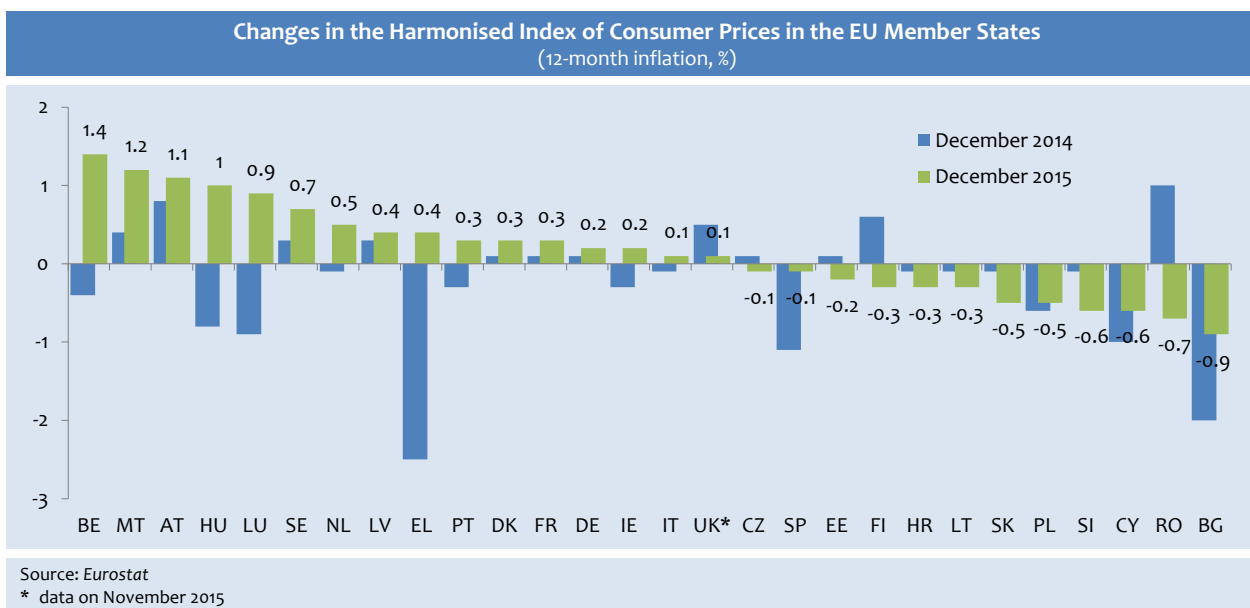
highest inflation in December 2015 was in Belgium and Malta, but the biggest deflation – in Bulgaria.

When comparing the Baltic States, the harmonised index of consumer prices in December 2015 increased by 0.4% in Latvia, compared to December 2014. Consumer prices in Lithuania and Estonia decreased – by 0.3% and 0.2% respectively. In December 2015, compared to December 2014, consumer prices in the food, alcohol,

and tobacco products group had an increase in Latvia and Estonia, mainly due to a rise in the prices of alcohol, tobacco, and non-alcoholic beverages, while the food

prices decreased in all three states. Prices in the energy group fell in all countries.

Figure 4.14



In the Baltic states, prices in the group of food, non-alcoholic beverages, alcohol, and tobacco products rose by 1.3% in Estonia, by 0.5% in Latvia and by 0.3% in Lithuania. Energy prices fell most sharply in Lithuania – by 11.5%, in Estonia – by 9.7%, while in Latvia energy prices experienced the smallest drop – by 2.8%. There was a drop in administratively regulated prices in all Baltic states. The drop was the sharpest in Estonia – by 7.2%, while in Latvia and Lithuania the prices fell by 2.6% and 2.2% respectively.

It should be noted that prices in the services group in Lithuania rose more sharply than in Latvia and Estonia – by 3.7% (in Latvia and Estonia – by 2.1% and 1.7% respectively) in December 2015, compared to December of the year before. Over the year, prices in Latvia were mostly affected by a rise in prices in the services groups and prices of alcohol and tobacco, since the prices in other groups fell.

Figure 4.15

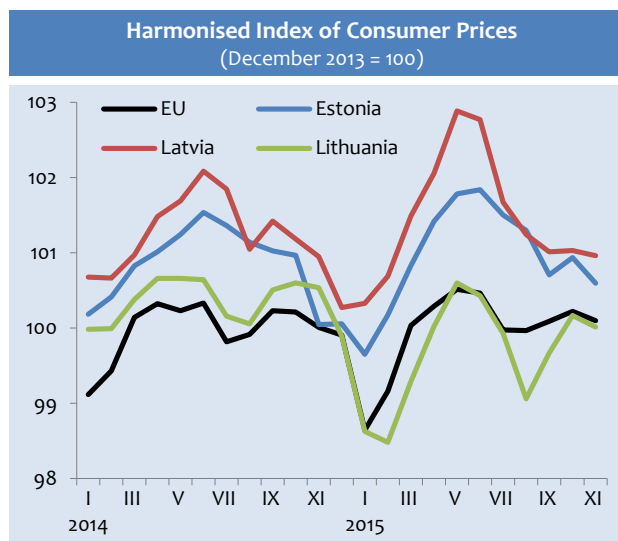
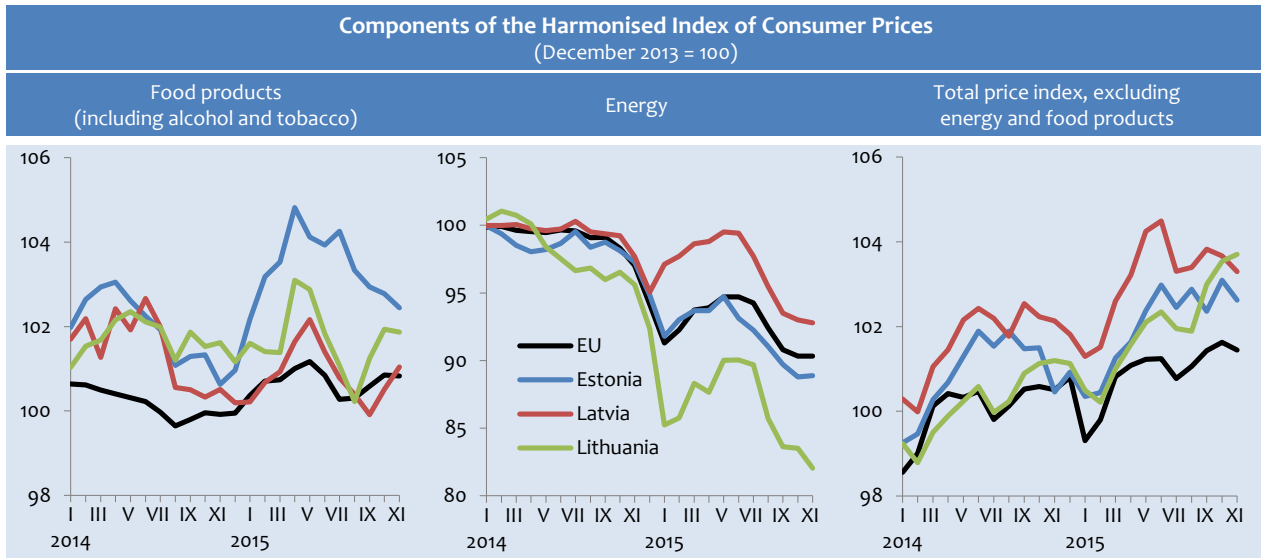


Figure 4.16

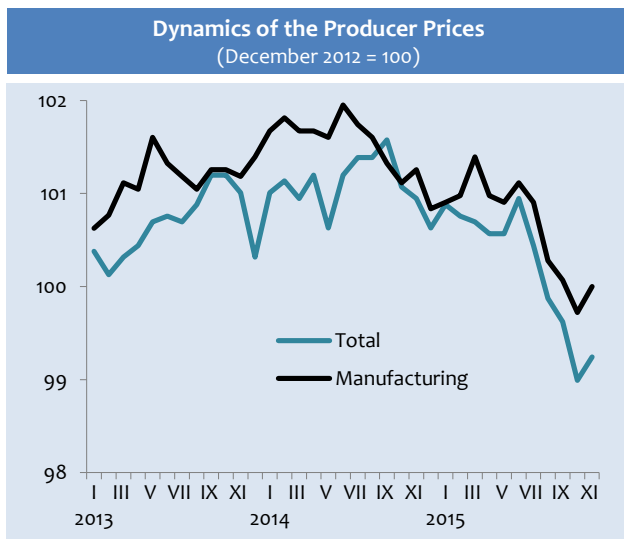


4.2.2 Producer Prices

Producer prices in 2012 showed a slight increase, but in 2013 producer prices increased very moderately – by 0.3%. In 2014, a moderate growth continued – by 0.3%, within a year the producer prices of products sold on the domestic market increased by 0.5% over the year, while the producer prices of exported products – by 0.1 per cent.

In December 2015, compared to December 2014, the average level of producer prices in the industry fell by 1.6% in total. The producer prices of products sold on the domestic market decreased by 2.6% over the year, while the producer prices of exported products – by 0.5%. Producer prices fell in all industrial sectors, except for the mining industry.

Figure 4.17



Slightly more than 60% of the manufacturing production is exported; therefore the overall producer price dynamics of the industry is largely affected by the fluctuations in producer prices of the exported production. The prices of exported production, in their turn, are mainly determined by the price dynamics of the Latvian key export goods, including timber, metal products, and food, in global markets. The price of production sold on the domestic market, in its turn, is affected by the domestic demand.

In December 2015, the total level of producer prices in the manufacturing fell by 1.1%. Producer prices of the production sold on the domestic market fell by 1.7% in the manufacturing over the year, while the producer prices of exported production – by 0.7%. Producer prices in the manufacturing were affected by Russia’s embargo on food, as well as the economic situation in the EU and Russia, and the global drop in prices of raw materials, in particular the decline in prices of energy resources since mid-2014. It should be noted that, in December 2015, compared to December of the year before, a sharp drop in global prices of energy, industrial, and agricultural raw materials was observed.

In terms of sectors, the most significant rise in producer prices in the manufacturing was experienced in the production of chemical substances and products (by 8.7%), production of beverages (by 8%) and manufacture of electrical equipment (by 3.3%). Increase in producer prices in these sectors was due to an increase in the prices of exported production, excluding the beverage industry, where the price increase was due to a rise in prices both of the production sold on the domestic market and the exported production.

By contrast, producer prices in the manufacturing fell in the production of wood products – by 3%, food – by 3.3%, and non-metallic mineral products – by 3.7%. A fall in producer prices for wood products was due to a more rapid decrease in prices of the exported production, whereas the prices in food production decreased more rapidly for the production sold on the domestic market, which was related to the trade restrictions introduced by Russia. It should be noted that the global food prices decreased significantly (by 17%) over the year. By contrast, prices in the non-metallic mineral products industry decreased more rapidly for the production sold on the domestic market because of the weak demand in the construction industry.

The rise in producer prices in the EU has been decreasing since mid-2011. It was mainly influenced by a drop in the prices of food, as well as agricultural and industrial raw materials, to some extent determined by a decrease in the global demand in connection with the escalation of the debt crisis in the euro area from 2011 to 2012, the deteriorating economic situation in other developed countries, as well as the slowdown of global trade growth and uncertainty about future fiscal consolidation in most developed countries. In 2014, producer prices experienced a sharp drop in the EU because of the economic situation between the EU and Russia due to the crisis in Ukraine, and a drop in the global prices of raw materials.

In January-November 2015, producer prices continued to fall in the EU's manufacturing (by 1.2%). When comparing the Baltic States, producer prices in the

manufacturing in November 2015, compared to November 2014, decreased in all Baltic states. The prices fell most rapidly in Lithuania due to a decline in the oil processing industry – by 9%, while producer prices in Estonia and Latvia fell by 1.4% and 1.3% respectively.

Figure 4.18

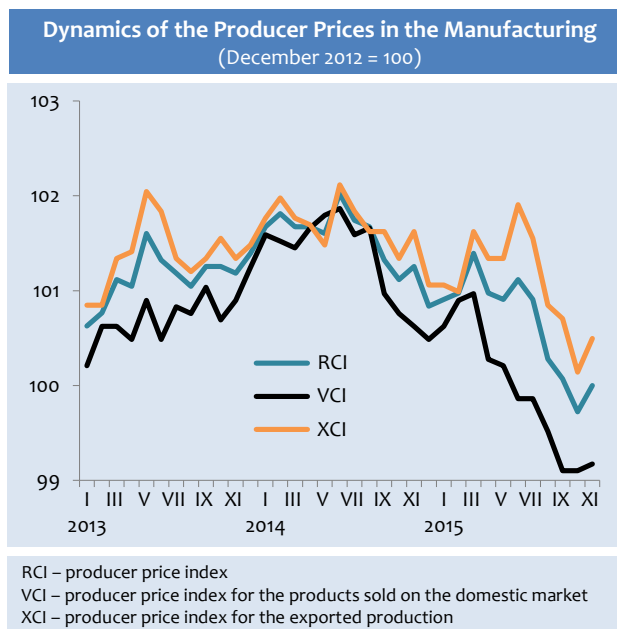
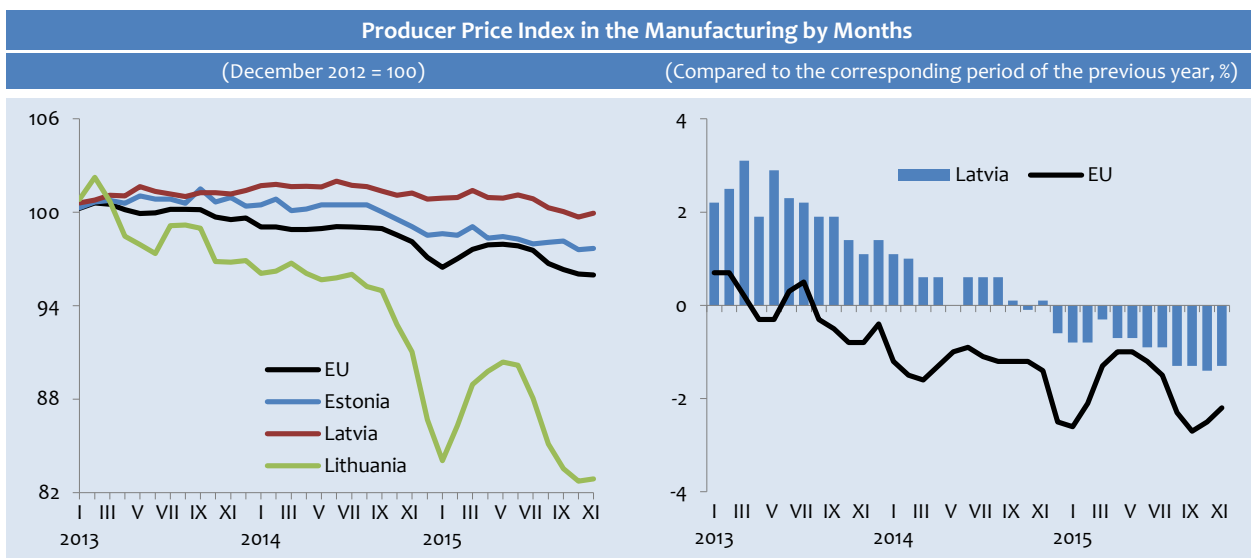


Figure 4.19



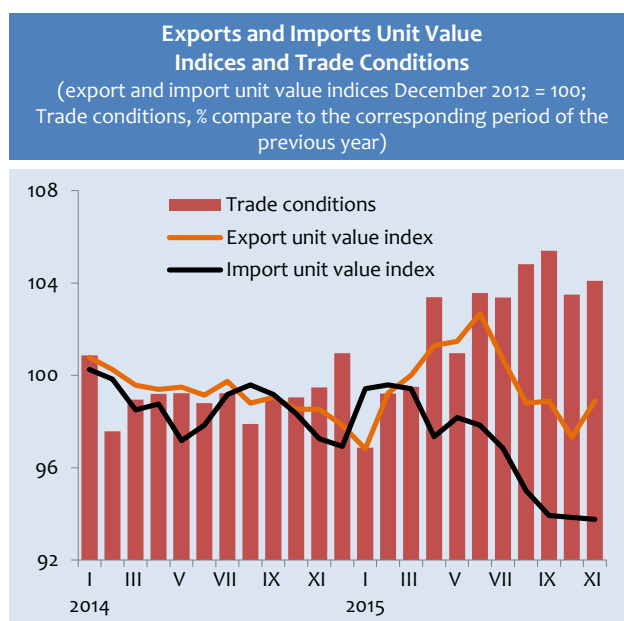
4.2.3 External Trade Unit Value Indices

In 2014, the terms of trade deteriorated slightly. The unit value of exported goods fell by 2.1%, but that of imported goods – by 3.1% in December 2014. The drop in both export and import unit value in 2014 was mostly due to a decrease in the unit value of coke and refined petroleum products.

Terms of trade improved rapidly in January–November 2015, with the unit value of exported goods exceeding the unit value of imported goods by more than 4 percentage points in November. In November 2015, the unit value of exported goods increased by 0.3% compared to the year before, while the unit value of imported goods fell by 3.6%. The average level of export unit value in November 2015, compared to November 2014, was mostly affected by an increase in the unit value of agricultural products, computers, electronic and optical equipment, chemicals, beverages, base metals and electrical equipment, as well as a decrease in the unit value of coke and refined petroleum products, wood and wood products, as well as food products. The average level of import unit value was mostly affected by a decrease in the unit value of coke and refined petroleum products, crude oil, and natural gas production, base metals and agricultural products, while at the same time it was increased by a rise in the unit value of computers,

electronic and optical equipment, pharmaceutical substances, food products, electrical equipment, clothes, and leather products.

Figure 4.20



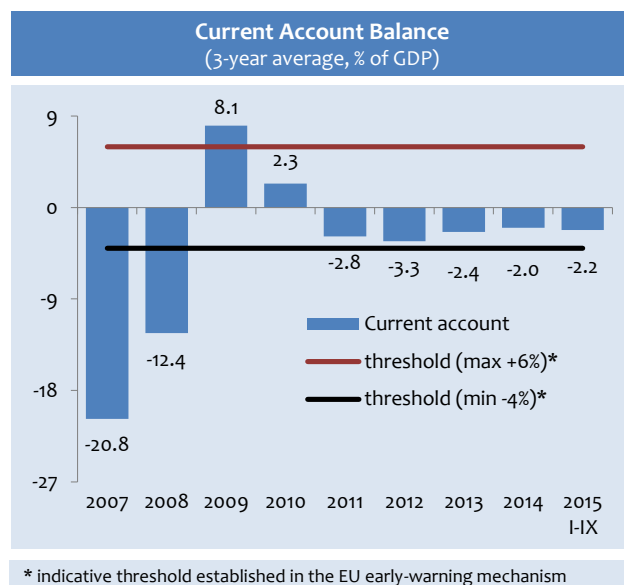
4.3 Balance of Payments

4.3.1 Current Account

Figure 4.21

The external stability of Latvia has improved significantly since the crisis. Current account of the balance of payments has been at a level of small deficit in recent years. It was 3.3% of GDP in 2012, 2.4% of GDP in 2013, 2% of GDP in 2014, which was greatly influenced by improvement of the external trade balance. The average negative balance of the current account was 2.6% of GDP in the last three years, which does not exceed the indicative threshold determined in the early warning mechanism of the EU, and can be assessed as sustainable. In the first nine months of 2015, current account of the balance of payments had a small deficit – 2.2% of GDP.

The indicator of the current account balance is close to the level of balance also in our neighbouring countries, and annual fluctuations of the indicator are quite insignificant. In nine months of 2015, the current account balance in Lithuania was at a level of a moderate deficit (3.8% of GDP), whereas in Estonia it had a small surplus (2.6% of GDP).



* indicative threshold established in the EU early-warning mechanism

The condition of the Latvian current account is mainly determined by changes in the balance of external trade. Latvia is characterized by an external trade deficit, which increased in the years of rapid growth and decreased in the years of recession. Cyclic adjustments of the current account were largely determined by a significant decrease in import volumes. When the economy stabilised, the import volumes also increased. By contrast, the export volumes of goods increased faster than the imports, and the balance of external trade improved. In recent years, dynamics of both exports and imports have become slower.

Since 2011, the deficit of external trade becomes lower each year, which is mainly due to exports growing faster than imports. From 2011 to 2014, exports of goods at current prices increased on average by 7% annually, and it exceeded the pre-crisis level by 80% in 2014. By contrast, imports of goods grew on average by 5.1% annually and, in 2014, it was by 15% higher than in 2007. Foreign trade deficit reached 9.6% of GDP in 2014,

which was by almost 1.5 percentage points lower than a year before and considerably lower than prior to the crisis (in 2007 – 22.9%).

Export volumes of goods increased faster than the imports also in 2015, and the balance of external trade continued to improve. In the first eleven months of 2015, export volumes of goods at current prices were by 1.2% higher than a year before, while imports rose by 0.3%. Exports were positively influenced by an increase in the volumes of exports of machines, appliances and electrical equipment, production of the chemical industry, as well as wood and wood products. At the same time, the export value of agricultural and food products and mineral products fell due to a significant drop in prices. The exports of vehicles, products of the light industry, as well as metals and metal products also fell.

Foreign trade deficit decreased by 0.5 percentage points and was 9.7% of GDP in three quarters of 2015, compared to the corresponding period of the year before.

Table 4.6

Balance of Payments of Latvia (% of GDP)						
	2011	2012	2013	2014	2014 I-IX	2015 I-IX
A. Current account	-2.8	-3.3	-2.4	2.0	-2.5	-2.2
Trade balance	-12.1	-11.7	-11.2	-9.6	-10.2	-9.7
Exports	41.0	44.2	43.1	43.2	42.9	42.2
Imports	53.9	56.0	54.3	52.8	-53.1	-51.9
Balance of services	7.3	7.4	7.8	7.4	7.5	7.3
Primary income	0.0	-0.6	-0.3	-0.2	-0.2	-0.2
Secondary income	1.9	1.6	1.3	0.4	0.4	0.4
B. Capital account	2.1	3.0	2.5	3.2	3.4	3.2
C. Financial account*	4.1	-2.9	0.7	3.9	5.1	-2.7
Direct investment	-4.9	-3.3	-1.6	-1.0	-0.8	-2.6
Abroad	0.2	0.7	1.4	0.9	0.5	0.3
In Latvia	5.2	4.0	3.0	1.9	1.3	2.9
Portfolio investment**	1.8	-4.8	-0.1	0.2	-0.3	7.3
Assets	1.0	1.8	0.0	6.0	7.8	6.0
Liabilities	-0.8	6.6	0.1	5.7	8.1	-1.2
Other investment	7.2	5.1	1.0	4.6	6.2	-7.4
Assets	1.5	1.2	0.0	6.0	11.5	-6.7
Liabilities	-5.7	-3.9	-1.0	1.3	5.3	0.7
D. Net errors and omissions	0.3	1.0	0.8	4.1	3.5	-1.6
E. Reserve assets	-4.5	3.6	1.7	-0.5	-0.6	2.2
* without reserve assets						
** portfolio investment and financial derivatives						

The balance of services is positive in Latvia. In 2012-2014, the surplus of the balance of services was 7.5% of GDP on average. In 2014, exports of services fell by 1.2%, largely due to a decrease in road freight transport.

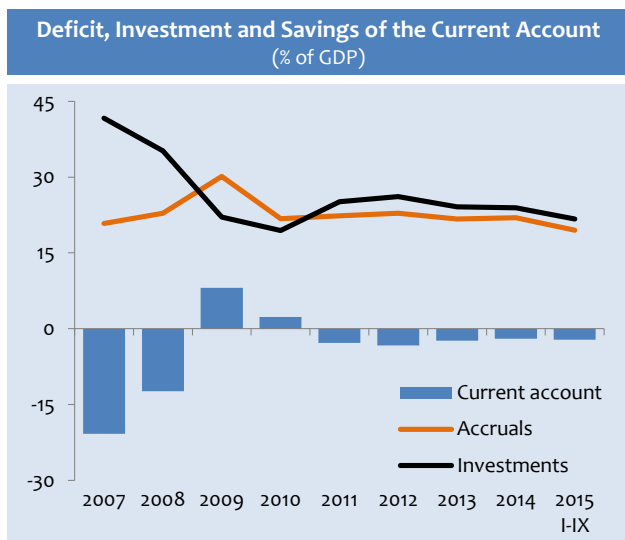
Imports of services fell by 0.9%, and in 2014 the surplus of the balance of services reached 7.4% of GDP in total (in 2013 – 7.8% of GDP). In 2015, dynamics of the imports of services were more rapid than the dynamics of

exports, which provoked a decrease in the surplus of the balance of services. In nine months of 2015, the volume of export of services at current prices was by 5.1%, whereas the imports – by 8.5% higher than a year before, and the balance of services reached 7.3% of GDP. Exports of services were positively influenced by an increase in the income from foreign tourists, financial services, as well as from computer and information services provided to non-residents. By contrast, road transport exports, in total, were by 9% lower than a year before. The positive balance of services covered the deficit of external trade of goods almost by 76% in nine months of 2015.

The initial balance of income has been negative over the last three years – an annual average of 0.7% of GDP with relatively minor fluctuations, mainly due to changes to non-residents' investment income, as well as the inflow of EU funds. In 2014, as well as in nine months of 2015, the initial income deficit was 0.2% of GDP. This was mainly due to an increase in reinvested profit.

Changes in the secondary income and capital account are mainly due to flows of finances of the EU funds and contributions made by Latvia into the EU budget. In 2014, the balance of secondary income account had a surplus – 0.4% of GDP. In the first nine months of 2015, the secondary income balance remained at the level of the previous year. In the first nine months of 2015, the capital account surplus was 3.2% of GDP. The capital account surplus is greatly affected by activities of acquisition of the EU funds, including attraction of the funding of the European Regional Development Fund and the Cohesion Fund.

Figure 4.22



The large deficit of the current account in the pre-crisis years showed a significant imbalance between the domestic investment and accruals. Since 2007, the level of national accruals showed a gradual growth, while the level of investment in the economy of Latvia decreased from 40% of GDP in 2007 to 23.9% of GDP in 2014. A

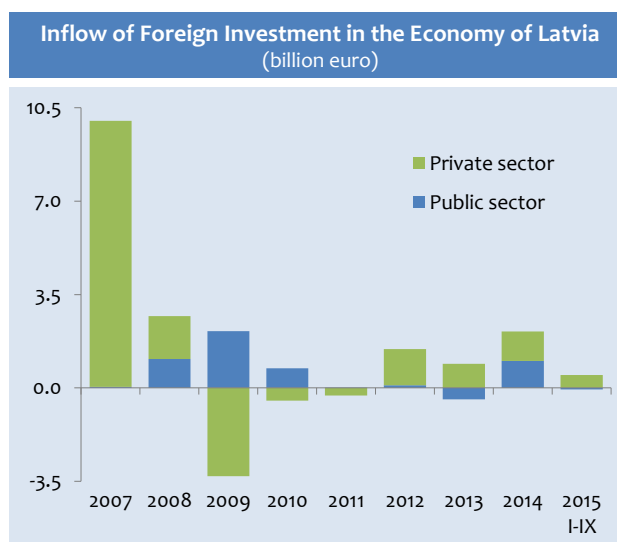
moderate deficit of the current account balance indicates that there is a balance between the accruals and domestic investment.

4.3.2 Financial Flows

The global financial crisis influenced cross-border financial and capital flows significantly, causing major adjustments to the financial account of the balance of payments. Since 2010, the deficit of the financial account is decreasing. At the same time, the instability of financial flows is also decreasing.

In recent years, the condition of the financial account balance was mainly determined by measures for stabilisation of the financial sector, as well as by the policy of restructuring of public sector debts and reduction of debt commitment.

Figure 4.23



In total, from 2009 to 2011, the balance of the financial account (assets minus liabilities) was positive, respectively, 6.1%, 2.1% and 4.1% of GDP. By contrast, in 2012 and 2013, the balance of the financial account was negative, respectively, 2.9% and 0.7% of GDP.

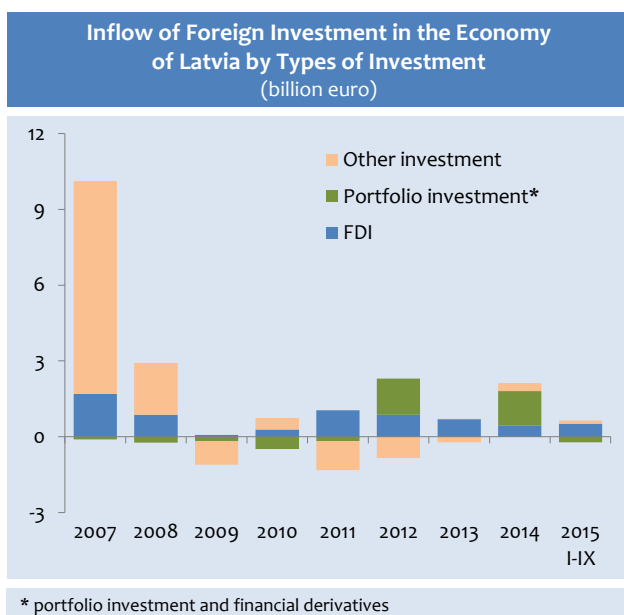
In 2014, the balance of financial account of the payments balance (excluding reserve assets) was positive, reaching 3.9% of GDP, mainly driven by growth in the assets of credit institutions in the form of debt securities and deposits in the first half of 2014. In the first nine months of 2015, the financial account was negative – 2% of GDP.

Foreign investment in the pre-crisis years was mainly attracted by the private sector. The unfavourable conditions in the global financial markets weakened the intensity of foreign investment flows, and the volume of private capital inflow decreased rapidly as of 2008. The structure of attracted foreign capital flows has also changed since 2007.

The inflow of direct investment exceeds the outflow, while the balance of direct investment is negative. From 2011 to 2014, flows of the attracted FDI amounted to almost 3.5% of GDP a year on average. It should be noted that the intensity of FDI flows decreased every year from 5.2% of GDP in 2011 to 1.9% in 2014. It was largely affected by the weak economic activity in the EU member states, as well as uncertainty of the geopolitical situation. In early 2015, foreign investors' activity increased, and the attracted FDI reached almost 3% of GDP over the first nine months of the year.

The share of portfolio investment has been constantly changing over the last three years. Fluctuations of portfolio investment flows are significantly influenced by transactions for stabilisation of the banking sector balances, as well as restructuring of the external state debt. In 2014, portfolio investment balance (assets minus liabilities) was negative, -0.4% of GDP. By contrast, in the first nine months of 2015, the portfolio investment balance was positive – 6.7% of GDP, mainly influenced by the portfolio investment of the Bank of Latvia and credit institutions in foreign long-term debt securities.

Figure 4.24



Other investment account of the balance of payments has been positive since 2009 with explicit quarterly fluctuations, mainly influenced by the reduction of investment in the banking sector.

The positive balance of other investment account constituted 4.6% of GDP in 2014. In the first nine months of 2015, the other investment account was negative – 7.4% of GDP, which was largely influenced by a decrease in monetary and investment assets of credit institutions. Similarly to the portfolio investment, fluctuations of other investment balances are also mainly related to the financial sector stabilisation measures and public sector debt restructuring policy.

In general, it should be noted that incoming flows of foreign investment are gradually becoming stable; however, they are much smaller than prior to the crisis.

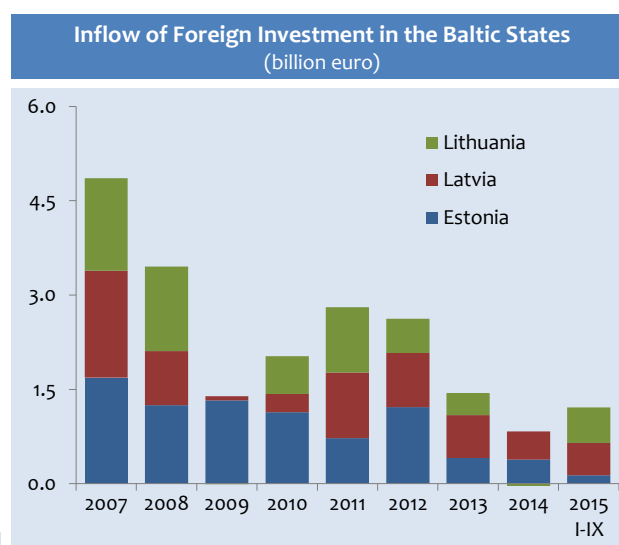
The gross external debt of Latvia remained at a relatively high level. As shown by the data of the Latvian international investment balance, the gross external debt constituted 144.3% of GDP at the end of September 2015. Also, the gross external debt of the government reached 6,965.8 million euro (28.8% of GDP).

4.3.3 Foreign Direct Investment

Intensity of FDI flows in Latvia, as well as in other Baltic countries is quite moderate. It should be noted that cross-border investment flows have decreased all over the world in general, which is primarily due to the instability of the global economy, increased geopolitical risks and political unpredictability.

From 2011 to 2014, the average annual inflow of FDI in the Baltic States was almost three times lower than in the pre-crisis years. In 2015, compared to 2014, the volume of incoming FDI increased in Latvia and Lithuania, while it was lower in Estonia.

Figure 4.25

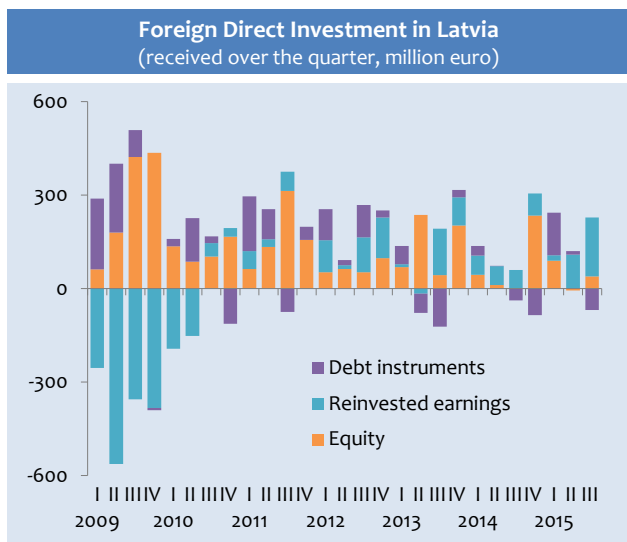


In total, the Baltic States attracted FDI of 1,213.1 million euro in the first nine months of 2015 – for 37% more than a year before. Latvia attracted approximately 42% of all FDI in the Baltic States, Estonia – 11%, and Lithuania – 47 per cent.

Dynamics of the flows of FDI attracted to the economy of Latvia have been more moderate in recent years than prior to the crisis. From 2011 to 2014, the volume of incoming FDI was almost a quarter less than in the years of high economic growth. In 2014, net inflow of FDI in Latvia reached 1.9% of GDP, i.e., almost 1 percentage point less than a year before. In 2015, the activities of foreign investors increased and, in the first nine months of the year, compared to the corresponding

period of the year before, FDI flows increased almost 2.3 times and constituted 3% of GDP, mainly influenced by an increase in reinvested earnings. It should be noted that reinvested earnings constitute almost 40% of the attracted FDI since 2011.

Figure 4.26

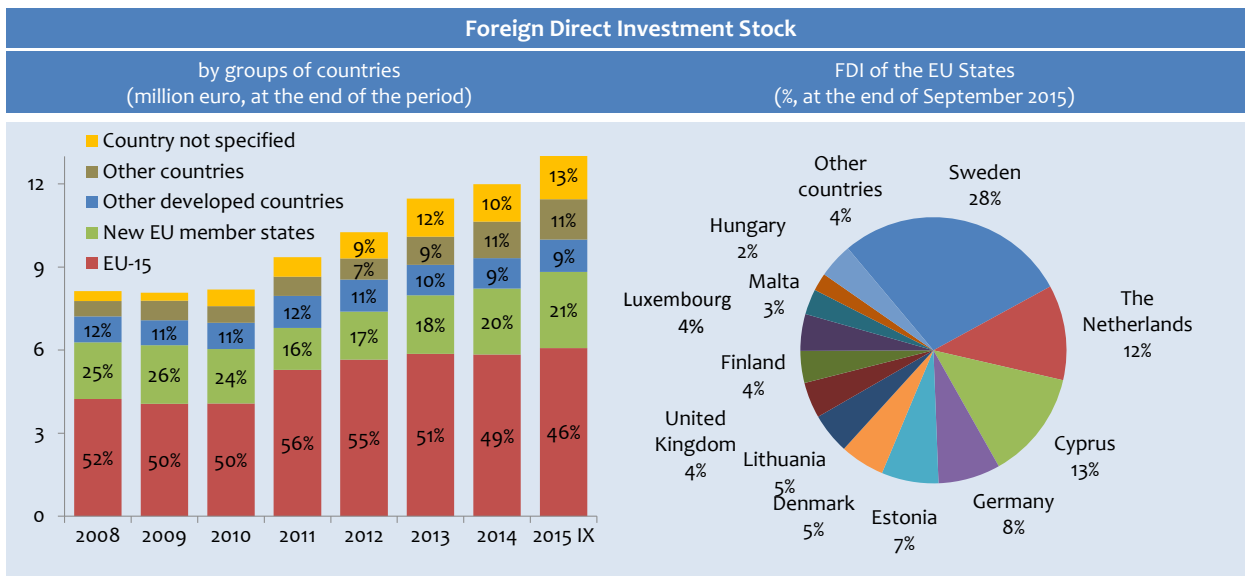


The external investment of Latvian entrepreneurs has become more moderate. The investment of Latvian entrepreneurs in the form of direct investment in the first nine months of 2015 was almost by half lower than a year before and constituted 0.3% of GDP.

According to the balance of international investment of Latvia, the amount of FDI accrued in the economy of Latvia at the end of September 2015, reached 13,143.4 million euro, whereas the share of the said FDI constituted almost 30% in the structure of the accrued foreign capital. Compared to the corresponding period of the year before, the level of accrued FDI rose by 10.8%, which was influenced by the increase in accrued direct investment of entrepreneurs from Cyprus, Russia, the Netherlands, Norway, Luxembourg, and the United Kingdom. Investment in the bank intermediation, transactions with real estate, and the manufacturing constitute a larger proportion of accrued FDI in the structure of sectors.

In general, the geopolitical structure of FDI accrued in Latvia has not changed significantly. Most of them are mainly investments of the EU states. At the end of September 2015, FDI of the EU states constituted 67% of all accrued FDI, and almost 60% of this amount was constituted by the investment of the euro area countries.

Figure 4.27



Sweden is the major investing country in the economy of Latvia. At the end of September 2015, the investment of Swedish entrepreneurs constituted 19% of the total accrued FDI. It was mainly the investment in the financial intermediation. Since the end of 2008, the direct investment of Sweden doubled, which was mainly related to mutual transactions in the banking sector between Estonia and Sweden. Due to these activities, the accrued direct investment of Estonian entrepreneurs in Latvia decreased almost by half and at the end of September 2015 constituted 4.7% of the total accrued FDI (at the end of 2008 – 16.1%).

A high level of investment is also reached by entrepreneurs from the Netherlands, Cyprus, Germany, Norway, Russia, Estonia, Lithuania, Denmark, and the United Kingdom. At the end of September 2015, the amount of investment by these countries constituted 70% of the total accrued FDI in the economy of Latvia. It must be noted that activities of Asian investors in Latvia have been increasing in recent years. At the end of September 2015, the accrued FDI of Asian countries constituted 2.5% of the total FDI in the economy of Latvia, which was almost three times higher compared to the end of 2008.

Most of FDI was attracted in service industries. During the years of rapid growth, the structure of incoming FDI flows was clearly dominated by the investment in the sector of financial intermediation. The annual amount of FDI in the services sector was almost four times higher on average than in the manufacturing sector.

Since 2010, the structure of incoming FDI flows in Latvia has become more steady, without a clear dominance of the financial sector.

At the end of September 2015, the accrued FDI in the services sector constituted 77% of the accrued FDI in the economy of Latvia. It rose by 78%, compared to the end of 2007. Almost a half of the accrued FDI in the

services sector was constituted by the sectors of financial intermediation and real estate.

At the end of September 2015, the accrued FDI in manufacturing sectors constituted 22.6% of the total amount of accrued FDI in the economy of Latvia. It rose by 67%, compared to the end of 2007.

The amount of investment in the manufacturing has increased significantly. From the end of 2007 to the end of September 2015, the amount of accrued FDI in the manufacturing increased more than twice, which was significantly influenced by large investment in the production of construction materials, woodworking, and food industry.

Table 4.7

FDI by Sectors (at the end of the period)						
	(balance in million euro)			(structure in %)		
	2005	2007	2015 IX	2005	2007	2015 III
Agriculture	64.6	130.3	464.7	1.6	1.7	3.5
Manufacturing	490.4	695.5	1486.7	11.8	9.3	11.3
Other industry	544.7	439.0	500.8	13.1	5.9	3.8
Construction	175.2	513.6	519.4	4.2	6.9	4.0
Trade and accommodation	577.4	1003.0	1433.7	13.9	13.4	10.9
Transport and storage	257.2	282.3	425.1	6.2	3.8	3.2
Financial intermediation	1062.9	2492.3	3474.1	25.6	33.4	26.4
Operations with real estate	283.9	662.3	1597.5	6.8	8.9	12.2
Other services	506.1	785.0	982.9	12.2	10.5	7.5
Unclassified activity	196.6	463.1	2258.4	4.7	6.2	17.2
Total	4159.1	7466.4	13143.4	100	100	100

Although FDI flows in the manufacturing of Latvia have been quite steady even in the years of rapid recession, it has to be noted that Latvia is lagging behind Lithuania and Estonia in terms of the amount of accrued FDI in this industry.

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

Servicing of incoming investment projects in 2015 was quite extensive – 304 requests for investment information were processed. Meetings with 128 potential investors were organised in the agencies of the IDAL, and visits to Latvia were organised for 129 potential investors. In total, work has been carried out with 264 foreign investors, both preparing proactive investment offers for 86 foreign investors and working with 103 potential investment projects, and 114 follow-up activities were carried out for 75 foreign investors.

In 2015, 12% of all projects were implemented in the metalworking and engineering sectors. However, taking the projects of the electronics sector (3%) into account, they account for 15% in total. IT is the second most important sector, constituting 12%, followed by service centres (10%). The number of projects announced is also growing in other sectors of services and manufacturing, such as green technology/energy, wood-processing and logistics, education, food processing, etc.

In total, 60% of potential investors the IDAL worked with in 2015 come from European countries. The largest number of potential investment projects the IDAL worked with in 2015 come from countries having agencies of the IDAL (except for the USA, India, Switzerland, Canada), the leading countries being China, the Netherlands, Germany, Finland, and Norway.

In nine months of 2015, 26 projects were approved for implementation in Latvia (in 2014 – 33). If all the projects are implemented completely, it is expected to receive investment of 31.23 million euro, creating 386 new jobs.

To improve attraction of investment significant for Latvia, the IDAL is continuing successful implementation of the methodology for attraction of investment – the POLARIS process, aimed at attracting export-oriented investment with high value added. The POLARIS process is based on a coordinated cooperation among the public, private, and academic sectors. The process is focused on eight priority sectors of investment attraction.

Within the framework of the POLARIS process, the IDAL performs regular follow-up visits to the existing investors in order to gather information about their needs, obstacles at work, summarises this information and prepares recommendations to the competent ministries directly or with the help of the Coordination Council for Large and Strategically Important Investment Projects.

One of the main obstacles in the attraction of investments, mentioned both by the existing and potential investors, is ensuring availability of skilled labour at the moment and in the near future. *Investors Sentiment Index 2015* or the assessment of foreign investors working in Latvia for the potential of the competitiveness of the Latvian economy, where investors name demographic and employment problems as the main factors of concern, was presented at the annual meeting of the Foreign Investors Council in Latvia with the government of Latvia in 2015. The said problems significantly limit the potential expansion of operation within the investment projects already existing in Latvia. By taking the initiative in solving this issue, the IDAL addresses the responsible authorities on a regular basis, emphasizes this problem in sectoral discussions and participates in the implementation of the *Plan of Re-emigration Activities for 2013-2016*, developed by the Ministry of Economics, through organising activities, as well as addressing the emigrated Latvian people in various events, calling them to return to Latvia in order

to use the knowledge and experience obtained abroad for launching entrepreneurship and building their welfare in Latvia.

Regular work is continued for overcoming identified investment obstacles within the framework of the Coordination Council for Large and Strategically Important Investment Projects, as well as outside the Council, performing daily work within the POLARIS process. In April 2015, the 14th meeting of the Coordination Council for Large and Strategically Important Investment Projects took place. At the beginning of 2015, support for solving five problem issues submitted to the IDAL by foreign investors was provided outside the framework of the Coordination Council for Large and Strategically Important Investment Projects. Primarily, these issues were related to communication problems with state administration authorities or state capital companies, or addressed restrictions of the legal framework or policy progress, which were considered by investors as unjustified obstacles for entrepreneurship. The IDAL continues to work actively on all the said issues.

Next year, it is expected to expand the range of activities of strategic cooperation with China in the field of trade and investment promotion. Latvia has assumed the role of transport and logistics coordinator in the China and the Central and Eastern European countries cooperation format 16+1, and acquired the right to organize a number of important events within the framework of 16+1.

When assessing global trends in the attraction of investment, in 2016, it is planned to continue to highlight the role of follow-up activities in making decisions concerning new investment. This approach promotes raising the satisfaction of foreign investors who have already invested in Latvia, and thus stimulates making of new investment decisions.

4.4 Financial and Capital Markets

4.4.1 Monetary Policy

Price stability is the primary goal of the Bank of Latvia (a moderate rise in consumer prices), which contributes to long-term economic growth. Functions of the Bank of Latvia are largely the same as they were before the Latvian participation in the euro area, only now the bank operates at European level and deals with matters of euro-area level. The main tasks of the Bank of Latvia as an independent institution and a member of the Eurosystem are as follows:

- to participate in the preparation, adoption and implementation of the Eurosystem's monetary policy decisions;
- to manage foreign reserves;

- to issue cash in Latvia and participate in ensuring cash circulation in the euro area;
- to participate in promotion of smooth functioning of the payment system in the Eurosystem;
- to prepare the financial, monetary and payments balance statistics;
- to maintain and develop the Credit Register;
- to operate in the field of international cooperation, representing Latvia in international financial institutions, such as the International Monetary Fund;
- to develop macro-economic and financial analysis and forecasting, thus raising public awareness of the fundamentals and the current situation of the economy and the monetary system.

The Bank of Latvia has been a member of the European Central Bank (ECB) since accession of Latvia to the EU. Before the introduction of the euro, monetary policy instruments and procedures for monetary policy operations were coordinated, and the central bank's foreign reserves management system was adapted to the ECB's requirements. The Bank of Latvia uses the same indirect monetary policy instruments based on free

market principles as the ECB. Latvia's participation in the European Monetary System means the following:

- a single currency with other Member States of the European Monetary System – euro;
- a single monetary policy throughout the euro area, implemented by the ECB together with the central banks of the euro area;
- coordination of the economic and fiscal policy among the Member States.

Box 4.1

Eurosystem

Being a member of the Eurosystem, the Bank of Latvia implements ECB monetary policy in relations with its partners (credit institutions registered in Latvia or Latvian branches of credit institutions registered abroad). Monetary policy decisions in the Eurosystem are made by the Governing Council of the ECB. Members of the Governing Council of the ECB are the governors of the national central banks of all countries of the euro area and six members of the Executive Board of the ECB. Latvia is represented in the Governing Council by the president of the Bank of Latvia. Members of the Governing Council of the ECB are independent in their views and vote. The aim of the Governing Council of the ECB is to act in favour of the euro area. Responsibilities of the ECB:

- to approve guidelines and to make decisions required to ensure the fulfilment of assignments entrusted to the Eurosystem;
- to formulate the monetary policy of the euro area. This includes decisions relating to the monetary objectives of the Eurosystem, key interest rates, provision of reserves and development of guidelines required for enforcement of these decisions.

Decisions on interest rates are made on a monthly basis, however, the Governing Council of the ECB may take a decision on interest rates at any time – even outside the regular meetings.

The main purpose of the Eurosystem is to maintain price stability. It has to support the EU's overall economic policy. The Eurosystem has to operate in accordance with the principle of an open market economy, which provides for free competition through efficient allocation of resources. An essential precondition for successful implementation of the established objectives of monetary policy is the independence of national central banks from government institutions and their decisions. Institutional independence is required as monetary policy has to be implemented according to the medium-term and long-term perspective, and the implementers of the monetary policy may not submit to short-term interests. Institutional independence also means the prohibition of the national central bank to finance any kind of expenditure of the government or its institutions.

As of 1 January 2014, by introducing the euro, the Bank of Latvia has become a member of the Eurosystem.

In order to implement the monetary policy of the Eurosystem and to ensure the liquidity of credit institutions, the Bank of Latvia offers financial market participants the following monetary policy operations:

- open market operations;
- overnight lending facility;
- overnight deposit facility;
- eligible assets marketable in the monetary policy operations of the Eurosystem.

4.4.2 Market Structure and Development

At the end of Q3 2015, there were 17 banks operating in Latvia and 10 branches of the member state banks registered in Latvia. Five branches of Latvian banks operate abroad. Credit institutions registered in the European Economic Area countries or their branches, which have submitted applications to the Financial and Capital Market Commission (FCMC), can also provide banking services in Latvia.

A number of significant changes were introduced in the banking sector in 2014 and 2015:

- the business activity of *Latvijas Hipotēku un zemes banka VAS* was terminated, and, as of 1 January 2014, it was transformed into a development finance institution with a new name – *Latvijas Attīstības finanšu institūcija Altum VAS*.
- In April 2015, by the FCMC and the ECB's approval, 75% of the shares of Citadele bank were sold to a group of international investors, represented by the investment company Ripplewood Advisors LLC along with 12 investors. The rest of the shares (25%) are owned by the EBRD. According to the deal concluded, investors and the EBRD have invested 10 million euro in the bank's capital to strengthen Citadele bank and increase its competitiveness.
- Despite the sale of credit portfolios of *Latvijas Krājbanka AS*, the bankruptcy procedure of the bank continues.

In order to implement a common supervisory approach in all countries and to avoid any problems in any of the countries in a timely manner, the Single Supervisory Mechanism of European banks was launched on 4 November 2014. It is aimed at moving towards an integrated financial supervision in order to restore confidence in banks and to minimize the cost of

bankruptcy of banks. The Single Supervisory Mechanism is constituted by the ECB and national competent authorities. In the case of Latvia, the ECB has taken over supervision of the three largest banks in terms of assets (*Swedbank*, *SEB banka*, and *ABLV Bank*). As regards the other banks, these tasks remain the competence of the FCMC. The FCMC also cooperates with the ECB, providing information on relevant supervisory decisions also on the rest of the Latvian credit institutions.¹

As of 1 January 2016, the single regulatory mechanism will start operating fully at the EU level to ensure equal approach to the regulatory process in all EU Member States in case, despite the close monitoring, a bank gets into financial difficulties. The main principle of this mechanism is to avoid the use of taxpayers' money to cover the regulatory costs, which means that if a decision is made in case of a bank's problems to rescue the bank, the losses will be covered, first of all, by the bank's shareholders and major creditors. It will also be possible to use funds from the Single Regulation Fund, and only after that state aid can be provided.

In Q3 2015, the performance indicators of all Latvian banks were in line with the regulatory requirements. The banking sector's liquidity ratio was high – 67.05%, which is more than two times higher than the minimum regulatory requirement – 30%. A single liquidity ratio for credit institutions came into force in the EU on 1 October 2015, aimed at promoting the banks' immunity against potential short-term liquidity problems. In 2013, the FCMC introduced individual increased liquidity requirements for banks, depending on the size of non-resident deposits in the banks' total assets.

The capitalization level of the banking sector continues to rise. In Q4 2015, the average capital adequacy ratio of the banking sector reached 21.3% (the regulatory minimum is 8%), which is the highest index in recent years. Return on assets (ROA)² of the banking sector has increased to 1.34%, while the return on equity (ROE)³ has increased to 12.6%.

Bank profitability is still positive, and banks operated with a profit of 314.6 million euro in the first three quarters of 2015. In the said period, 14 Latvian banks and 5 branches of foreign banks operated with a profit (their market share in total assets of the banking sector – 94.1%).

Steady development continues in the **insurance market**. In the first three quarters of 2015, 8 insurance companies operated in Latvia (7 companies in 2014), 2 of which provided life insurance, while 6 – non-life insurance. There were also 14 branches of foreign insurance companies operating in Latvia.

In the first three quarters of 2015, the amount of gross premiums written by insurance companies grew by

5.8% to 286.9 million euro compared to the corresponding period of 2014. The amount of life insurance premiums written increased most rapidly in the first three quarters of 2015, while the amount of direct non-life insurance gross premiums written decreased. The amount of gross indemnities paid increased by 8.4%, reaching 164.8 million euro. In the first three quarters of 2015, insurance companies worked with a profit of 3.3 million euro, the profit of non-life insurance companies was 5.2 million euro, while life insurance companies operated with losses of 1.9 million euro.

In the first three quarters of 2015, insurance companies in total earned for 71.5% (11.6 million) less than in the corresponding period of the previous year.

From late 2011 to 2013, situation in the **Latvian securities market** improved significantly. In 2014, the situation became somewhat worse, and the value of the OMX Baltic Benchmark index fell slightly. The value of the NASDAQ OMX Riga and NASDAQ OMX Tallinn indexes also fell; however, over a longer period (3 years), the Baltic market indexes have increased considerably. The value of all indexes continued to rise in 2015. Since the beginning of the year, the value of the NASDAQ OMX Riga index increased almost by a half (as at November 2015), while the lowest increase was in the OMX Vilnius index.

Reduction in the volume of crediting has contributed to banks' increased investment in securities. In Q3 2015, compared to Q3 2014, the amount of central government debt securities in banks' assets increased by one fifth. The increase was observed in almost all categories, except for shares and other securities with non-fixed income that fell by half in this period. As of March 2015, the ECB commenced a large-scale buying up of government securities (quantitative easing) to stimulate growth of crediting. By implementing the Public Sector Purchase Programme, the Bank of Latvia acquired the securities of Latvian organisations and international organisations of the euro area for 1.44 billion euro in the first eight months of 2015. Securities purchase programme was launched, implementing the main purpose of the Eurosystem – to maintain the medium-term inflation close to, but less than 2% a year. This programme will be implemented from March 2015 until the end of March 2017, or until the ECB has made sure that the level of inflation is approaching the objective of price stability in a steady manner. By implementing this programme, the Bank of Latvia will have the opportunity to buy the securities for several hundred million every month, making credit resources available to Latvian entrepreneurs.

¹ Of all the 6000 banks of the euro area, 123 major banks of the euro area are subject to the direct supervision of the ECB according to the approved criteria. These banks hold almost 82% of the assets of banks of the euro area.

² ROA – profit/loss to assets ratio.

³ ROE – profit/loss to capital and reserves ratio.

4.4.3 Assets, Deposits and Loans

An increase in the Latvian **bank assets** was observed in late 2013, which was largely due to the upcoming introduction of the euro – people's cash savings in lats went into bank accounts. Consequently, the amount of cash in circulation significantly decreased and the use of non-cash means of payments significantly increased. However, when the euro replaced lats, the amount of cash in circulation increased significantly – from 667.8 million euro at the end of 2013 to 3,515.6 million euro in early 2014. Since the introduction of the euro, the growth of the amount of cash in circulation has been moderate, and no significant fluctuations can be observed. At the end of Q3 2015, there were 3,736.6 million euro cash in circulation.

As of the end of Q2 2014, the bank assets resumed growth, and in Q3 2015 they amounted to 31.6 billion euro, which was by 7.4% more than a year before. The share of non-bank credits in total assets decreased to 46.9% (for comparison – bank credits accounted for 60.5% of the bank assets in Q3 2011), while the proportion of securities increased significantly.

The **volume of deposits** continues to grow, although growth rates decreases. In Q3 2015, deposits reached 22.8 billion euro, which was by 8.8% more than in the corresponding period a year before. Since the beginning of the year, the amount of deposits made by entrepreneurs in banks grew faster, while household deposits grew moderately. Provisioning in the long term could also facilitate provision of co-funding for credit applications, which, in turn, would have a positive impact on economic development. The amount of non-resident deposits continued to grow more rapidly – by 13.8%, exceeding the amount of resident deposits and accounting for over a half of the total amount of deposits (52%). In the combined structure of depositors, 8.9% are the deposits of CIS countries, 17.8% – deposits of the rest of the EEA countries, and 25.4% – deposits of other countries. Latvian commercial banks are explicitly divided into those focused on the business of non-residents and those working mainly with residents. However, it should be taken into account that higher requirements in relation to liquidity and capital adequacy are set for the banks working with non-resident deposits. Most of the resident deposits are in the euro (89.5%), while the majority of non-resident deposits are in US dollars (67.4%), just as before.

Table 4.8

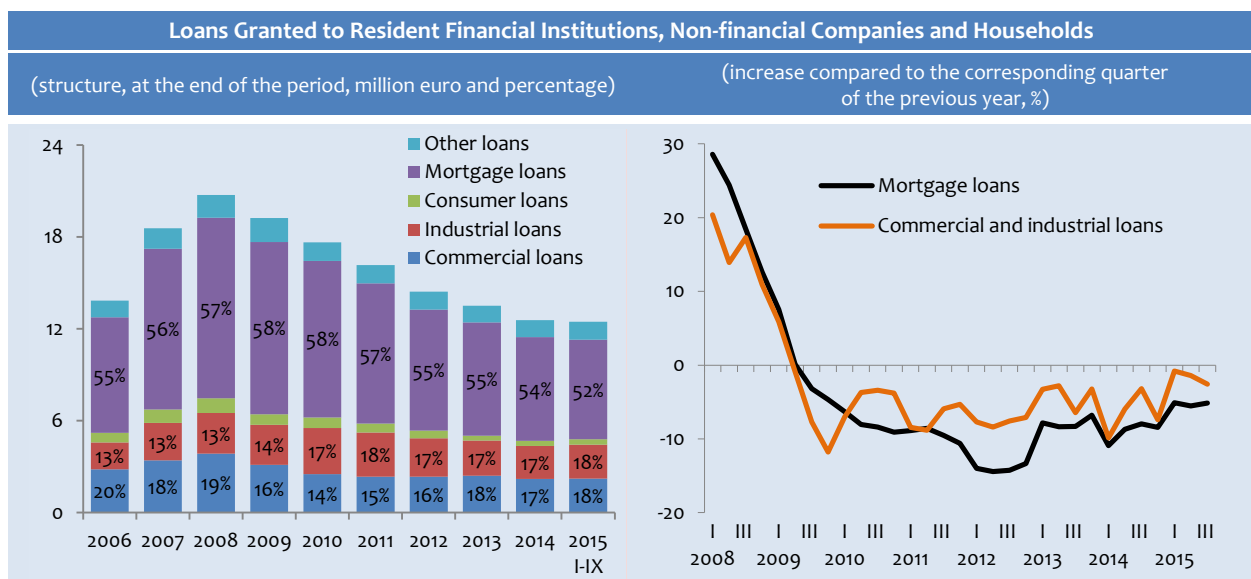
Monetary Indicators of the Latvian Banking System									
	2007	2008	2009	2010	2011	2012	2013	2014	2015 IX
at the end of the period, billion euro									
Net foreign assets	-6.4	-8.4	-4.3	-1.7	-0.3	0.9	1.2	-1.8	-1.8
Net domestic assets	15.2	16.9	12.6	10.8	9.5	8.8	8.6	11.3	11.6
Credits to residents	18.5	20.3	17.4	16.0	15.7	13.7	13.5	12.6	12.7
to the general government (net)	-0.1	-0.5	-2.1	-2.0	-0.9	-1.3	-0.7	-0.5	-0.3
to enterprises and households	18.6	20.8	19.5	18.0	16.7	14.9	14.1	13.2	13.1
Other assets (net)	-3.4	-3.5	-4.8	-5.1	-6.2	-4.9	-4.8	-1.3	1.1
Broad money M2X	8.8	8.4	8.3	9.1	9.2	9.6	9.8	9.4	9.7
Currency outside IMF	1.3	1.2	0.9	1.1	1.5	1.5	0.7	3.7	3.7
Deposits of households and enterprises, including:	7.5	7.2	7.3	7.9	7.7	8.1	9.2	9.5	9.7
overnight deposits (resident)	4.1	3.3	3.1	4.0	4.4	5.1	6.6	7.0	7.4
deposits with agreed maturity	3.4	3.9	4.2	4.0	3.3	3.0	2.6	2.5	2.3
% change compared to the corresponding period of the year before									
Credits to residents, including:	31.8	9.7	-14.5	-8.1	-1.5	-13.1	-1.4	-5.9	0.8
to enterprises and households	34.0	11.8	-6.6	-7.6	-7.4	-10.4	-5.3	-6.8	-3.5
Broad money M2X	12.6	-3.9	-1.9	9.8	1.5	4.5	2.0	-3.6	9.0
Currency outside IMF	-7.1	-3.8	-22.9	21.0	28.8	4.1	-56.6	461.0	3.4
Deposits of households and enterprises	16.9	-3.9	1.7	8.3	-2.4	4.5	13.2	-3.6	9.0
Gross domestic product (at current prices)	32.3	9.3	-18.7	-2.2	11.7	8.7	5.6	3.6	3.8*

* in the three quarters of 2015

After a decline in crediting for couple of years, positive features can be observed in the field of crediting in 2015. According to the FCMC data, **outstanding**

amounts of non-bank credits increased by 0.2% at the end of Q3 2015 compared to the corresponding period of the year before.

Figure 4.28



After a significant decrease in the **amount of new loans** in 2014, the situation improved in 2015, and the amount of new loans started increasing again, but banks are still cautious towards a more active crediting of economy, and crediting amounts are not large enough to stimulate economic growth. Improvement of the situation is to a certain extent due to the more favourable credit conditions offered by banks and more preferential crediting standards. In Q3 2015, new loans for 866.4 million euro were granted in the banking sector in total, which was for almost 27% more than a year before. The amount of new loans granted to non-residents has increased more rapidly, and the proportion of such credits exceeds the proportion of new loans granted to residents at the beginning of 2015, reaching 54%, which was for 7 percentage points more than a year before. The credits granted to non-residents amount to 15.5% of the total credit portfolio of the banking sector.

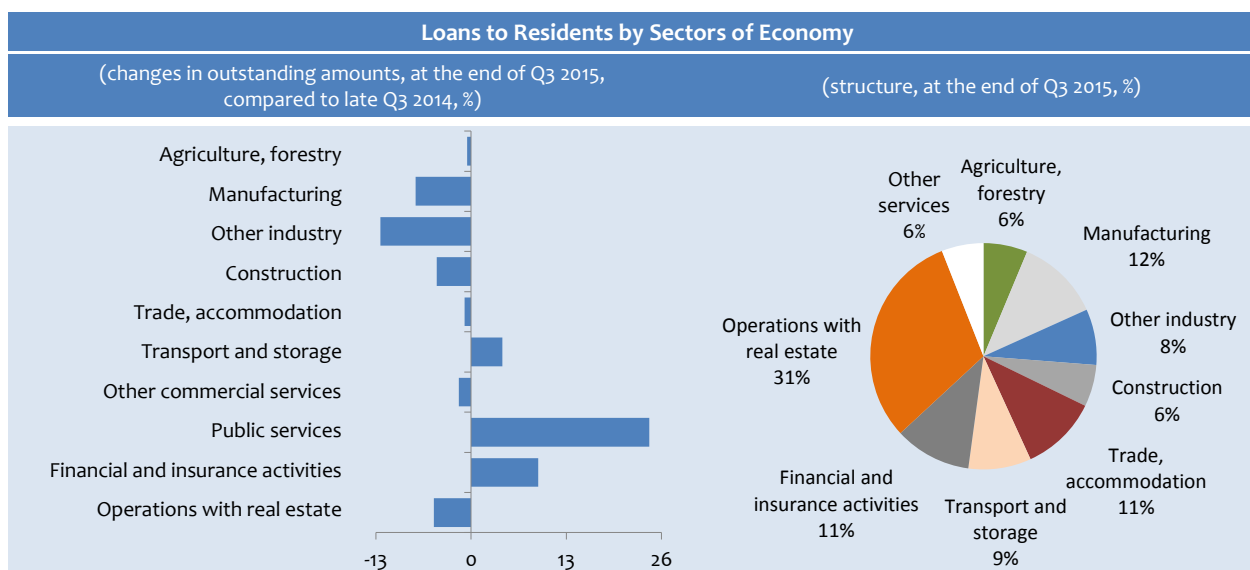
Although household crediting remains weak, it is gradually improving. In Q3 2015, the amount of new loans granted to households increased by 22% and amounted to 14% or 123.5 million euro of the total amount of new loans granted. In terms of volume, most of the new loans were granted for house purchase. Housing crediting is still hindered by insufficient household income for the first instalment, but the support programme for acquisition of housing property, which provides for loans for families with children for the house purchase or construction of housing property, can be evaluated positively. In total, dynamics of household credits are still negative, and the proportion of household credits in the total credit portfolio is shrinking.

The business crediting is also still relatively weak, largely due to banks' crediting policies, although the entrepreneurs' demand for new loans rose in 2015, and, in Q3 2015, the amount of new loans granted to enterprises increased by 16.1% compared to the corresponding period in 2014 and amounted to 28% or 241.7 million euro of the total amount of new loans granted. However, a decline was observed in a number of key sectors of the economy, such as manufacturing (by 53%). Also, the dynamics of the total business credit portfolio are still negative.

There are no significant changes observed in the credit structure. Mortgage loans still dominate the structure of credits granted to domestic enterprises and individuals, the share of which decreased to 52.2% in Q3 2015 (in 2009, it was 58.5%). The share of commercial and industrial credits in the total credit structure increased slightly, reaching 35.6% (in 2009, it was 29.9%). The share of consumer credits in the total structure of credits has risen to 2.8%. The most rapid decrease was observed in the outstanding amount of mortgage credits (by 5.1%) and commercial credits (by 4.9%) at the end of Q3 2015, compared to the corresponding period of the year before, while the outstanding amounts of consumer credits increased slightly.

In terms of volume, most of the credits by industry were granted in real estate activities (31% of total loans granted) and manufacturing (12%). There is a relatively large share of credits in trade, accommodation and catering activities (11%), and financial and insurance activities (11%).

Figure 4.29



The quality of credit portfolio improved significantly from 2010 to 2014, mainly due to improvement of the economic situation, as well as writing off of bad debts. In total, banks wrote off credits for 45 million euro in Q3 2015, which is for 5.1% less than in the corresponding period of 2014. The quality of credit portfolio has not changed significantly in the last two years. At the end of Q3 2015, the amount of credits with a payment delay in the total bank credit portfolio was 12.9%, which was for 1.4 percentage points less than a year before, and it was one of the lowest indicators since late 2008. The decrease in the share of credits with late payments, where the delay exceeds 180 days, which amounted to 5.9% of the total credit portfolio in the first three quarters of 2015, can be evaluated positively.

Banks continue to work with the customers who have credit repayment difficulties. The share of restructured credits and credits in a work-out process in the total credit portfolio of banks continues to decrease. At the end of Q3 2015, restructured credits and loans with overdue payments constituted 13.9% of the total credit portfolio. The share of restructured credits in the total credit portfolio of banks fell to 8.1%, while the share of credits in a work-out process – to 5.8 per cent.

Long-term interest rates (on outstanding amounts) for credits granted to non-financial companies continue to decrease, and they reached the lowest point in recent years in October 2015. Short-term interest rates for non-financial companies also decrease, but their fluctuations are more pronounced. Also, the interest rates (on

outstanding amounts) for credits granted to households for house purchase have been decreasing since 2012; however, the medium-term (1-5 years) interest rates on credits granted to households for house purchase have increased slightly since the end of 2014, and the rate fluctuations were more pronounced in 2015 than in the past.

Figure 4.30

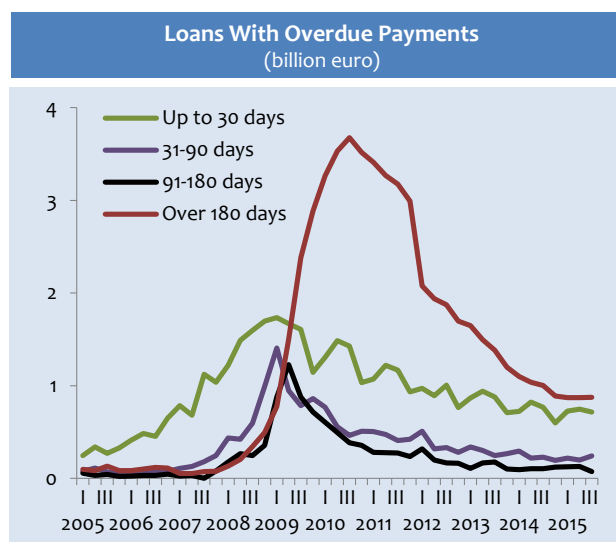
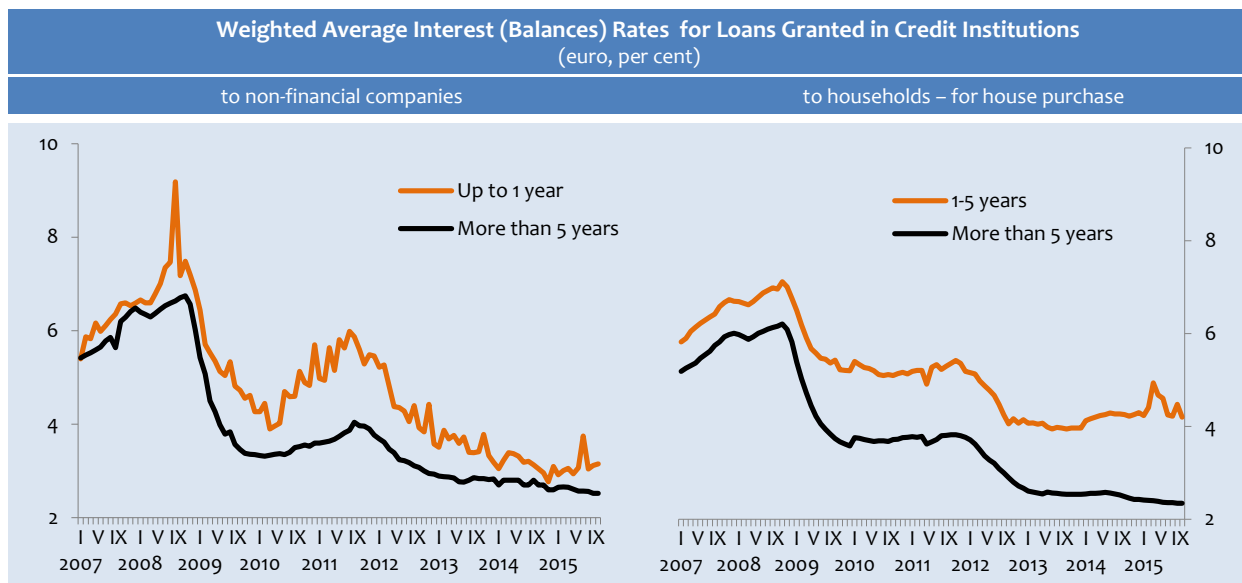


Figure 4.31



5. Labour Market

5.1 Employment and Unemployment

Along with the improvement of the economic situation, positive trends in the labour market can be observed – reduced unemployment and increased employment rate. At the same time, improvements are slowing down, influenced by the gradual decline in the base effect in the labour market, as well as the relatively low growth rates.

Since mid-2010, the number of employed has been gradually increasing. According to the labour force survey data for the period from 2011 to 2014, the number of employed population has increased by 33.9 thousand or for an average of 8.5 thousand per year. Employment growth is based on economic recovery – since 2010, GDP has increased by a fifth. Employment growth has contributed to reduced unemployment. Over 4 years, the unemployment rate has decreased by almost a half.

The unemployment rate fell to 10.8% in 2014, which was for 1.1 percentage point less than in 2013 and for 8.6 percentage points less than the highest point in 2010. The employment rate increased by 0.9 percentage points to 59.1% in 2014, compared to 2013. In total, 884.6 thousand people were employed in 2014, but 107.6 thousand people were looking for a job, which was by 12.7 thousand less than in 2013.

Figure 5.1

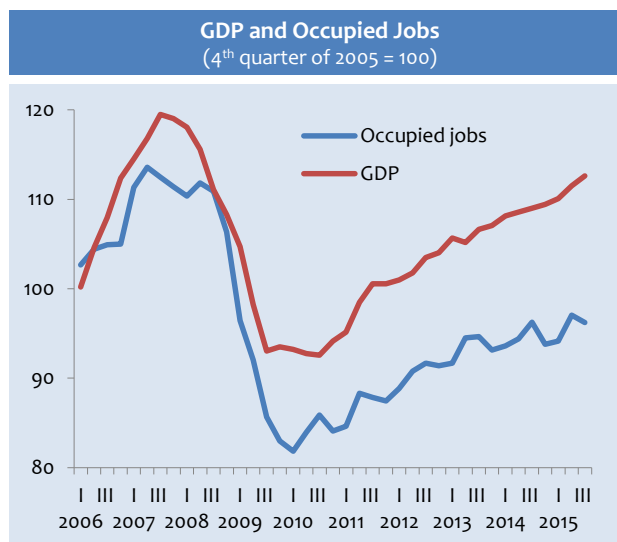
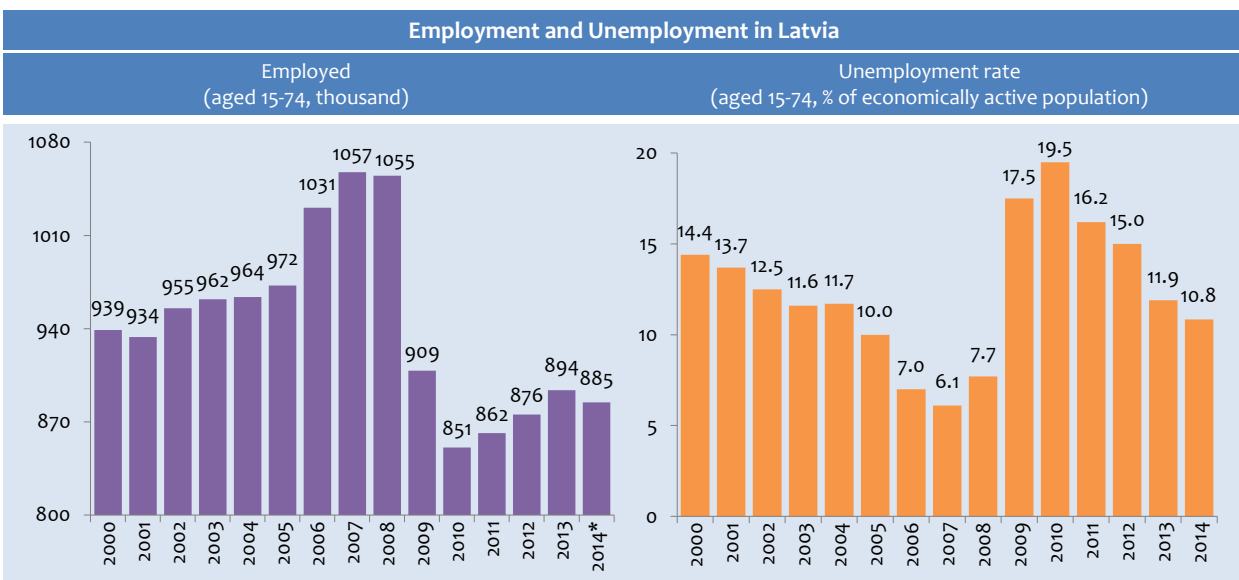


Figure 5.2



* From 2014 are made changes to the Labour Force Survey methodology. For data generalizations is used for the quarterly average in private households living in the population (before – the population of the beginning of year)

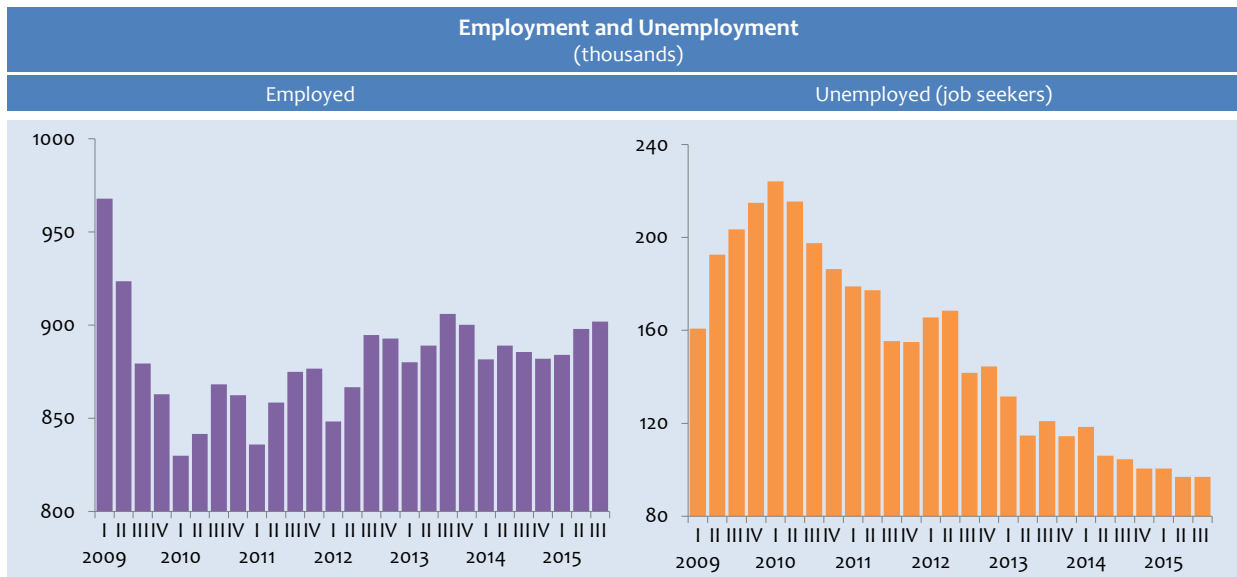
The number of economically active population continued to decrease in 2014 – in annual terms it

decreased by almost 22 thousand or 2.2%, compared to 2013. It should be noted that the trend of decreasing

number of economically active population continued since the beginning of 2013. Decrease in the number of economically active population is mainly influenced by

the negative demographic trends. Despite this, economic activity rate increased by 0.3 percentage points in 2014 and reached 66.3% among people aged 15-74 years.

Figure 5.3

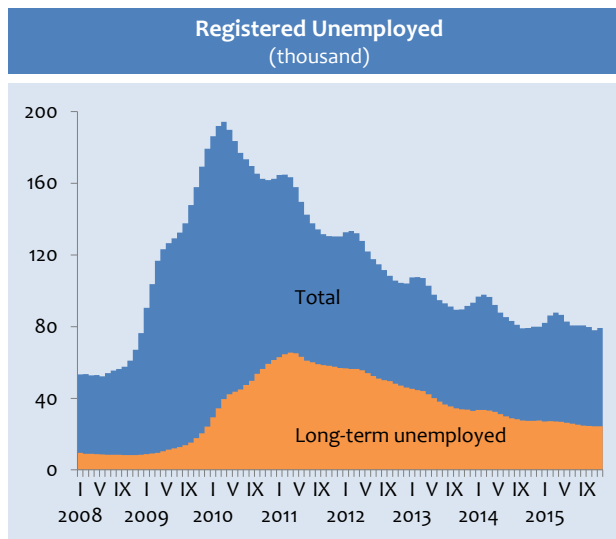


Positive trends were also observed in the labour market in 2015. In the first three quarters of 2015, the number of employed population increased by 1%, compared to the respective period of the previous year. In total, 902 thousand people were employed in Q3 or 61.4% of the total number of population aged 15-74 years. Compared to 3rd quarter of 2014, the employment rate has increased by 2 percentage points.

jobs were lost during the crisis. Change of the economic structure can contribute to the formation of non-conformities between labour supply and demand – the skills of job seekers may not comply with the skills required by employers.

Figure 5.4

The unemployment rate decreased by 0.9 percentage points to 9.7% in the 3rd quarter of 2015, compared to the same period in 2014. But, compared to the previous quarter, the unemployment rate remained essentially the same.



Registered unemployment is also decreasing. At the end of December 2015, registered unemployment rate was 8.7% – 81.8 thousand unemployed people were registered, which was by 0.25 thousand less than in December 2014. The highest unemployment rate remains in Latgale region (18.5%), while the lowest rate – in Riga (5%). Almost a third of the total number of registered unemployed were long-term unemployed (out of work for more than a year).

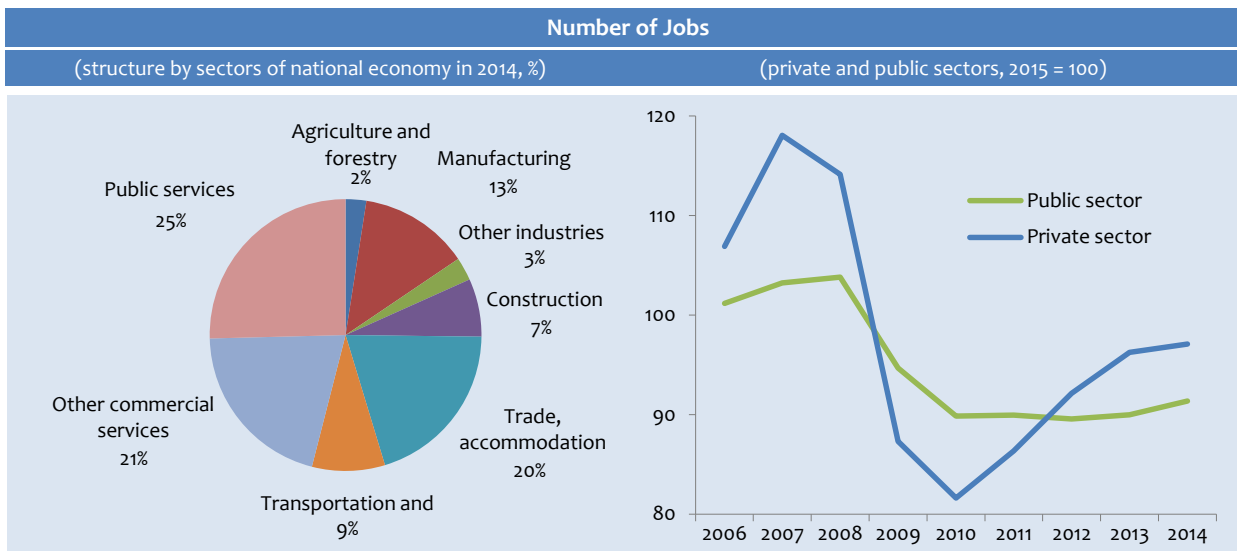
During the crisis, along with an increase in the overall unemployment rate, the number of long-term unemployed population also increased. Although the situation is gradually improving, the share of long-term unemployed remains very high – almost 1/3 of the total number of registered unemployed. It has to be taken into account that a high long-term unemployment rate may lead to an increase in structural unemployment, namely,

the longer these people are unemployed, the greater the risk of losing skills and abilities.

At the same time, it has to be taken into account that the compliance of labour demand with labour supply is

influenced not only by the education and skills of the labour force, but also the remuneration, therefore there still remain vacancies, although the unemployment rate is high.

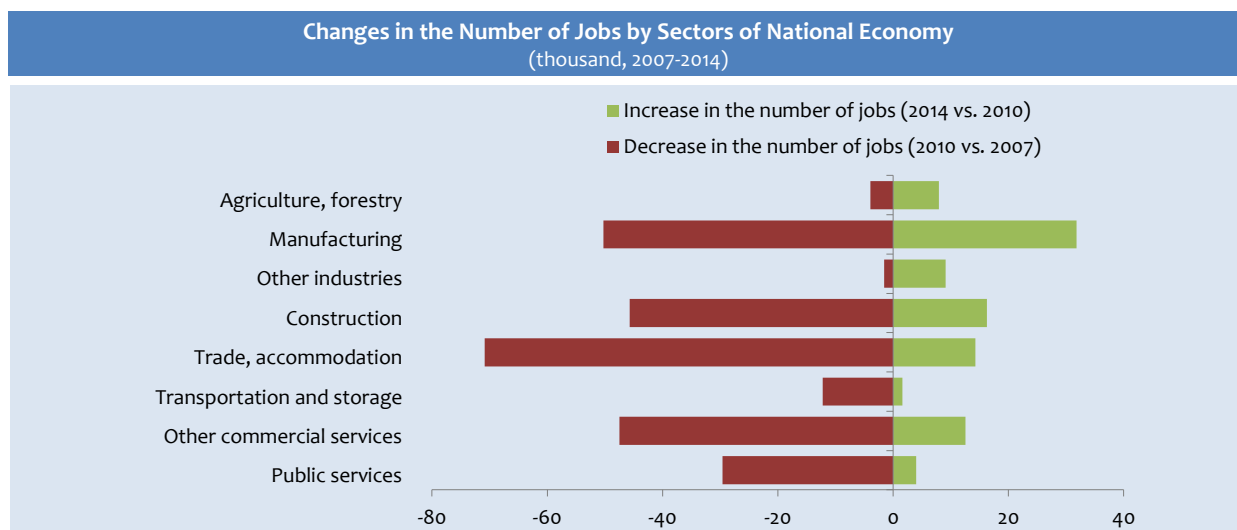
Figure 5.5



Along with the improving economic situation, there has been a steady job growth since mid-2010. According to the CSB data, the number of occupied jobs increased by 9.4 thousand or 1.1% in 2014, compared to 2013. At the same time, the number of vacancies increased by 5.6% or about 0.2 thousand jobs.

In 2014, the number of occupied jobs mainly grew in service industries. The fastest increase in the number of jobs in 2014, compared to 2013, was in the information and communication services sector (by 10.2%) and health care (by 6.3%).

Figure 5.6



In 2014, the most significant decrease in the number of jobs was observed in manufacturing industry – by 2.9 thousand or 2.5%, compared to 2013. The major decrease in the number of jobs in manufacturing industry was observed in metal production, which was affected by

ceasing the activities of JSC “Liepājas Metalurģs” in 2013, and in garment manufacture.

The number of occupied jobs continued to increase in the first three quarters of 2015, compared to the corresponding period of 2014, and the number of occupied jobs increased by 1.1% or 9.7 thousand. The

most significant increase in the number of jobs was observed in the service sector – commercial services, health and social services, as well as accommodation and catering services.

At the same time, the largest decrease in the number of jobs was observed in manufacturing industry (food production, especially fish processing, and garment manufacture), construction and public administration.

In recent years, the number of jobs has increased significantly in the private sector. After a decline in the number of jobs by 30% during the crisis in the period from 2010 to 2014, the number of jobs in the private sector increased by almost a fifth.

At the same time, there has been a relatively slow increase in the number of jobs in the public sector, where the number of occupied jobs grew only by 1.7% from 2010 to 2014. A more rapid increase in the number of occupied jobs in the public sector was observed in 2014, when the number of occupied jobs increased by 1.5%, compared to 2013.

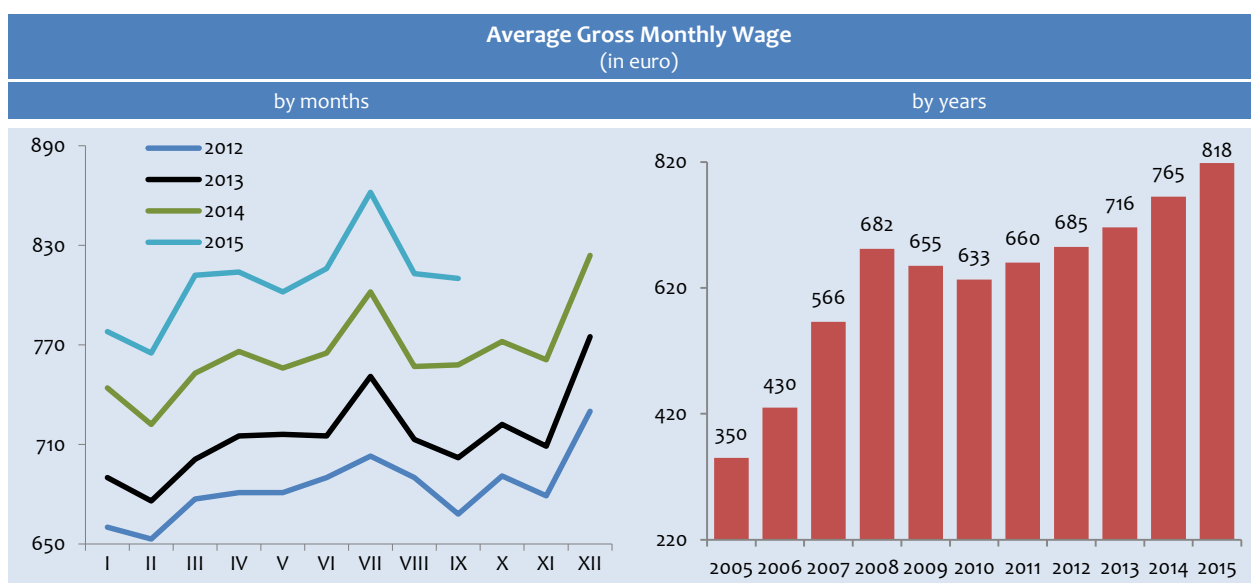
The number of occupied jobs in the private sector increased by 1.8% in the first three quarters of 2015, compared to the corresponding period of 2014, while the number of jobs in the public sector decreased by 0.3 per cent.

5.2 Labour Costs and Productivity

In recent years, the dynamics of labour costs and productivity were largely determined by different adaptation of the labour and product market to cyclical fluctuations of the conjuncture. With the economic growth resuming, wage growth is becoming more rapid, substantially due to the growing competition in the EU

labour market and the low competitiveness of Latvia in the said market. By contrast, growth of productivity has been more moderate, and it means that the advantages of cheap labour cost competitiveness are being gradually lost.

Figure 5.7



The average gross wage in 2014 was 765 euro, which was by 6.8% higher than the wage in 2013. Compared to the pre-crisis period – year 2008, the average gross wage was by 12.2% higher in 2014.

Since 2010, the average gross wage has increased in both the private and public sectors. In 2014, wage in the private sector was 741 euro or by 7.4% higher than the year before, while in the public sector – 813 euro or by 6.1% higher. The wage in the public sector in 2014 was basically at the level of 2008, whereas the wage in the private sector – by 18.9% higher.

The difference between wages in the sectors has significantly decreased in recent years. In 2008, the

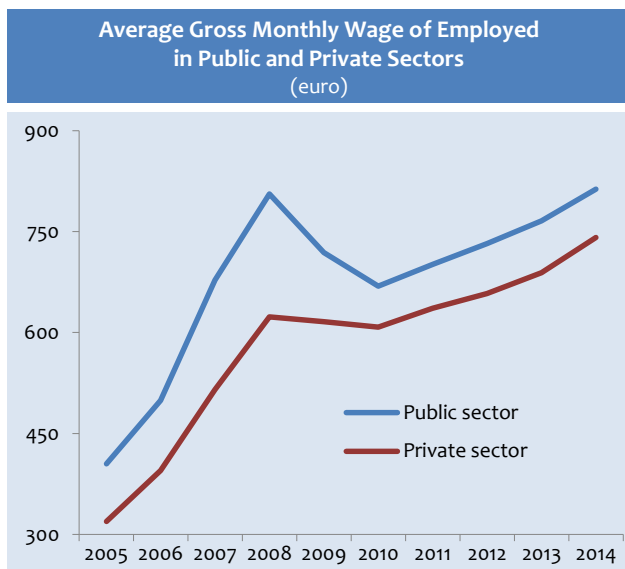
average gross wage in the private sector was by 22.8% lower than in the public sector, whereas in 2014, this difference was only 8.9 per cent.

The average gross wage grew by 6.6% in three quarters of 2015, compared to the corresponding period of 2014. Wages grew more rapidly in the private sector – by 7.6%, whereas in the public sector – by 4.9 per cent.

Wage equalisation was largely driven by differences in labour market adjustment mechanisms in the public and private sectors. In the years of economic recession, employment rate in the private sector fell significantly, whereas the decrease in wages was fairly moderate. Decrease in the number of employed in the public sector

was almost a half of that in the private sector, and wages were reduced substantially, due to the need to limit national budget spending. Since 2011, wages have been increasing gradually, and wage dynamics in the private and the public sectors have been relatively similar.

Figure 5.8



Over the past six years, the average gross wage increased more rapidly in agriculture, manufacturing, and trade, while wages in public service sectors are by nearly 4% lower than in the pre-crisis level, which is due to a

reduction in remuneration during the crisis to limit national budget spending.

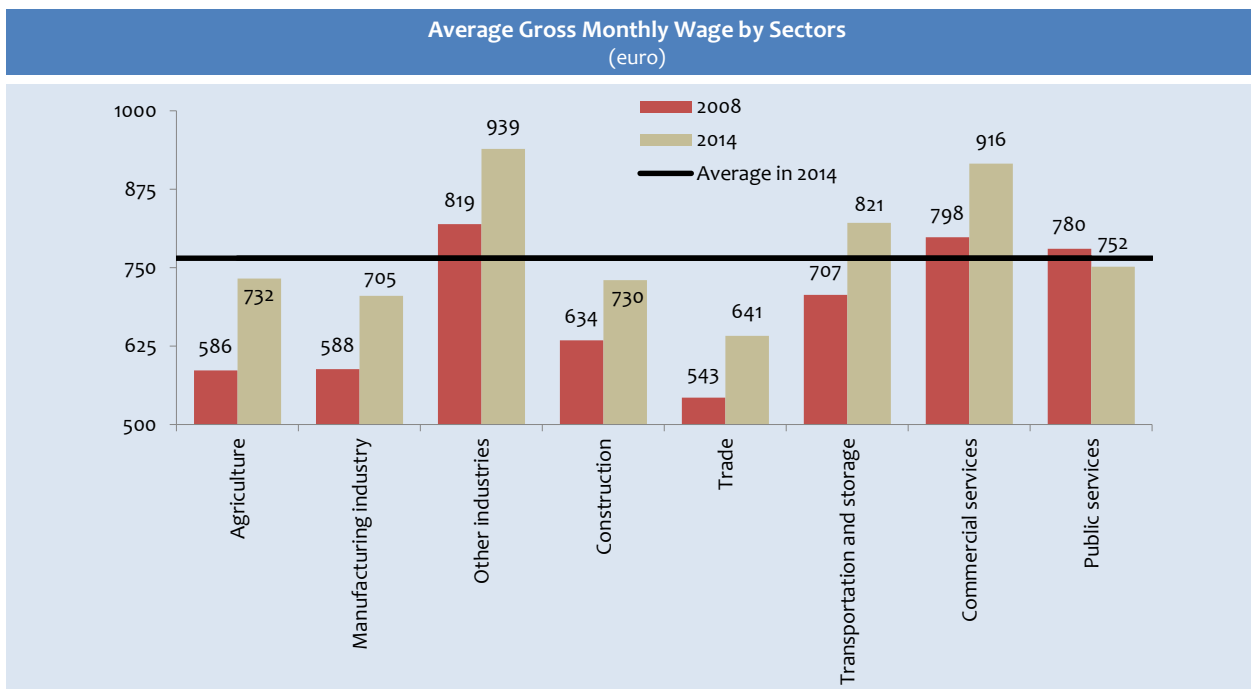
In 2014, the average gross wage increased in all sectors of the economy, and it grew faster in agriculture, construction, trade, and manufacturing industry. Wages continued to grow in all sectors of the economy also in 2015.

Since 2011, the average gross wage in the main export industry of Latvia – manufacturing industry – has been growing more rapidly than in the national economy on average. Compared to 2008, the average gross wage in the industry has grown by almost 20%. Increase in wages was stimulated by the growth of industry production output from 2009 to 2012, when the manufacturing industry was the main driver of economic growth. The most significant wage increase since 2008 has been in production of non-metallic mineral products, wood-processing, paper manufacturing and printing, and food production, as well as in the high-tech industry – production of electrical and optical equipment. A more rapid wage growth in these subsectors was largely related to a more rapid growth of production output and productivity.

In 2014, wages in the manufacturing industry grew by 7%, while in three quarters of 2015 – by 8.1%. Increase in wages can be observed in almost all subsectors of the manufacturing industry.

In terms of occupations, wages have increased in all groups of occupations over the last five years – more rapidly in the groups of higher and secondary qualification occupations, and more moderately in the elementary occupations.

Figure 5.9



Despite a gradual increase in wages, great differences between wages in different groups of occupations remain. For example, wages in the elementary occupations are 2.5 times less than in the groups of the highest-qualification occupations, compared to the average-qualification occupational groups – 1.5 times less, while the wages of the highest-qualification occupations are 1.7 times higher than the ones of the average-qualification occupations.

The average wage of the highest-qualification occupations is for a third higher than the average gross wage in the country, while the wage in the group of average-qualification occupations is lower by almost a fifth. In elementary occupations, wages are almost a half of the national average.

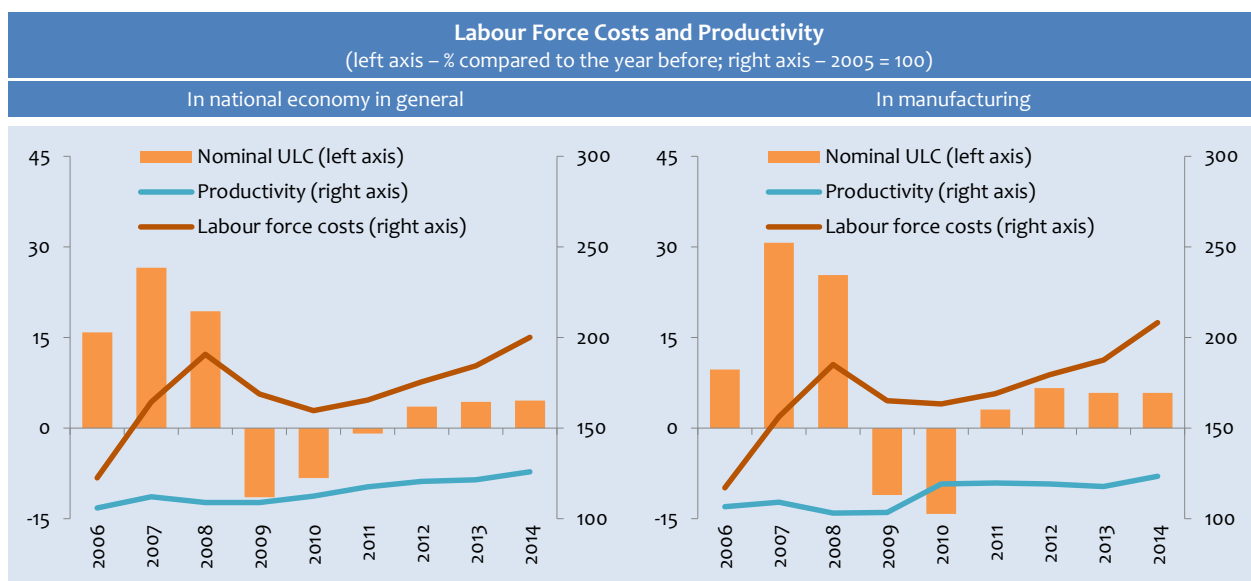
Wage is a significant factor of cost competitiveness; therefore wage growth must be balanced with the increase in productivity. Otherwise, the competitiveness in tradable sectors is lost, which ultimately does not ensure a sustainable increase in the total income (welfare).

As shown by the unit labour cost (ULC)¹ dynamics, wages increased almost five times faster than productivity from 2004 to 2007, negatively affecting the international competitiveness of Latvia. Adjustments in product and labour markets due to the crisis reduced the gap between productivity and labour cost dynamics, resulting in

Latvia's competitiveness improving gradually in foreign markets. However, there have been positive dynamics of the ULC in recent years, which have been more rapid than the EU average. This was largely due to a more rapid increase in labour costs as compared to productivity.

From 2008 to 2010, the ULC dynamics were largely related to cyclical factors or consequences of the crisis. Commodity markets are more sensitive to cyclical fluctuations of the conjuncture than labour markets, therefore output decreases more rapidly at an early stage of economic downturn than the number of employed, and productivity falls. Since labour costs continued to rise in 2008 (mainly due to an increase in employee termination costs), production unit labour costs (nominal ULC) also rose. By contrast, a more rapid drop in labour costs in comparison with productivity in 2009 and a rise in productivity in 2010 determined a decrease in ULC on average by almost 10% a year, which indicated an improvement in the competitiveness of the Latvian producers. Since 2011, productivity dynamics have been more moderate than labour cost dynamics. From 2011 to 2014, productivity rose on average by 3% a year, whereas labour costs increased by 5.8%, i.e., almost three times faster. Similar trends were observed in the manufacturing industry.

Figure 5.10



Unit labour costs continued to rise faster than efficiency also in 2015. In nine months of 2015, labour costs per employed were by 6.6% higher than a year before, while productivity increased by 1.7%, as a result of which ULC grew by 4.9%. It should be noted that, in total, the gap between the growth rates of labour costs

and productivity, compared to the pre-crisis years, has decreased, and the growth of ULC is relatively moderate. However, over the last few years, unit labour cost dynamics shows that the advantages of cheap labour cost competitiveness are being gradually lost.

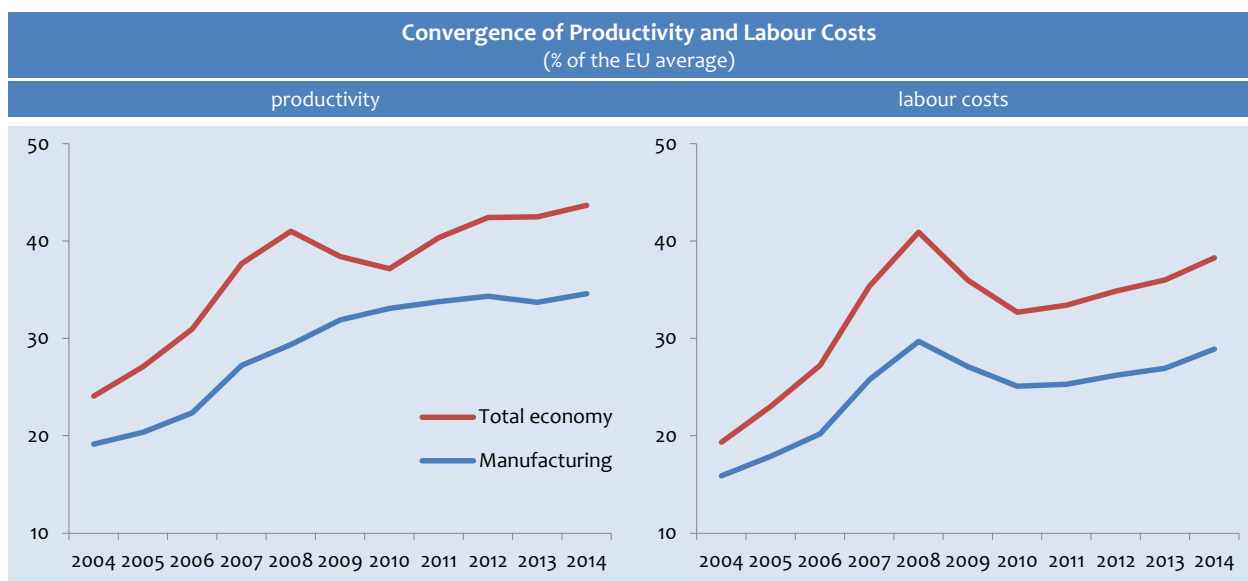
Nominal ULC dynamics in the medium term will be greatly affected by factors of structural nature, while the impact of cyclical factors (such as fluctuations of the conjuncture in foreign trade partner countries) will be lower. One of the most significant factors increasing the

¹ ULC is the ratio between labour costs and labour productivity. If productivity grows faster than wages, ULC decreases, which indicates that the national cost competitiveness is increasing, and vice versa.

ULC is an increase in wages (wage convergence), which is largely influenced by the growing competition in the EU

labour markets and the low competitiveness of Latvia in the said markets.

Figure 5.11



Labour costs in Latvia are among the lowest in the EU member states. In 2014, labour costs per employed in the economy of Latvia were 38% of the EU average in total, whereas in the manufacturing industry – 28.9%. From 2011 to 2014, labour cost gap decreased by almost 5 percentage points, while Latvia's lagging behind in terms of productivity index in the national economy fell by 4 percentage points in total, but in the industry – by 1 percentage point. Wage equalisation (convergence) is an

objective process, which has to be taken into account in the future. A more rapid growth in wages can be influenced by an increase in the minimum wage, entrepreneurs' wish to retain highly qualified workers, reduction of unemployment rate, etc. Therefore, strengthening of Latvia's competitiveness will largely depend on the ability to reduce the productivity gap with the advanced economies.

5.3 Labour Market Forecasts

The labour market forecasts until 2020 are prepared in accordance with the economic development scenarios (see Chapter 3.3).

It is expected that the situation in the labour market will continue to improve in the coming years, while improvements will become more moderate, which will be affected by a higher base effect in the labour market and negative demographic trends that will become more explicit in the availability of labour.

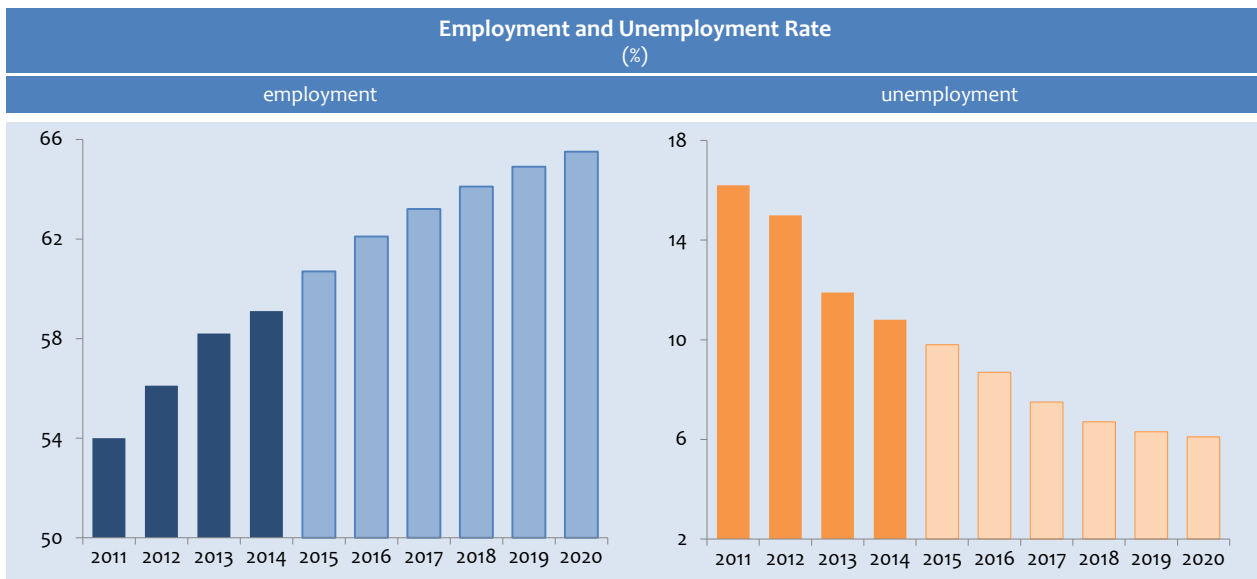
In general, moderate growth in employment is expected in 2015 – the number of employed will increase by 1% or about 9.3 thousand, compared to 2014. In total, the average number of employed per year could reach 894 thousand, while the employment rate will rise to 60.7%. At the same time, unemployment rate will get close to 9.8% in 2015, which is by 1 percentage point less than in 2014. By contrast, the number of job seekers will drop by almost 11 thousand, compared to 2014 – to an average of 97 thousand.

Similar trends will remain in the labour market also in 2016. The number of employed in 2016 could increase to approximately 902 thousand or approximately by 0.9%, compared to 2015. Thus, the employment rate could reach 62%, while the unemployment rate could fall to 8.7 per cent.

Improvements in the labour market are also expected in the medium term. At the same time, increase in employment will be slower than the growth, since output will be primarily based on the growth of productivity. Similarly, the negative demographic trends/aging workforce, mismatch between labour demand and supply, as well as regional disproportions of the labour market will hinder a more rapid employment growth.

According to the more rapid growth scenario, it is expected that the number of employed will increase by approximately 3.8% by 2020, or about 34 thousand, compared to 2015. Thus, the number of employed could exceed 928 thousand in 2020, while the share of employed in the population aged 15-74 years could grow to 65 per cent.

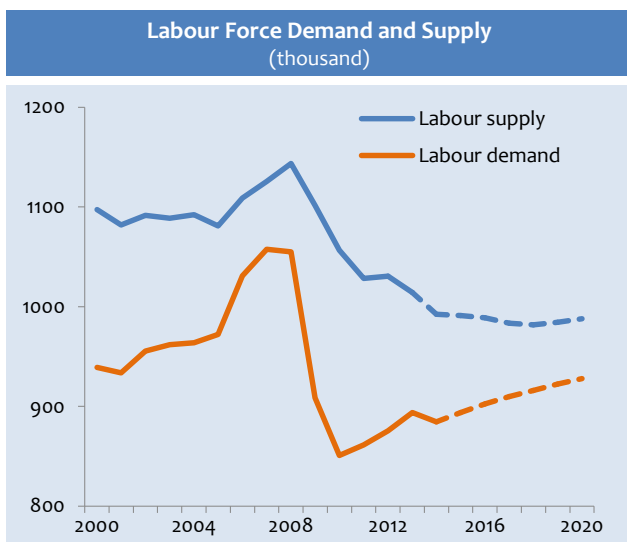
Figure 5.12



Unemployment will also continue to fall in the medium term, and the problem of labour shortage will become more pronounced. In total, unemployment rate could get close to 6% by 2020.

In 2015, economic growth rates increased in most sectors of the national economy, especially in the domestic-demand-oriented sectors, which was reflected accordingly in the sectoral employment growth. Similar trends will be observed in 2016.

Figure 5.13

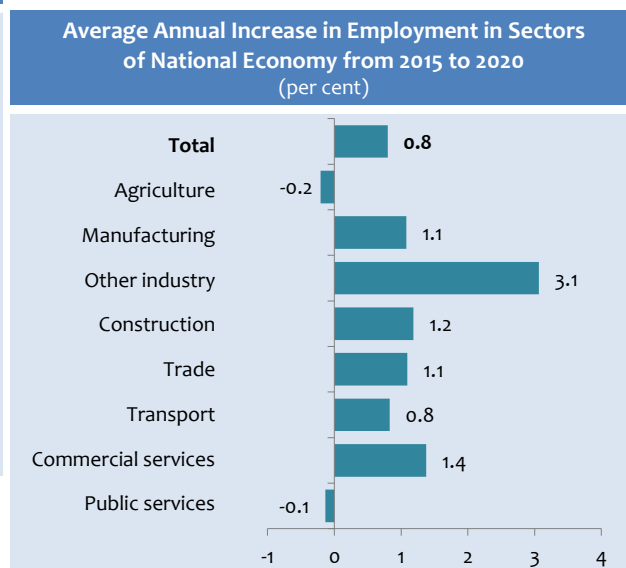


The most significant increase in the number of employed in 2016, compared to 2015 is expected in domestic-demand-oriented sectors – commercial service sectors (by 2.6 thousand or 1.6%) and trade (by 2.5 thousand or 1.5%). The number of employed will increase slightly in the manufacturing industry, but at a slower pace than previously expected.

At the same time, it should be noted that the role of domestic-demand-oriented sectors in the labour market will continue to increase in the coming years. Growth of the tradable sectors will be mainly based on the increase in productivity, which is crucial for ensuring competitiveness, therefore the growth of employment in these sectors might be relatively slower.

By 2020, the number of employed will increase in most of the sectors. The most significant increase in the number of employed will be observed in the commercial services sector, in the manufacturing industry and trade.

Figure 5.14



At the same time, a drop in the number of employed is expected in the primary sector – mainly in the agriculture and forestry sector, as well as the public utilities sectors. Decrease in labour demand in the

agricultural sector is mainly attributable to efficiency enhancement of the industry – formation of farmers' cooperatives and large farms, introduction of systematic production organisation, introduction of more complex technological solutions in the production process.

Overall, the labour market situation in the medium and long term will be determined by development of a number of significant factors. The main uncertainty still arises from development of the external environment – weak external demand may hamper successful recovery of the labour market.

At the same time, the internal challenges of Latvia are mainly related to a gradual decrease in the number of the

population (especially the population of working age), as well as to the general trends of aging of the labour force.

According to the forecasts of the Ministry of Economics, the number of people of working age (15-62 years of age) will decrease by more than 10% by 2030, compared to 2014. At the same time, dependency ratio will rise by around 1/5. Significant changes are expected in the age structure of the population – the share of elderly in the total population will continue to grow.

In general, the said trends will exacerbate the problem of labour shortage by 2030, which could add up to formation of various disproportions in the labour market.

5.4 Employment Policy

The quantitative aim set by Latvia within the context of implementing the *EU 2020 strategy* is to achieve employment rate of 73% in the age group 20-64 by 2020 (see Chapter 6.1). To achieve the aim, policy directions are planned in relation to both labour supply and labour demand.

The main elements of the Latvian employment policy:

- supporting the labour demand – stimulation of economic activities and entrepreneurship, including reduction of the labour taxes, the fight against undeclared employment, indirect and direct support measures for businesses ensured by the government, measures to reduce administrative barriers, implementation of support measures for micro-enterprises, business incubators, etc. (see Chapter 6.7 and 6.8);
- strengthening the labour supply – increasing the competitiveness of the unemployed and people at risk of unemployment in the labour market, including skills development according to the labour market needs, lifelong learning measures, advice for starting a business, etc.;
- facilitating the process of aligning the labour supply and demand, including the improvement of the education system, involvement of employers' organizations in the improvement of the quality of education, forecasting the compliance of the labour market supply with the labour market demand, educating the labour market participants, including pupils and students, on labour market and career issues.

Demographic trends indicate that the number of working age population is decreasing in Latvia, so, in the coming years, **labour force availability issues** (see Chapter 5.3) will become more topical in Latvia, due to the development of the economy and changes in its structure. Along with the improvement of the economic situation, demand for labour is gradually increasing in Latvia, and a lack of specialists can already be felt in some areas. Labour shortage may become a growth-inhibiting factor in the future. This may result in the need to attract

additional labour force from abroad. The aim of Latvia is to achieve that the vacancies are filled with Latvian nationals, who have left the country, rather than immigrants from other countries. Therefore, migration policy should be facilitating in relation to the population, who have moved to live abroad in the past for various reasons, but would love to return home to live and work in Latvia or develop business relations with Latvia, for example, start their own business, as well as their family members (re-emigration policy).

The main factors that provide incentive to return to Latvia – the chances of finding a job and the amount of remuneration. But other conditions related to social protection, social life, education of children, etc. are just as significant. Ensuring a stable economic growth, job creation and an increase in remuneration are the key prerequisites for reducing the flow of emigration and facilitating the return of fellow Latvians living abroad.

It has to be noted that the *Plan of Re-emigration Support Measures 2013-2016* has been drawn up at the initiative of the Ministry of Economics, which prescribes support for the nationals who want to or have already decided to return to Latvia (see Box 5.1). The support measures included in the plan mainly provide for the following:

- to ensure information and give advice to people who are considering the possibility of returning to Latvia, to strengthen their ties with the fellow Latvians living abroad;
- to provide practical support and to reduce the difficulties faced by Latvian nationals and their families, when returning to and settling in Latvia.

Measures included in the Plan of Re-emigration Support Measures cover different areas and, therefore, a wide range of institutions are involved in their implementation. The Ministry of Economics coordinates the implementation of the plan – collects the information provided by the responsible institutions on the implementation of the measures within their competence on a regular basis, as well as organises meetings with the representatives of the involved institutions and NGOs in order to discuss the identified problems and try to find

solutions to them. It has to be noted that the most important obstacle to successful implementation of the plan is the lack of funding required for the measures. In total, additional 1.6 million euro have been granted for the implementation of various measures in 2014-2016 from the national budget for the implementation of various measures. However, it is almost three times less than planned, therefore, in accordance with the information provided by the institutions, a number of measures are being implemented partially or not implemented at all.¹ Key issues to be addressed in connection with the implementation of the re-emigration support measures:

- establishing an institution, which would provide advice and information in one place to people who are planning to return to Latvia, and help re-emigrants to fit well into the Latvian society;
- improvement of the portal www.latvija.lv, so that the Latvians living abroad could easily access and find information on living, working, business opportunities in Latvia, as well as the services provided by the national and local governments – regular updates of information, adding services provided by local governments, etc.;
- providing support measures for pupils in the Latvian educational institutions, including private lessons, development of teachers' professional competence, availability of information to pupils' parents, etc.;
- provision of support (material assistance in connection with moving to Latvia) to repatriates who have been living abroad for 10 years or more, and their family members. Since funding was not allocated, draft law *Repatriation Law* drawn up by the Ministry of the Interior (submitted to the Saeima on 11 March 2015) does not provide for changes to the beneficiaries of material assistance covered by the law.

In addition, the issue in relation to diaspora policy development, as well as improvement of the monitoring and coordination of both policies (the diaspora and re-emigration policy) has to be resolved in general.

The group of researchers of the University of Latvia started implementing the ESF project *Latvian Emigrant Communities: National Identity, Transnational Relations and Diaspora Policy* in early 2014. The project aims to analyse the diversity of migration processes and to provide justified information to policy makers in order to strengthen the Latvian diaspora, as well as to provide support to compatriots who wish to return to Latvia.² Under this research project, the largest survey of the Latvians and Latvian nationals living abroad up to date was conducted with more than 14 thousand respondents.

¹ *Summary on the Progress of Implementation of the Re-emigration Support Measures* of May 2015. Available at: https://www.em.gov.lv/lv/nozares_politika/reemigracijas_atbalsta_pasakumi/

² Information about the project and its interim results is available here: <http://migracija.lv/>

The project was concluded in August 2015. The main results are reflected in the collective monograph *Emigrant Communities of Latvia: Diaspora of Hope*. Based on the researchers' conclusions, it is planned to evaluate the diaspora and re-emigration policies and the implemented measures and to prepare suggestions for further action.

National employment policy is aimed at building an inclusive labour market. In May 2015, the CoM approved *Inclusive Employment Guidelines 2015-2020*. The aim of the Guidelines is to promote development of an inclusive labour market, making full use of the human potential of the Latvian population, also by reducing the social consequences of unemployment, supporting the return of unemployed people to the labour market and keeping the people at risk of social exclusion in the labour market for as long as possible, as well as improving the quality of jobs.

By stressing the need to reduce long-term unemployment, the Guidelines have set the objective of reducing long-term unemployment to 15% of all unemployed population and 2.5% of the economically active population by 2020 and in the long term.

Measures are planned under three main lines of action.

In order to favour an inclusive labour market, it is planned:

- to expand the provision of services to the registered unemployed population according to the individual needs identified as a result of profiling;
- to increase the intensity of use of career services in the career planning process;
- to increase the involvement of risk groups of the unemployed into the labour market by tackling the key causes of unemployment;
- to develop social entrepreneurship;
- to increase regional mobility opportunities for encouraging of economic activity.

In order to favour a well-balanced labour market, it is planned:

- to expand the availability of information on current events in the labour market;
- to improve the efficiency of labour market situation analysis;
- to improve the cooperation mechanism to ensure better outcomes of the labour market;
- to increase the competitiveness of the unemployed and job seekers by improving the knowledge and skills required in the labour market;
- to increase employment and business opportunities for the registered unemployed population;
- to facilitate the improvement of job quality.

Box 5.1**Plan of Re-emigration Support Measures 2013-2016**

In August 2012, a working group for drawing up the plan of re-emigration support measures was formed at the initiative of the minister of Economics, which was intended to cover the wide range of issues of re-emigration and facilitate the cooperation of the institutions involved in this process, as well as to identify the existing measures and to draw up new measures for creating favourable conditions for re-emigration. Representatives of state and municipal institutions, trade unions, entrepreneurs and foreign Latvian organizations took part in the activities of the working group.

Proposals prepared by the working group for re-emigration support measures were passed on to public discussion, which took place in November 2012 on the public debate platform www.musuvlsts.lv.

After evaluating all proposals received in the working group, the Ministry of Economics prepared the Informative Report on Proposals for Re-emigration Support Measures (the Cabinet of Ministers approved it on 29 January 2013), reflecting the directions of re-emigration support measures suggested by the working group for creating favourable conditions for re-emigration.

In 2013, the Ministry of Economics in cooperation with the involved institutions continued development of specific re-emigration support measures included in the Plan of Re-emigration Support Measures 2013-2016. The plan was approved at the Cabinet meeting of 30 July 2013.

The plan aims to support and help those Latvian nationals and their family members living abroad who are considering or have already decided to return to and work in Latvia or want to start their own business or to develop business relations with Latvia. The plan is not aimed at asking every Latvian living abroad to come back immediately without carefully assessing the employment and remuneration situation in Latvia. The plan is also not aimed at offering solutions to all problems in the Latvian economy, society and the country as a whole that have been neglected for years.

The plan includes 33 measures in accordance with eight lines of action:

- ensuring the one-stop shop principle – to provide information and advice, including remotely, on matters of moving to and staying in Latvia, to help the Latvian nationals living abroad or their family members in dealing with the necessary activities with various public authorities;
- availability of information of the labour market – development and promotion of the State Employment Agency's *CV/Vacancy Database*; complete, most current information on the professionals required in Latvia / vacancies etc. is available in the *CV/Vacancy Database*;
- attraction of highly qualified labour force – support for attraction of highly qualified professionals (scientists and academic staff living abroad), also to facilitate the return of highly skilled young people with education acquired abroad; the requirements have to be reviewed, as well as the list of professions in Latvia, for which the government extinguishes student loans, etc.;
- Latvian language training – support for Latvian language training upon returning to Latvia for all family members of Latvian nationals; Latvian language learning materials have been developed, including electronic teaching aids;
- expanding the cooperation with the diaspora (development and maintenance of business relations) – measures for informing the representatives of diaspora on current events in Latvia and support for entrepreneurs, consultations on how to start a business, etc.; information about entrepreneurs and professionals of the Latvian diaspora around the world has been gathered and their involvement in the development of the Latvian economy has been facilitated; identification and dissemination of the stories of experience of returning and cooperating with the diaspora, etc.;
- support for pupils returning to / adapting themselves to the education system of Latvia, as well as their parents – development and expansion of the existing support mechanism for pupils returning from abroad; adaptation measures are provided for pupils at educational institutions;
- facilitating the transparency of state and local government institutions and state-owned enterprises – transparent recruitment procedures are facilitated, also by evaluating the validity of requirements (for example, related to foreign languages) set for candidates and the relevance of such requirements to their job functions, as well as by providing opportunities for the people living abroad to participate in job interviews (in government institutions) using web communication facilities;
- expanding the range of people who can claim the status of a repatriate, so that the persons who emigrated after 4 May 1990 and lived abroad for at least 10 years can get the status (draft law *Repatriation Law* has been submitted to the Saeima).

The plan also specifies the amount of funding necessary for the implementation of measures, the sources of funding, the expected performance indicators, the implementation deadlines, as well as the responsible and involved institutions.

By contrast, it is planned to ensure environment that facilitates employment with the help of development of inclusive employment-friendly tax and benefit systems.

The national policy in the field of unemployment reduction and support for the unemployed is implemented by the **State Employment Agency (SEA)**. Active and preventive labour market measures are used to influence the labour market, facilitating the competitiveness of the target group of the measures in the labour market.

The main target audience of the employment measures implemented by the SEA is the unemployed registered at the SEA. Although certain measures have

different target groups, the overall activities are focused on servicing the unemployed.

The dynamics of the number of registered unemployment is consistent with the national economic development indicators. In recent years, the number of the unemployed registered at the SEA and the rate of registered unemployment has been declining steadily (see Chapter 5.1).

The amount of the funding granted for active labour market policy measures is linked to the unemployment situation. When the number of the unemployed starts to decrease, there is a similar trend in the funding granted for the labour market measures.

The largest amount of funding was granted in 2010 – 91.1 million euro. The funding spent in 2011 was 71.1 million euro, in 2012 – 44.4 million euro, in 2013 – 45.7 million euro, in 2014 – 38.5 million euro.

More than 2/3 of the total funding consists of the funding of the European Social Fund.

Most funding in 2014 was spent on measures aimed at training (vocational training, retraining, improvement of professional skills and acquisition of non-formal education, lifelong learning activities for employed persons).

When analysing the funding structure, it is clear that 44% of the funding has been spent on the improvement and development of practical skills of the unemployed, 29% – for the support of the most disadvantaged unemployed and creation of subsidized jobs, including youth initiatives and implementation of the initiative *Youth Guarantee*. The share of funding spent on paid temporary public service jobs is 21%, while 6% of the total funding have been spent on the improvement of professional skills of the employed and business initiatives.

Also in 2015, the largest share in the funding structure of active labour market policy measures was allocated to the measures of professional development and improvement of the unemployed.

At present, the SEA implements the following **active employment measures**:

- vocational training, retraining, improvement of professional skills and acquisition of non-formal education;
- measures for increasing competitiveness;
- paid temporary public service jobs (in 2010 and 2011, this measure was completely replaced by the measure *Work Practice with a Grant*);
- measures for starting a business or self-employment;
- measures for certain groups of persons;
- complex support measures;
- facilitating regional mobility of persons employed by merchants;
- training by the employer.

During the years of economic growth, the demand for active employment measures had decreased, but due to the significant rise in unemployment, it increased substantially in 2009. It remained at a high level also in the following years, although it has begun to decrease.

The largest number of people involved in the active employment measures was observed in 2010 – 299.2 thousand people. In 2014, the number was 176.8 thousand people, while in the first three quarters of 2015 – 100.6 thousand people (one person may be involved in several activities).

Training programmes offered to the unemployed under the training measures are selected in accordance with the suggestions of the Training Commission or at the employer's written request.

To reduce the labour market disproportions in terms of professions, labour market measures can be used to a limited extent. Of the training measures implemented to reduce disproportions in the labour market, measure *Professional Training, Retraining and Improvement of Professional Skills* can be used directly. Under the measure, unemployed people are given the opportunity to acquire new professional knowledge, acquiring or improving professional qualifications. Currently, there is an offer to acquire only knowledge suited to the secondary qualification occupations.

Other training measures can be perceived as a support for the acquisition of additional knowledge to increase competitiveness in the labour market. Non-formal education programmes are targeted at both the unemployed and job seekers.

Career advice provided by the SEA can be considered to be a **preventive measure for reducing unemployment**. In 2010, career advice services were provided to 78.4 thousand people, in 2011 – 47.7 thousand people, in 2012 – 67.1 thousand people, in 2013 – 44.1 thousand people, in 2014 – 45.6 thousand people, 39.7 thousand of which are unemployed or job seekers, in the first three quarters of 2015 – 29 thousand people, 26 thousand of which are unemployed or job seekers.

Adapting to the changes in the labour market situation, there have been the following changes to the active labour market policy measures in 2014 and 2015.

The unemployed profiling system that was created last year for work with the unemployed is fully operational, so that every unemployed person is provided with proper services. Profiling facilitates efficient and targeted application of services offered by the SEA to shorten the time spent unemployed and to avoid the potential risks that could prevent successful return to the labour market. At the end of 2014, almost all (97%) of the registered unemployed people had been profiled.

The measure *Training Programmes for Adult Involvement in Lifelong Learning* concluded in 2014. Since the commencement of the measure in 2010, a total of 28 thousand employed people have taken part in the measure.

Particular attention is paid to the stimulation of youth employment. After a five-year break, the pupil summer employment measure was resumed. Thus, pupils have the opportunity to acquire basic professional skills, as well as gain insight into future professional choice.

Using state aid, pupils aged 15-20 years attending institutions of general, special and vocational educational have the opportunity to work during their summer holidays. Under the measure, pupil's salary in the amount of 50% of the national minimum monthly wage is covered by public funds.

In 2014, 4.3 thousand pupils used the opportunity to work in the summer. In 2015, 3.8 thousand pupils were involved in the measure: 2,152 girls and 1,652 boys. Pupils aged 15-17 years were the most active participants of the measure.

The implementation of the measure *Training by the Employer* was resumed in 2015. It is organized to carry out the practical training of the employee required by the employer, by organizing employee's training by the employer. The practical training lasts for 6 months, after which a job must be ensured for at least 6 months.

To reduce youth unemployment, Latvia is actively involved in the implementation of the EC initiative *Youth Guarantee*. Measures for the implementation of the initiative *Youth Guarantee* are implemented from 2014 to 2018. Total funding for the implementation of the measures of *Youth Guarantee* is 66.7 million euro.

Since the beginning of 2014, young people aged 15-24 years, who are not studying or working, can receive the necessary support in the form of employment, training or education measures. Certain measures are offered to young people aged 13-15 years and 25-29 years. It is established that young people of the target group will be able to get support for the involvement of the labour market under the guarantee no later than four months after leaving the school or acquiring the status of unemployed person.

In 2014, 24,445 young people took part in the initiative *Youth Guarantee* (23,468 people completed the initiative), while in the first three quarters of 2015 – 21,021 young people, including 931 people from the previous year (19,218 people completed the initiative).

Total funding spent on the measures of *Youth Guarantee* in 2014 was 4.7 million euro, 4 million euro of which were the co-funding of the EU funds. Funding planned for 2015 is 13.8 million euro, including 11.7 million euro funding of the EU funds.

In order to enhance cooperation and to provide proposals for efficient implementation and improvement of the measures, advisory board for the implementation of the *Youth Guarantee programme* was established in July 2014.

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

The new *Trade Union Law* came into force in late 2014. It was drawn up to improve and modernize the legal framework of trade union activity. It governs the general principles of establishment and operation of trade unions and their associations, as well as their cooperation with employers, national and local governments.

Safety at work is an important aspect of labour relations, favouring conditions for a safe and healthy work environment.

An EU strategic framework on health and safety at work 2014-2020 has been developed to improve working conditions and to reduce the number of accidents at work and occupational diseases. The EC published the

new strategy in June 2014. The main tasks at the EU level are the following:

- to improve the implementation of the current requirements of health and safety at work in the Member States, in particular by promoting the ability of micro-enterprises and small enterprises to implement useful and efficient risk prevention measures,
- to improve work-related disease prevention, in particular focusing on the existing, new and emerging risks,
- to take into account the EU's aging workforce.

In the field of labour safety, two draft policy planning documents have been drawn up, which are currently being agreed upon: *Labour Safety Policy Guidelines 2015-2020* and *Plan for the Development of the Field of Labour Safety 2015-2017*.

Reduction of administrative burden in the field of labour safety is being continued in Latvia.

In 2014, the requirements for work at height and work equipment were improved. Employees working at height will have improved working conditions, and greater safety will be ensured, thus also reducing the risk of accidents. The new requirements came into force on 1 September 2014.

In July 2014, the CoM approved the improved requirements for labour safety when carrying out construction work.

In April 2015, the CoM approved changes to several regulations of labour safety. It specifies the requirements for the labelling and classification of chemicals. At the same time, clarifications were approved in the working environment factors and actions that may pose a risk to pregnant women and women who are breast-feeding. Also the list of jobs, where employment of adolescents is prohibited, especially if the particular work requires coming into contact with chemical substances and mixtures, has been specified.

In October 2015, the Cabinet of Ministers approved labour safety requirements for protecting the employed against risks of electromagnetic field in the working environment. They set the minimum requirements for protection of the employed against the risks arising from the effects of electromagnetic field during work. The new requirements will come into force on 1 July 2016.

There is a relatively high rate of **undeclared employment** in certain industries in Latvia, which increases unfair competition and reduces the social security of employees.

In the policy planning documents developed up to now, measures for reduction of unregistered employment have been implemented in such key directions as improving efficiency of the unregistered employment control mechanism, reduction of unfair competition, review of the penalty policy in relation to undeclared work, raising public awareness and education about the negative consequences of unregistered employment.

The main lines of action in the field of reducing the shadow economy and ensuring fair competition were tax policy, reduction of administrative burden, support for honest entrepreneurs and facilitating the transition to legal economy, capacity building of the controlling institutions, development of legislation, policy on penalties, work with the public, reducing the amount of shadow economy in risk sectors.

Being aware of the need to continue dealing with these issues, the government set up a high-level Shadow Economy Combating Council, headed by the Prime Minister, in the autumn of 2014. The Council is comprised of ministers, the heads of institutions involved and the social partners. The functions of the Council are to coordinate the development of draft policy planning documents on the fight against the shadow economy and to coordinate and improve cooperation in the fight against the shadow economy in order to ensure the efficiency of the said activities.

The Ministry of Finance continues to develop the draft Work Plan of Governmental Authorities on Reducing the Shadow Economy 2016-2020, which evaluates and includes the proposals of ministries and social partners for reducing the shadow economy.

In the context of labour market development, an important role is played by the education system, particularly emphasizing the importance of **lifelong learning**. The introduction of the principle of lifelong learning is also emphasized in the National Reform Programme of Latvia for the implementation of the *Europe 2020 strategy*.

Latvia is committed to facilitate continuous improvement and development of its residents' knowledge, skills and competences, providing access to lifelong learning, so that 15% of the population (25-64 years of age) would be involved in the learning process on an ongoing basis by 2020.

Dynamics of lifelong learning in recent years shows that it is necessary to implement adult education activities more purposefully.

The indicators of adult participation in lifelong learning¹ have been becoming worse in recent years. In 2014, 5.5% of the population aged 25-64 years were involved in lifelong learning.

Introduction of the lifelong learning principle is implemented in several directions:

- facilitating cooperation and ensuring coordination among the partners involved in adult education;
- development of the national qualifications framework and aligning its levels to the European Qualifications Framework;
- ensuring the evaluation of knowledge, skills and professional competence acquired outside the formal education system;
- second chance education as a compensating mechanism to reduce the number of early school leavers;
- support for improving the staff qualification according to the employers' requirements, which is required for training of the employed within the framework of the sectors.

¹ The data source is the Labour Force Survey of the CSB. The indicator is included in the EU's structural indicators, and it shows the participation of adult population aged 25-64 years in lifelong learning activities.

6. ECONOMIC POLICY AND PRIORITIES OF THE STRUCTURAL POLICY

6.1 Europe 2020 Strategy and National Reform Programme of Latvia

6.1.1 Europe 2020 Strategy and its Progress

On 3 March 2010, the EC published a communication *Europe 2020: strategy for smart, sustainable and inclusive growth* that laid down the Commission's vision of the *Europe 2020* strategy.

On 17 June 2010, the European Council officially approved the *Europe 2020* strategy and its principal elements: EU-level quantitative targets for 2020, *Integrated guidelines* (drafted according to Articles 121 and 148 of the *Treaty on the Functioning of the European Union*, contains key economic and employment policies, and forms the basis for the development of national reform programmes in the EU Member States), and agreed that EU Member States in co-operation with the EC should develop national reform programmes and submit them to the EC by the end of April 2011, along with their *Stability or Convergence programmes* (drafted and implemented to fulfil the requirements of the *Stability and Growth Pact*).

Figure 6.1

Monitoring Mechanism for National Reform Programmes and Stability or Convergence programmes of the EU Member States		
Quantitative targets of Europe 2020 strategy		
Integrated guidelines of Europe 2020 strategy		Stability and Growth Pact
Macroeconomic monitoring	Coordination of thematic areas	Fiscal monitoring
National level	National reform programmes	Stability or Convergence programmes
EU level	Annual Growth Survey of the Commission Annual recommendations EU's flagship initiatives and support pillars (i.e., internal market, trade and internal policy, EU financial support)	

Monitoring of the implementation of the *Europe 2020* strategy consists of two pillars (see Figure 6.1) – macroeconomic and thematic surveillance (national reform programmes for the implementation of the *Europe 2020* strategy of the EU Member States and their compliance with the *Integrated guidelines* are evaluated), as well as fiscal monitoring (*Stability or Convergence programmes*

of the EU Member States and their compliance with the *Stability and Growth Pact* are evaluated).

On 5 March 2014, the EU published a Communication titled *Taking stock of the Europe 2020 strategy for smart, sustainable and inclusive growth*. The aim of the communication is to evaluate the first results and lessons learned in the four years of the implementation of the *Europe 2020* strategy, and to express an opinion on the desirable future of *Europe 2020* strategy. To identify and collect opinions of all interested parties, from 5 May until 31 October 2014 the EC initiated a public consultation of the aforementioned Communication. The EC is currently continuing to analyse the evaluation of the *Europe 2020* strategy and to develop a future plan.

A **European Semester** has been conducted annually since 1 January 2011, to evaluate the economic situation in the EU as a whole and in the EU Member States, as well as to propose recommendations to the EU Member States for the implementation and strengthening of their economic policies.

The *Europe 2020* strategy and national reform programmes of the EU Member States and *Stability or Convergence programmes* are the main elements in the coordination and monitoring of economic policies of the EU Member States at the EU level within the European Semester (see Figure 6.2). Based on the multilateral surveillance of both programmes, which is performed at the EU level, the EC may give a policy warning, if the economic policy of any EU Member State fails to comply with the EU *Integrated guidelines* and objectives set at the EU level. The national reform programmes are linked also to the EU budget, because a part of the measures is co-financed from the EU budget.

In 2015, several improvements were introduced into the European Semester process, to make it more efficient and to allow more time for discussions between all stakeholders. The first improvement concerns faster publication of the *Commission Staff Working Document*, which includes a *Country Report*, and also an *In-Depth Review on the Prevention and Correction of Macroeconomic Imbalances*, if macroeconomic imbalances are found. These Commission documents evaluate the progress achieved by the EU Member States in addressing the country-specific recommendations issued by the EU Council and in the correction of macroeconomic imbalances. Commission Staff Working Documents for the EU Member States were published on 26 February 2015. The second improvement is related to a faster

publication of an EC recommendation for country-specific recommendations issued by the EU Council. The EC recommendation for country-specific recommendations issued by the EU Council was published on 13 May 2015. The third improvement concerns the time and the deadline, when EU Member States have to prepare and submit to the EC their comments on the draft EC country-specific recommendation project. In 2015, in comparison with the previous years, EU Member States were given ten days to do so.

Along with the publication of the *Annual Growth Survey 2016*, on 26 November 2015 a new practice was

initiated within the European Semester, namely, the first stage of the European Semester from November until February is from hereinafter referred to as 'the European stage', but the following period from February until June is referred to as 'the national stage'. Therefore, within the framework of better integration of the euro area and national dimensions, for the first time in the practice of the current European Semester, a Commission recommendation for Council recommendations to the euro area was published, along with the *Annual Growth Survey 2016*.

Figure 6.2

European Semester: Partnership Between the EU and Member States							
	November-February	March	April	May	June	July	September-October
European Commission	Annual Growth Survey and Alert Mechanism Report Publication of recommendations for the euro area	Commission Staff Working Document for each Member State (reform programme and imbalances)		Publishing of country-specific recommendations			EU level review
European Council/ Council	Discussions				Discussion of recommendations	Approval of recommendations	
European Parliament	Discussions						
Member States		Approval and submission of national reform programmes and <i>Stability</i> or <i>Convergence</i> programmes to the European Commission					National level decisions

The EC's *Annual Growth Survey* is an important element in the European Semester process, as its publication starts discussions in different EU Council formations at the beginning of the European Semester (see Box 6.1). As a result of these discussions, EU

Member States agree on key economic policy priorities that will have to be taken into consideration when updating national reform programmes, *Stability* or *Convergence programmes*.

Box 6.1

Annual Growth Survey 2016

The EC published its *Annual Growth Survey 2016* on 26 November 2015, along with other important documents, namely, the *Alert Mechanism Report*, the *Joint Employment Report*, Council recommendations for the euro area, as well as the proposal for a regulation on the establishment of the Structural Reform Support Programme.

The *Annual Growth Survey 2016* reviews the economic and social situation in Europe and sets political priorities for the EU as a whole. This is the start of a new European economic policy coordination cycle: European Semester, which ensures coordination of economic policies between EU Member States to promote growth and jobs.

The *Annual Growth Survey 2016* states that the EU's economy is experiencing a moderate recovery, and at the same time the survey says that the pace of activity is expected to accelerate gradually.

Along with the abovementioned, the *Annual Growth Survey 2016* also states that economic performance, social conditions and reform implementation still remain uneven. High long-term unemployment and youth unemployment, slow productivity growth, as well as high private and public debt levels are highlighted as the main problems.

To resolve these problems, the EC offers solutions in its *Annual Growth Survey 2016*, based on three integrated pillars (priorities):

1. re-launching-investment;
2. pursuing structural reforms to modernise economies;
3. responsible fiscal policies.

Box 6.1 continued

Therefore, the solutions proposed within the framework of the three main pillars (priorities) of 2016 in the EU's economic and social policy are:

- **Re-launching investment** – active implementation of the Investment Plan for Europe needs to be continued and involvement of the state and institutions into it should be promoted; the Banking Union needs to be completed; work on the Capital Markets Union needs to be accelerated; modern and effective frameworks to deal with insolvency and business failure should be introduced; investment priorities must go beyond traditional infrastructure and extend to human capital and related social investment;
- **pursuing structural reforms to modernise our economies** – benchmarks for economic and social development should be designed and implemented in practice; national, regional and local authorities should advance the work on youth employment; job integration agreement and a single point of contact should be created; taxation related to labour and benefit systems should be designed and implemented to encourage investment and employment; wages must continue to move in line with productivity; modernisation and simplification of employment protection legislation should be continued; open and competitive product and services markets should be provided; an appropriate and accommodating business and regulatory environment should be created, and partnerships between businesses and universities should be strengthened; adequate administrative capacity and focus on the increased use of e-procurement and on tackling corruption should be ensured; swift proceedings should be ensured, the court backlogs should be addressed, safeguards for judicial independence should be increased and the quality of the judiciary should be improved;
- **responsible fiscal policies** – responsible fiscal policies that respect the common fiscal rules should be maintained at the Member States' level. These also include the need to continue to support growth- and equity-friendly fiscal consolidation in many countries. Tax systems need to address disincentives to employment creation and be made fairer and still more effective; reducing of aggressive tax planning and fighting of tax fraud and tax evasion should be continued; pension, healthcare and social protection systems should be modernised in order to efficiently respond to all the risks throughout the life cycle.

New monitoring rules for economic and fiscal policies (also known as the 'six-pack') consisting of five regulations and one directive entered into force on 13 December 2011. The adoption of these new rules in the EU created a macroeconomic imbalances procedure (in addition to the existing excessive budget deficit procedure), the purpose of which is to timely identify

(using the scoreboard created by the alert mechanism) and correct any macroeconomic imbalances (such as high current account deficit, etc.) – see Box 6.2. Since the national reform programmes of the EU Member States focus on the implementation of key structural reforms, this helps to promptly prevent an excessive budget deficits and macroeconomic imbalances.

Box 6.2**Alert Mechanism Report and Scoreboard**

Every year, the EC publishes the *Alert Mechanism Report* that analyses the situation in the EU Member States based on the set indicators and their thresholds:

- 3 year backward moving average of the current account balance as percent of GDP, with thresholds of +6% and -4%;
- net international investment position as percent of GDP, with a threshold of -35%;
- 5 years percentage change of export market shares measured in values, with a threshold of -6%;
- 3 years percentage change in nominal unit labour cost, with thresholds of +9% for euroarea countries and +12% for non-euroarea countries;
- 3 years percentage change of the real effective exchange rates based on HICP/CPI deflators, relative to 41 other industrial countries, with thresholds of -/+5% for euroarea countries and -/+11% for non-euroarea countries;
- private sector debt (consolidated) in % of GDP with a threshold of 133%;
- private sector credit flow in % of GDP with a threshold of 14%;
- year-on-year changes in house prices relative to a Eurostat consumption deflator, with a threshold of 6%;
- general government sector debt in % of GDP with a threshold of 60%;
- 3-year backward moving average of unemployment rate, with a threshold of 10%;
- year-on-year changes in total financial sector liabilities, with a threshold of 16.5%;
- 3 years change in p.p. of the activity rate, with a threshold of -0.2%; 3 year change in p.p. of the long-term unemployment rate, with a threshold of +0.5%;
- 3 year change in p.p. of the youth unemployment rate, with a threshold of +2%.

If the situation in any EU Member State exceeds the threshold set for any indicator, the Commission should carry out an in-depth analysis and publish an *In-depth review*.

In its *Alert Mechanism Report 2016*, the EC identified 18 EU Member States (Belgium, Bulgaria, Germany, France, Croatia, Italy, Hungary, Ireland, the Netherlands, Portugal, Romania, Spain, Slovenia, Finland, Sweden, United Kingdom, Estonia and Austria), which need an in-depth analysis in order to further evaluate the increase or the drop in imbalance and the related risks. It should be noted that a first time in-depth analysis on Estonia will be prepared, assessing the risks and vulnerabilities linked to a renewed build-up of demand pressures, as well as on Austria, evaluating the risks and vulnerabilities related to the financial sector. For the EU Member States that benefit from financial assistance (such as Greece and Cyprus), the monitoring of their imbalances and monitoring of corrective measures takes place in the context of their programmes.

At this stage, the EC did not carry out further analysis in the context of the Macroeconomic Imbalances Procedure, for the other EU Member States. The EC is of the opinion that the macroeconomic challenges of the Czech Republic, Denmark, Latvia, Lithuania, Luxembourg, Malta, Poland and Slovakia do not represent imbalances causing macroeconomic imbalances.

At the same time, the EC points out that careful monitoring and policy coordination are necessary on a continuous basis for all EU Member States, to identify emerging risks and propose the policies that contribute to growth and jobs.

Box 6.2 continued

The *Alert Mechanism Report 2016* emphasises that, all in all, risks stemming from vulnerabilities or trends that may potentially contribute to macro-financial instability or disorderly corrections, are present in the majority of Member States and are as follows:

- large negative net international investment positions in the external sector: Romania, Poland, Latvia, Lithuania, Slovakia, the Czech Republic;
- large and persistent current account surplus: Germany, the Netherlands;
- large stocks of public debt and a declining trend in potential growth or competitiveness: Italy, France, Belgium;
- unsustainable trends and vulnerabilities, confined to a particular sector: Sweden (a continuous increase in house prices and household debt), the Netherlands (high household debt), the United Kingdom (increase in house prices), Austria (high exposure of the financial sector to developments abroad and the impact on credit provided to the private sector), Estonia (build-up of demand pressures in the domestic economy), Finland (challenging structural shift in the economy following a downsizing of the electronics sector), Denmark, Luxembourg and Malta (high level of household debt);
- large stocks of net liabilities – Portugal, Spain, Cyprus, Greece, Ireland, Slovenia, Hungary, Croatia and Bulgaria.

6.1.2 National Reform Programme of Latvia for the Implementation of the Europe 2020 Strategy

The *National Reform Programme of Latvia for the Implementation of the Europe 2020 Strategy* (NRP of Latvia) was approved by the Cabinet of Ministers on 26 April 2011 together with the *Convergence Programme of Latvia 2011-2014*. Both programmes were submitted to the EC on 29 April 2011.

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

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

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

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

According to the progress of the European Semester, the Cabinet of Ministers approved the fourth *Progress Report on the Implementation of the NRP of Latvia* and the *Latvia's Stability Programme for 2015-2018* on 13 April 2015. Both documents were submitted to the EC.

The Progress Report on the Implementation of the NRP of Latvia 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 2014, gives a detailed description of the NRP policy directions, including national quantitative targets of Latvia in the context of the *Europe 2020* strategy, and reflects information on the use of EU funds.

Having evaluated the updated National reform programmes, Stability or Convergence programmes, which were submitted by the EU Member States, and the progress of their implementation, on 13 May 2015 the EC presented a recommendation for **Council Country-specific recommendations for EU Member States**, including Latvia. After discussions in various EU Council formats, these recommendations were approved in the EU Council in July 2015.

According to the Commission's recommendation, the following recommendations are made for Latvia for 2015-2016:

- To ensure that the deviation from the medium-term budgetary objective in 2015 and 2016 is limited to the allowance linked to the systemic pension reform;
- To improve vocational education and training, speed up the curricula reform and increase the offer for work-based learning. Ensure that the new financing model of the higher education system rewards quality. Better target research financing and incentivise private investment in innovation on the basis of the *Smart Specialisation Framework*;
- To take concrete steps to reform social assistance, ensuring adequacy of benefits, and take measures to increase employability. Reduce the high tax wedge for low-income earners by shifting the tax burden to other sources less detrimental to growth. Take action to improve the accessibility, cost-effectiveness and quality of the healthcare system and link hospital financing to performance mechanisms;
- To improve efficiency of the judicial system, by increasing accountability of all parties (including insolvency administrators), by providing adequate

means to fight tax evasion and by strengthening the role of the Judicial Council. Improve the public service legislation to strengthen the conflict of interest regime and link remuneration to responsibilities.

Council recommendations to Latvia are an essential element for setting national priorities, formulating necessary reform and policy activities, as well as successfully implementing *National Reform Programme of Latvia* and *Latvia's Stability Programme*. Taking into account the scale, impact, implementation costs of individual recommendations (e.g. concerning reforms in education, research, healthcare) and the need to discuss them with representatives of social partners, non-governmental organisations and the society, it is unlikely that some of them can be implemented within one year.

It should be noted that the *National Reform Programme of Latvia* and the *Latvia's Stability Programme* are being implemented in close cooperation with the European Commission. The progress of the implementation of both programmes is regularly discussed in **bilateral**

meetings. For example, a bilateral meeting between Latvia and Commission's representatives was held in Brussels on 2 December 2015. During the bilateral meeting health reform measures implemented up to the moment were discussed, as well as the planned activities and priorities for health reforms in 2016 and 2017, further actions for the improvement of the quality and offer of work-based learning, the progress in the implementation of the vocational education content reform, the promotion of the *STEM* (science, technology, engineering and mathematics) on all levels of education, as well as the progress in the implementation of social reforms was discussed. Further steps in the implementation of the European Semester 2016 were also discussed with the EC.

The Ministry of Economics will continue monitoring the implementation of measures addressing the NRP of Latvia and Council recommendations, and the information on the progress in the implementation of these measures will be included in the *Progress Report on the Implementation of the National Reform Programme of Latvia within the Europe 2020 strategy* for 2016.

6.2 Integration of Latvia into EU Economic and Structural Policy

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

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

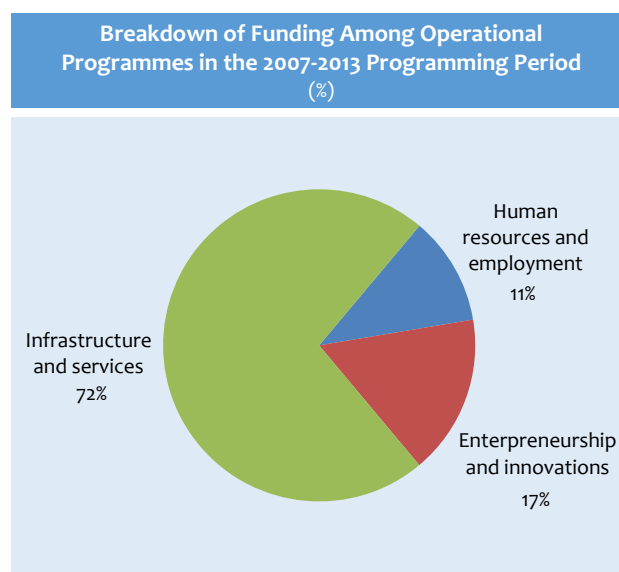
2007-2013 programming period

In the 2007-2013 programming period, SF support was primarily intended for education of the population, technological excellence and flexibility of enterprises, as well as development of science and research, in order to facilitate the creation of knowledge-intensive economy in the country and to strengthen other necessary prerequisites for sustainable economic development and human life in Latvia as a whole.

The programming of SF and CF funds is carried out on three levels: EU level strategy or the *Community Strategic Guidelines*, Member States' strategy or the *National Strategic Reference Framework* (NSRF) and Member States' *Operational programmes* (OP).

The NSRF, on which the allocation of SF and CF funding of 4.53 billion euro available to Latvia in the 2007-2013 programming period is based, was approved by the Cabinet of Ministers on 19 June 2007. The Commission approved it on 20 September 2007.

Figure 6.3



Based on the decision of the EU Council of Ministers on the multiannual financial framework for the 2007-2013 programming period, Latvia received 4.53 billion euro for the implementation of cohesion policy objectives through EU funds (European Regional Development Fund – ERDF; European Social Fund – ESF) and the CF.

Table 6.1

Financial Progress of EU Funds in the 2007-2013 Programming Period until 30 November 2015							
	Funding from the EU fund	Concluded agreements		Paid to beneficiaries		Repayments received from EC (including advances)	
	million euro	million euro	%	million euro	%	million euro	%
ESF	583.1	641.5	110	627.7	108	553.9	95
ERDF	2407.6	2566.6	106	2282.5	95	2224.3	92.4
CF	1539.8	1542.7	100	1430.4	93	1427.7	92.7
Total	4530.5	4750.8	105	4340.7	95	4206.0	92.8

Breakdown of the funding of the total of 4.53 billion euro of EU funding between OPs in the 2007-2013 programming period:

- 1. OP *Human Resources and Employment* (ESF) – 583 million euro. 653 million euro together with over-commitments;
- 2. OP *Entrepreneurship and Innovations* (ESF) – 696 million euro. 833 million euro together with over-commitments;

- 3. OP *Infrastructure and Services* (ERDF+CF) – 3.2 billion euro. 3.4 billion euro together with over-commitments.

In this entire planning period, 105% of projects for the funding from the EU funds available to Latvia have been approved, and agreements for a total of 4751 million euro had been concluded by 30 September 2015. 4206 million euro had been paid to beneficiaries by 30 September 2015.

Box 6.3

Activities within the competence of the Ministry of Economics in the 2007-2013 programming period

741.4 million euro of the EU funds are available for the activities of the Ministry of Economics in the 2007-2013 programming period, which break down as follows:

1. OP *Human Resources and Employment* – 50.9 million euro;
2. OP *Entrepreneurship and Innovations* – 474.4 million euro;
3. OP *Infrastructure and Services* – 216.1 million euro.

Agreements concluded within the activities supervised by the Ministry of Economics by 30 November 2015:

- 30 agreements for a total contract amount of 31.6 million euro were concluded within the activity *Support for Employee Training to Foster Competitiveness of Undertakings – Support for Training Organised in Partnerships*.
- 84 agreements for a total contract amount of 2.7 million euro were completed within the activity *Support for Individual Training Organised by Undertakings*.
- 6 agreements for a total contract amount of 6.4 million euro were concluded within the activity *Support for Creation of Jobs*.
- 3 agreements for a total contract amount of 143.6 thousand euro were completed within the activity *Attraction of Highly Qualified Employees*.
- 6 agreements for a total contract amount of 53.1 million euro were concluded within the activity *Competence Centres*.
- 8 agreements for a total contract amount of 1.9 million euro were concluded within the activity *Technology Transfer Contact Points*.
- 79 agreements for a total contract amount of 7.1 million euro were concluded within the activity *Development of New Products and Technologies*.
- 114 agreements for a total contract amount of 35.7 million euro were concluded within the activity *Introduction of New Products and Technologies in Production*.
- 1 agreement for a total contract amount of 0.013 million euro were concluded within the activity *Development of New Products and Technologies – Support for Strengthening of Industrial Property Rights*.
- 22 agreements for a total contract amount of 0.2 million euro were concluded within the activity *Programme for Development of New Products and Technologies of Micro, Small and Medium-Sized Enterprises*.
- 198 agreements for a total contract amount of 188.1 million euro were concluded within the activity *High Value Added Investment*.
- 3297 agreements for a total contract amount of 18.4 million euro were concluded within the activity *Entering into Non-Domestic Markets – External Marketing*.
- 2 agreements for a total contract amount of 18 million euro were concluded within the activity *Entering into Non-Domestic Markets – Strengthening of International Competitiveness of Industries*.
- 1298 projects of starters for over 24.7 million euro were supported within the activity *Support for Starting Self-Employment and Business*.
- The following results were achieved within the financial instruments implemented in the activity *Investment Fund*:
 - 1) venture capital – an agreement on the creation of a venture capital fund was concluded with *Ltd BaltCap AIFP* in January 2010. In addition to public funds of 20 million euro invested by the Investment Fund, the co-funding of *Ltd BaltCap AIFP* from private investors was 10 million euro. 15 investment agreements for a total funding of 18.2 million euro (public funding part – 12.1 million euro) had been concluded by 30 October 2015;

Box 6.3 continued

- 2) seed and initial capital – an agreement on the creation of a seed and initial capital fund was concluded with *Ltd AIFP Imprimatur Capital Fund Management* in June 2010. The total funding available for investments and unsecured loans in the seed capital fund is 8.5 million euro, while the funding of the Investment Fund into the seed capital fund is 5 million euro (2.4 million euro private co-funding was also raised). By 30 October 2015, the funds had concluded 67 unsecured loan and seed capital investment agreements for 4.5 million euro and 9 initial capital investment agreements for 4.3 million euro (the part of funding from the Investment Fund was 2.9 million euro);
- 3) high-risk loans – agreements with *AS Swedbank* and *AS SEB Banka* on the issue of a shared risk loan were concluded in March 2010. The programme had been implemented by 2012. 18 loan agreements for a total funding of 6.9 million euro were concluded within the programme (the part of funding from the Investment Fund was 3.4 million euro);
- 4) microloans – agreements with financial intermediaries *Ltd Capitalia* and *Ltd Grand Credit* on the implementation of the indirect microloan crediting programme were concluded in July 2014. 85 agreements for 1 million euro (the part of funding from the Investment Fund was 0.5 million euro) had been concluded within this programme by 30 October 2015;
- 5) growth capital instruments – limited partnership agreements with *Ltd ZGI Capital*, *Ltd EXPANSION Capital AIFP*, *Ltd FlyCap AIFP* on the implementation of growth capital funds were concluded in August 2013. 55 loan agreements for 20.6 million euro were concluded within the funds (the part of funding from the Investment Fund was 19.7 million euro).
- The activity *Guarantees to Improve Enterprise Competitiveness* closed on 31 December 2013. 347 credit guarantee agreements and 131 agreements on export loan guarantees for a total amount of 124.9 million euro were concluded within it. The availability of commercial bank loans in the amount over 250 million euro was ensured as a result of loan guarantees.
 - 23 mezzanine loan agreements on public funding of 12.1 million euro were concluded, 161 loan guarantees in the amount of 31.5 million euro and 44 export credit guarantees for 3 million euro were issued within the activity *Mezzanine Loans and Security Guarantees for the Improvement of Competitiveness of Economic Operators* by 30 October 2015.
 - 1 agreement for a total amount of 2.85 million euro was concluded within the activity *Activities for Raising Motivation for Innovation and Starting Business*. 40,929 persons were involved in the events, seminars and contests organised within the activity.
 - 15 agreements on provision of business incubation services in the Latvian regions and 2 agreements on provision of business incubation services to enterprises in creative industry in Riga were concluded within the activity *Business Incubators*. Within the activity, 1184 undertakings received support in business incubators.
 - 101 contracts for a total amount of 7.2 million euro were concluded within the activity *Support for Investments for Micro, Small and Medium-Sized Enterprises in Specially Supported Territories*.
 - 11 agreements for a total amount of 5.4 million euro were concluded within the activity *Cluster Programme*.
 - 21 agreements for a total amount of 9.8 million euro (ERDF) were concluded within the sub-activity *Preservation, Renovation of National-Level Urban Building Monuments and Adjustment of Infrastructure for Development of Tourism Products*.
 - 7 agreements for a total amount of 5.2 million euro (ERDF) were concluded within the sub-activity *Development of a National-Level Bicycle Tourism Product*.
 - 788 agreements for a total amount of 67.9 million euro (ERDF) were concluded within the sub-activity *Activities to Improve Heat Insulation of Multi-Apartment Buildings*.
 - 55 agreements for a total amount of 5.1 million euro (ERDF) were concluded within the sub-activity *Activities to Improve Heat Insulation of Social Residential Buildings*.
 - 135 agreements for a total contract amount of 78.3 million euro (CF) were concluded within the activity *Activities to Increase the Efficiency of Centralized Heat Supply Systems*.
 - 10 agreements for a total amount of 28.8 million euro (CF) were concluded within the sub-activity *Development of Cogeneration Plants Using Renewable Energy*.

Overall, 7.9 thousand agreements on the implementation of projects for 4.7 billion euro, i.e. 104.7%, were concluded from 5 billion euro of the public funding available for the implementation of projects of the EU funds, which include funding from the EU funds and state budget and local government budget co-financing (the funding for over-commitments of 377.2 million euro granted from the state budget is not included). 4.3 billion euro or 94.7% were paid to beneficiaries.

Selecting only the funding from the EU funds, the total amount of concluded contracts is 4750.7 million euro or 104.9% from the funding available from the EU funds. This means that contracts are being concluded for an already granted amount of over-commitments.

The total amount of concluded contracts is 4751 million euro or 104.9% from the funding available from the EU funds. This means that contracts are being concluded for the already granted amount of over-

commitments. Contracts are concluded only within some activities.

Regress is observed in the area of transport¹, because the amount of funding was updated according to the actual costs, as initially planned costs reduced in completed projects.

Regress can be observed in the area of entrepreneurship and innovations, because increasing numbers of projects are being completed and therefore project funding plans are updated according to the actual costs. 7 projects were suspended in the financially-intensive activity *High Value Added Investment*.

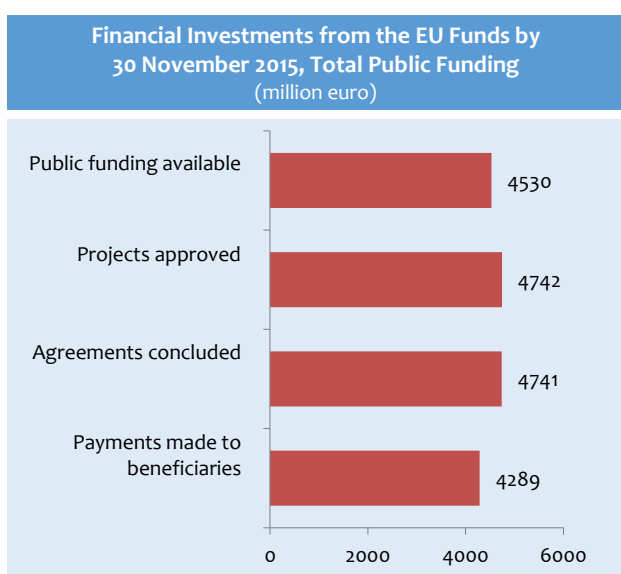
In the area of education, regress is due to the scope of funding updated according to the actual costs of completed projects in the activity *Modernisation of Equipment and Improvement of Infrastructure for Implementation*

¹ concluded contracts vs the available funding from the EU funds in the area

of Vocational Education Programmes, and respective amendments to the contracts have been made.

In the area of employment and social services, regress in concluded contracts can be explained by the non-compliance found in the sub-activity *Improvement of Infrastructure for the Provision of Social Rehabilitation Services to Persons with Mental Disorders* and by the amount of funding updated according to the actual costs of completed projects in the activity *Development of Infrastructure of Pre-School Education Establishments in National and Regional Development Centres*, as well as by the large-scale amendments to the contract in the activity *Training of the Unemployed and Job-Seekers*, taking into account the savings, which occurred during the implementation of the project.

Figure 6.4



In the area of science, progress can be explained by the fact that 12 contracts for ERDF co-funding of 11.2 million euro were concluded as a result of the project selection round within the sub-activity *Development of Institutional Capacity of Scientific Institutions*. The open call of the 2nd selection round of project applications of the activity *Support for International Cooperation Projects in Science and Technology* was also completed in March 2015. As a result, 16 contracts for the ERDF co-funding of 1.3 million euro were concluded.

In the area of health, regress in concluded contracts can be explained by four suspended projects in the sub-activity *Development of the Network of Family Doctors*, as well as by the amount of funding updated according to the actual costs of completed projects in this sub-activity and the sub-activity *Development of Inpatient Health Care*, taking into account non-compliances and savings.

In the ICT area, regress is being observed, taking into account the increase in the number of completed projects, amendments are being approved to the project contracts, updating project funding plans according to the actual costs. Regress was also promoted by the decision made by the CFCA on 15 December 2014 on

the application of a financial adjustment in the amount of 100% to the project *Development of Portal www.skolas.lv (round 2)* for the non-achievement of goals. In addition, ERDF funding was reduced within the projects for improper costs, on the recovery of which the Cabinet of Ministers decides.

In the area of support for management of the EU Funds, the number of concluded contracts has reduced, which can be explained by the fact that Technical aid projects were amended and total eligible amounts of projects were reduced, taking into account the actual status of implementation of projects and the planned funding necessary until the conclusion of the project implementation.

In the area of culture, regress can be explained by one suspended project in the sub-activity *Support for Private Owners of Cultural Monuments for Preservation of Cultural Monuments and Efficient Use of Their Social and Economic Potential*, as well as by the scope of funding updated according to the actual costs of projects in the sub-activity *Restoration of Cultural Heritage Sites of Social and Economic Importance*.

In the area of administrative capacity, regress is caused by the amendments made to the projects in the activity for mitigation of administrative obstacles, supervised by the State Chancellery, and the activity for the implementation of structural reforms, supervised by the Ministry of Finance, which reduced the total amount of eligible costs of projects, taking into account that savings in procurements reduced the amount of necessary funding, compared to the initial plans in the projects.

Only one project in sub-activity *Development of a National-Level Bicycle Tourism Product* is still at the stage of implementation in the tourism area. A non-compliance was found in the project, and, as a result of that, regress can be observed in the concluded contracts.

Although the total amount of concluded contracts is higher than the available funding from the EU Funds, there are activities, in which contracts are still being concluded.

2014-2020 programming period

The Commission officially approved the OP *Growth and Employment* for the 2014-2020 programming period of the EU funds on 11 November 2014.

On 6 November 2014, the Cabinet of Ministers received a draft order on the composition of the Monitoring Committee (MC) for the 2014-2020 programming period of the EU funds, which entered into force on 21 November 2014; therefore, the MC of the 2014-2020 programming period of the EU funds officially started to perform its job duties, including monitoring the efficiency of use of the funding from the EU funds, the progress of the implementation of projects and the compliance with approved programming documents, as well as taking decisions related to the implementation and monitoring of the EU funds.

The OPs were prepared based on such principles as coherence with the *Europe 2020 Strategy* and other

programming documents, a strategic vision, which is based on the analysis of shortages and needs, on efficient, sustainable development and result-oriented solutions. The priority axes and specific objectives, defined in the programming documents, focus on the achievement of specific results with the maximum pay-off for economic development and contributing to the achievement of the objectives of Cohesion policy.

The new 2014-2020 programming period of the EU funds will provide our country the possibility to receive and invest 4.4 billion euro in the development and growth of Latvia and its population. Latvia will be the fourth largest net beneficiary among all other Member States and will receive about 3000 euro per capita from the EU budget in the 2014-2020 period. Latvia's objective in the next programming period is to get closer to the level of welfare of the EU, using the opportunities provided by EU funds wisely and responsibly.

The development of a supplement to the OP *Growth and Employment* was completed on 30 April 2015, to add more details to the OP.

Several important steps in the development of programming documents for the 2014-2020 programming period of the EU funds have been made. The *Law on Management of the EU Structural Funds and the Cohesion Fund in the 2014-2020 Programming Period* entered into force on 11 July 2014, and the development of the rules of the specific objectives, which need to be started as soon as possible, continues.

Inter-institutional agreements have been concluded with the Ministry of Transport, on cooperation in the 2014-2020 programming period within 6.1.5 SAM *Reconstruction and Increase of Bearing Capacity of Covering of the Main National Roads*, 6.1.3.SAM *Providing Necessary Infrastructure on Riga's Main Flyovers and Eliminating*

Fragmentary Nature of Arterial Streets and 6.3.1.SAM *Increasing Regional Mobility by Improving the Quality of Regional Roads*. The monitoring of these SAM projects has been started (procurement plans have been evaluated, preliminary inspections of procurements have been carried out, first inspections at project sites have been carried out, there has been communication with the responsible authority and implementers of projects in relation to the identified gaps and risks in eligibility of costs).

In their projections made in August 2015, the responsible authorities planned costs for a total of 53.2 million euro. The plan was to use most of the planned funding for the SAMs, supervised by the Ministry of Transport, which are directed toward national and regional road improvement activities – 47.1 million euro. 8.5 million, or 18.1% of this amount, had been used by the end of the year. Although the coordination of the regulations regarding the implementation of 6.1.5.SAM *Reconstruction and Increase of Bearing Capacity of Covering of the Main National Roads* and 6.3.1.SAM *Increasing Regional Mobility by Improving the Quality of Regional Roads*, which should be started as soon as possible, started in January 2014, the failure to adhere to the budget can be explained by the long cooperation of these regulations, taking into account that parallel coordination of the OP *Growth and Employment* with the Commission is ongoing and there were discussions between state administration authorities regarding the form of regulation of the implementation of SAM, which should be started as soon as possible. The Ministry of Welfare and the Ministry of Health also planned to use 5.5 million euro for guarantees for young people and 0.5 million euro for the development of health guidelines, respectively. The Ministry of Welfare used 4.7 million or 85.5%, but the Ministry of Health used 0.2 million euro or 40%.

Table 6.2

Breakdown of the Funding from the EU Funds and Total Investments in the 2014-2020 Programming Period in the OP <i>Growth and Employment</i> (the European Commission officially approved it on 11 November 2014)			
	Scope of EU funding, million euro	Structure of EU funding, %	Total scope of funding, millions euro
To strengthen research, technological development and innovation	467.5	10.8	550.0
To enhance access to, and use and quality of, information and communication technologies	172.8	4.0	203.3
To improve competitiveness of small and medium-sized enterprises	314.3	7.3	369.7
To support the shift towards a low-carbon economy in all sectors	480.6	11.1	565.4
To protect environment and facilitate efficiency of resources	623.1	14.4	733.0
To facilitate sustainable transportation and eliminate deficiencies in the main network infrastructures	1159.8	26.9	1364.4
To promote employment, support labour mobility and social inclusion	164.4	3.8	188.3
To invest in education, skills and lifelong learning	934.5	21.6	1099.4
Total	4316.9	100	5073.6

The work on matters of the management and control system in the 2014-2020 programming period is ongoing:

- a draft description of the management and control system has been developed and sent to the bodies involved in the management of the EU funds, in order to acquire recommendations and comments;
- the *Risk Management Strategy* for Bodies Involved in the Management of the European Social Fund, the European Regional Development Fund, and the Cohesion Fund in the 2014-2020 Programming Period has been developed;
- the work is ongoing on the preparation of a communication on necessary human resources, to ensure functions defined for the 2014-2020 programming period of the EU funds and

monitoring mechanisms for the SAM's responsible authorities, which, according to the decision made by the Cabinet of Ministers, has to be submitted within three months after the Commission's approval for the OP *Growth and Employment* is received;

- the work is ongoing on the creation of a Cohesion Policy *Unified Information System* (CP UIS), incl. an expert working group for CP UIS has been created, tests of the project application form in the electronic environment have started, and meetings with holders of public registers (Register of Enterprises, State Land Service, State Regional Development Agency) on cooperation in exchange of information available in the registers of these authorities were organised.

Box 6.4

Activities within the competence of the Ministry of Economics in the 2014-2020 programming period

764.15 million euro of the EU funds are available for the activities of the Ministry of Economics in the 2014-2020 programming period, which break down as follows:

1. Innovation – 193.5 million euro;
2. Fostering competitiveness of small and medium-sized enterprises – 237.1 million euro;
3. Energy efficiency and energy – 333.6 million euro.

Innovation:

Innovation vouchers – 7 million euro;
 Technology transfer – 49.5 million euro;
 Competence centres – 102.3 million euro;
 Motivation for innovation – 4.8 million euro;
 Training of employees – 29.9 million euro.

Fostering competitiveness of the small and medium-sized enterprises:

Availability of finances – 61.4 million euro;
 Contribution to the awareness of Latvia as a travel destination and attraction of events – 20 million euro;
 Entering into non-domestic markets – 31.8 million euro;
 Risk capital – 45 million euro;
 Business incubators – 31 million euro;
 Development of industrial areas – 21.7 million euro;
 Cluster programme – 6.2 million euro;
 Technology accelerators – 20 million euro.

Energy efficiency and energy:

Energy efficiency in residential buildings – 150 million euro;
 Energy efficiency in public buildings – 97.8 million euro;
 Energy efficiency at industrial sites – 32.55 million euro;
 Centralised heat supply systems – 53.2 million euro.

The most significant investments of 2014-2020 programming period of the EU funds are planned for directing to the following objectives:

- reduction of the number of the population at-risk-of-poverty, by providing respective training, improving their health conditions and integrating them into the labour market;
- promotion of employment, by integrating the long-term unemployed and young people into the labour market;
- decreasing primary energy consumption, by improving energy efficiency of private and public buildings, improving energy efficiency in manufacturing and supporting increase in energy efficiency for public transport;

- increase of investments in research and development, by facilitating an increase in private investments, as well as the cooperation between research institutions and businessmen;
- improvements to the ICT and transport infrastructure, which directly affect the productivity of the economy, serve as a basis for innovations and increase the internal and external mobility of persons and goods.

6.2.2 Foreign Trade Policy

Bilateral economic cooperation

To foster and deepen bilateral economic cooperation with the most important trade partners, Latvia has concluded bilateral economic cooperation agreements with Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Russia, China, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. Within the scope

of these agreements, Intergovernmental commissions for economic, scientific and technical cooperation matters (IGC) and United committees (UC) were created, with the aim to activate bilateral cooperation in different areas and to search for opportunities to improve further cooperation. Latvia has also concluded a Declaration on Creation of a United Economy and Trade Commission with Turkey.

Box 6.5

Latvia's bilateral economic cooperation in the second half of 2015

Latvia-United States

On 13-17 July 2015, the Minister of Economics made a work-related visit to Washington and Houston, United States. During this visit, the minister met high-level US officials and representatives of the energy sector to discuss matters of the planned EU and US Transatlantic Trade and Investment Partnership falling within the competence of the Ministry of Economics, as well as essential energy sector matters for Latvia, incl. the creation of European Energy Union, the planned liberalisation of the Latvian gas market starting from the year 2017, and diversification of gas supplies, as well as attraction of investments to the energy sector.

Latvia-Uzbekistan

On 9-12 November 2015, the State Secretary of the Ministry of Economics and Latvian businessmen visited Tashkent (Uzbekistan). The delegation of the Latvian businessmen included 25 representatives from 16 companies, representing sectors like transport, logistics, metalworking, medicine, food production and green technologies.

During the visit, the 6th session of the Latvian-Uzbek Intergovernmental Commission for Economic, Scientific and Technical Cooperation Matters (IGC) was held on 12 November. On behalf of Latvia it was chaired by the Minister of Environmental Protection and Regional Development. At the IGC session they discussed the possibilities of extension of bilateral cooperation in sectors like transport and logistics, clean and energy-efficient technologies, education and science, tourism, agriculture and food, etc.

During this IGC, a Latvian-Uzbek business forum was held. On behalf of Latvia, it was opened by the State Secretary of the Ministry of Economics. Two cooperation agreements, including a Cooperation Agreement between the Employers' Confederation of Latvia and the Chamber of Trade and Commerce of Uzbekistan, which, inter alia, envisage the creation of a Latvian-Uzbek Business Cooperation Council, as well as a Memorandum of Understanding between the Latvian Institute for Environmental Solutions and the Administration of Ecological Information and Forecasts of the Nature Protection Committee of Uzbekistan were signed at the end of this forum.

During this visit, there was also a meeting with *Uzbektourism*, the national tourism company of Uzbekistan, where the possibilities of extension of cooperation in the tourism area were discussed.

Latvia-Azerbaijan

On 25-26 November 2015, the Minister of Economics and a delegation of businessmen visited Azerbaijan, and during this visit they opened Days of Latvia in Azerbaijan – *Taste Latvia*, the purpose of which was to promote exports of the Latvian products to Azerbaijan and to raise awareness and sales of the Latvian products that are already present in the market of Azerbaijan, as well as to strengthen cultural and economic links between these two countries.

A Latvian-Azerbaijani business forum was held during the visit, in which 17 Latvian companies participated, representing more than 10 sectors of the national economy.

During this visit, the minister met several high-level officials of Azerbaijan, incl. the President of Azerbaijan, the Minister of Economic Development, the Minister of Transport, the Minister of Energy and the Minister of Foreign Affairs, to discuss the possibilities of extension of economic cooperation.

Latvia-Georgia

On 7-8 December 2015, the Minister of Economics and businessmen visited Georgia, and the 2nd Latvian-Georgian IGC session was held during this visit. At the IGC session, there were discussions about the current trade and economic cooperation between the two countries and the possibility to further foster a bilateral cooperation between the two countries in several areas and lines of mutual interest, incl. standardisation, transport and transit, science and education, agriculture, tourism, public administration, etc. An agreement on cooperation in the area of standardisation was signed between Latvian Standardisation Bureau and Georgian Standardisation Agency.

A session of the Latvian-Georgian Business Cooperation Council was also held during this visit. It was attended by more than 10 Latvian businessmen. The minister had bilateral meetings with the Georgian Minister of Economics and Sustainable Development and the Minister of Energy to discuss important matters of bilateral cooperation between the two countries.

Latvia-Belarus

On 20-21 October 2015, the Minister of Economics and businessmen visited Belarus. The delegation of businessmen represented IT, telecommunications, financial, metalworking and machinery, food, design, environmental services and construction material production sectors. During this visit, the minister opened Days of Latvia in Belarus, the purpose of which were to promote the awareness of the Latvian products that are already present in the Belorussian market, to open broader paths for new manufacturers, and the Latvian-Belorussian business forum.

Box 6.5 continued

On 10-11 December 2015, the 11th session of the Latvian-Belorussian IGC was held in Daugavpils. Within the framework of this IGC, delegations of both countries discussed the current economic cooperation of Latvia and Belarus, as well as a range of matters to extend bilateral economic cooperation. During this session, special attention was devoted to the promotion of cooperation in the sectors of business and industry, transport and transit, agriculture, education and science, communications, tourism, border management, cross-border cooperation, regional planning and regional policy implementation, environmental protection and other sectors.

In parallel with the IGC session, another Latvian-Belorussian Business Cooperation Council session was held, during which Latvian and Belorussian businessmen discussed issues in economic cooperation, potential cooperation areas, as well as got acquainted with the latest developments in the business environments of both countries.

To foster the extension of economic cooperation, in the second half of 2015 the highest officials of the Ministry of Economics and businessmen visited the United States, Azerbaijan, Belarus, Georgia, Uzbekistan, as well as met officials of partner countries of Armenia, United Kingdom, China, Tajikistan and the Eastern Partnership.

There were also IGC sessions with Uzbekistan (in Tashkent), Georgia (in Tbilisi) and Belarus (in Daugavpils).

Latvia on its way to the OECD

In the second half of 2015, representatives of the Ministry of Economics and its subordinate state administration institutions actively participated in meetings and activities of the OECD's structural units, as well as followed and introduced the OECD recommendations. As a result, a formal opinion about the compliance of Latvia with the OECD instruments and recommendations in the areas of economic and development analysis, consumer policy, statistics and statistical policy, as well as competitions, was adopted at a session of OECD member states in the second half of 2015.

The OECD talks on Latvia's accession have currently reached their final phase. The current progress in these talks allows to make projections that Latvia will become a full-scale member of the OECD in 2016.

6.2.3 Single Market of the European Union

The EU Single Market unites 31 countries (28 EU Member States and 3 countries of the European Economic Area (EEA) – Norway, Iceland and Liechtenstein) having over 500 million consumers. The EU Single Market means a territory without internal borders providing free circulation of goods, services and capital, as well as free movement of people. After a long and coordinated work within the EU, unified principles and rules for economic operators have been developed, border control has been cancelled, a more competitive business environment has been created, consumers have been provided with a wider range of goods and services, new jobs were created, the population was provided the possibility to live, work and study in other Member States, a possibility was found to introduce a single currency, as well as many other benefits were provided.

However, the potential of the EU Single Market is still not fully used, and its improvement still continues,

promoting sustainable, stable development of the EU's economy and the welfare of its population.

By November 2015, Latvia's transposition deficit of EU laws and regulations in the area of the EU Single Market was 0.4% (4 of 1099 Directives), and thus Latvia was in the group of Member States having the highest results of transposition of EU laws in this area.

Based on Article 34-36 and 49-62 of the *Treaty on the Functioning of the European Union* (TFEU), the Ministry of Economics supervises and coordinates the freedom of provision of goods and services and the right to do business in Latvia, by constantly identifying legal provisions, which may potentially or actually hinder the use of freedoms of the EU Single Market, including evaluation of pending laws and regulations.

Based on the 8 June 2012 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: *Better Governance for the Single Market*, an electronic **Single Market Centre** was created on the website of the Ministry of Economics (https://www.em.gov.lv/lv/eiropas_savieniba/es_vienota_tirgus_centrs/), providing information on the EU information and aid services. The main purpose of the EU Single Market Centre is to help businessmen to use all the advantages related to the EU Single Market, as well as to provide practical assistance in relation to the limitations of the freedom of provision of goods and services.

The Ministry of Economics has also created an online questionnaire through which one can report on barriers to business 24 h a day (https://www.em.gov.lv/lv/eiropas_savieniba/zino_par_skersliem).

The **technical regulations notification procedure** serves as a preventive, uniform and transparent monitoring tool to evaluate and prevent the inclusion of such requirements into laws and regulations, which might create barriers for free 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 of coordination of technical regulations, and provide its comments and objections regarding drafts prepared by other EU Member States, which might potentially affect that economic operator's product exports or cross-border provision of information society services. The information on draft technical regulations notified by Member States is freely available in the database of the *Technical Regulations Information System* (TRIS)

<http://ec.europa.eu/enterprise/tris/lv/>, where draft technical regulations can be viewed in Latvian. If any economic operator has any objections to draft technical regulations of other countries, which might potentially or actually affect sales of its product in the market of the respective EU country, the economic operator has the right to submit its objections to the responsible ministry, which is competent to coordinate the respective policy area in Latvia.

The **mutual recognition principle** is a legal mechanism to ensure free circulation of goods in the EU. This principle essentially envisages that destination Member States are not allowed to prevent sales of those goods in their territory, which are already legitimately sold in some other Member State, even though they are manufactured based on the requirements differing from the requirements of the destination Member State. This principle is applicable to the goods, which are not subject to harmonised EU laws and regulations (free circulations of goods in a non-harmonised area).

To improve the application of the mutual recognition principle, the *Regulation (EC) No 764/2008 of the European Parliament and of the Council laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State and repealing Decision No 3052/95/EC* entered into force on 2 September 2008, and its purpose is to define the procedure of observation of the mutual recognition principle in the work of public authorities, as well as in communication with economic operators. *Regulation 764/2008* also obliges countries to create *Product Contact Points* (PCP). PCPs provide companies and responsible authorities of Member States information on the regulations, which are applicable to the specific type of products, and the information whether any product type needs to receive permits before being placed on the market. In Latvia, the Ministry of Economics fulfils functions of a PCP (e-mail: pcp@em.gov.lv). From January to November 2015, the PCP responded to 24 information requests from economic operators. In this period of time, the Construction Contact Point had provided answers to 30 information requests from merchants.

To ensure administrative cooperation between EEA's national regulatory authorities, the EC has created an **Internal Market Information System** (IMI). The IMI allows to contact responsible authorities of the countries of the European Economic Area at national, regional and local level in a fast and effective way. Using the IMI system, authorities of Member States can verify the information indicated in applications of legal entities and individuals, authenticity of documents issued in other Member States, and clarify other matters according to respective EU laws and regulations. Hence, the applicant is free from bureaucratic barriers in the resolution of different cross-border matters in the EU Single Market. The Ministry of Economics is the national coordinator of the IMI system in Latvia. Today, the IMI system in Latvia is operating in the area of *Services Directive* (2006/123/EC), *Professional Qualifications Directive*

(2005/36/EC), *Posting of Workers Directive* (96/71/EC), *Patients' Rights Directive* (2011/24/EU), *Commission Implementing Decision on train drivers' licences* (2014/89/EU) and *Regulation on the cross-border transport of euro cash by road* (1214/2011), and pilot drafts in the area of – *Directive on the return of cultural objects unlawfully removed* (2014/60/EU), *E-Commerce Directive* (2000/31/EC) and *Public Procurement Directive* (2014/24/EU and 2014/25/EU). The *Services Directive* obliges Member States to inform about services, which can cause significant harm to human health, life and the environment; therefore, the IMI system has an *Alert mechanism*, which ensures cooperation between supervisory authorities for risk prevention. 87 responsible authorities of Latvia are registered in the IMI system (61 authorities deal with the services area, 21 – with professional qualifications area, 6 – with posting of workers area, 4 – with patients' rights area, 2 – with e-commerce area 2 – with train drivers' licences, 14 – with public procurement area (one authority can deal with several areas)). The introduction of *Directive No 2013/55/EU* into national legislation should be completed by 18 January 2016. It regulates the creation of a *European Professional Card* in the IMI system, which will be electronic and will be issued to those representatives of regulated professions who want to pursue the same profession in another EU Member State or a Member State of the European Economic Area. It also envisages a new tool – an *alert mechanism* to inform all Member States about a professional, whose pursuit on the territory of that Member State of the following professional activities in their entirety or parts thereof has been restricted or prohibited in professions related to healthcare or child care or education.

From January to November 2015, Latvia has sent 34 information requests to other Member States within the IMI system: 10 in professional qualifications area and 13 in the posting of workers area, 9 in services area and 2 on public procurements. Latvia received 112 information requests: 1 in the services area, 93 in professional qualifications area, 12 in the posting of workers area, 6 in patients' rights area.

SOLVIT Centre – an alternative EU Single Market problem solution network, created by the EC and the Member States, has been operating in Latvia since 2004. Its task is to find a fast and practical solution of the EU Single Market's problems caused by activities of public authorities in case of incorrect application of EU law. In situations, when a resident or a businessman is harmed by wrongful decisions taken by responsible authorities of other Member States, the *SOLVIT Centre* operates as a free problem-solving tool. There are *SOLVIT Centres* in each of the EU Member States (and also in Iceland, Norway, and Liechtenstein). From January to November 2015, the Latvian *SOLVIT Centre* received 34 complaints. 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) EU's legal norms (regulations,

directives, etc.) have been violated. Most frequently the Latvian *SOLVIT Centre* solves cases of individuals related to social benefits and issues of residence permits, cases of businessmen related to restrictions on freedom of provision of goods and services, repayment of value added tax and recognition of professional qualifications.

To promote commercial activities and innovation in the services sector, as well as gradual modernisation and simplification of state administration, one of Latvia's priorities is promotion of the **freedom of provision of services**. In the services area, the requirements of laws and regulations are analysed regularly and recommendations for required changes are prepared to reduce the administrative burden on undertakings in cooperation with non-governmental organisations and national regulatory authorities. Administrative barriers and procedures are reviewed by respectively removing or simplifying requirements for issue of permits (licences, certificates, certifications and other documents), as well as creating the possibility to carry out the necessary procedures electronically. In addition, the implementation of a one-stop-shop principle continues, by improving the availability of services provided by public administration in a Single Control Point – a single national and local government services portal www.latvija.lv.

The “tacit consent” principle is one of the tools promoting modernisation of public administration, to reduce delays in decision-making by authorities, costs and unfavourable consequences to small and medium-sized enterprises. This principle defines that in case a responsible institution fails to make a timely decision on the application for a permit, it shall be considered that the service provider has received the permit and is entitled to commence the provision of services. On 12 June 2012, the *Action plan for the implementation and application of the “tacit consent” principle into administrative practices of responsible authorities* was approved, which envisages the initial implementation of the “tacit consent” principle for 15 services. The implementation

of the principle continued and amendments to the *Action Plan for Improvement of the Business Environment 2014-2015* were developed and adopted on 19 May 2015, envisaging that the “tacit consent” principle will be implemented for another 17 public services by the end of 2016, by implementing task 12.2 of the Government Declaration.

Latvia also participates in the **Frontrunners Initiative**. This initiative was started by national regulatory authorities of the United Kingdom, Denmark, Sweden and the Netherlands, and now it unites 16 EU Member States. The purpose of the Frontrunners Initiative is to resolve problems faced by businessmen and consumers in the EU Single Market through cooperation and exchange of best practices. The Member States cooperate in important areas such as:

- the creation of a *Single Market Centre*, for businessmen to have access to information on EU Single Market's help and information centres in one place;
- the development of single contact points in the services area, where businessmen can settle all necessary formalities to operate in the services area, incl. in other Member States;
- recognition of professional qualifications, to reduce the number of regulated professions and remove barriers in the process of recognition of professional qualifications in other Member States;
- review of regulations with regard to electronic trade, by identifying potential barriers for doing business in the area of e-commerce, as well as researching barriers in the process of registration of highest level domain names.

Additional areas in which Member States can cooperate within this initiative are being evaluated right now.

6.3 Industrial Policy

A new concept of industrial policy is recognised as one of the most modern economic concepts in scientific literature. The new industrial policy, in contrast to the industrial policy created over the previous decades, takes the challenges of globalization into account, and the emphasis is put on the creation of new competitive advantages in all processes related to the expansion and modernization of production. One of the fundamental principles defined is not “the identification of winners”, but rather the process, which includes a dialogue between the private and the public sector to reveal the limitations hindering new economic activities and to offer solutions for their prevention or management.

Within the framework of the industrial policy, it is important not only to understand the global challenges of development of the sector, but also to clearly identify the

national economic benefits and functional obstacles of products, finances and labour market hindering sustainable development of industry.

The planning document framework of the Latvian Industrial Policy (NIP) consists of several documents, the most significant ones being the following: *National Development Plan*, *Smart Specialization Strategy* included in the *Science, Technology Development and Innovation Guidelines*, *National Industrial Policy Guidelines*, *Education Development Guidelines*, and policy planning documents of other sectors.

Guidelines on *the National Industrial Policy*

Latvian Guidelines on the National Industrial Policy were approved by the Cabinet of Ministers on 28 May 2013, and they aim to promote the structural changes of

economy in favour of the production of goods and services with higher added value, including an increase in the role of industry, modernization of industry and services, as well as complexity of export.

In order to achieve the objective defined in the Guidelines, the following performance indicators to be achieved have been established:

- the share of the manufacturing industry in GDP in 2020 – 20%;
- the growth in productivity of the manufacturing industry in 2020 compared to 2011 – 40%;
- the growth of the manufacturing industry in 2020 compared to 2011 – 60%;
- investment in research and development – 1.5% of GDP.

To identify market shortcomings, potential of the most exportable niches and products and services with higher added value was determined, and an in-depth analysis of producers was carried out, which led to the conclusion that the most important challenges of the NIP on which government activities shall be directed are the following:

- funding restrictions;
- labour costs and price competitiveness;
- low productivity and weak innovation performance;
- transformation of international business;
- demographic situation (aging of the labour force).

Taking into account the advantages and main challenges of Latvian companies, the lines of action established in the NIP are focused on the following:

- issues related to the **availability and skills of the labour force**, such as implementation of further reforms of the vocational education system and higher education system by concentrating and using vocational education programmes that meet the requirements of the labour market, as well as increasing the share of the practical part of the programme; continuing the use of state aid instruments aimed at improvement of the qualifications and skills of professionals employed by the company, opportunities for retraining to specialities sought after in the market; reducing the number of students acquiring general secondary education in favour of the vocational education system;

- issues related to the **development of industrial zones**, such as adaptation of the existing industrial zones, improving the condition of roads and utilities (electricity, water supply, sewerage, gas, lighting, etc.) to production facilities, creation of new industrial zones in the centres of international, national, and regional importance;
- issues related to the **access to finance**, such as providing the necessary funding to start-ups, micro- and small enterprises, providing support for ensuring working capital or making initial investments, continuing the issue of loan guarantees, continuing the provision of corporate income tax relief to encourage production when acquiring new production equipment, creation of venture capital instruments that would stimulate investments in the development of businesses and expansion of their activities;
- issues related to the **promotion of innovation**, such as increasing the research and innovation capacity of economic operators, replacement of corporate income tax relief on research and development costs with a new incentive, establishing write-off of particular research and development costs in triple the amount, development of the research base and excellence;
- issues related to the **facilitation of export**, such as supporting the cluster initiative, minimizing the risks of export transactions, entering external markets, and compensating certification costs;
- issues related to the **energy costs**, such as development of a support programme solutions for increasing the energy efficiency and reducing emissions in the industrial sector.

A plan of activities for the period of time until 2017 has been drawn up in compliance with the proposed lines of action, providing a certain set of activities for each line of action, determining the institutions responsible for the implementation of activities, as well as defining the operational performance indicators to be achieved.

Within the framework of execution of the action plan, the Ministry of Economics has commenced the development of support measures planned within the framework of the EU programming period 2014-2020 in order to implement the first state aid programmes starting from 2016.

6.4 Energy Policy

The main directions of efficient, balanced market-based energy policy of Latvia, which are set out in the informative report *Long-term Energy Strategy 2030 – Competitive Energy for the Society (Energy Strategy 2030)*

approved at the Cabinet meeting of 28 May 2013, are aimed at the development of competitiveness of the national economy, contributing to public well-being.

Table 6.3

Electricity Supply in Latvia (GWh)							
	2000	2005	2010	2011	2012	2013	2014
Total energy supply	5922	7053	7500	7340	7859	7564	7457
Gross output of electricity, including:	4136	4905	6627	6094	6167	6209	5140
from renewable energy:	2824	3414	3635	3078	4109	3534	2803
big HPPs*	2794	3263	3445	2823	3627	2852	1925
small HPPs	25	62	75	64	80	60	68
biomass power plants	–	6	9	13	65	215	319
biogas power plants	–	36	57	107	223	287	350
wind farms	5	47	49	71	114	120	141
from fossil fuels:	1312	1492	2992	3017	2059	2675	2337
big CHPs**	1163	1278	2402	2425	1409	1957	1648
other CHPs	149	214	590	592	650	718	689
Net electricity imports	1786	2148	873	1245	1691	1355	2317

* Cascade of Daugava River – Riga HPP, Kegums HPP and Plavinas HPP
** Riga CHP-1 and Riga CHP-2, source: Latvenergo AS

The main objective of *Energy Strategy 2030* is to ensure a positive impact of the energy sector on the Latvian economy, while striving for security and sustainability of energy supply:

- security of energy supply – access of energy users to stable energy supplies and a developed infrastructure;

- sustainable energy – reduced dependence on energy imports, promotion of new, efficient technologies for the use of renewable energy, energy efficiency improvement measures have been carried out.

Box 6.6

Energy Industry in Latvia

To provide the sectors of the economy, commercial users and the general public with fuel, electricity, and heat, imported (natural gas, electricity, oil products, coal, coke, etc.) and local (hydropower, wind power, fuel wood, charcoal, straw, other biomass, biogas, bioethanol, biodiesel, peat, used tires, municipal waste for heating) energy is used in Latvia.

The amount of energy generated and products recycled in Latvia in 2013 reached 99.7 PJ, while energy imports were 148.8 PJ, including natural gas imports – 32.7 PJ.

A part of electricity is generated by Latvian HPPs, CHPs, biomass, biogas, and wind power plants. Volume of electricity generated in Latvia depends on the flow of Daugava River and other rivers.

In 2014, total electricity supply reached 7,457 GWh, which is for 1.4% less than in 2013. *Latvenergo AS* generated 48.6% of the total energy supply in its power stations, while 20.3% were purchased from the small producers of electricity, and 31.1% consisted of the net electricity imports. In 2014, 43.8% of the total final consumption of electricity was consumed by services, 25.5% – industry and construction, 26.5% – by households, 2.4% – by agriculture, 1.8% – by transport.

Domestic fuel – fuel wood – and imported fuel – natural gas – are mainly used in heat production. In 2014, heat for sale was generated in 631 boiler-houses and 175 CHP plants with the total amount of generated heat for sale of 7.2 TWh. Natural gas was mainly used for generation of heat for central heating and electricity. The proportion of heat for central heating generated from natural gas was 60.3%, from wood chips – 32.4%, from firewood – 2.2%, from fuel oil – 3.3%, from other types of fuel – 1.8%.

The structure of users of central heating has not changed in recent years, where central heating constitutes 65-70% and hot water supply – 30-35%. In 2014, 69.5% of the total final consumption of central heating was consumed by households, 25% – by services, 4.2% – by industry and construction, 1.3% – by agriculture. The breakdown of the total final consumption of central heating by regions is as follows: Riga Region – 54.9%, Pierīga Region – 11.7%, Vidzeme – 6.5%, Kurzeme – 9.8%, Zemgale – 7.6%, and Latgale – 9.5%.

In 2014, total primary energy consumption of Latvia reached 186.2 PJ, which is by 0.5% less than in 2013 (see Table 6.4).

Based on the energy policy development directions established in the *Energy Strategy 2030*, the Ministry of Economics is developing new *Energy Policy Guidelines 2015-2020* that will replace the *Energy Industry Development*

Guidelines 2007-2016 approved with the CoM Decree of 27 June 2006. The guidelines include measures to be implemented by 2020 in order to achieve the aims of the Latvian energy sector development.

Table 6.4

Consumption of Primary Energy Resources in Latvia (PJ)							
	2000	2005	2010	2011	2012	2013	2014
Total consumption* , including:	163.9	192.1	194.8	184.2	190.5	187.1	186.2
coal and coke	3.1	3.3	4.5	4.6	3.8	3.0	2.5
peat	2.5	0.1	0.1	0.0	0.0	0.0	0.0
oil products	56.4	61.9	64.6	59.5	58.4	59.3	59.7
natural gas	45.6	56.9	61.3	54.0	50.8	50.3	45.4
firewood	39.7	49.4	45.6	46.9	52.5	53.1	55.9
electricity**	16.6	19.9	16.0	15.1	19.8	15.8	16.0
other energy***	–	0.6	2.7	4.1	5.2	5.6	6.7

* All energy amounts are calculated, using the lowest calorific value
** Hydropower, wind power and net imports of electricity
*** Used tires, municipal waste for heating, charcoal, straw, other biomass, biogas, bioethanol, biodiesel

Electricity Market

Latvian electricity market is fully liberalized as of 1 January 2015. According to the amendments to the *Electricity Market Law* of 18 September 2014, households, just like legal users, shall freely choose a trader, agreeing on the price of electricity.

Implementing the provisions of the amendments to the *Electricity Market Law* of 18 September 2014, a support instrument for protected users was introduced as of 1 January 2015 along with full opening of the electricity market (see Box 6.7).

Box 6.7

Social Support Instrument

Protected user is a poor or a low-income family (person) or a large family, which uses electricity in their household for their own needs (final consumption).

In 2015, which is a transitional period, support to protected users is provided by *Latvenergo AS*:

- to a poor or a low-income family (person) support is provided with up to 100 kilowatt hours per month at a price of 0.0131 euro per kWh;
- to a large family support is provided with up to 300 kilowatt hours per month at a price of 0.0131 euro per kWh.

In 2015, the total electricity price (including the price of electricity, trade services, mandatory procurement component, value added tax, and network services) was equal to the Start Tariff of 2014 – 0.1164 euro per kWh.

On 29 September 2015, the Saeima endorsed amendments to the *Electricity Market Law*, which provides for the extension of the circle of protected users to families (persons), caring for a disabled child, and persons with a disability of group I as of 1 January 2016.

In the Cabinet meeting of 1 December 2015, the Cabinet Regulations drawn up by the Ministry of Economics providing for procedure of ensuring the support instrument to protected users as of 1 January 2016 were approved.

In 2016, support for protected users will be ensured by the electricity dealer who will be selected in a procurement by the Ministry of Economics in accordance with the requirements of the *Public Procurement Law*, assessing the provision of the protected user's trade service with the lowest national budget co-funding as the primary aspect. Until the closing of the procurement, the protected user support at the beginning of 2016 will be still provided by the previous support provider (*Latvenergo AS*).

The following amount of support is established for the protected users in 2016:

- poor or low-income families (persons), families (persons) caring for a disabled child, and persons with a disability of group I are provided with up to 100 kilowatt hours per month at a price of 0.0131 euro per kWh;
- large families are provided with up to 300 kilowatt hours per month at a price of 0.0131 euro per kWh.

Under the EU third legislation package on liberalization of the internal energy market, one of the factors ensuring the optimal functioning of the electricity market is separating the network services from the production and trade activities.

Electricity transmission and distribution system operators were legally separated through restructuring the vertically-integrated energy supply merchant, shares of

which are owned by the Ministry of Economics – *Latvenergo AS*.

According to the electricity trade register of the Public Utilities Regulation Commission, 75 traders were registered for sale of electricity as of 9 November 2015, and 32 of them have entered into the agreement on using the system with *Sadales tīkls AS*. On 1 January 2012, *Augstsprieguma tīkls AS* started operating outside the *Latvenergo Group* as an independent transmission system

operator. *Augstsprieguma tīkls AS* is responsible for development of the transmission network, security of electricity transmission, stability of the power grid and quality of electricity and ensures it according to technical and economic requirements and modern technologies. The Ministry of Finance is the shareholder of *Augstsprieguma tīkls AS*. Assets of the transmission system are owned by *Latvijas elektriskie tīkli AS*, subsidiary of *Latvenergo AS*, which started its operation on 1 April 2011. As of 1 January 2015, all employees servicing the high-voltage network are working at *Augstsprieguma tīkls AS*.

As of 1 July 2007, functions of the electricity distribution system operator are performed by *Sadales tīkls AS*, independent subsidiary of *Latvenergo AS*. *Sadales tīkls AS* ensures the supply of electricity to more than one million facilities of electricity users, covering 99% of the territory of Latvia with its service. In total, there are 11 distribution system operators working in Latvia. The main requirements for the distribution service quality are laid down in the CoM *Rules on Public Power Supply Network Voltage Requirements* of 4 October 2011, which provides for mandatory application of the EU standard *LVS EN 50160: 2010 Voltage Characteristics of the Public Electric Supply Networks* adopted in Latvia.

Accordingly, the possibilities of improving the distribution service tariff structure are evaluated. Currently, the tariffs of distribution system services for households are based exclusively on power consumption. It is planned to split the existing tariff into two parts – a fixed one and a variable one. The fixed part would be established as an ampere fee, the amount of which will depend on the current (amps) of the input protection device used for the connection, and which will be characterized by the relevant costs. The variable part, in its turn, may be established according to the power consumed. Such a tariff structure would reflect the network costs more accurately, since they are related not only to the amount of the split cost; it would also ensure a more efficient use of the network, which determines a lower level of investment in the long term, stimulate the user to determine the required power (namely, the size of the input protection device), to use the network in a more responsible manner in terms of economy, thus ensuring efficient use of network capacity and changing the electricity consumption.

Moreover, in order to promote business development, the electricity distribution system operator currently evaluates the possibility of optimizing the connection conditions, which, in addition to the electricity users' rights to recover the connection fee paid initially by executing the criteria established in the conditions on efficient use of load, will also provide for the rights of electricity users to avoid paying the initial connection fee, if the user undertakes to meet the criteria established in the conditions on efficient use of load.

Full integration of electricity markets of Latvia, Lithuania and Estonia in the EU common market, both joining the Nordic electricity market and ensuring sufficient interconnections, is an important goal not only for the Baltic countries, but also at the EU level.

Historically, the electricity transmission networks of Estonia, Latvia, and Lithuania are tightly integrated into the transmission networks of Belarus and Russia and are operating in a parallel, synchronous mode with them. Operational activities of the power systems are determined by the BRELL agreement entered into between the transmission systems of Belarus, Russia, Estonia, Latvia, and Lithuania. Internal electricity trading of Russia and Belarus, as well as other countries of the Commonwealth of Independent States, fluctuations and failures of their power system modes technically affect and strain the electrical transmission network of the Baltic states by limiting their ability to fully implement the EU legal framework in the electricity market, particularly in relation to the calculation and planning of capacity, overload management, and network balancing.

The Latvian bidding area of electricity exchange *Nord Pool Spot* (NPS) started its operation on 3 June 2013. Currently, NPS bidding areas are opened in all three Baltic States – Estonia, Lithuania, and Latvia; and electricity trade is carried out in a uniform and consistent manner throughout the Baltic Sea region.

The NPS Latvian open electricity bidding area and the introduced ELSPOT day-ahead market for trading power enables market participants to submit their quotes for transactions that will take place the following day. The next step in development of the electricity market in Latvia was the establishment of ELBAS intraday market. ELBAS market was successfully opened in Latvia on 10 December 2013. The difference of an intraday electricity market from a day-ahead market is that the price offers are submitted for transactions that will take place on the current day, after the ELSPOT trading session results are published. The existence of both markets not only ensures greater liquidity of the Latvian electricity market, but also a more efficient utilisation of transfer capability, and transparent energy price that the market participants can rely upon.

The Latvian electricity market, just like the energy market of the Baltics, is currently connected to the common European energy market with only two sea cables connecting the Estonian and Finnish power systems – *Estlink I*, with the transmission capacity of 350 MW, and the *Estlink II*, with the transmission capacity of 650 MW. Transmission capacity of both interconnection links is sufficient for aligning electricity prices in the NPS Estonian and Finnish bidding areas. Although the implementation of this project potentially improves the situation of ensuring the integration of Estonian and Finnish power systems, and liquidity of the Estonian and Finnish bidding areas, it does not reduce the risk of overload in the Latvian-Estonian cross-section, which, although of a highly seasonal nature, is characterized by a negative impact on the dynamics of electricity prices in

the NPS Latvian and Lithuanian bidding areas. In addition, the load on *Estlink II* in the direction from Finland to Estonia could lead to additional load on the Latvian-Estonian cross-section, thus increasing the risk of overload or line outage.

Current transfer capability of the Latvian-Estonian cross-section is not sufficient to ensure the required volume of electricity sales in the Baltic region: between Estonia, where there is a surplus of electricity generated in annual terms, and Latvia and Lithuania, where there is an explicit shortage of electricity. This fact has a particular influence on the electricity trade in the Baltic States during the summer season. The said limit of transfer capability severely troubles the ability of Latvia and Lithuania, as well as, in some cases, the Kaliningrad region, to import electricity from areas of lower electricity prices – Estonia and the Scandinavian countries, as a result of which the average electricity price in Latvia and Lithuania is higher than the electricity prices in Estonia and Scandinavia.

In order to improve the interconnection capacity, Lithuanian-Polish interconnection “LitPol Link” stage 1 with transmission capacity of 500 MW started its operation at the end of 2015. In addition, the Lithuanian-Swedish interconnection “NordBalt” with transmission capacity of 700 MW was established. Under the project “NordBalt”, project *Kurzemes loks* is implemented, which provides for the construction of a 330 kV overhead high-voltage power line in the western part of Latvia, in order to eliminate the lack of options for increased-power connections, to ensure the development of wind farms and to increase the security of electricity supply in Kurzeme. The first stage of *Kurzemes loks* includes the construction of a 330 kV high-voltage line, connecting the 330 kV substation “TEC-1” of Riga with the substation “Imanta”; line construction works, including inspections, were completed on 25 September 2013. The second stage of *Kurzemes loks* includes construction of a 330 kV high-voltage line Grobiņa-Ventspils; design phase started in 2010, and the works were finished in 2014. The planned total length of the new 330 kV electric lines of *Kurzemes loks* is about 330 km, capacity – 800 MW, costs – around 220 million euro, half of which will be covered under the EC co-funding programmes. It is planned to complete the third, final stage of *Kurzemes loks* by the end of 2019.

Construction of a new, third Latvian-Estonian interconnection is strategically important, which will allow eliminating the existing transmission network overload and increasing the available transmission capacity of the Latvian-Estonian interconnection. The project of the third Latvian-Estonian interconnection will significantly improve the security of energy supply in the cross-section between Estonia and Latvia, as well as the power systems of both countries, ensuring an efficient power transmission corridor between the Baltic and Nordic power systems. Third Latvian-Estonian interconnection will also facilitate the development of Latvian, Estonian and Lithuanian infrastructure, since the

implementation of the third stage of the transmission network modernization and reconstruction project *Kurzemes loks* will allow creation of a connection point of the third Latvian-Estonian interconnection. Total costs of the third Latvian-Estonian interconnection are approximately 172.7 million euro. The total planned costs of the project in the territory of Latvia (from the 330 kV substation Riga CHP-2 to the Estonian-Latvian border) are approximately 102 million euro. In November 2014, European co-funding of 65% was granted for the construction of the third Latvian-Estonian interconnection from the Connecting Europe Facility funds. Currently, the environmental impact assessment of the project is being implemented, and the study of the planned line is being conducted. It is planned to launch the connection of the said interconnection by 2020.

In 2013, both projects – the third stage of *Kurzemes loks* and third Latvian-Estonian interconnection – were included in the 1st list of the *European Projects of Common Interest (PCI)*. The PCI list is updated every two years. Accordingly, the two projects were also included in the EC’s 2nd list of PCI published on 18 November 2015. *Regulation No 347/2013* of the European Parliament and of the Council prescribes that the projects included in the list of Projects of Common Interest not only may qualify for the support of the EU financial instruments, but also benefit from fast and efficient authorization procedures, while respecting the environmental assessment and protection standards.

In addition, the 2nd list of PCI also includes the following projects important for the Latvian power supply infrastructure:

- *BalticCorridor* - Tartu (EE) - Valmiera (LV);
- *BalticCorridor* - Tsirgulinā (EE) - Valmiera (LV);
- *BalticCorridor* - Riga CHP-2 (LV) - Salaspils (LV);

It is planned to implement the three projects by 2030, and they are considered to be a prerequisite for successful synchronization of the power supply system of the Baltic States with the electricity systems of mainland Europe.

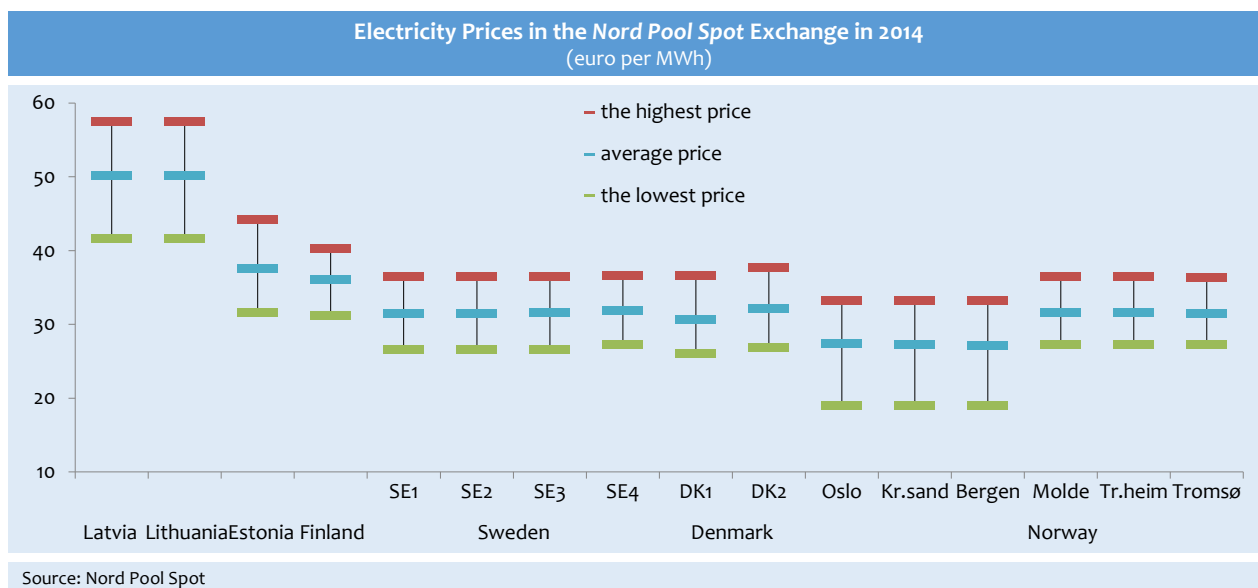
The issue regarding the synchronization of the power supply system of the Baltic States with mainland Europe is important in the long term for development of the electricity sector of Latvia and Baltic States, and market integration. In October 2013, the EC published the report *Long Term Infrastructure Vision for Europe and Beyond*, which stressed that one of the future challenges in the field of electricity is the synchronization of the power supply systems of the Baltic states with the electricity systems of mainland Europe, putting an end to their actual isolation from other EU countries.

On 17 July 2009, Memorandum of Understanding on the reinforced *Baltic Energy Market Interconnection Plan (BEMIP)* was signed by the EC and 8 Baltic Sea countries, including Latvia. Given that a number of the original objectives of the BEMIP have been achieved since 2009, work on drawing up a new Memorandum of Understanding and Action Plan was carried out at the

beginning of 2015. On 8 June 2015, the EC, Germany, Estonia, Latvia, Lithuania, Poland, Finland, and Sweden, with Norway as an observer, signed the new *Memorandum*

of Understanding. Denmark signed the document later due to the elections and formation of the new government.

Figure 6.5



Source: Nord Pool Spot

The Action Plan defines six key areas of activity, such as electricity and gas markets, security of supply, energy infrastructure, nuclear energy, renewable energy, and energy efficiency, where it is necessary to develop specific projects in future in order to achieve the targets and indicators established in the Action Plan.

The following issues are among the most important ones in the Baltic region:

- full implementation of internal market requirements in the Baltic Sea countries, including the opening of the market for households;
- overload management based on market principles, implicit capacity auctions between the Baltic states (useful for overload management in the Latvian-Estonian cross-section) organized by the power exchange *Nord Pool Spot* (NPS);
- development of a common reserves and balancing market;
- development of a financial products market in Latvia and Lithuania, commencing the operations of the stock exchange *Nasdaq OMX Commodities*;
- implementation of the Baltic infrastructure projects included in the PCI list;
- improvement of the products in development of the regional dimension of the European electricity market models;
- synchronization of the power supply systems of the Baltic states with the power systems of mainland Europe in the long term.

Natural Gas Market

Latvian natural gas supply system is not connected to the EU's common natural gas supply system. Latvia receives natural gas from Russia only, but, along with the launch of operations of the Klaipeda LNG terminal at the beginning of 2015, Latvia has access to gas supply of limited volume from Lithuania. The only natural gas field in the Baltic region is located in Latvia – Inčukalns Underground Gas Storage Facility (UGSF) with the total volume of 4.3 billion m³, including the active natural gas volume of 2.3 billion m³. In 2014, total consumption of natural gas reached 1,313 million m³, which is by 10.1% less than in 2013. The major consumers of natural gas in 2014 were the CHPs of *Latvenergo AS* and heating companies – 66.7%, industry and construction – 11%, other users – 19.1%, and the rest is constituted by the consumption of natural gas in the energy sector and losses. Approximately 65% of the natural gas used in Latvia is consumed in Riga region.

Wholesale prices of natural gas in the Baltic States are higher than the EU average. At the same time, it should be noted that the retail prices for households and industrial consumers in the Baltic States are close to the EU average. This is determined by several factors, such as infrastructure costs, including storage capacity and transmission tariffs, as well as tax policy.

Currently, one merchant is operating in the natural gas market of Latvia – *Latvijas Gāze AS*, which has an exclusive right to carry out natural gas transmission, distribution, storage, and sale by 2017 according to the *Privatization Agreement* concluded in 1997.

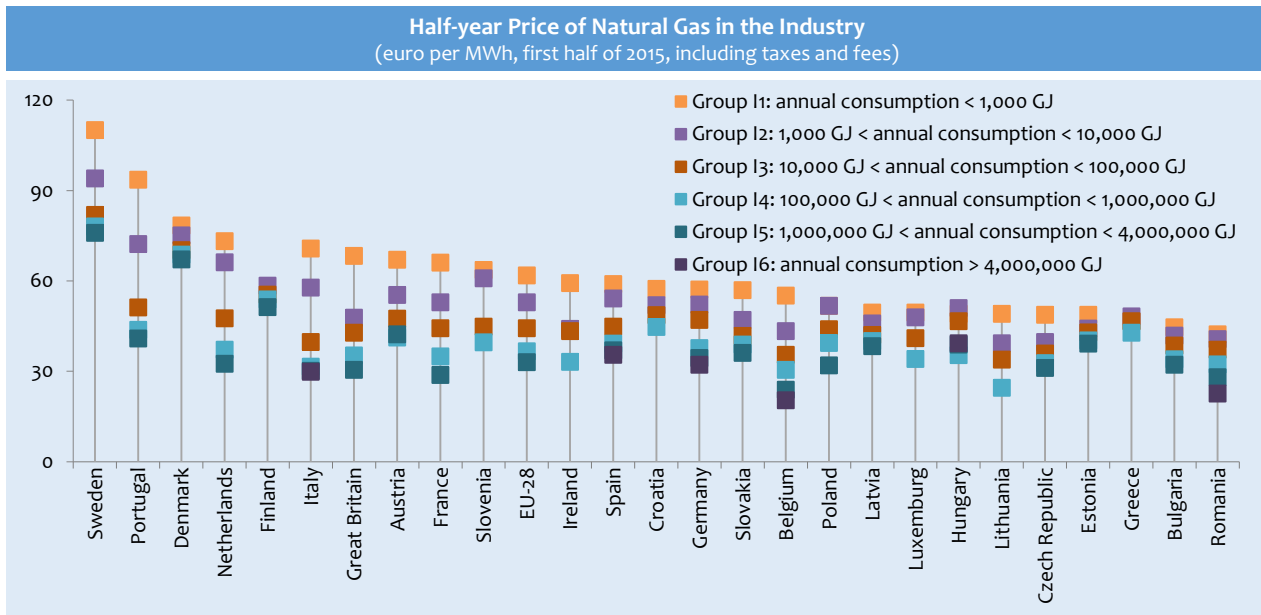
Figure 6.6



The EU-wide natural gas market principles are prescribed in the *Directive 2009/73/EC* of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing *Directive 2003/55/EC (Directive 2009/73/EC)*.

Taking into account that the Latvian natural gas supply system is not connected to the EU's common natural gas supply system, Latvia has applied "isolated market derogation" from the *Directive 2009/73/EC* until 2017.

Figure 6.7

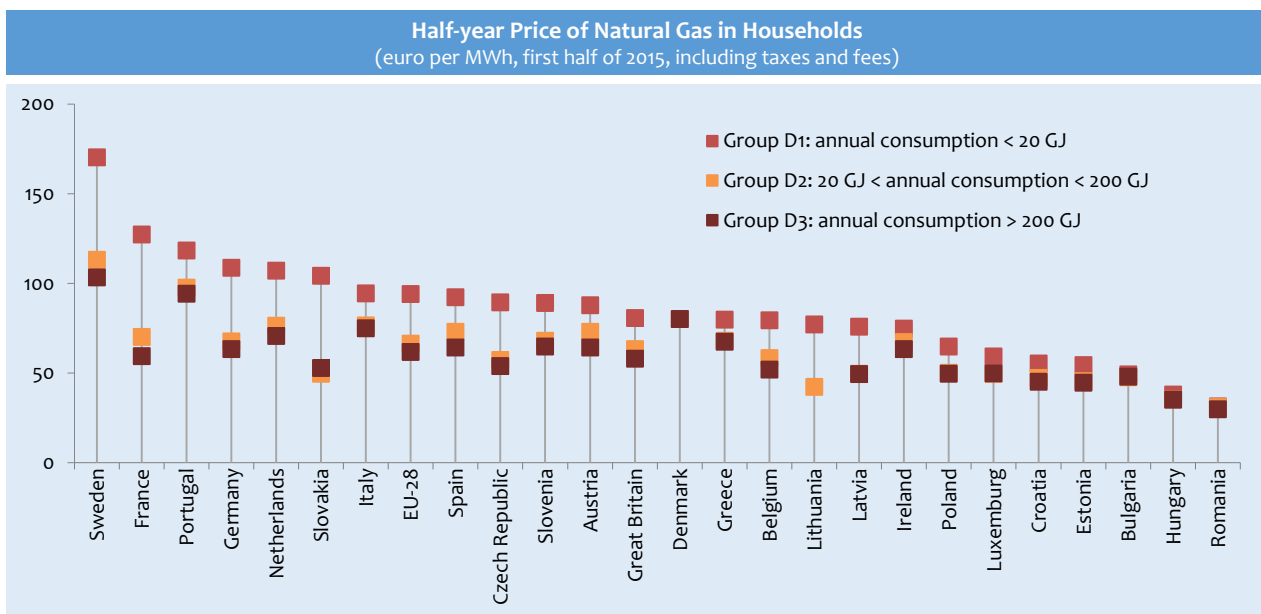


Source: Eurostat

Law *Amendments to the Energy Law* was adopted at the Saeima on 20 March 2014, which provides for a gradual liberalisation of the market, establishing that, as of 4 April 2014, operators of the natural gas transmission, distribution, storage, and LNG systems have to provide

all users of the system and applicants, who request it, with equal and open access to the respective system, providing them with services of natural gas transmission, distribution, storage, or liquefied natural gas services.

Figure 6.8



Source: Eurostat

On 10 September 2015, the Council of the Public Utilities Regulatory Commission approved the terms of use of the natural gas infrastructure – *Terms of Use of the Natural Gas Transmission System of Joint-Stock Company*

“Latvijas Gāze” and *Terms of Use of Inčukalns Underground Gas Storage Facility of Joint-Stock Company “Latvijas Gāze”*. In future, the use of the natural gas transmission system and underground gas storage facility and allocation of spare

capacity will be transparent, open and will operate under equal terms. Till now, third party access was based on a bilateral agreement with *Latvijas Gāze AS*.

The said terms prescribe the provisions of using the natural gas infrastructure, the procedure for granting the rights to use the spare capacity of the transmission system and Inčukalns underground gas storage facility, cases when the infrastructure operator is allowed to suspend or limit the usage of the transmission system and the storage facility, rights and obligations of the operator and the users of the transmission system, payment procedure and balancing procedure of the natural gas entered into the system and discharged from the system.

According to the terms, information about the spare capacity of the transmission system and Inčukalns underground gas storage facility available on the market is publicly available on the website of *Latvijas Gāze AS* and is updated on a regular basis.

In order to ensure uninterrupted operation and proper technical condition of the natural gas transmission system and storage facility, *Latvijas Gāze AS* is obliged to control the quality of gas entered into and discharged from the system, to keep relevant records and balance the natural gas transmission system, while the market participants wishing to transport natural gas are obliged to ensure the compliance of the natural gas, biogas, and gas produced from biomass, as well as liquefied natural gas converted to its gaseous form, to be entered into the transmission system with the natural gas quality characteristics established by the Cabinet of Ministers, as well as obliged to comply with the established operating modes and natural gas transportation schedule.

Continuing a gradual liberalization of the natural gas market, based on the Cabinet approved road map for further reforms in the natural gas market of 3 March 2015, as well as the decision on the model for separation of the transmission system operator – full separation of ownership as of 3 April 2017; draft law *Amendments to the Energy Law* was adopted in the first reading at the Saeima on 22 October 2015. The draft law provides for two main deadlines for full separation of ownership of the natural gas transmission and storage system operator:

1. 3 April 2017, when a legally independent company shall be established that provides the services of the natural gas transmission system operator and storage system operator and owns the transmission system assets and has the Inčukalns underground gas storage facility (owns or uses parts of it) at its disposal, as well as licenses for provision of natural gas transmission and storage services, and is confirmed as the transmission system operator;
2. 31 December 2017, when the separation of ownership of the natural gas transmission and storage system operator has to be completed, namely, it has to be achieved that the transmission and storage system operator is a capital company independent from *Latvijas Gāze AS*, the owners of which are not related to *Latvijas Gāze AS* or its

shareholders either directly or indirectly. This requirement does not apply to financial institutions that hold shares of the single natural gas transmission and storage system operator, as well as the energy supply merchant engaged in the production or sale of natural gas. State pre-emption rights are provided for in the draft law in relation to the change of ownership of *Latvijas Gāze AS*.

The draft law prescribes that, as of 3 April 2017, the price of natural gas is determined by the natural gas market participants by a mutual agreement. By ensuring the opening of the natural gas market, the draft law provides for the right of all natural gas users to freely choose a natural gas trader as of 3 April 2017. To reduce social tension, a gradual opening of the market is planned for household users, namely, they reserve the right not to use the opportunity of becoming a market participant to freely choose a natural gas trader. By using the right not to become a market participant, household users will retain the user status and the possibility to buy natural gas according to the tariffs set by the regulator, rather than the market price.

To diversify the natural gas supplies in Latvia and throughout the Baltic region, it is necessary to involve alternative natural gas suppliers in the market. It is possible by doing the following (see Box 6.8):

- constructing interconnection GIPL of the Lithuanian-Polish natural gas supply systems;
- implementing the regional LNG terminal project;
- ensuring third-party natural gas supplies to the region through the existing natural gas supply infrastructure (namely, by diversifying the natural gas supply sources, rather than the supply routes).

Since Inčukalns UGSF is a significant component of the natural gas supply system of the Baltic region, which ensures natural gas supply not only to Latvia, but also to Estonia and Russia, as well as serves as a safety backup element for the region, it is planned to implement the project *Modernization and Expansion of Inčukalns UGSF*.

The project aims to raise the level of security of energy supply in the Baltic Sea region, as well as to facilitate diversification of energy supply routes and sources after the completion of the GIPL and Estonia-Finland interconnections. The estimated costs of the project – 191 million euro for modernization, 360 million euro for expansion. The first stage of the project Modernization and Expansion of Inčukalns UGSF provides for increasing the natural gas discharge capacity. At the moment, 30 million cubic meters of natural gas can be discharged from the storage per day. It is planned that the natural gas discharge capacity will be 32 million cubic meters per day in 2020. In situations where the demand for natural gas is higher than usual, for example, due to climatic conditions or disruption in natural gas supplies from third countries, Inčukalns UGSF will be

able to ensure the required volumes not only in Latvia, but also in Lithuania and Estonia.

Box 6.8

Projects on Diversifications of Natural Gas Supplies

GIPL will connect the Rembelszczyszna gas compressor station in Poland with the Jauniunai gas compressor station in Lithuania. The project aims not only at integrating the isolated natural gas market of the Baltic states in the EU, but also providing access to the EU gas trading platforms (such as the Central European gas trading platform CEGH) and the global market of liquefied natural gas (LNG). Feasibility study was carried out in 2011, while the technical and economic substantiation of the project was prepared in 2013. GIPL construction is planned for 2016-2019, but, taking into account the scale and nature of the project, the term of implementation may be changed. Lithuanian company "Amber Grid" and Polish gas transmission operator "GazSystem S.A." are the investors of the project. EU funding covered 50% of the costs of the project's technical and economic substantiation. GIPL is included in the EU list of priority projects, and funding of 306 million euro was granted to the project within the framework of CEF in November 2014. The cost of construction of GIPL will be around 558 million euro. The construction of GIPL will provide Latvia with access to other sources of natural gas supply, apart from Russia, and integrate the isolated natural gas market of the Baltic states into the EU natural gas market.

On 15 October 2015, a grant agreement regarding the GIPL was entered into between the project implementers GAZ-SYSTEM S.A. (Poland) and AB Amber Grid (Lithuania) with INEA (Innovation and Network Executive Agency).

It was concluded in the EC study involving an independent expert that the optimal location for a regional LNG terminal would be the Gulf of Finland. It has to be noted that, in any of the cases, Inčukalns UGSF has an important role in the functioning of the natural gas market of the Baltic region.

Accordingly, the following projects important for the development of the Latvian natural gas infrastructure were included in the EC's 2nd list of PCI published on 18 November 2015:

- the project for modernization and expansion of Inčukalns UGSF;

- expansion of capacity of the Latvia-Lithuania gas interconnection;
- expansion of capacity of the Estonia-Latvia gas interconnection;
- GIPL project of the Lithuanian-Polish natural gas supply system interconnections.

Box 6.9

The Component of Mandatory Procurement of Electricity

In 2016, like in 2015, additional funds are earmarked for the support of the users of electricity from the national budget, which will allow maintaining the mandatory procurement component (MPC) in the current amount – EUR 26.79 per MWh. Conceptual report "Complex Measures for the Development of Electricity Market" drawn up by the Ministry of Economics was approved by the Cabinet Decree No. 567 of 17 September 2015. By approving this conceptual report, the Cabinet of Ministers has decided to maintain the MPC in the amount of EUR 26.79 per MWh until 2019. To do this, funding has been earmarked for the national budget programme "Support for the Users of Electricity" (68,6 million euro in 2016, 96,7 million euro in 2017, 109 million euro in 2018), where the income will be generated from the revenues from the subsidised electricity tax, part of the dividends of *Latvenergo AS*, as well as revenues from the value added tax.

On 14 July 2015, the Cabinet of Ministers supported the Cabinet Regulation "Procedures for Energy-Intensive Manufacturing Companies to Obtain the Right to a Reduced Participation in Payment of the Mandatory Procurement Component" drawn up by the Ministry of Economics. According to this support mechanism, after agreeing upon it with the European Commission on its compliance with the European Union's internal market, energy-intensive companies will have the opportunity to apply for a reduced payment of the mandatory procurement component, which is 85% of the mandatory procurement component, calculated for the mandatory procurement from producers, who generate electricity from renewable resources.

A big challenge for the Ministry of Economics is related to the further development of renewable energy and opportunities for creating a new support mechanism.

Stocks of Oil Products

Stocks of oil products are created in Latvia, like in other EU Member States, in accordance with the provisions of Article 3 of Council *Directive 2009/119/EC* of 14 September 2009 imposing an obligation on Member States to maintain minimum stocks of crude oil and/or petroleum products, namely, Member States shall ensure that the total oil stocks maintained at all times

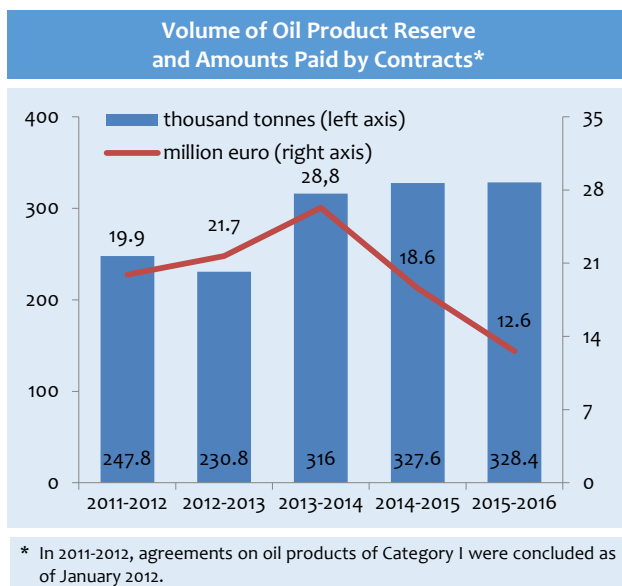
within the Community for their benefit correspond, at the very least, to 90 days of average daily net imports or 61 days of average daily inland consumption, whichever of the two quantities is greater. Since Latvia is an importer of oil products, the stocks of oil products are made for 90 days in the daily average amount of net imports.

Box 6.10**Heat for Central Heating in Latvia**

In 2014, heat for sale was generated in 631 boiler-houses and 175 CHP plants with the total amount of generated heat for sale of 7.15 TWh. Natural gas was mainly used for generation of heat for central heating and electricity. The proportion of heat for central heating generated from natural gas was 66.2%, from solid biomass – 30.1%, from biogas – 3.0%, from other types of fuel – 0.7%.

The structure of users of central heating has not changed in recent years, where central heating constitutes 65-70% and hot water supply – 30-35%. In 2014, 69.5% of the total final consumption of central heating was consumed by households, 25.0% – by services, 4.2% – by industry and construction, 1.3% – by agriculture. The breakdown of the total final consumption of central heating by regions is as follows: Riga Region – 54.9%, Pierīga Region – 11.7%, Vidzeme – 6.5%, Kurzeme – 9.8%, Zemgale – 7.6%, and Latgale – 9.5%.

Figure 6.9

**Renewable Energy**

Quantitative objectives of Latvia have been established in the *National Reform Programme of Latvia for the implementation of Europe 2020 strategy* – to achieve a 40% share of renewable energy in the gross final energy consumption and a 10% share of renewable energy in the gross final energy consumption in the transport sector by 2020. Economically justified use of local energy and secure supply of energy is one of the main conditions for national economic independence and security of energy supply. Consequently, improvement of efficiency of the existing heating systems and a more efficient use of

energy, which also contributes significantly to reduction of the greenhouse gas emissions, retain their importance.

To reduce the negative effect of increased electricity costs on the competitiveness of energy-intensive companies, increasing their competitiveness in export markets, on 14 July 2015 the Cabinet of Ministers supported the Cabinet Regulation “Procedures for Energy-Intensive Manufacturing Companies to Obtain the Right to a Reduced Participation in Payment of the Mandatory Procurement Component” drawn up by the Ministry of Economics. The support mechanism will be in force after the receipt of the Commission decision on compliance of the respective state support mechanism with the European Union’s internal market. According to this support mechanism, after agreeing upon it with the European Commission, energy-intensive companies will have the opportunity to apply for a reduced payment of the mandatory procurement component, which is 85% of the mandatory procurement from producers, who generate electricity from renewable resources. For energy-intensive economic operators of manufacturing industry to qualify for the reduced payment of the mandatory procurement component, the economic operator has to fulfil the following criteria at the same time: (1) power consumption in the previous calendar year was 10 GWh or more; (2) electric intensity is 20% or more; (3) the economic operator has introduced a certified energy management system; (4) the economic operator works in one of the sectors specified in Annex 1 of the Cabinet Regulation *Procedures for Energy-Intensive Manufacturing Companies to Obtain the Right to a Reduced Participation in Payment of the Mandatory Procurement Component*, such as production of glass fibre and cement.

Table 6.5

	The Share of Energy Generated from Renewable Sources (percentage, in accordance with the methodology of the Directive 2009/28/EC)							
	2000	2005	2009	2010	2011	2012	2013	2014
In gross final energy consumption	33.0	32.3	34.3	30.4	33.5	35.8	37.1	38.7
In the energy sector	50.5	43.0	41.9	42.1	44.7	44.9	48.8	51.1
In heating and cooling	39.7	42.7	47.9	40.7	44.8	47.4	49.7	52.2
In the transport sector	1.5	1.4	1.1	3.3	3.2	3.1	3.1	3.2

Until 2020, not only the contribution of the existing instruments, but also the support measures for renewable energy chosen in the coming years will be crucial for

Latvia to contribute to combating climate change and to reduce the imports of fossil fuels, with particular emphasis on the heating sector. First of all, when

evaluating record keeping, static transfer and joint projects of the existing support instruments, including electricity net settlement system, it is necessary to discuss

the development and implementation of a new support measure for renewable electricity generation by limiting the development of unprofitable projects.

Box 6.11

Renewable Energy in Latvia

Taking into account the objective of Latvia arising from the *Directive 2009/28/EC* and the *National Reform Programme of Latvia for the implementation of Europe 2020 strategy* to achieve a 40% share of renewable energy in 2020, a share indicator of 38.7% was achieved in 2014.

In 2014, total gross electricity generation reached 5,140 GWh, which is for 17.2% less than in 2013. From the total gross electricity generation, 54.5% (2,803 GWh) were produced from RES (HPP, wind, biogas, biomass, etc.).

In 2014, the total installed capacity for electricity generation from RES, compared to 2013, increased by 16 MW, totalling 1,780 MW. In 2014, the installed capacity of wind power stations was 69 MW (67 MW in 2013), while the installed electric capacity of biomass and biogas plants was 121 MW (108 MW in 2013), increasing the volume of electricity generated in these plants.

Total transport energy consumption in 2014 in Latvia was 27.5 thousand tons of biofuel (pure or a mix of fossil fuel and biofuel). In 2014, compared to 2013, the consumption of biofuels in the final energy consumption in transport increased, reaching the consumption of bioethanol of 257 TJ (in 2013 – 264 TJ) and consumption of biodiesel of 666 TJ (in 2013 – 521 TJ).

The decision taken at the meeting of 23-24 October 2014 of the European Council with regard to the EU climate and energy policy framework for the period until 2030 and the resulting policy objectives, as well as the Energy Union implementation conditions for economic decarbonisation and energy saving have to be taken into account.

To significantly increase electricity and heat production from renewable energy sources, to diversify

the supplies of primary energy sources and to increase electricity self-sufficiency, complementary activity 3.5.2.2 *Development of Cogeneration Power Plants Using Renewable Energy Sources* of the operational programme *Infrastructure and Services* is being implemented. Agreements on implementation of 10 projects with the Cohesion Fund (CF) funding of 28.8 million euro have been concluded within the framework of the selection of project applications.

Table 6.6

Final Energy Consumption in the Transport Sector								
	2000	2005	2009	2010	2011	2012	2013	2014
TJ								
Final energy consumption	32239	45746	48401	50855	45984	44713	45315	46295
Fossil fuels	31692	45106	47792	49265	44603	43444	44084	44951
Biofuel, including:	–	107	173	1137	935	805	785	923
Bioethanol	–	–	108	350	318	279	264	257
Biodiesel	–	107	65	787	617	526	521	666
Electricity	547	533	436	453	446	464	446	421
percentage								
Fossil fuels	98.3	98.6	98.7	96.8	96.9	97.1	97.2	97.1
Biofuel	–	0.2	0.4	2.3	2.1	1.8	1.8	2.0
Electricity	1.7	1.2	0.9	0.9	1.0	1.1	1.0	0.9

In order to achieve the aim set with regard to energy generated from renewable energy sources, the share in gross final energy consumption in the transport sector, the use of energy generated from renewable sources in the transport sector should be encouraged, for example, more environmentally-friendly use of both private and public transport and development of the infrastructure of public and private electric transport.

Taking into account the EC Guidelines on State Aid for Environmental Protection and Energy 2014-2020, which include the conditions that the European Union

Member States have to comply with, among other things, developing support mechanisms for favouring renewable energy, providing for substantially different conditions for new support for energy generation from renewable energy sources as of 1 January 2016, the Ministry of Economics has concluded that it will be impossible to continue the operation of the existing state support mechanism for electricity generation. Based on the above, on 24 November 2015, the Cabinet of Ministers has approved the amendments to the Electricity Market Law drawn up by the Ministry of Economics, which provides,

inter alia, for excluding from this law the relevant articles on granting new aid, while providing for the CoM duty to issue regulations for the support mechanism to encourage energy generation from renewable energy sources until 1 January 2018.

Energy Efficiency

By implementing energy efficiency measures in the sector of final energy consumption and energy transformation, Latvia is moving towards the target set to achieve energy savings of 0.67 Mtoe in 2020. Along with this objective, Latvia also has to achieve national mandatory final accumulated energy savings of 0.85 Mtoe by 2020 and renovate 3% of the space of buildings owned and used by the central government annually.

Transposition of the requirements of *Directive 2012/27/EU* of the European Parliament and of the Council of 25 October 2012 on energy efficiency, amending *Directives 2009/125/EC* and *2010/30/EU* and repealing *Directives 2004/8/EC* and *2006/32/EC* in laws and regulations is being continued. Draft law *Law on Energy Efficiency* was supported by the CoM on 19 May 2015 and adopted at the second reading in Saeima on 3 December 2015. Aim of the draft law is to ensure cost efficiency in generation, distribution, and end-use of energy, establishing the obligations of the public sector, local governments, and the private sector.

Drawing up of the Draft Regulations of the CoM on the development and implementation of energy efficiency obligation schemes, which provide for complex measures to facilitate energy efficiency, as well as other draft regulations in the field of energy efficiency has commenced.

Draft law *Amendments to the Energy Law* was adopted at the second reading in Saeima on 3 December 2015, the aim of which is to improve the regulation in the field of cogeneration and heating by providing a precise and uniform terminology.

Draft law *Amendments to the Law on the Energy Performance of Buildings* was adopted at the second reading in Saeima on 3 December 2015, which imposes an obligation for direct public administration institutions to purchase and rent energy-efficient buildings.

On 20 October 2015, the CoM backed supported the draft law *Amendments to the Public Procurement Law* that imposes an obligation for direct public administration institutions to purchase energy-efficient goods and services, as well as sets requirements for energy efficiency of goods and services.

On 3 November 2015, the CoM approved amendments to the *Regulations on Heat Supply and Use* of 21 October 2008, which provide that heat meters or heat cost allocators per apartment or room group will have to be installed until 31 December 2016 in newly built, rebuilt, or renovated apartment buildings and non-residential buildings, for which a building permit will be issued after 1 January 2016.

Based on the fact that a requirement to carry out energy audits in large enterprises has been introduced in the EU, the Ministry of Economics has drawn up *Recommendations for Carrying Out Mandatory Energy Audit in Large Enterprises*, as well as published a list of Latvian companies that met the criteria for large enterprises in 2013. In order to identify and exploit opportunities for energy savings in the energy infrastructure, potential assessment of energy efficiency of the Latvian gas and electricity infrastructure was conducted in cooperation with energy network operators.

In order to standardize the accounting of energy savings, the Ministry of Economics together with the associations and companies representing the industry have developed the *Catalogue of Energy Savings*, which is available on the Ministry's website.

Major challenges for the Ministry of Economics in the near future will be related not only to the development of support programmes to boost energy efficiency in apartment buildings, the public sector, and heating, but also in relation to the identification of additional alternative measures in order to reduce the volume of the national energy-efficiency obligation scheme and implementation of a comprehensive evaluation of central heating and high-efficiency cogeneration.

Energy Efficiency of Energy Using Products

EC will continue its work to improve the energy efficiency of energy-using products (eco-design), in order to minimize the negative impact of these products on the environment and to achieve greater energy savings during their operation, as well as to develop energy labelling for various product groups to raise consumer awareness of energy efficiency.

Since 2008, more than 30 EC eco-design and energy labelling regulations have been adopted that set out certain energy-efficiency and labelling requirements for energy-using products and are mandatory for Latvian manufacturers, importers and distributors. Eco-design and energy labelling regulations apply to such product categories as household and office devices, lighting, home appliances (including television sets, washing machines, air-conditioners, vacuum cleaners), heating and cooling equipment, etc. (full list of the adopted eco-design regulations is available at the websites of the EC DG Enterprise and Industry, and DG ENER (eco-design – http://ec.europa.eu/energy/efficiency/ecodesign/doc/overview_legislation_eco-design.pdf; energy labelling – http://ec.europa.eu/energy/efficiency/labelling/doc/overview_legislation_energy_labelling_household_appliances.pdf). Over the next two years, it is planned to develop a framework for at least 15 more groups of products, including such products as compressors, windows, sewage pumps, and shower heads.

6.5 Construction and Housing Policy

One of the main goals of **construction policy** is improvement of business environment, perfection of the state administrative system, as well as reduction of the administrative burden. The tool for achieving these goals is the improvement of the system of laws and regulations regulating construction and the improvement and optimisation of the institutional system of the sector.

In the first half of 2015, Ministry of Economics completed the revision of the *Latvian Construction Standards*, which was planned after the adoption of the new *Construction Law*. A range of Latvian construction standards, setting the requirements to be observed in designing different types of structures, entered into force on 1 July 2015 – LBN 222-15 “*Water Supply Structures*”, LBN 223-15 “*Sewage Structures*”, LBN 262-15 “*Electrical Communication Networks*”, LBN 224-15 “*Melioration System and Hydrotechnical Structures*”, LBN 501-15 “*Procedure of Determination of Construction Costs*”, LBN 208-15 “*Public Structures*”, LBN 005-15 “*Rules of Engineering Research in Construction*”, LBN 221-15 “*Internal Water-Pipe and Sewage of Buildings*”, LBN 201-15 “*Fire Safety of Structures*”, LBN 242-15 “*System of External Gas Pipes for Natural Gas*”, LBN 243-15 “*System of External and Internal Gas Pipes for Liquefied Petroleum Gas*”, LBN 241-15 “*System of Internal Gas Pipes for Natural Gas*”, LBN 003-15 “*Building Climatology*”, LBN 002-15 “*Thermal Technology of Building Envelopes of Buildings*”, LBN 211-15 “*Residential Buildings*”, LBN 231-15 “*Heating and Ventilation of Residential and Public Buildings*”, LBN 261-15 “*Internal Electrical Wiring of Buildings*”, LBN 305-15 “*Geodetic Works in Construction*”. Cabinet of Ministers Regulations Regarding Latvian Construction Code LBN 229-15 *Hydrotechnical Structures of Class A Hydroelectric Power Plants* were approved on 1 September 2015.

To promote high-quality construction, Latvian construction codes include not only specific requirements set out by the state for designing different structures, but also references to respective *Eurocode Standards*, which are applicable in construction of respective structures, thus ensuring that the construction of buildings meets European practices.

On 28 July 2015, the Cabinet of Ministers adopted *Rules of the Construction Information System*, which entered into force on 14 August. Furthermore, on 24 November 2015 the Cabinet of Ministers accepted special construction rules *Construction Rules for Radiation Safety Related Structures*.

A draft plan *On Measures to Improve Eurocode Standards for 2016-2018* was prepared and submitted for approval to the Cabinet of Ministers. The purpose of the plan is to ensure that the current *Eurocode Standards* are maintained and new *Eurocode Standards* are adopted in the national standardisation system, as well as to ensure the participation of national standardisation institutions in the development process of the second generation *Eurocode Standards*. The *Eurocode Standards Improvement Plan for 2016-2018* prescribes the maintenance and update of

the standards, incl. development of translations of *Eurocode Standards* and development of *National Annexes to Eurocode Standards*.

Development of amendments started for certain Cabinet of Ministers Regulations, which are at the harmonisation stage – *Amendments to Cabinet of Ministers Regulations No.499 of 19 August 2014 “Regulations on Construction Inspectors”*, *Amendments to Cabinet of Ministers Regulations No.501 of 19 August 2014 “Procedure of Installation, Construction and Supervision of Electronic Communication Networks”*, *Amendments to Cabinet of Ministers Regulations No.500 of 19 August 2014 “General Construction Regulations”*, *Amendments to Cabinet of Ministers Regulations No.529 of 2 September 2014 “Construction Regulations for Buildings”*.

In the second half of the year, the Latvian Construction Council met in three sessions, and during these sessions, the Council reviewed different construction-related matters. Members of the Construction Council worked in working groups on matters related to the amendments of the *Public Procurement Law and the Regulation on Classification of Construction Merchants*. A new Construction Council was elected on 16 November. For further information see the website of the Ministry of Economics (www.em.gov.lv).

Since 1 July 2015, the State Construction Control Bureau has started state control of construction works of new public buildings and reconstruction of commissioned public buildings. The Bureau also supervises construction of new buildings or reconstruction of commissioned buildings, if the submitter of the concept is a municipality and the contract price of the contract of public construction works is 1.5 million euros or more.

By 19 November 2015, 5202 merchants (the number of active construction merchants), incl. 790 construction merchants in 2015, have been registered in the **Register of Construction Merchants** maintained by the Ministry of Economics, which was created on 1 July 2005 and has been available in the Construction Information System (https://bis.gov.lv/bisp/lv/construction_merchants) since 2014.

The registration in the Register of Construction Merchants entitles merchants to perform commercial activities in one or more construction areas, and in the areas of architecture or electric energy. The Register of Construction Merchants includes data on merchants and construction specialists employed by them (architects, engineering research specialists, designers, construction experts, managers or supervisors of construction works), data about the scope of construction works provided by construction merchants themselves and provided by the use of subcontractors, data about the average number of persons employed in construction and the violations committed by construction merchants in construction, which were found according to the laws and regulations and reported to the register, as well as notes on the

exclusion from the VAT Payers Register of the State Revenue Service for the detected violations of laws and regulations.

Taking into account the changes in the construction regulations and the growing role of standards in the construction area, the Standardisation Bureau, in association with the construction merchants registered in the Register of Construction Merchants of the Ministry of Economics, created a *Standards Reading Room* – a remote access to over 3000 construction standards, where national (LVS) standards and adapted European (EN) and international (ISO, IEC) standards are available. The service *Standards Reading Room* is available for construction merchants free of charge from 1 November 2015 to 15 February 2016.

In order to ensure qualitative and publicly safe construction, and to reduce the administrative burden on

people employed in the construction industry, a state fee was introduced for construction merchants for the provision of construction services, which is intended for the creation and provision of a construction control system, the development and improvement of standards in the construction sector, the performance of sectoral research activities, the extension of services of the construction information system and the creation and provision of the classification system of construction merchants.

8473 construction specialists (the number of active construction specialists) to whom were issued 10837 certificates, including 2272 certificates in 2015 (including re-registered certificates), are registered in the **Register of Construction Specialists** (<https://bis.gov.lv/bisp/lv/certificates>).

Box 6.15

Evaluation of competence of construction specialists and supervision of independent practices

The following orders and Cabinet of Ministers regulations were issued according to the Construction Law and Cabinet of Ministers Regulations of 7 October 2014 No 610 *Regulations for Evaluation of Competence and Supervision of Independent Practice of Construction Specialists*, to delegate the evaluation of competence and the supervision of independent practice of construction specialists in engineering research, design, management and supervision of construction works:

- Cabinet of Ministers Order of 14 April 2015 No 181 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the “Latvian Union of Heat, Gas and Water Technology Engineers”;*
- Cabinet of Ministers Order of 14 April 2015 No 182 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the “Latvian Association of Electric Energy and Energy Construction Specialists”;*
- Cabinet of Ministers Order of 14 April 2015 No 183 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the “Latvian Association of Architects”;*
- Cabinet of Ministers Order of 14 April 2015 No 184 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the “Latvian Association of Construction Engineers”;*
- Cabinet of Ministers Order of 14 April 2015 No 185 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the “Latvia’s Electricians’ Brotherhood”;*
- Cabinet of Ministers Order of 14 April 2015 No 186 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the Latvian Railwaymen Association;*
- Cabinet of Ministers Order of 31 July 2015 No 419 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the Latvian Association of Irrigation Engineers;*
- Cabinet of Ministers Order of 31 July 2015 No 420 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the Latvian Maritime Association;*
- Cabinet of Ministers Regulations of 7 April 2015 No 176 *Price list of paid services provided by the “Latvian Union of Heat, Gas and Water Technology Engineers” at the order of the public administration;*
- Cabinet of Ministers Regulations of 7 April 2015 No 177 *Price list of paid services provided by the “Latvian Association of Architects” at the order of the public administration;*
- Cabinet of Ministers Regulations of 7 April 2015 No 178 *Price list of paid services provided by the Latvian Railwaymen Association at the order of the public administration;*
- Cabinet of Ministers Regulations of 7 April 2015 No 179 *Price list of paid services provided by the “Latvian Association of Construction Engineers” at the order of the public administration;*
- Cabinet of Ministers Regulations of 7 April 2015 No 180 *Price list of paid services provided by the “Latvia’s Electricians’ Brotherhood” at the order of the public administration;*
- Cabinet of Ministers Regulations of 7 April 2015 No 181 *Price list of paid services provided by the “Latvian Association of Electric Energy and Energy Construction Specialists” at the order of the public administration;*
- Cabinet of Ministers Regulations of 28 July 2015 No 430 *Price list of paid services provided by the Latvian Maritime Association at the order of the public administration;*
- Cabinet of Ministers Regulations of 28 July 2015 No 439 *Price list of paid services provided by the Latvian Association of Irrigation Engineers at the order of the public administration;*

The Register of Construction Specialists registers persons, who have obtained permanent rights to practice in engineering research, design, management and supervision of construction works and construction examinations or the certificate of a construction specialist. The Register of Construction Specialists

includes information on construction specialist’s education, independent practice (list of works in the performance of which the construction specialist has participated), information about the certificate of the construction specialist, which was granted to the person (sector, speciality and area of activities), information on

decisions made by the competence verification authority and related documents concerning the specialist, information on the professional improvement of the construction specialist.

In order to evaluate competence of construction specialists and to supervise their independent practices in architecture, engineering research, design, management of construction works and construction supervision, the Cabinet of Ministers orders were issued, prescribing delegation of this function to eight authorities in charge of verification of construction specialists' competence and defining the scope of paid services to be provided within the scope of fulfilment of this function for each authority, and delegation agreements were also concluded.

Starting from 2016, the State Construction Control Bureau will be in charge of the evaluation of competence and the supervision of independent practice of construction specialists in construction examination.

By 19 November 2015, 242 persons (the number of active construction inspectors) who were granted construction control rights, incl. 26 construction inspectors in 2015, have been registered in the **Register of Construction Inspectors** maintained by the Ministry of Economics, which was created on 4 November 2010 and has been available in the Construction Information System (https://bis.gov.lv/bisp/lv/building_inspectors) since 2014.

An e-service was created in the process of development of the **Construction Information System**, to provide information to competence verification authorities on education, independent practice and professional improvement of construction specialists for evaluation of competence and supervision of independent practice. In order to successfully ensure the operation of this e-service, methodical materials were created and consultations were provided to construction specialists and competence verification authorities.

As the development of the project progresses, a Register of Independent Experts in the Area of Energy Efficiency of Buildings, and a Register of Energy Certificates of Buildings are being added to the Construction Information System in addition to the already existing registers of construction merchants, construction specialists, construction inspectors and managers, and e-services (review of a construction concept, issue of a construction permit, coordination of simplified reconstruction or renovation and commissioning of buildings), as well as electronic application forms in registers were created.

When the system will be fully implemented, the society will obtain a convenient and operative mechanism, as well as be able to trace processes in the construction sector, and obtain the possibility to publicly control construction, which will reduce the possibility of illegal start of construction or corruption.

On 15 September 2015, in the area of **housing policy** the Cabinet of Ministers adopted the *Procedure of determination, calculation and registration of the portion to be paid by each owner of a residential house for the services required to maintain the residential house*. It summarizes the most common practice methods, which are already being used by managers and service providers to calculate the portion to be paid by each apartment owner. This procedure does not affect the current legal relations, i.e. settlement procedures currently existing based on agreements or regulatory enactments, which are currently being used to determine the portion to be paid by owners of residential houses for the received services. Therefore, owners of residential houses will be able to choose the methods or criteria prescribed by the procedure, only if the apartment owners want to conclude a new agreement with the respective services provider.

The Cabinet of Ministers *Regulations on Public Aid for Acquisition or Construction of a Residential Space* came into force on 9 August 2014. They envisage that Joint Stock Company "Latvijas attīstības finanšu institūcija Altum" (Latvian Development Financial Institution Altum) issues a surety to the person, who lives together with or has in custody at least one minor. 1044 sureties for homes have already been granted to families, which are raising 1564 children. The total surety amount granted is 6.5 million euros. Up to now, most of the sureties were issued for purchasing homes in Riga – 448 sureties and in municipalities near Riga – 163 sureties. 60 sureties were granted for purchasing a home in Liepāja, 50 – in Jelgava, 18 – in Jūrmala, 17 – in Ventspils, 15 – in Daugavpils and Valmiera, 9 – in Rēzekne. As for the rest of the territory, 234 sureties were granted, which make 24% of the total amount. 8% of all the sureties for purchasing homes were granted to families having three or more children, 33% – to families with two children, while the majority – 59% of all the sureties were granted to families having one child.

By 19 November 2015, 623 managers (the number of active managers), incl. 23 managers in 2015, have been registered in the **Register of Managers of Residential Houses** maintained by the Ministry of Economics, which was created on 1 January 2012 and has been available in the Construction Information System (https://bis.gov.lv/bisp/lv/house_managers) since 2014.

The main task of the Register of Managers of Residential Houses is to provide the latest information on persons handling or wishing to handle management of residential houses and meeting the requirements of the law. This register includes information on manager services according to the NACE classification, the territory of provision of the services, qualification of the manager or its employees, and also contains a note on the rights of the manager to offer management services in the market, depending on the professional qualification acquired. Registry information on the residential houses managed by the manager is available to authorised users of the system.

6.6 Tourism Policy

Tourism policy in Latvia is designed to promote the development of domestic and international tourism, increasing the competitiveness of the tourism industry and export of tourism services.

In 2010, the *Latvian Tourism Marketing Strategy 2010-2015* was developed and approved, defining the vision of tourism development in Latvia and the objectives for achieving it, as well as determining Latvian priority

tourism products, key principles of their development and target markets. According to the priorities set out in the strategy and involving the representatives of the tourism industry, a new image of Latvian tourism was developed, which has become a unifying idea and common element of the product and marketing development activities in the public and private sectors.

Box 6.13

Tourism Development Indicators

According to the data provided by the UN World Tourism Organization, the number of international tourists in 2014 reached 1.133 billion, which is by 4.3% or 46 million more, in comparison to 2013. America (+8%) has shown the best results among the regions, while in other regions the increase is more moderate: + 5% in Asia and Oceania, +5% in the Middle East and + 2% in Africa. There was a 3% increase in Europe, largely facilitated by the increase in the number of travellers in the Mediterranean countries and Northern Europe (+7%). It is important to note that the annual increase in the tourism sector has been exceeding long-term forecasts (+3.3% annually) for the fifth year in row, since the financial crisis. Forecasts of the UN World Tourism Organization evidence that in 2015 the annual increase in the sector will be 3 to 4 percent.

As evidenced by CSB data on operation of hotels and other tourist accommodations, in three quarters of 2015 Latvian tourist accommodations served 1.72 million guests, 1.19 million of which were foreign tourists. Nine months of 2015 showed an increase in the number of tourists by 2.6%, compared to the same period of 2014, and a large increase of 3.4% in the number of foreign tourists. In total, foreign and Latvian tourists spent 3.4 million nights in accommodations, however, the duration of stay reduced by 1.9% on average in comparison to the nine months of 2014.

Upon assessing the incoming tourism structure by countries, it can be concluded that, in three quarters of 2015, Latvia was most often chosen as the destination for overnight travel by tourists from Russia (13.5%), Germany (12.8%) Lithuania (9.8%), Estonia (8.9%), Finland (5.8%), Norway (4.8%), Sweden (4.7%), which makes up 60% of all foreign travellers, and corresponds to the high-priority and priority markets defined in the *Latvian Tourism Marketing Strategy 2010-2015*. When analysing the increase in the number of tourists by countries, it is necessary to note the impact of economic sanctions of the Russian Federation in the tourism sector – the number of incoming tourists from Russia dropped by 33% in the nine months of 2015, in comparison with the previous period. In 2014, the proportion of Russian tourists in the total number of incoming foreign tourists made 20.9%, in three quarters of 2015 their percentage was only 13.5%. When evaluating the incoming tourism dynamics from other high-priority markets, an increase in the number of tourists from neighbouring countries should be noted – Lithuania (23%) and Estonia (17%), as well as Norway, Sweden and Finland (11%), which compensated the drop in the number of tourists from the Russian Federation in the period concerned.

When analysing the data of bed occupancy rate that describes the hotel demand, significant seasonal fluctuations are observed, which exceed 2 times in individual months. The highest rate of hotel room occupancy in the nine months of 2015 was in July, in the hotels of Latvia in general – 55.6%, and in August in Riga – 66.8%.

Export of tourism services in Latvia grew by 4.4% in 2014 and was 935.7 million euro in 2014. According to the data of the Bank of Latvia, the expenditure of foreign visitors for recreation and other personal trips in Latvia increased by 14.7%, while the expenditure for business travel decreased by 3.1%. In 2014, the travellers' balance remained positive, and its balance was 182.5 million euro. The travellers' balance in Latvia has been positive since 2011, when the balance was only 3.6 million euro.

In 2014, the tourism sector employed over 74.8 thousand people, constituting 8.4% of the total employment in different services sectors in Latvia – in the transport sector (20 thousand), in the restaurant sector (23.6 thousand), in the hotel sector (10.3 thousand), in the culture, sport and recreation sector (22.3 thousand), as well as in travel agencies (2.8 thousand).

On 1 July 2014, a medium-term tourism policy planning document *Latvian Tourism Development Guidelines 2014-2020* was adopted, where MICE tourism (meetings, incentives, conferences, and exhibitions), wellness tourism, nature tourism, culture tourism, and creative industries were established as the strategic forms of tourism. Sustainable development of Latvian tourism, promoting increase in the competitiveness of tourism services in foreign markets, has been set as the objective of the tourism policy development. The policy results and performance indicators to be achieved are:

- an increase in the number of foreign overnight travellers;
- an increase in the average occupancy (bed occupancy rate) of accommodation

establishments outside the busy summer season (except for June-August);

- an increase in the daily average expenditure of a foreign overnight traveller;
- an increase in the total annual expenditure of foreign overnight travellers.

Main lines of action:

- to ensure the recognition of the Latvian tourism offer in the target markets, especially through modern means of communication;
- to promote the improvement of the quality of tourism products, also by ensuring a better regulatory framework of the industry and support

both to the tourism businesses and product consumers;

- to promote the development of competitive tourism products, supporting the development of new, innovative tourism products with higher value added, by developing an infrastructure for the growth of tourism, promoting the formation of regional tourism clusters and inclusion of the Latvian tourism product into the common tourism offer of the Baltic Sea Region.

Further development of tourism products must be based on seven fundamental values: quality, sustainability (including the introduction of green technologies and approaches), individualization, high value added, cooperation, involvement of tourists/gaining experience and cooperation for ensuring competitiveness.

To ensure a consistent involvement of industry partners in the implementation of tourism policy, the Advisory Council of the Latvian Tourism Development Agency (LTDA) has been actively working to bring together authorized representatives of professional and regional tourism associations, the advertising industry, as well as the Ministry of Foreign Affairs and the Riga Tourism Development Bureau.

Support Measures

In 2015, the main priorities of LTDA concern the facilitation of a single tourism information system, promotion of the Latvian tourism image and promotion

of Latvia as a tourist destination, conducting marketing research in the domestic and international tourism market, improving the quality of tourism services, as well as the developing domestic tourism and implementing international cooperation.

Annual state budget co-financing for facilitating the development of tourism is intended for the implementation of the ERDF Operational Programme *Entering into Non-Domestic Markets – Strengthening of International Competitiveness of Industries*. The following activities are supported within the framework of this sub-activity:

- organization of national stands at international exhibitions abroad;
- organization of advertising campaigns abroad.

In the nine months of 2015, the LTDA has ensured the participation of a national stand of Latvia in 11 international tourism exhibitions, has organized 18 Latvian tourism presentation events, participated in 27 specialised tourism promotion events, organised press conferences and workshops in the priority tourism markets, implemented the Latvian cultural tourism campaign in 8 countries, and organised visits of 34 foreign media and tour operators to Latvia. 3 billion contacts were made, when implementing advertising campaigns in 8 priority target markets (Germany, Finland, Sweden, Norway, UK, Estonia, Lithuania, Russia).

Box 6.17

Improvement of the Regulatory Framework

To implement a more efficient management of the tourism sector, at its session of 27 October 2015 the Cabinet of Ministers accepted amendments to the *Tourism Law* envisaging that the LTDA will merge with the IDAL. Thus, more beneficial conditions for the development of Latvian tourism and services will be created, at the same time promoting the reinforcement of Latvia as a travel destination and the increase of its competitiveness, as well as a more efficient use of human resources through the reinforcement of administrative functions.

In the Cabinet meeting of 19 November 2013, the draft order prepared by the Ministry of Economy was approved, granting the status of resort to the administrative territory of Jurmala City, except in the territories of Varnukrogs, Priedaine and Brazciems.

On 27 October 2015, the Cabinet of Ministers approved the draft order prepared by the Ministry of Economics, which granted the status of resort to the territory of Liepaja from Tirdzniecības Channel to Perkones Channel, including Jurmala Park, historical buildings, a sport complex, a children's playground, the territory of Piejuras Hospital and bicycle trails.

To ensure the inclusion of the "tacit consent" principle (in compliance with *Directive 2006/123/EC* of the European Parliament and of the Council of 12 December 2006 on services in the internal market) in the registration of tourism agents and operators in the *Travel Agents and Tour Operators (TATO) database*, amendments to the *Regulations Regarding the Rights and Duties of Tourism Operators, Tourism Agents and Clients, the Procedures for the Preparation and Implementation of a Package Tourism Service, the Information to be Provided to a Client and the Procedures for Deposition of Security Guarantee of Money* of 13 April 2010 came into force on 8 February 2013.

To ensure effective implementation of the Council *Directive of 13 June 1990 on package travel, package holidays and package tours*, informing both the consumers and other interested parties on the activities of the business operators of the industry, as well as contributing to the prevention of fraud in the industry, the Ministry of Economics established the TATO database (<http://tato.em.go.lv>) in 2010. By 10 November 2015, 698 market operators, providing travel agent's and/or tourism operator's services, had been registered in the TATO database, of which 447 had been registered in the TATO database as agents, and 251 providing services of a tourism operator or combined services (those of a travel agent and a tourism operator). According to the data of the Central Statistical Bureau, 684 thousand customers had used services of tourism market operators in 2014, of which 434 were Latvian residents.

Unlike in other years, in the reporting period the activities of the LTDA were more notably linked to the preparation of tourism information materials, using Internet resources – the official tourism portal www.latvia.travel, *If you like Latvia, Latvia likes you* account on *Facebook*, the social media network *Instagram*, as well as

using the Google search system and special travel websites *TripAdvisor*, *Expedia*, *Travellink*. The new initiative of the LTDA in marketing activities is related to cooperation with bloggers, which, based on their experience during travels and having learned the travel offer, post their articles in blogs, lifestyle magazines, as

well as in social media with a vast number of followers. Over 16 million opportunities to see were reached from 21 August to 30 October.

A number of marketing studies have been launched, the data of which will be used for the development of the *Latvian Tourism Marketing Strategy 2015-2020*, which will set out priorities in the marketing area for the next operational period.

In 2015, the total amount of funding (state budget funds and ERDF co-funding, as well as funding for the implementation of the project EDEN) for tourism marketing is 3.6 million euro.

International Cooperation in the Field of Tourism

In 2015, Latvia continues to develop closer cooperation in the field of tourism with other countries, especially with high-priority tourism target markets: Lithuania, Estonia, Finland, Sweden, Russia, and Germany. Issues related to the promotion of cooperation in the field of tourism are regularly included in the agenda of foreign visits of intergovernmental commissions and senior government officials.

The funding allocated to the LTDA is primarily used for advertising campaigns and marketing activities in the aforementioned target markets.

During the *12th European Tourism Forum* that took place on 17 October 2013 in Vilnius, Lithuania, a protocol was signed on amendments to the *Agreement of the governments of the Republic of Latvia, Republic of Estonia and Republic of Lithuania* on cooperation in the field of tourism. It can be considered to be an international acknowledgement of the progress of the Baltic States in building regional cooperation in the field of tourism.

The amendments to the agreement aim to promote the integration of the Baltic States into international tourism activities. One of the most important amendments provides for the possibility to establish shared tourism information offices or appoint shared tourism representatives in the relevant and third countries. Similarly, amendments to the Agreement clarify and complement the directions of cooperation of the Parties, for example, by providing for cooperation in the development of the Baltic tourism brand, reduction of the administrative burden, usage of advanced technology for the development of tourism, as well as development of the projects of various international assistance programmes (e.g., EU funds).

An important step in promoting international cooperation has been the fact that in October 2013, Latvia received an invitation to join the OECD Tourism Committee. Latvian authorities, responsible for tourism, are expecting to work together with the rest of the OECD Member States in developing the prospects of national and international tourism, as well as promoting sustainable growth of tourism.

In 2015, the national tourism organizations of the Baltic states are cooperating in the implementation of joint marketing activities in the distant markets (Japan, the USA, China), as well as implementing other cooperation activities – organization of an international workshop for tourism professionals, *Baltic Connecting 2015*, visits of journalists and tour operators, publishing informative materials about the Baltic tourism, organization of tourism presentations and press conferences of the Baltic States.

On an international level, representation of Latvia's interests in the field of tourism is mainly ensured by the participation in the work of European tourism authorities. Latvia regularly participates in the work of the European Commission's Tourism Advisory Committee and is an active member of the European Travel Commission, which deals with facilitating the recognition of Europe, including Latvia, as a tourist destination. In April 2015, a general meeting of the European Travel Commission was organized in Riga, with the participation of the representatives of European national tourism organizations and the United Nations World Tourism Organisation.

The Latvian Tourism Development Agency continues to implement two EC-funded projects in 2015. The project *European Destinations of Excellence – EDEN*, in cooperation with the Lithuanian State Department of Tourism, as well as the project *The Iron Curtain Trail – Euro Velo 13*, which aims to facilitate the development of the *Euro Velo 13* route in countries where it is not yet completed, to promote tourism products for bicycle tourists in order to encourage the flow of tourists along this route. In order to achieve the project objectives, after evaluating the current situation and development of the route in each of the countries, the leading partner of the project and coordinator of *Euro Velo* routes in Europe – the European Cyclists' Federation, has involved national and regional tourism organizations, tour operators and educational institutions as partners, a total of 13 organizations from 8 countries.

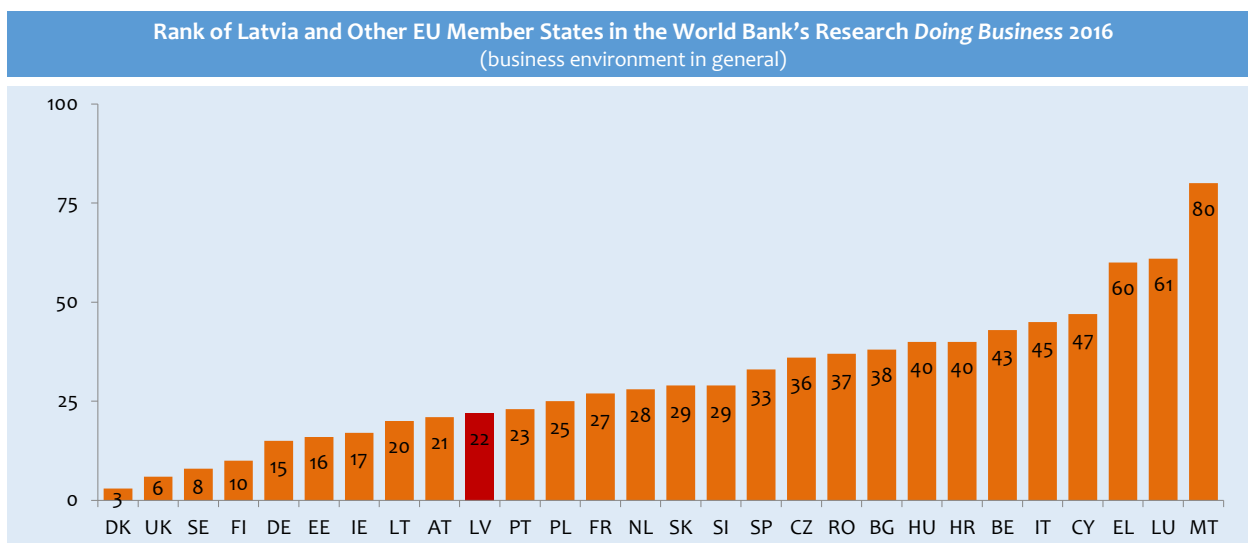
6.7 Improvement of the Business Environment

The World Bank's international study *Doing Business*, as well as the *Study of the Impact of Administrative Procedure on the Business Environment* are essential tools for assessing business environment that help to find out the views of entrepreneurs on disincentive factors hindering their activity. Thanks to the said tools, a list of tasks to be carried out has been prepared within the framework of

the annual *Action Plan for Improvement of the Business Environment*.

In the World Bank's study *Doing Business 2016*, with the reference period from 2 June 2014 to 1 June 2015, Latvia ranks in the 22nd place among 189 countries. In the assessment of the business-friendly environment, Latvia is ranked 10th among the EU member states.

Figure 6.10



It should be noted that there were changes in the methodological indicators *Doing Business 2016*, the evaluation includes indicators, which were measured differently before, therefore *Doing Business 2015* data were recalculated using the new methodology and the evaluation of Latvia has respectively changed.

Table 6.7

Rank of Latvia in the World Bank's Research Doing Business 2015-2016			
	2015	2016	changes
Starting Business	36	27	+9
Dealing with Construction Permits	24	30	-6
Getting Electricity	62	65	-3
Registration property	30	23	+7
Getting Credit	17	19	-2
Protection minority investors	46	49	-3
Paying taxes	24	27	-3
Trading across borders	22	22	0
Enforcing Contracts	35	25	+10
Resolving Insolvency	39	43	-4

In Latvia, measures for the improvement of the business environment have been implemented since 1999. The Ministry of Economics, with the participation of a wide range of sectoral ministries and organizations representing entrepreneurs, prepares the *Action Plan for Improvement of the Business Environment*, which is annually updated and approved by the government.

The *Action Plan for Improvement of the Business Environment 2014-2015* was approved by the Cabinet of Ministers Order of 28 November 2014 to ensure simple and qualitative services in business: additional e-services, and amendments to the *Action Plan for Improvement of the*

Business Environment 2014-2015, which envisages 87 tasks, were approved by the Cabinet of Ministers Order of 19 May 2015. By 1 December 2015, 28 tasks had been performed – of which the main tasks were:

- **in the field of starting businesses** – as of 1 June 2015, the payers of micro-enterprise tax no longer need to separately provide the State Revenue Service with details on the acquisition of the employee's status, as their employees are registered in the *Electronic Declaration System* of the State Revenue Service when registering an enterprise in the Company Register. Also, the *Regulations on Registration of Taxpayers and Taxpayer Units in the State Revenue Service*, will enter into force on 1 January 2016, which will no longer envisage issue of hard copies of registration certificates of taxpayers and taxpayer units, and at the same time define that this information should be published in the Database System of Information to be Published within two working days from the date of the decision on registration;
- **in the field of construction** – the development of the *Construction Information System* was completed on 29 September 2015 and the configuration of the e-service (review of a construction concept, issue of a construction permit, coordination of simplified reconstruction or renovation, commissioning of buildings) for the use of the system was initiated. It is planned that by the end of 2015 the system will provide information about the construction authorities, which started to use the *Construction Information System* (agreements with 51 municipalities were concluded until 1 December 2015). Also, State Construction Control Bureau was founded on 1 October 2014, and monitoring of the use of public buildings was launched. Moreover, control of construction works and commissioning of buildings was

- launched on 1 July 2015, and it is planned to start the monitoring of construction specialists in the field of inspection as of 1 January 2016;
- **in the field of registering property**– electronic registration of immovable property was introduced in 2015. Amendments to the *Land Register Law* came into force on 29 November 2014, and they define the range of persons, who should sign corroboration requests electronically, when they submit them to the Land Register using a special form on the website www.zemesgramata.lv. At the same time, an electronic archive functionality was created, which provides judges and employees with the access to scanned corroboration requests and attached documents, thus simplifying the circulation of documents and ensuring faster and more efficient process of registration of property rights;
 - **in the field of taxes and accounting** – a new *Law on Annual Reports and Consolidated Annual Reports* will come into force as of 1 January 2016, to transpose *Directive 2013/34/EU*. The introduction of tax payments according to the FIFO methodology and the introduction of a single account for all tax payments will also continue. There are plans to approve the concept of the ERDF project *Modernisation of tax information services* by 1 January 2016, to submit an ERDF project application to the Ministry of Environmental Protection and Regional Development by 1 March 2016, and to sign the agreement on the implementation of the ERDF project by 1 June 2016 – complete fulfilment of this task is intended by 2021 (prescribes changes in the State Revenue Service system, as well as requires amendments to laws and regulations);
 - **in the field of cross-border trade** – the Cabinet of Ministers Regulations *Procedure of Labelling of Alcoholic Beverages and Tobacco Products with Excise Tax Labels* were approved on 12 May 2015, which help to simplify rules of ordering and reception of excise tax labels and provision of information about circulation of excise tax labels for alcoholic beverages and tobacco products. The Cabinet of Ministers Regulations came into force on 1 June 2015;
 - **in the field of fulfilment of contractual obligations** – the *Law on Arbitration Courts* came into force on 1 January 2015, which determined the procedure of establishment procedure and the main principles of operation of arbitration courts, to ensure effective and fair resolution of civil disputes in an arbitration court. As of 1 January 2015, natural persons can follow the data of court proceedings online on the portal www.tiesas.lv in the cases where the legal entity represented is a participant. Also, the amendments to the *Civil Procedure Law* came into force on 2 July 2015, which envisage introducing a single electronic auction model in the judgement enforcement process and insolvency proceedings. The adopted amendments to the law envisage strengthening the legal foundation of creation and operation of the Electronic Auction Portal, as well as to determine a legal framework for the course of auctions organised in the electronic environment, by completely terminating the organisation of physical auctions of immovable property, by changing the procedure of auctions from physical auctions to auctions in an electronic environment. Electronic auctions in the judgement enforcement process have been introduced since 1 July, while in the insolvency proceedings they will be introduced from 1 January 2016;
 - **in the field of termination of business** – as of 1 March 2015, the amendments to the *Insolvency Law* have come into force, providing for the improvement of the legal framework in order to avoid problems that have been observed in practice and are related to the application of the *Insolvency Law*. Among other things, the amendments provide for ensuring that the protection of the creditor's and debtor's rights is strengthened.
 - **in the area of the “tacit consent” services** – by 2017, it is intended to introduce the “tacit consent” principle in the services of 17 state administration institutions, for example, in the certification and re-certification of forensic experts, issuing a certificate for experts in the field of conservation of species and habitats, registration of veterinary medical service providers, as well as the operation of animal cemeteries.
- Currently, the Ministry of Economics has started the development of a new *Action Plan for Improvement of the Business Environment 2016-2017*, to forward it for approval to the government. Representatives of sectoral ministries and their subordinate institutions, cooperation partners from the Employers' Confederation of Latvia, the Latvian Chamber of Commerce and Industry are involved, and recommendations provided by the Foreign Investors' Council in Latvia are taken into account in the development of the *Action Plan for Improvement of the Business Environment*.
- The information about the course of implementation of the *Action Plan for Improvement of the Business Environment* is available on the website of the Ministry of Economics: https://www.em.gov.lv/lv/nozares_politika/nacionala_industrial_a_politika/uznemejdarbibas_ride_/uznemejdarbibas_vides_uzlab_osana/.

6.8 Small and Medium-Sized Enterprises

Small and medium-sized enterprises (SMEs) in Latvia, as well as elsewhere in Europe, account for a large part of

the economy, and have a significant role in the formation of GDP and the employment.

Box 6.15

The Number of Small and Medium-Sized Enterprises in Latvia

According to the provisionally CSB data from 2014, there were 98863 economically active individual merchants and commercial companies in Latvia (excluding agricultural and fishing farms and self-employed persons performing economic activity), 99.6% of which corresponded to the SME category. The distribution of the economically active SMEs in Latvia: 89.6% are micro-enterprises, 8.9% are small enterprises, 1.5% are medium-sized enterprises. The number of economically active merchants and companies (including agricultural and fishing farms and self-employed persons performing economic activity) per 1000 inhabitants is an important indicator of economic activity. The indicator of Latvia has constantly grown over the last 10 years from 17 in 2001 to 78 in 2013.

It is equally important to highlight the number of individual workers (self-employed persons) – 55502 in 2014 (28 per 1000 inhabitants), and the number of agricultural and fishing farms – 10367 in 2014 (5 per 1000 inhabitants). Given the fact that there is no single methodological practice in the EU Member States for the calculation of an indicator that characterizes economic activity as the number of enterprises per 1000 inhabitants, it is difficult to conduct an objective comparative analysis of this indicator. The current practice of the competent EU institutions shows that the calculation of the number of enterprises per 1000 inhabitants included both individual merchants and commercial companies, as well as self-employed persons, agricultural and fishing farms, etc. Thus, applying an analogous practice, there were 83 performers of economic activity per 1000 inhabitants in 2013 in Latvia.

According to the statistics of the Register of Enterprises, in the eleven months of 2015 13,874 entities were registered and 9058 entities were excluded. In comparison, 2014 16,404 entities were registered in and 6664 entities were excluded from the registers maintained by the Register of Enterprises.

Definition of SMEs

Definition of SMEs given in Annex 1 to the Commission Regulation (EC) No 800/2008:

medium-sized enterprises:

- number of employees: 50 – 249;
- annual turnover not exceeding 50 million euro;
- annual balance sheet total not exceeding 43 million euro;

small enterprises:

- number of employees: 10 – 49;
- annual turnover not exceeding 10 million euro;
- annual balance sheet total not exceeding 10 million euro;

micro-enterprises:

- number of employees: 1 – 9;
- annual turnover not exceeding 2 million euro;
- annual balance sheet total not exceeding 2 million euro.

Measures to Promote the Establishment and to Support the Development of Micro-Enterprises

On 30 October 2009, the Cabinet of Ministers approved *The Concept of Support Measures for Micro-Enterprises*, which aims to create the necessary prerequisites for urging the unemployed inhabitants to start business activities, to create a business environment that facilitates the activities of micro-enterprises, thus reducing the level of unemployment, as well as to develop entrepreneurial skills, thereby increasing the share of entrepreneurs in the total number of employed people. The concept is being implemented successfully.

Amendments to the *Commercial Law* of May 2010 significantly reduced the costs of starting a business, prescribing that a limited liability company (Ltd) may be formed with a reduced share capital (starting from 1 euro). Furthermore, the stamp duty for registering such a limited liability company was reduced. According to the data of the Register of Enterprises, as of 1 December 2015, there were 7.4 thousand limited liability companies

registered with a reduced share capital that make 64% of the total number of registered limited liability companies.

At the same time, it should be noted that starting of business activities are significantly falling year after year. The data of the Register of Enterprises evidence that every year since 2012 by a 1000 less companies had been established (18,574 in 2012, and only 13,899 in eleven months of 2015), and the number of companies terminating their activities has also drastically increased – by 2000 companies every year (4442 companies in 2012 and already 9092 companies in eleven months of 2015).

As of 1 January 2010, a natural person performing economic activity in certain professions or activities may choose to pay a license fee, which is a final tax payment for economic activity of the natural person in a given profession (mostly craft production services). The payers of license fees are provided with respective social guarantees. 19,262 payers of license fees have been registered at the SRS during the time period from 1 January 2010 to 1 November 2015. During the said period, the average monthly number of license fee payers

was 485. The actual number of licence fee payers on 1 November 2015 was 1398. Primarily the representatives of such professions as photographers, hairdressers, nurses, and manicurists choose to register as license fee payers.

The *Micro-Enterprise Tax Law* entered into force on 1 September 2010 providing the possibility for legal and natural persons to acquire the status of a payer of the micro-enterprise tax, subject to meeting certain criteria (shareholders are natural persons, turnover does not exceed 100 thousand euro in a calendar year and the number of employees does not exceed five) and to pay micro-enterprise taxes in the amount of 9% (includes all the national tax payments, excluding consumption taxes) of turnover or business income. From 1 September 2010 to 1 November 2015, there were a total of 46,764 registered micro-enterprise tax payers, who employed more than 87.4 thousand employees in the three quarters of 2015. It is easier for the micro-enterprises to go through the formalities at the SRS (4 reports a year).

It should be noted that in the past years significant changes have been made to the *Micro-Enterprise Tax Law*.

Amendments to the *Micro-Enterprise Tax Law* envisaging a change in the concept of the micro-enterprise tax regime were adopted twice in 2015.

Amendments to the *Micro-Enterprise Tax Law* entered into force on 13 May 2015 providing for maintaining the micro-enterprise tax rate of 9% in 2015 and later on during the first three years of operation with the status of a payer of micro-enterprise tax, but starting from the fourth year of operation the micro-enterprise tax rate will increase to 12% for micro-enterprise tax payers with a turnover exceeding 7000 euro, thus resolving the matter of social guarantees of employees.

In addition, the amendments made to the *Micro-Enterprise Tax Law* on 13 May 2015 authorized the Cabinet of Ministers to determine the sectors in which micro-enterprises will not be able to acquire the status of a micro-enterprise tax payer. On 22 September 2015, the Cabinet of Ministers adopted regulations proposed by the Ministry of Finance *Sectors Not Subject to the Micro-Enterprise Tax Regime*, which state 37 sectors, in which micro-enterprises are not able to become micro-enterprise tax payers. It was envisaged that the planned regulations would enter into force as of 1 January 2016.

At the same time, taking into account the extensive scope of the sectors, on 22 September 2015 the Cabinet of Ministers at its session entrusted the Ministry of Finance jointly with the Ministry of Economics and sectoral associations representing entrepreneurs to continue the discussion on sectors not subject to the micro-enterprise tax regime, and entrusted the Minister of Finance to submit respective amendments to the Cabinet of Ministers for examination, as necessary.

Having learned the opinions of organisations representing companies of 16 sectors and having concluded that it is of the same opinion as entrepreneurs that such a wide scope of sectors cannot be conceptually supported, the Ministry of Economics submitted a

proposal for amendments to the draft law *Amendments to the Micro-Enterprise Tax Law* together with the package of draft budget laws for 2016, to postpone the restriction of sectors until 1 January 2017, taking into account the need to reach a compromise in this matter. The Saeima approved this proposal and the decision was postponed for a year.

Taking into account the still topical issue of the low level of social guarantees of employees employed by micro-enterprises, along with the package of draft budget laws for 2016, amendments were made to the Law *On State Social Insurance*, which envisage the implementation of the model of the minimum mandatory state social insurance contributions as of 1 January 2016. The purpose of the implementation of the model of the minimum mandatory state social insurance contributions is to prescribe that all micro-enterprise employees are socially insured, and to reach the amount of mandatory state social insurance contributions corresponding to the amount of contributions paid by the employer and the employee calculated from the minimum monthly wage established by the Cabinet of Ministers, i.e. 122 euro per month (in 2015) within the period of three years.

In practice, this means that entrepreneurs will pay mandatory state social insurance contributions for their employees:

- fixed costs (a preparation period for the implementation of the model of the minimum mandatory state social insurance contributions) in 2016;
- 75% from the minimum wage (92 euro per month) in 2017;
- 100% from the minimum wage (122 euro per month) in 2018.

It should be taken into account that this model concerns not only micro-enterprise tax payers, but also all the companies performing economic operation and paying taxes in a general regime.

Along with the decision made on the implementation of the model of the minimum mandatory state social insurance contributions, amendments were made to the *Micro-Enterprise Tax Law*, which further envisages establishing the rate of the micro-enterprise tax of 5% (in the first three years) and 8%, except for the part of the mandatory state social insurance contributions (it made 65% of the total micro-enterprise tax).

Taking into account the current situation, with the changes to the micro-enterprise tax regime and practically implemented measures for the prevention of the tax optimisation scheme and amendments to the *Micro-Enterprise Tax Law* for the arrangement of this regime, the Cabinet of Ministers made the decision on the necessity to conceptually review the existing tax regime for business starters and small business performers.

At its session of 22 September 2015, the Cabinet of Ministers entrusted the Ministry of Economics in cooperation with the Ministry of Finance and organisations representing entrepreneurs, to develop

draft law and entrusted the Minister of Economics by 1 September 2016 to submit for examination to the Cabinet of Ministers this draft law on the implementation of a special simplified tax regime for starters of business at the initial stage of their operations and amendments to regulatory enactments on the

implementation of a specialised simplified tax regime for small and medium-sized enterprises with a small annual turnover, envisaging simplified accounting, submission of reports and payment of taxes. It is intended that this regulation will replace the micro-enterprise tax regulation and will be applicable as of 1 January 2017.

Box 6.16

EU Activities for the Support of Entrepreneurship Small Business Act for Europe

On 25 June 2008, the EC approved the report *Small Business Act for Europe*, the main goal of which is to improve the overall policy approach to entrepreneurship, by integrating the use of the principle *Think Small First* in the policy document drafting process, in particular by promoting the development of SMEs and helping to prevent the obstacles hindering the development. The Act includes 10 proposals for politically binding guidelines and a number of specific regulatory proposals for laws and regulations. So far, various activities have been implemented at the EU and national level that comply with the guidelines set out in the Small Business Act.

On 8 September 2014, the EC launched a public consultation to gather the views and ideas of the Member States and organizations representing entrepreneurs on how the *Small Business Act for Europe* should be revised, continuing the European Policy to Support SMEs 2015-2020. The consultation is based on research carried out by the Network of SME Envoys, and it takes account of the political debate on the future SME policy, which took place in September 2013 at the Competitiveness Council of Ministers. Four main directions of the *Small Business Act*, namely, to facilitate SMEs' access to finance and markets, to reduce the administrative burden and to promote entrepreneurship, are also priorities for the coming years. In addition, after a proposal by the SME Envoys, the fifth priority has been proposed: to prevent the lack of skilled labour.

The public consultation on the *Small Business Act for Europe* ended on 15 December 2014. On 2 March 2015, the European Commission provided the EU Competitiveness Council with an overview of the results of the public consultation of the *Small Business Act for Europe*, stressing that the consultation had a high response rate. Responses of approximately 1800 respondents were received, more than 60% of which were companies. The respondents have recognized the following as important SME's support pillars: reduction of the administrative burden, access to markets, access to finance, skills and abilities, as well as support for innovation.

Taking into account the results of consultations, European SME envoys, meeting at the SME Assembly in 2015 in Luxembourg, agreed that it is necessary to design an action plan envisaging the establishment of specific business improvement events for EU institutions and Member States to strengthen the guidelines and priorities set in the *Small Business Act for Europe*.

European Small and Medium-Sized Enterprises (SME) Week

In order to implement the objectives of the *Small Business Act for Europe*, the EC organized the annual European-wide campaign *European Small and Medium-Sized Enterprises (SME) Week* in 2015, to provide the existing and future entrepreneurs with information (seminars, conferences, discussions, etc.) on the activities of the EU, national, regional and local government institutions related to the regulation of entrepreneurship, thus promoting entrepreneurship and showing recognition to entrepreneurs for their investment in Europe's prosperity, creation of jobs, innovation and competitiveness. This year the SME Assembly, the most important event of the *European SME Week 2015*, was held in Luxembourg from 18 to 20 November. Different discussions, working groups and exchanges of ideas between the public and private sector were held during this Assembly to jointly identify the SME business situation and challenges in Europe, as well as to agree on further actions necessary for the creation of policies that are favourable for SMEs. **The closing ceremony of the European Enterprise Promotion Awards 2015 was held during the SME Assembly**, certifying the highest gratitude for the value-added created by them for the European national economy, highlighting the best examples of reinforcement of the spirit of business and business-oriented thinking, which is the basis of Europe's welfare and competitiveness. This year, 52 projects from EU countries, Iceland, Norway, Serbia and Turkey were submitted for the award. **TechHub Riga project applied by Latvia was awarded by the European Jury in the category Supporting the internationalisation of business.**

Unlike in other years, this year the SME Assembly devoted special attention to the stories of entrepreneurs focusing on the future of Europe – Ideas from Europe. Jānis Spoģis from Latvia, a representative of AirDog, was one of the speakers from 28 European Member States.

10 events were organised within the *SME Week 2015 in Latvia* from October to December. Within the scope of these events, Latvia organised forums *Support for Entrepreneurs*, to provide information on the possibilities to support starters of business and entrepreneurs with experience, on the potential services offered to entrepreneurs, incl. measures focused on the promotion of investments and export. Forums *Support for Entrepreneurs* were organised in Valmiera, Balvi, Bauska, Liepāja, Jēkabpils, Madona, Talsi and Riga. Furthermore, a *Small Business Day* was organised to provide practical information about business trends, possibilities to expand customer range, how to address potential partners and how to see new business opportunities.

Measures facilitating the start of a business

In order to facilitate the formation and development of new, viable and competitive economic operators in the regions of Latvia, providing them with the environment and advisory services necessary for business, IDAL is implementing the ERDF co-funded project *Development of Business Incubators in Latvia*.

Overall, from 2009 to 2014, incubation services were received by 603 micro-, small and medium-sized

enterprises in 10 Latvian regional business incubators and the business incubator of creative industries in Riga. These economic operators ensured (maintained) 1364 jobs. By the end of 2014, 22.1 million euro have been spent for ensuring the support measures provided by business incubators within the framework of the programme. Total funding available within the framework of the programme is 28.6 million euro (including ERDF co-funding of 24.4 million euro).

In order to use all the project funding available, on 2 September 2014, IDAL announced a procurement procedure on the provision of business incubation services (the total contract price is 4 million euro, the contract performance deadline is 31 October 2015). IDAL accepted tenders until 11 December 2014. By 22 May 2015, 7 contracts have been concluded:

- with the society Latgale Machinery and Technology Centre (*Latgales aparātubūves tehnoloģiskais centrs*), regarding the facilitation of formation and development of new businesses in the Latgale Planning Region 2 (in Rēzekne, in Viļāni municipality, Rēzekne municipality, Ludza municipality, Zīlupe municipality, Cibla municipality, Kārsava municipality, Rugāji municipality, Balvi municipality, and Viļaka municipality);
- with the general partnership Riga Region Business Development Incubator (*Rīgas Reģiona biznesa attīstības inkubators*), in regard to the facilitation of formation and development of new businesses in the Riga Planning Region (Ogre and Tukums municipality);
- with Ltd *B-CAP*, in regard to the formation and development of new businesses in the Kurzeme Planning Region 1 (in Ventspils, in Ventspils municipality, Dundaga municipality, Roja municipality, Talsi municipality, Mērsrags municipality);
- with Ltd *Kurzemes Biznesa inkubators*, in regard to the formation and development of new businesses in the Kurzeme Planning Region 2 (in Liepāja, in Kuldīga municipality, Saldus municipality);
- with Ltd *HUB Rīga*, in regard to the formation and development of new businesses in the business incubator of creative business industries in Riga;
- with Riga Technical University in regard to the formation and development of new businesses in the Vidzeme Planning Region 2 (in Cēsis municipality and Madona municipality);
- with Ltd *Energo Consult* in regard to the formation and development of new businesses in the Zemgale Planning Region 2 (in Jelgava municipality and Dobeles municipality).

Ensuring Access to Finance for Entrepreneurs

After the reorganisation, as of 15 April 2015 three institutions, which provided support in financial instrument programmes – *Latvian Development Finance Institution Altum*, Latvian Guarantee Agency, and Rural Development Fund – were merged into a single financial institution *AS Development Finance Institution Altum* (hereinafter referred to as *Altum*), which ensure the implementation of financial instrument aid programme in the 2007-2013 programming period and the 2014-2020 programming period.

Box 6.17

Establishment of the Development Finance Institution

On 15 April 2015, a single financial institution *AS Development Finance Institution Altum* was formed, by merging three institutions that provided support in the form of financial instruments: *Latvian Finance Development Institution Altum (ALTUM)*, Latvian Guarantee Agency (LGA) and Rural Development Fund (LAF).

AS Development Finance Institution Altum has taken over all the rights and obligations of these institutions.

After the formation of a single institution, the full spectrum of state aid programmes and financial instruments – loans, venture capital, guarantees, aid to farmers in the form of financial instruments – are available to performers of economic activity for establishment and development in one place:

- Credit guarantees;
- Export credit guarantees;
- Mezzanine loans;
- Venture capital investments;
- Microcredits;
- Loans for starting of business;
- Microcredits;
- Growth loans;
- Loans for the improvement of competitiveness;
- Loans to farmers;
- Loans for the acquisition of land;
- Home sureties.
- Credit guarantees for farmers;

The purpose of establishment of *AS Development Finance Institution Altum* is to ensure effective implementation of state aid financial instruments and provision of support to performers of economic operations within one institution, as well as to fulfil other functions delegated by the state.

The ***Support Programme for Loans to Improve Competitiveness of Enterprises*** started in 2007-2009. Loans of investments and current assets are provided to small and medium-sized performers of economic operations for their development within it. At the end of

2014, the aid programme was extended (the ***Support Programme for Loans to Improve Competitiveness of Starters of Economic Operations and Enterprises***) ensuring the availability also to loans to start business and microloans. 463 loans for a total co-funding of 87.5

million euro (including funding from *Altum*), including 111 microloans for the total funding of 1.5 million euro and 228 loans for starters of business for a total funding of 4.2 million euro, were concluded within this support programme from its beginning to 31 October 2015.

The ***Support Programme for Starting Self-Employment and Business*** was started in 2009, within which support was provided to performers of economic operations in the form of consultations and loans. Working age population, including the unemployed, who had expressed a wish to start a business or self-employment, as well as new businesses were eligible for the support. Taking into account the demand for such type of support and the acquisition of the public funding available, no new loan agreements have been concluded since July 2015, continuing the provision and financing of such loans within the *Support Programme for Loans to Improve Competitiveness of Starters of Economic Operations and Enterprises* for the purposes of availability of this support. By June 2015, 1358 loan agreements for a total funding of 25.9 million euro have been concluded within this programme. The programme has made a significant contribution to employment – 2986 jobs were created through projects.

The implementation of the ***SME Growth Loan Programme*** was started in 2010, ensuring the availability of investment and current asset loans to merchants, including credit facilities, as well as loans for production of agricultural products. Financial resources of the European Investment Bank have been attracted for the implementation of this programme. By 31 October 2015, 1308 growth loans for a total funding of 77.5 million euro had been concluded.

The ***Latvian and Swiss Micro-Lending Programme*** was approved and started on 2011, in order to promote the availability of funding to microloans (investments and current assets). Grants were also issued until August 2014 within the framework of the programme. By 31 October 2015, 1140 loans for a total funding of 9.4 million euro have been concluded.

To provide performers of economic operations the availability of loans from commercial banks for the implementation of sustainable projects in situations, when actions of the performer of economic operations have no sufficient security, in 2009 the ***Loan Guarantee Programme to Improve Competitiveness of Enterprises and Cooperative Companies Providing Respective Agricultural Services*** was started. Guarantees are provided for such financial services as investment loans, current asset loans, financial leasing, factoring, as well as bank guarantees (bid, advance payment, payment, performance or time guarantee). The guarantees cover up to 80% of the principal amount of the financial service, and the guaranteed amount of the financial service does not exceed 1.5 million euro. By 31 October 2015, 508 loan guarantees for a total funding of 143.9 million euro have been issued. Loan guarantees have made a significant contribution to the availability of loans from commercial banks – as a result of loan

guarantees, by September 2015, the availability of loans from commercial banks for more than 296 million euro has been ensured.

In May 2013, the implementation of loan guarantees for residential houses heat insulation projects was started, their purpose is to serve as additional security and thus provide the possibility to receive loans of commercial banks for the implementation of such projects. In total, 162 loan guarantee agreements with 112 companies for a total funding of 26.5 million euro were concluded within this programme. The availability to loans from commercial banks in the amount of 36.1 million euro was ensured as a result of the guarantees.

The ***Short-Term Export Loan Guarantee Programme*** was started in 2009, in order to promote the development and strengthening in markets of export-oriented companies, ensuring the coverage of export transaction risks up to 90% from the amount of the deferred payment (its term cannot exceed 2 years), but no more than 1, million euro. By 31 October 2015, 175 export credit guarantees for a total funding of 15.6 million euro have been issued within the programme. The programme provides insurance for transactions to high-risk markets.

The ***Mezzanine Loan Programme*** was started at the end of 2011, to provide funding for the development of stable and growing companies, whose financial indicators do not meet credit policies of commercial banks (for example, undertaken liabilities vs net income) and to promote the raising of funding from commercial banks for the implementation of projects, ensuring the availability of investment loans, and later also current asset loans and grants to fund transaction structuring expenses. The current scope of mezzanine loans does not exceed 5 million euro for investments, and 200 thousand euro – for current assets. The loan is provided together with a loan from commercial banks, i.e. a subordinated loan, and the proportion of the mezzanine loan does not exceed 40% from the total costs of the investment project. In total, 23 mezzanine loan agreements for a total funding of 12.1 million euro have been concluded by 31 October 2015.

On 1 January 2012, Ltd Latvian Guarantee Agency (successor in liabilities and title *Altum*) overtook the liabilities of the European Investment Fund in the implementation of the Investment Fund. A shared risk loan programme had been implemented within it until 2012 and several venture capital funds (availability of venture capital investments is ensured at all stages of development of enterprises), as well as the indirect microloan programme is being implemented:

- a venture capital fund – an agreement on the creation of a venture capital fund was concluded with Ltd *BaltCap* AIFP in January 2010, ensuring the availability of risks capital investments in the amount of 3 million euro per company. The total amount of the fund is 30 million euro. By 31 October 2015, 15 investment agreements for a

total funding of 18.2 million euro have been concluded within the fund;

- seed and initial capital funds – an agreement on the creation of a seed and initial capital fund was concluded with *Ltd AIFP Imprimatur Capital Fund Management* in June 2010, to ensure the availability of early stage investments for the creation and development of a business concept. The amount of the seed capital fund is 8.5 million, and the initial capital fund – 7.4 million euro. The seed capital fund provides initial funding for the development of a business concept in the form of an unsecured loan up to 50 thousand euro and investments in the amount of 200 thousand euro, while further investments in the amount up to 1 million euro are made into the seed capital fund. By 31 October 2015, the funds concluded 67 unsecured loan and seed capital investment agreements for a total of 6.2 million euro and 9 initial capital investment agreements for 4.3 million euro;
- growth capital funds – limited partnership agreements with *Ltd ZGI Capital*, *Ltd EXPANSION Capital AIFP*, *Ltd FLyCap AIFP* on the implementation of growth capital funds were concluded in August 2013, in order to provide the availability of growth funding to fast growing companies with export potential, as well as to ensure initial funding for the establishment of innovative companies. The total amount of public funding allocated to the funds is 45 million euro, and the amount of one investment in a company is up to 1.5 million euro. By October

2015, 55 investment agreements in the amount of 20.6 million euro have been concluded within the funds.

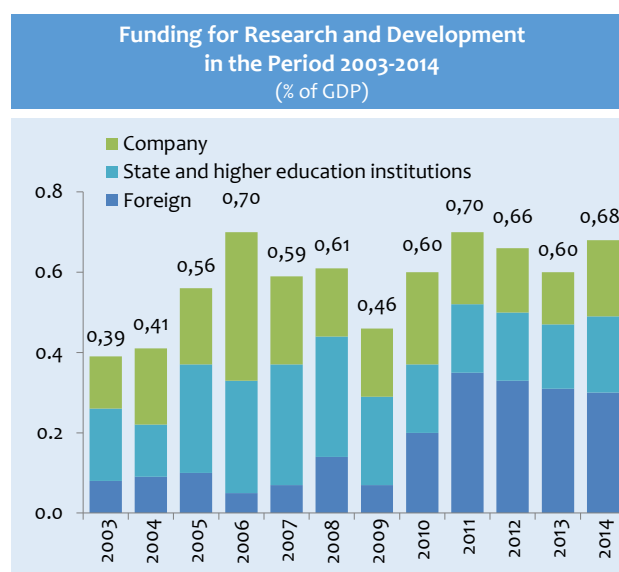
- microloans – agreements with financial intermediaries *Ltd Capitalia* and *Ltd Grand Credit* on the implementation of the indirect microloan crediting programme were concluded in July 2014. By 31 October 2015, 85 agreements for a total funding (part of financial intermediaries makes 50%) of 1 million euro have been concluded within it. The programme had been implemented by the end of November 2015;
- high-risk loans – agreements with *AS Swedbank* and *AS SEB Banka* on the issue of a shared risk loan were concluded in March 2010. The programme had been implemented by 2012. Within this programme, 18 loan agreements for a total funding of 6.9 million euro were concluded.

Two **microloan funds** commenced their activities in August 2014: *Capitalia* and *Grand Credit*. Microloans are medium-term loans for small and medium-sized enterprises to finance current asset and capital asset investments. This type of financing is particularly appropriate for cases when bank funding is not available to the company or does not meet the requirements for receiving a loan, such as the company's branch and duration of activity, the available security or other reasons. The amount of a microloan is up to 25 thousand euro, which is granted to finance the formation, growth and expansion of activity of economic operators, as well as to attract current assets for the implementation of viable business projects.

6.9 Innovation and New Technologies

According to the data of the Central Statistical Bureau (CSB), the total funding for research and development (R&D) in Latvia in 2014 increased and was 0.68% of the GDP or 162.8 million euros (in 2013 – 0.6% or 139.5 million euros). In comparison to 2013, in 2014 the amount of private sector (company) investments into R&D increased by 46.9%, which were 27.8% of total investments into R&D (45.3 million euros in real figures) or 0.19% of GDP (0.13% of GDP or 30.4 million euro in 2013). In 2014, the funding of state and higher education establishments to R&D activities also increased, making 45.5 million euros in real figures (37.1 million euros in 2013) or 0.19% of GDP compared to 0.16% of GDP in 2013. Compared to 2013, in 2014 the amount of foreign investment, including the EU structural funds for R&D remained unchanged – 72 million euros respectively, which constitutes 0.3% of the GDP (in 2013 – 0.31%).

Figure 6.11



Despite the fact that, in comparison to 2013, total expenses in R&D in 2014 increased by 0.8 percentage points, it is important to indicate that the achievement of the aim of R&D investment, promoted in the *Latvian National Reform Programme for Implementation of the EU 2020 Strategy*, which envisages an increase of the total amount of R&D investment in Latvia in 2015 to 1% of the GDP, and to 1.5% of the GDP in 2020, is an enormous challenge.

According to the latest innovation survey, conducted by the CSB for 2010-2012, it can be observed that in the respective period the number of active companies in the field of innovations has increased, constituting 30.4% (52% is the EU average) of the total number of companies (29.9% in the period 2008-2010).

The data of the Innovation Survey for 2010-2012, conducted by the Central Statistical Bureau, evidence that the proportion of active companies in the field of innovation in services sectors is on average 31.4% of the total number of companies in the respective group, and 29.6% of manufacturing companies of the total number of companies in the respective group. Furthermore, when analysing the innovative performance across sectors, it can be concluded that there is a range of manufacture sectors in Latvia (manufacture of machinery and

equipment, manufacture of electrical and optical equipment and chemical industry and related sectors), where the proportion of innovative companies exceeds or is close to the EU average.

Figure 6.12

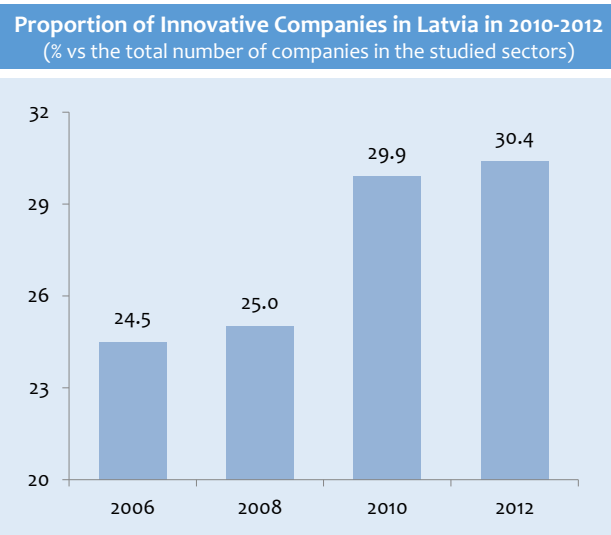
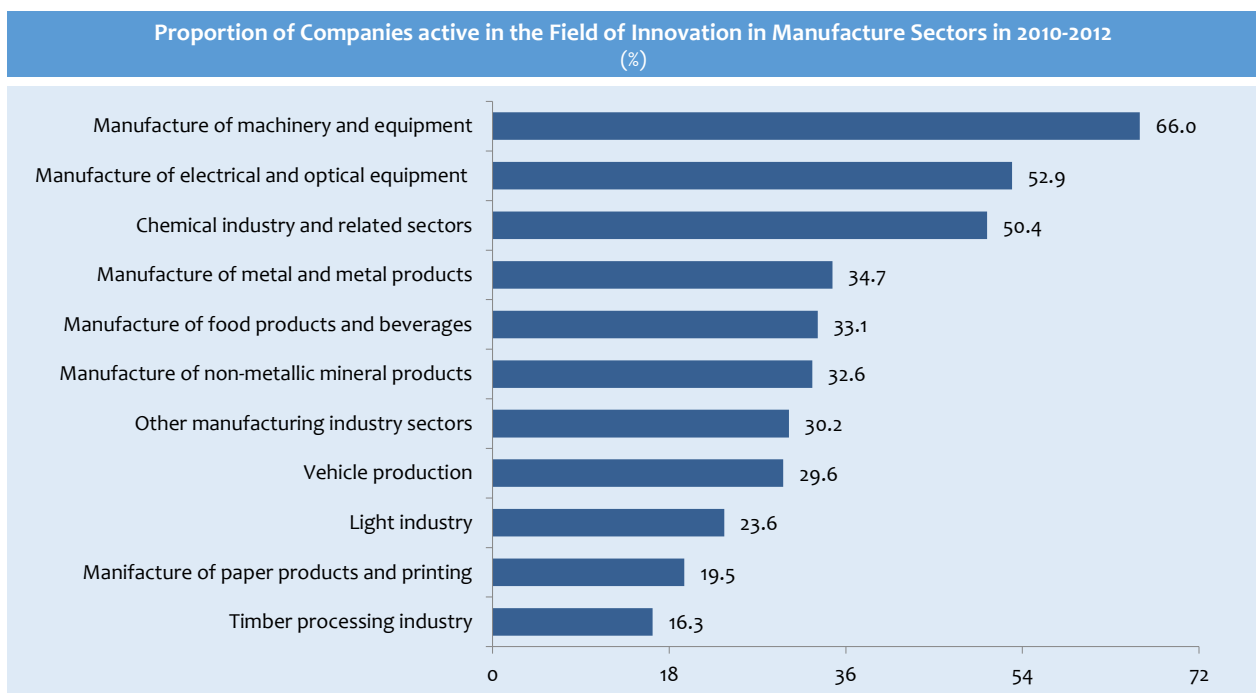


Figure 6.13



By analysing the structure of innovative companies by their size, it can be seen that large companies are more active in the field of innovations – 64.6% of all large companies are assessed as innovative. In the group of medium-sized companies, 43.2% of all companies have been innovative, whereas in the category of small companies only 26.5% were assessed as innovative. It should be noted that in the period from year 2010 to

2012, when 30.4% of companies, active in the field of innovation, were surveyed, 64% of them had implemented innovations of products and processes (technological innovations), whereas 36% of all innovative companies had implemented marketing or organizational innovations (non-technological innovations). In the field of innovations, expenses of the technologically innovative companies in 2012 were 366

million euros, of which 94% were costs for purchasing new equipment, machinery, computer equipment and software, and only 3.3% were devoted to internal research activities and 1% to purchasing external research services.

In compliance with the existing policy planning documents, the main directions for improvement of the Latvian innovation system in 2015 were as follows:

- development of the scientific activity potential;
- promotion of long-term cooperation between companies and scientists;
- support for the development of innovative companies.

In 2015, for the **development of the scientific activity potential**, Latvia continued the implementation of activities for the development of internationally competitive scientific institutions with modern material and technical supplies, as well as continued to increase the number of employees in the sector of science and research.

According to 14 *National Research Programmes for 2014-2017*, approved by the Cabinet of Ministers, the implementation of National Research Programmes continued in 2015. The National Research Programmes approved by the Cabinet of Ministers:

- *Energy-efficient and low-carbon solutions for safe, sustainable and climate change reducing energy supply;*
- *Value of Latvian eco-systems and its dynamics under the climatic influence;*
- *Multifunctional materials and composites, photonics and nanotechnologies;*
- *Innovative materials and smart technologies for safe environment;*
- *Cyberphysical systems, ontology and biophotonics for safe and smart city and community;*
- *National research programme for next generation information and communication technologies;*
- *Biomedicine for public health;*
- *Research, sustainable use of forest and subsoil assets – new products and technologies;*
- *Agricultural resources for sustainable production of qualitative and healthy food in Latvia;*
- *Innovative solutions in social tele-rehabilitation in the context of inclusive education in the Latvian schools;*
- *Transformation of the national economy, smart growth, management and legal framework for sustainable development of state and community – to create a new approach to a sustainable knowledge society;*
- *Innovation and sustainable development: Latvia's post-crisis processes in the global context;*
- *Sustainability of the Latvian cultural traditions in the innovative environment;*
- *Latvian studies (Letonika).*

National Research Programmes are government-ordered programmes for performance of scientific researches in a particular sector of economy, education, culture or any other national priority, in order to promote development of this sector. The financing for national research programmes is allocated within the framework of annual state budget financing. In 2014, a tender was announced for *National Research Programmes 2014-2017*, which resulted with the Cabinet of Ministers Order of 7 October 2014, *On National Research Programmes*, approving 10 programmes with the total financing of 20.67 million euros, whereas under the Order *On Additional National Research Programmes* the Cabinet of Ministers approved another four *National Research Programmes* with the total financing of 5.34 million euros. In total, 28 draft programmes were submitted for the *National Research Programmes 2014-2017* tender with the total required amount of financing equal to 32.9 million euros. 6.15 million euros are allocated for the implementation of the second stage of *National Research Programmes* in 2015.

The implementation of the *Science Infrastructure Development* activity of the EU Structural Funds, which was developed to improve the infrastructure of the leading nation-wide research centres and to ensure a modern material and technical base for research activities, continued in 2015. The total co-financing of the EU structural funds for the activity constitutes 103.9 million euros, and it is implemented in two rounds of selection. 9 projects are implemented in the first round, since the end of 2011, with the total co-financing of the EU structural funds in the amount of 80.1 million euros, modernizing and appropriately equipping 9 national research centres, which encompass 27 national scientific institutions. By 1 December 2015, in the second round of the selection of projects of the activity, implementation of six projects was completed, with the total co-financing of the EU structural funds constituting 17.8 million euros, and implementation of one project still continues with the total co-financing of the EU structural funds equal to 5.7 million euros. Implementation of projects results in the development of research infrastructure in the private sector and ensures provision of research services for the private sector. Since the launch of these projects until 1 December 2015, financing of the EU structural funds in total of 92.17 million euros and the state budget financing of 1.87 million euros has been allocated to beneficiaries for the improvement of the science infrastructure.

To provide support for practical research projects in state priority areas of science, in 2015 the implementation of the EU structural funds activity *Support for Science and Research* is being continued. As a result of the implementation of this activity, the implementation of 10 projects with the total co-financing of the EU structural funds constituting 1.9 million euros, were completed in the second round of the selection of project applications by 1 December 2015, and the implementation of 14 projects with the total co-financing of the EU structural

funds, constituting 3.8 million euros still continues. The implementation of 7 projects with the total co-financing of the EU structural funds constituting 1.7 million euros, were completed in the third round of selection of project applications, and the implementation of 34 projects with the total co-financing of the EU structural funds constituting 9.06 million euros still continues. By November 2015, 846 internationally recognized publications have been published and 99 international patent applications were submitted within the framework of projects approved in three rounds of selection of project applications of the activity.

To promote long-term cooperation between companies and scientists, in 2015 the implementation of activities to promote commercial implementation of research results continued. The state aid programme *Centres of Competence*, as well as the initiated improvement of the technology transfer system are the most significant activities in this direction.

In 2015, the Investment and Development Agency of Latvia (IDAL) continued to support the cooperation of scientists and companies for conducting collective industrial research and development of new products and technologies within the EU structural funds programme *Centres of Competence*. Centres of competence are established in six sectors, significant for the Latvian national economy – the pharmacy and chemical industry, information and communication technologies, the forest sector, manufacture of electrical and optical devices, the sector of environment, bioenergetics and biotechnologies, and the sector of transport and mechanical engineering. The programme *Centres of Competence* is being implemented until 31 December 2015, and its total public financing constitutes 53.17 million euros. It is estimated that additional private financing of at least 20 million euros will be attracted for R&D activities as a result of operation of the six created competence centres. In all six centres of competence, established within the programme, in total 231 projects of industrial studies and development of new products and technologies are being implemented, 84 of which were completed by 1 December 2015. Centres of competence involve, in total, 165 companies and 24 scientific institutions, and during the implementation of projects, 455 R&D jobs have been created. At the same time, works were ongoing in 2015 to ensure the continuity of implementation of the *Centres of Competence* programme in 2014-2020 programming period of the EU structural funds.

Also, until the end of 2015, the implementation of the *Cluster Programme*, administered by the IDAL and co-financed from the EU structural funds, will continue. The Cluster Programme was created to improve cooperation between unrelated companies, research, education and other institutions within one sector, in order to increase competitiveness of sectors and companies. The cooperation between companies and other partners within clusters is mainly focused on the implementation of joint activities in order to develop new products and

services, as well as to coordinate actions, when entering new export markets. The *Cluster Programme* provides support for 11 cluster projects, which involve, in total, more than 300 companies and more than 20 educational and research institutions, as well as a range of non-governmental organizations and municipalities. Until 2015, the total public financing of the programme constitutes 4.95 million euros. At the same time, actions were implemented in 2015 to ensure the implementation of the *Cluster Programme* also in the 2014-2020 programming period of EU structural funds.

The improvement of the system of technology transfer continued in 2015 to attract financing of the 2014-2020 programming period of EU structural funds. The system of technology transfer is being established to raise income of scientific institutions from commercialization of state-financed studies, and to achieve that results of studies conducted by scientific institutions are market-oriented and are transformed into practical businesses. It is expected that within the framework of the system of technology transfer a two-level transfer system will be created, thereby strengthening the capacity of the state agency both in the field of technology transfer and provision of services to scientific institutions, and providing technology transfer services and supporting the work of technology transfer specialists at the level of scientific institutions. At the same time, knowing the necessity to increase the degree of preparedness of commercialization offers and to promote attraction of licentiates/investors, it is planned to create a fund intended specifically for this purpose.

In 2015, **for the development of innovative companies**, the support of company projects aimed at new product and technology development and their implementation in the manufacturing process, as well as aimed at development of technologies with reduced impact on the environment, continued. The implementation of projects supporting investments of companies into the creation of new production facilities also continued.

In 2015, within the framework of the programme *Implementation of New Products and Technologies in Manufacturing* co-financed by the EU structural funds, support was provided to company projects that provide for implementation of new or significantly improved products, technologies or technological processes in the manufacturing process. Also, the implementation of 114 projects (with total financing of 35.7 million euros), supported in the first and second round of the selection process of the programme, was continued in 2015, 113 of which (with the total financing of 35.24 million euros) were completed by 1 December 2015. The programme granted the most support to medium-sized companies, which operate in the manufacturing industry, where the average amount of support provided within the programme was 0.37 million euros for one project.

In 2015, the implementation of the *High Value Added Investment* state aid programme co-financed by the EU structural funds also continued. The aim of this

programme is to raise the potential of the Latvian manufacturing companies to implement knowledge or technology in intensive projects, besides attracting foreign investment in areas with a high value added, and supporting purchase of manufacturing equipment, and construction or modernization of production units in order to promote creation of new jobs. 198 projects with the total co-financing of 188.17 million euros, supported in the first, second, third and fourth round of the selection process of project applications of the programme were implemented in 2015. By 1 December 2015, the implementing parties of projects supported within the first, second, third and fourth round of the programme, had received in total 166.33 million euros, and 102 projects had been completed for 96.80 million euros.

At the same time, the implementation of projects within the framework of the *Programme for Development of New Products and Technologies of Micro-, Small and Medium-sized Merchants*, administered by the Investment and Development Agency of Latvia and co-financed from the EU structural funds, was continued in 2015. The programme was developed to promote innovation activities of micro-, small and medium-sized companies in the area of development of new products or technologies, providing support for purchase of external services – performance of industrial researches and experimental developments, corroboration of industrial property rights, industrial design development, and testing and certification of a new product or technology. The total financing from the EU structural funds available in the programme from the end of 2012, when the programme was started, to April 2014, was 2.85 million euros. One beneficiary of the financing could receive 14.23 thousand euros with the maximum allowable financing intensity of 60%. During the invitation phase for submission of project applications within the programme, in total 41 project applications were submitted, 22 of which were supported (agreements were concluded) with the financing constituting 0.25 million euros. 20 of these projects, with the total financing of 0.22 million euros, were completed (incl. disbursed financing) by 1 December 2015. At the same time, preparatory works were executed in 2015, to start the implementation of this programme in the new 2014-2020 programming period of EU structural funds.

Pre-incubation and incubation services, financial support to the development of commercial activities for the development and commercialisation, as well as the production launch of new or significant improvement of environmental products and technologies were provided in 2015 within the framework of the Norwegian financial instrument *Innovations in the area of "green" production*.

In the *Green Technology Incubator*, created within the framework of the Norwegian financial instrument programme, provision of pre-incubation services to 81

business ideas, which were supported in five rounds of project selection organised in 2014 and 2015, was continued in 2015. At the same time, in 2015 the *Incubator of Green Technologies* started to provide incubation services to 24 implementers of projects with the total amount of granted co-financing of 2.47 million euros. According to the regulatory framework of the programme, the right to receive incubation services is granted to those beneficiaries of co-financing, whose project applications were approved in any of project application selection rounds of the small-scale grant scheme of the *Innovations in the area of "green" production* programme organised by the IDAL.

Within the framework of the Norwegian financial instrument programme *Open Competition*, the process of implementation of 15 supported company projects was continued in 2015, with the total amount of co-financing constituting 6.9 million euros. As a result of implementation of projects, it is planned to introduce new products and technologies in the manufacturing process with a reduced impact on the environment.

In 2015, the IDAL continued to implement the programme co-financed by the EU structural funds *Activities for Raising Motivation for Innovation and Starting Business* (Motivation programme) for the sixth year in a row. The aim of the Motivation Programme is to raise public awareness as well as to educate society about innovation and business, including practical involvement of different groups of society in business activities, and development and further implementation of innovative ideas and solutions. The target audience of the Motivation Programme includes students and teaching staff of general and vocational education institutions, university students, future and existing entrepreneurs, developers of innovative ideas, individual inventors etc. In 2015, various activities are being implemented for developers of ideas within the Motivation Programme, for example, support for the cooperation platform of students and companies *DEMOLA* is being continued, networking seminars for business starters and developers are organised, as well as mentoring activities are supported. In 2015, the Motivation Programme also supported developers of newly-established innovative companies (*start-up*), providing them with the necessary consultations and knowledge for drafting and implementation of projects, as well as for attraction of external financing. The total financing available in the Motivation Programme constitutes 3 million euros. In 2015, which is the extension year of the Motivation Programme, the financing of 0.19 million euros is estimated for implementation of all activities planned in the programme. It is intended to continue the implementation of the Motivation Programme also in the 2014-2020 programming period of EU structural funds. For this purpose, the creation of content for a new Motivation Programme was activated in 2015.

From 1 July 2014, companies in Latvia can use the corporate income tax incentive for R&D costs of companies, which can be written off in the year when such costs have occurred, by applying a value increasing coefficient “3”. The tax incentive can be applied to the following eligible R&D costs:

- costs of the scientific and scientific technical staff, which are related to the research and development work performed by the company;
- costs for research services provided by scientific institutions;
- costs for certification, testing and calibration when receiving services provided by accredited certification, testing or calibration institutions.

The R&D tax incentive was introduced according to the amendments to the law *On Corporate Income Tax* adopted by the Saeima on 6 November 2013. Furthermore, the Cabinet of Ministers Regulations *On Research and Development Activity for Application of Corporate*

Income Tax of 1 July 2014 set requirements for compliance and assessment of R&D activity for calculation of corporate income tax, requirements for project documentation, as well as requirements for accounting procedure of R&D costs, and compliance and assessment of these costs. 98 companies indicated R&D costs for the total amount of 11.24 million euro in their Corporate Income Tax Declarations for 2014. In order to ensure advisory assistance to entrepreneurs and the State Revenue Service, the Ministry of Economy has established a *Commission for Assessment of Research and Development Activities*, which has to ensure assessment of activities included in the documentation of an R&D project, and to prepare an opinion of recommendatory nature on compliance of activities included in the project with the status of R&D activities. 10 project applications were submitted by 1 December 2015, of which the commission examined and supported 6 projects, while 4 project applications are in the evaluation process.

6.10 Information Society

The information society is a stage of social development which is based on free mutual exchange of information and develops knowledge-based economy. The information society is composed of the technological basis (infrastructure, software), a range of information services available to society, as well as the level of skills and knowledge of individuals.

The development of information and communication technologies (ICT) results in increasingly extensive use of information and knowledge at work and in labour relations, studies, as well as in household (see: Box 6.18).

In preparation for the new multi-annual budget period (2014-2020), guidelines, concepts, conceptual and

informative reports have been drawn up, for example, *Information Society Development Guidelines for 2014-2020*, *guidelines “Latvian Cybersecurity Strategy 2014-2018”*, *Guidelines on Protection and Provision of Intellectual Property Rights 2015-2018*, *Development Concept of the National Education Information System (NEIS)*, *Concept of the Official Electronic Address*, *Concept of Development of a Unified Information System of the National Real Estate Cadastre and the State Unified Computerised Land Register*, etc.

The *Information Society Development Guidelines for 2014-2020* adopted by the Cabinet of Ministers on 1 October 2013 analyse the results achieved in the previous 7 years and establish priorities until 2020.

Box 6.18

The Role of the ICT Sector

According to the data of the Central Statistical Bureau of Latvia (CSB), the proportion of the ICT sector in the GDP constituted 3.8% in 2014. In 2014, the ICT sector in Latvia was represented by 5,534 companies which employed more than 26.6 thousand employees, while the turnover of these companies exceeded 3.1 billion euro and staff costs constituted 421 million euro. The value added of ICT manufacturing reached 61 million euro, and in the provision of ICT services – 660 million euro. The balance of ICT external trade was negative, constituting -118.6 million euro, because the amount of import exceeded the export, respectively, 1,119.3 million euro and 1,000.7 million euro. It has to be noted that the import of ICT products in 2014 increased by 28.2%, and the export – by 30.4%, compared to 2013.

According to the data of the survey *Use of Computers and the Internet by Households* conducted by the CSB, 76% of households (households with at least 1 person aged 16-74) had an Internet connection in 2015. The most frequently used devices by households with an Internet access in 2014 were the following: laptops – 68%, desktop computers – 58%, mobile phones and other mobile devices – 37%, other devices – approximately 10%. In terms of Internet accessibility, the best situation among households in 2015 was in Riga region – 81% and Pieriga region – 80%, whereas the situation in other regions was worse: in Zemgale region – 73%, Kurzeme region – 72%, Vidzeme region – 71%, and Latgale region – 69%. In 2015, a computer and the Internet was used regularly (at least once a week) by 71% and 74% of the population aged from 16 to 74 respectively.

In 2015, computers were used by 98% of companies with 10 or more employees, an Internet connection was available to 97% of these companies, whereas 59% of these companies had their own website on the Internet. In 2015, 49% employees of all companies used a computer connected to the Internet.

At the beginning of the academic year 2014/2015, comprehensive schools used 25.9 thousand computers for their study process, which is approximately one computer per 8 students. Out of 827 schools with an Internet connection, 615 schools or 74.4% had their own home page in the academic year 2013/2014.

The most significant political results of the achieved ones are the high number of regular Internet users, the relatively high proportion of households having a broadband Internet connection, the high number of employees using a computer and the Internet on daily basis, as well as the relatively high proportion of people using distance learning services. The determined proportion of the ICT in the GDP, in its turn, was not achieved, there is a small number of people shopping online, as well as there is a small turnover of companies achieved from online sales.

The guidelines for the new planning period set the following goals:

- to raise the efficiency of the operation of public administration (by optimizing processes);
- to improve the business environment (by improving the e-commerce indicators);
- to raise the level of e-skills of the population (by improving the average level of skills and decreasing the proportion of people not using the Internet);
- to improve Internet accessibility (by improving Internet accessibility for households);
- to ensure easy access of services in the electronic environment (by raising the proportion of the population and companies using the Internet for cooperation with public and local authorities, as well as with medical institutions);
- to increase the investment in research and innovation (by increasing the amount of investment and the proportion of innovative companies).

For the development of electronic administration and information society, the financing of EU structural funds, as well as the public and local government budget funds amounting to 149 million euro were acquired by 2014. In total, more than 120 projects in different areas of economy were implemented.

Of all projects, the planned results have not been achieved only in the project *Skolas.lv*, the total costs of which amounted to 3.5 million euro, since there had been insufficient administrative capacity for high-quality monitoring of the project, but a number of private companies had been more successful in offering analogous services.

There is a high risk that the project *E-health in Latvia* will not be implemented in the planned amount and quality. Even though 14.5 million euro have already been invested in the project, its commencement terms have already been moved several times. On 1 December 2015, the CoM reviewed the process of implementation of several e-health services and instructed the Ministry of Health to ensure the implementation of these services by the end of 2016.

In this multi-annual budget period (2014-2020), it is planned to use the financing of EU structural funds in the amount of 192.8 million euro.

By implementing activities of the priority direction of the Cohesion Policy *ICT Accessibility, E-administration and Services*, it is planned to provide support for promotion of balanced development in the entire territory of Latvia, creating or improving the infrastructure of electronic communications, at the same time, developing environment which promotes the economic activity and is based on available information, repeated use of the public sector information, ICT solutions integrated by public and private sectors, and involvement of Latvia in the European single digital market, as well as improving the overall quality of life of the population, contributing to the accessibility of services, raising the productivity of the public, reducing the administrative burden and improving the mobility.

Also, NGOs of the sector take active participation in the formation of the information society. In 2012, the Latvian Information and Communications Technology Association (LIKTA) developed the *Charter on Priorities of the ICT Sector* where it specified 6 target directions for the following 5 years. Whereas, on 9 April 2014, LIKTA, the Ministry of Environmental Protection and Regional Development, *Lattelecom SLA*, the Latvian Association of Local and Regional Governments (LALRG), the Latvian Association of Large Cities (LALC), and the Latvian Chamber of Commerce and Industry (LCCL) signed a cooperation memorandum on the e-administration efficiency measurement for national-scale public authorities and local governments – the *Latvian e-index*.

In 2013, during the *E-skills Week*, a cooperation memorandum was signed on the establishment of *E-skills Partnership* in Latvia. It was signed by representatives of the public sector, ICT sector, and NGOs, in response to the EU initiative – *the Grand Coalition for Digital Jobs Creation*.

The *E-skills Week 2015* took place in 88 regions and towns of Latvia. More than 150 public and non-governmental organisations participated in ensuring these activities, involving 23.6 thousand people in the training process.

Since the accession to the EU, the EU initiatives related to the formation of information society have become binding for Latvia.

In the declaration *Digital Agenda for Europe*, adopted by the EC on 26 August 2010 (see Box 6.19), a goal was set – to gain economic and public benefits from the single digital market, which is based on fast and ultra-fast Internet, in compliance with the *EU 2020* strategy.

In the first half of 2015, Latvia undertook the presidency of the Council of the European Union. One of the three priorities of the Latvian presidency was creation of a truly digital Europe, paying special attention to raising trust in the Digital Single Market, digitisation of the public sector, as well as promotion of security in the digital environment.

Box 6.19**Action plan for the Digital Agenda for Europe**

Seven priority activities (areas of action) have been determined for the *Digital Agenda for Europe*: establishment of a single digital market, improvement of the main conditions for the interoperability of ICT tools and services, increasing Internet security and trust of users, faster access to the Internet, more investment in research and development, improvement of digital skills, abilities and inclusion, as well as adaptation of ICT in order to solve current problems of society, for example, climate change, health care, and ageing of society. In total, 132 activities are planned in the areas specified in the agenda.

The following areas are specified in the action plan as particularly supportable:

- *accessibility of fast and ultra-fast Internet*. In order to ensure equal access of electronic communication services in the entire territory of Latvia: a national broadband network implementation plan shall be developed and executed, and appropriate legislation which would facilitate investment in broadband networks shall be implemented; also the financing provided by the EU structural funds (see the section on the broadband Internet) and the Rural Development Fund shall be fully used, and the European Radio Spectrum Policy Programme shall be implemented;
- *improvement of digital skills, abilities and inclusion*. In order to promote development of the information society through providing an opportunity for the Latvian population to acquire e-skills according to the level of their education and professional activity: a long-term policy for using e-skills and digital means shall be implemented, and a respective motivation of SMEs and groups being in an unfavourable situation shall be promoted; regulations on disability of the telecommunications legal framework and the *Audiovisual Media Services Directive* shall be implemented; e-studies shall be integrated in the public education and training modernisation policy;
- *reliability and security*. In order to increase trust of people in using the Internet: the European-scale *Information Technology Security Incident Response Network* (CERT network) shall be joined and used; an extensive attack imitation shall be performed and the prevention strategy shall be tested; a hotline shall be introduced for reporting of offensive or harmful online content, educational campaigns on Internet security shall be organized for children.

The action plan also provides for activities in other areas of action. In the area of action *Digital Single Market*: the main directives shall be implemented, which support the single digital market, including the *Services Directive*, the *Unfair Commercial Practices Directive*, and the legal framework on telecommunications, and the legislation on the conditions of invoicing shall be adapted. In the area of action *Interoperability and Standards*: the *European Interoperability Framework* shall be applied (also in the field of geospatial information) and the obligations in the area of interoperability and standards determined in the *Malmö and Granada Declarations* shall be implemented. In the area of action *Research and Innovations*: by 2020, the total ICT expenses of the public sector shall be doubled, respectively, by attracting equivalent private expenses, and part shall be taken in large-scale test projects in order to test and develop innovative and interoperable solutions in areas of public interest. In the area of action *ICT Benefits for the EU Society*: smart meters shall be introduced, also agreeing on their additional functions, conditions on total service life costs of devices shall be included in the procurement specifications of the lighting equipment; the interoperability of e-administration services shall be improved; compliance of points of single contact with the *Services Directive* shall be ensured; an agreement must be reached on a common list of main cross-border public services; the requirements of the *European Railway Traffic Management System* shall be met.

In order to assess the results achieved by the *Digital Agenda for Europe*, in May 2014, the European Commission published information on the progress in the implementation of the programme since the beginning of the programme (*Progress Report Digital Agenda Targets 2014*). In general, the results can be assessed as positive, since: the usage of Internet has increased rapidly (by 12 percentage points), reaching 72% of the population; also, the level of online shopping has increased by 10 percentage points, reaching 47%; high-speed broadband Internet is available to 62% of the population (an increase by 33 percentage points), although the majority of this population is residing in towns (these indicators are significantly lower in rural regions). The following shortcomings have been specified: the slow increase in the usage of e-administration (only by 4 percentage points over 4 years), and even a decrease in this indicator in certain countries; the low increase of e-commerce in the sector of SMEs, reaching 14% (by 2 percentage points in 4 years), which is mentioned as an obstacle for creating new jobs; the low level of state aid for research and development of ICT; the increase of cross-border online trade is very slow.

In contradistinction to the general trends in the EU, Latvia has exceeded the EU average level of using the e-administration and the next generation broadband access network coverage (in towns). The level of digital skills and the proportion of employees in the ICT sector against the total number of employees is slightly below the average level in the EU. However, the increase of e-commerce in the SME sector and the state aid for research and development in the ICT sector is not sufficient. In 2013, the largest difference in comparison to the average level in the EU was detected in the accessibility of fixed broadband Internet in rural regions (in Latvia – 44%, the EU average – 90%), which was partially compensated by the relatively high coverage of next-generation broadband access network (in Latvia – 29%, the EU average – 18%).

By summarizing the results of 2014, the EC has published the *Digital Economy and Society Index (DESI 2015)*, which contains 5 different digital area aspects on all EU states:

- 1) compatibility, which describes the development of the broadband Internet infrastructure;
- 2) human capital, which describes the different level of e-skills of Internet users;
- 3) Internet usage, which describes the online activities of citizens;
- 4) integration of digital technologies, which describes the digitisation and online activities of companies;
- 5) digital public services, which describes the digitisation of public services (mainly e-administration and e-health).

According to the assessment of the *DESI 2015* index, Latvia is positioned among the low-performance countries (in total, 18th position in the EU), which are recommended to improve their performance. In terms of Internet usage (8th position) and compatibility (9th position), the indicators of Latvia exceed the average indicator in the EU, whereas the indicators of human capital (20th position), digital public services (20th position), and integration of digital technologies (28th position) are lagging behind.

Compared to *DESI 2014*, the number of Internet users has slightly increased in Latvia over the year, the e-skills of the Internet users have improved, and the range of digital public services has been extended; however, the share of the SMEs selling goods on-line has decreased along with the e-commerce turnover. Also, the use of such digital technologies as the electronic information exchange, cloud computing services, use of social networks, which is necessary in the digital economy, is expanding in Latvia very slowly.

During the Latvian presidency, Riga hosted such significant events as the conference *Open Europe: Open Data for Open Society*, the conference *E-skills for Employment*, the *Single Market Forum*, the *Riga Summit 2015* on the multilingual single digital market, the conference *SEMIC 2015*, the conference *CONTACT RIGA 2015*, the conference *The Role of ICT in the*

Accessibility of Information in the Study Process, the *Digital Assembly 2015* etc.

On 6 May 2015, the EC determined 16 basic activities within the framework of three pillars in the *European Digital Single Market Strategy* which shall be implemented by the end of 2016 (see Box 6.20).

Box 6.20

EC declaration European Digital Single Market Strategy

Pillar I – better access to digital goods and services for consumers and companies throughout Europe

This pillar includes basic activities, which have to facilitate the cross-border e-commerce (by coordinating the regulations on agreements and protection of consumers), ensure better protection of consumers (reviewing the Regulation on consumer protection cooperation), achieve more efficient and accessible (in terms of price) delivery of parcels, prevent unjustified blocking of consumers due to their geographical location, determine competition problems of the e-commerce market (launching an anti-monopoly competition investigation in the e-commerce sector of the EU), draw up draft laws for coordination of copyright regimes among countries, increase cross-border accessibility to broadcaster services in Europe (by reviewing the Satellite and Cable Directive), reduce the administrative burden (faced by companies due to differences in the VAT regimes).

Pillar II – creation of appropriate conditions and equal conditions of competition for the development of digital networks and innovative services

This pillar includes basic activities in the area of telecommunications, which have to improve the coordination of radio frequencies spectrum at the EU level, promote investment in high-speed broadband and ensure equal competition for all market participants (by performing an extensive reform of the EU regulations on telecommunications), and also review the framework of audiovisual media sources (by adapting the Directive on Audiovisual Media Services), analyse the role of online platforms on the market and facilities to fight against illegal content, strengthen trust in digital services (by reviewing the E-privacy Directive), and cooperate with the sector concerning the cybersecurity issues.

Pillar III – maximum use of the digital economy growth potential

This pillar includes basic activities, which have to promote free data circulation in the EU (by proposing the *European ‘Free flow of data’ initiative* and the *European Cloud Computing Initiative*), improve the standards and interoperability in the e-health, transport planning, power industry (smart measuring) and other areas, support an inclusive digital society (by improving skills, developing an e-administration action plan for connecting registers of enterprises in the EU, speed up the implementation of e-purchases and interoperable e-signatures).

Electronic Services

Web portal www.latvija.lv is the point of single contact for accessing state and local government services in Latvia, which is also part of the EUGO European e-government web portal network. In 2015, the portal had been improved in compliance with the general guidelines of the *European E-administration Action Plan 2011-2015*. It will be possible to use the authentication options available in the portal as of 1 February 2016 to collect signatures electronically, thus providing more opportunities for people to participate in political processes.

Usage of electronically signed documents is becoming more and more common. As at November 2015, the number of documents signed with an e-signature exceeded 10 million in Latvia; however, only one in ten e-signatures on average was made using an electronic identification card (eID). A smart card, which is available to legal entities and is issued by *Latvijas Valsts radio un televīzijas centrs VAS*, and virtual e-signature were used for signing much more often.

According to the Global Open Data Index 2015 drawn up by “Open Knowledge International”, Latvia ranked 31st among 122 countries and territories (34th in 2014). The Index describes the possibilities for the public to access different types of public data (national budget expenditure, data of the register of enterprises, data on properties, state and local government procurements,

official statistics, election results, adopted legislative acts, etc.).

Significant economy of human resources, time and money (approximately 10-20%) is ensured by usage of the *Electronic Purchase System* which is mandatory for public authorities. According to the data of the State Regional Development Agency, public and local government authorities have acquired goods in the *Electronic Purchase System* for 64.9 million euro in 2015 (in 2014 – 45.9 million euro). The majority of these purchases was comprised of purchases of hardware and software, medicinal products, accessories of printing equipment, and stationery.

Broadband Internet

According to the data of the EC study *Broadband Internet Access Cost 2015* at the beginning of 2015, the costs in Latvia were 2 times lower than on average in the EU (the greatest difference was observed in the speed ranges from 4 to 8 Mbit/s and above 100 Mbit/s) in almost all combined connection types (fixed broadband Internet, fixed broadband Internet with cable TV, fixed broadband Internet with a fixed telephone line and cable TV). About a half of broadband Internet connections in Latvia have a download speed from 10 to 30 Mbit/s. In addition, the share of high-speed Internet connections (over 30 Mbit/s) is well above the EU average (in Latvia – 46.7%, the EU average – 25.8%).

According to the *State of the Internet Report* of Internet solutions company *Akamai* on Q3 2015, Latvia ranks 9th in terms of average Internet connection speed among 145 countries and territories, 8th – in terms of share of the broadband Internet connections, the speed of which exceeds 15 Mbit/s, and 4th – in terms of share of the broadband Internet connections, the speed of which exceeds 25 Mbit/s.

However, according to the EC study *Broadband Coverage in Europe 2014*, only 92% of households in Latvia had access to the fixed broadband Internet (the EU average – 96.9%). The worst situation concerned the fixed broadband Internet access in rural areas (in Latvia – 51.2%, the EU average – 89.6%). In its turn, the coverage of the next-generation access (NGA) network (including 4G mobile communications) in Latvia was well above the EU average (in Latvia – 89.6%, the EU average – 68.1%). The coverage of the NGA network in rural regions also was above the EU average (in Latvia – 43.7%, the EU average – 25.1%).

According to EC-approved aid scheme for expanding broadband Internet in Latvia for a total of 101.7 million euro, the first stage of the project *Development of the Next-Generation Electronic Communications Networks in Rural Regions* was implemented from October 2012 until the end of August 2015, by using the ERAF financing of 23 million euro and private financing of 3.4 million euro. The project was implemented by *Latvijas Valsts radio un televīzijas centrs VAS*, creating 177 internet access points and installing optical cable lines with the total length of 1,866 km. It is planned to complete the second stage by the end of 2020.

Using the financing of the EU structural funds available in the new EU programming period to implement two project selection rounds, it is planned to install at least 500 access points in “white” areas (areas outside the cities, where services are not provided). During the first round by the end of 2018 for the total amount of 46.7 million euro (ERDF funding – 39.7 million euro, private funding – 7 million euro), it is planned to enter into agreements on construction of the “middle mile” infrastructure sections, which will provide at least 78.7 thousand households with access to broadband Internet with a speed of at least 30 Mbit/s.

On 15 May 2014, the European Parliament and the Council adopted *Directive 2014/61/EU* on measures to reduce the cost of deploying high-speed electronic communications networks in order to make efficient use of the existing infrastructure and to remove obstacles to

new engineering works. In order to implement the Directive, the Cabinet of Ministers approved a conceptual report *On the Measures to Reduce the Costs of Expanding High-Speed Electronic Communications Networks* on 22 December 2015, supporting solutions that would ensure timely implementation of the Directive and would not increase the administrative burden significantly: website *Latvija.lv* would be used as a single point of information, with references to the Construction Information System (BIS) and the Information System of Encumbered Territories (ATIS); the competence of the Public Utilities Commission in dispute resolution will be extended; it is planned to commission the next survey for optical network infrastructure mapping in 2018.

Combating Computer Piracy and Cyber Security

According to the data of the international software protection organisation *Business Software Alliance (BSA)*, the level of computer piracy in Latvia reached 53% (the average in Central- and Eastern Europe countries – 61%) in 2013. The damage caused to the Latvian economy by computer piracy constituted 39.6 million euros.

In the latest study conducted by *BSA – EU Cybersecurity Dashboard* – the activities of the EU member states in the field of cybersecurity have been compared. Latvia has not been mentioned among the problem countries in this study, because the appropriate legislation has been adapted and the *Latvian Cybersecurity Strategy for 2014-2018* was approved in 2014.

In the *Global Cybersecurity Index 2014* created by the technology research company *ABI Research* and the International Telecommunication Union, Latvia ranks 20th-22nd among 195 countries and territories worldwide (among 40 European countries – 9th-11th).

E-commerce

According to the *Eurostat* data, 38% of the Latvian population have ordered goods or services on-line in 2015 (the EU average – 53%), while goods and services from other EU members states were ordered on-line by 19% of the Latvian population (the EU average – 16%).

In 2015, 35% of companies (excluding the financial sector) with 10 or more employees purchased goods or services by using the Internet or other computer networks (the EU average – 40%). 10% of companies (excluding the financial sector) with 10 or more employees, in their turn, sold goods or services by using the Internet or other computer networks in 2015 (the EU average – 19%). The e-commerce turnover in 2014 constituted 7% of the total turnover of the said companies (the EU average – 15%).

6.11 Competition Policy

The goal of competition policy is to ensure an opportunity for each company to work in conditions of free and fair competition, as well as to promote competition development in all sectors of economy in

the public interest. Competition promotes development of each individual company and economy, and ensures lower prices, wider choice, better quality and innovative solutions for consumers.

Box 6.21**Improvement of the Regulatory Framework**

On 21 May 2015, the Saeima adopted the *Unfair Commercial Practice Prohibition Law*, which will come into force on 1 January 2016.

The purpose of the development of this law is to limit the use of procurement powers by retailers with regard to suppliers, to balance the interests of suppliers and retailers in retail sales of food.

The law concerns retailers, prohibiting them to use unfair practices and set unfair deadlines for settlements for supplied goods, as well as prescribes responsibility for committed violations.

Protection and Control of Competition

The body responsible for the implementation of competition policy is the Competition Council (CC) – it investigates and prevents infringements of competition rights, takes care that state and municipal normative acts do not create unjustified obstacles for free and fair competition among companies, and educates representatives of companies, the state and municipalities, thereby promoting their understanding of competition rights and intolerance towards infringements of these rights.

The main areas of operation of this authority are protection and control of competition, prevention of infringements, as well as development of competition culture, helping to create beneficial environment for fair competition among companies.

The CC protects competition, by taking action against infringements of the *Competition Law* – forbidden agreements and abuse of a dominant position – and controls mergers of large companies.

The priority of the CC is to detect and prevent the most serious infringements of the *Competition Law* – such forbidden agreements and abuse of a dominant position

that pose the greatest harm to markets, competition and consumers.

According to the *Competition Law*, any such agreements between companies are forbidden, the aim or consequences of which include restriction of fair competition. For example, it is forbidden for companies to agree on a particular level of prices for similar goods, on division of market, in order to avoid competition in the same territories, on participation or, on the contrary, non-participation in public procurements and other activities, which lead to replacing company competition, beneficial for consumers, being replaced by forbidden cooperation.

In the second half of 2015, the CC completed investigation of two prohibited agreements and continued investigation in another 10 cases. Both detected violations were committed by applicants of public procurements. In one case: when they participated in the timber preparation procurement of AS “Latvijas valsts meži”, and in another case (see Box 6.22) participating in the procurements for dismantling works of AS “Latvenergo”.

Box 6.22**The CC punishes 11 logging applicants for cartel activities**

The CC decided to punish 11 companies, who harmonised their tenders with one or more rivals for the timber preparation procurement of AS “Latvijas valsts meži”. The total fine of 70,003.44 euros was charged from these companies.

Within the scope of this investigation the CC stated that in 2014, 11 companies participated in a procurement for timber preparation and transportation to the road at cuttings of damaged trees, who harmonised their tenders with one or more rivals, thus creating four cartels of tender groups.

If companies replace real competition with imitation of competition, the contracting authority is misled about the real situation in the market, as well as does not receive the benefits provided by rivalry between companies. It is impossible to maintain real competition between companies by exchanging information about participation in a procurement and rules of this participation. This action is considered to be a cartel agreement, which is an especially severe violation of the competition law.

During the investigation of the case, four companies used the possibilities provided by the leniency programme to admit their responsibility for the violation after the initial initiation of the case and to inform the CC that a prohibited agreement was used. The first company, to whom the fine was calculated, received a reduction of 50%, but three other companies – 25%. These companies will also be prohibited to participate in public procurements for a year.

A small reduction of the fine was also applied to other parties, because during the investigation they cooperated with the CC by immediately providing explanations and honestly disclosing the actual conditions, in which the capitalised applications for the procurement were created. The penalty for violations of the competition law is calculated as a percentage from the net turnover of the previous year, and the fine applied for these companies was reduced by 0.5 percentage points.

Similarly to forbidden agreements, significant harm to the competition and consumers can also be caused by dominant companies on the market, provided that they abuse their power on the market. According to the *Competition Law*, abuse of their dominant position is forbidden to large companies. The end of the investigation into the violation of the Freeport of Riga

Authority is considered to be an especially significant event of 2015 (see Box 6.26).

Whereas, to resolve less severe violations as soon and as efficiently as possible, the CC can act as a mediator in talks between companies – in the second half of the year the authority prevented two potential abuses of dominant positions.

Box 6.26**The CC concludes a settlement agreement with the Freeport of Riga Authority, in order to immediately prevent distortion of competition in the port**

The CC signed a settlement agreement with the The Freeport of Riga Authority (FRA), which prescribed that the FRA would pay a fine of 622,363.40 euros into the state budget for the allowed distortion of competition. The settlement agreement also envisages that the FRA will stop provision of commercial towing services and will terminate the illegal opposition to private providers of towing services, which has lasted for more than seven years.

The FRA has been deforming competition for a long time, using its administrative powers to provide competitive advantages to the towing vessels of SIA "Rīgas brīvostas flote" it owns, and to hinder the possibilities of private towing companies to work in the port. The CC found this violation in FRA's activities for the first time in 2009, and a similar violation was also found in 2011. The Supreme Court declared that both decisions of the CC were justified, however, the free port continued to distort competition and the FRA continued to ignore its obligation to ensure equal competition conditions in the port.

The investigation discovered that the FRA did not conclude or delayed conclusion of agreements without any justification, did not licence towing vessels of its rivals, limited their activities in the port and affected choice of ship agents and terminals in favour of FRA's towing vessels and otherwise used its position to hinder operations of private companies.

According to the concluded settlement agreement, the FRA shall cease to provide and will no longer provide towing services as of 31 December 2015. It is essential that in this way the FRA only refuses such commercial activities that can be fully provided by private companies. As before, the company will not be prohibited to use its towing vessels to provide public functions entrusted to it, such as winter navigation, rescue, fire-fighting and pollution prevention works.

Rules of settlement proposed by the FRA allow to fully and immediately prevent the distortion of competition, which continued to exist until now, despite the decision taken by the CC, as well as to prevent long-term judicial proceedings. To achieve the objective of its investigation – to prevent a violation and to prevent its recurrence – the CC agreed to the settlement and decided to reduce the fine, which was intended in the amount of more than 1.5 million euros.

Any company, against which the Competition Council initiated a violation case, can use the possibility to conclude a settlement, admitting its responsibility for any violation at its own initiative, and providing all the information necessary to the Competition Council to take a decision. Such action allows to discover and prevent any violation faster, as well as to save resources, which are usually necessary for examination and potential judicial proceedings; therefore the company's fine is reduced. Settlements are often used in practices of the EC's and EU competition monitors.

In order to exclude significant weakening of competition as a result of mergers of companies, the CC performs the control of mergers of large companies, allowing only those merging transactions that do not pose harm to the market. Also, by allowing a merger, the CC is entitled to apply binding conditions to the merging companies, which prevent potential harm caused by merging. According to the *Competition Law*, it is required to receive a permit by the CC, in cases when the total turnover of the merger participants in the territory of Latvia in the previous accounting year has been at least

35,6 million euros or if the total market share of the merger participants exceeds 40%. If companies create a merger without receiving a permit from the CC, the state is not able to implement its obligation to protect competition on the market and irreversible harm can be done to the structure of competition. Therefore, a fine is imposed on companies for failure to make a timely notice on merging.

In the second half of 2015, the CC has examined over a dozen of merger transactions.

Box 6.24**The CC analyses cooperation between food retailers and invites to eliminate shortcomings**

Within the scope of market surveillance of retailer cooperation networks – procurement groups, the CC analysed the competitive situation, as well as stated shortcomings, which should be prevented by retailers by the beginning of 2016, to make sure that their cooperation with suppliers meet the requirements of the new *Unfair Commercial Practice Prohibition Law*.

In total, six procurement groups of food retailers are operating in Latvia – Ltd "Baltstor" with Mego and Vesko shops, Ltd "Latvijas tirgotāju kooperācija "AIBE"", Ltd "Latvijas tirgotāju savienība (LaTs)", Ltd "ELVI Latvija", Ltd "Iepirkumu grupa" with the shops *top!* and *Labais*, and Ltd "Rust" and Ltd "Save!" with BETA shops. Through cooperation in a group, individual shop owners can make joint procurements to get better trade conditions and better discounts from suppliers of goods. Within procurement groups, retailers can also use one brand and implement joint marketing activities, for instance, in the form of unified customer loyalty programmes.

Although there is close cooperation between members of one procurement group, shops are owned by different owners and can compete with each other with prices of their goods.

Currently, the relationship between traders and suppliers in Latvia are regulated by a special Section of the *Competition Law*, however, a new *Unfair Commercial Practice Prohibition Law* will come into force as of 1 January 2016 (see Box 6.24). According to this law, no food retailers, regardless of their size, will be allowed to misuse their market powers with regard to suppliers. Thus, starting from the next year members of procurement groups, who are currently not subject to the applicable regulation, will need to shape their cooperation with suppliers according to the requirements of the new law.

Within the scope of market surveillance, the CC identified several issues, which members of procurement groups would have to review before the new law comes into force. Traders should ensure that the penalties used by them are proportionate, that goods that have not been sold during discount campaigns are sold in line with the interests of both parties – the supplier and the trader, and that the freedom of action of suppliers is not affected, when they offer their prices of goods to other traders.

One of the most important tools for control and promotion of competition is market supervision or in-depth competition situation analysis, conducted by the CC in one particular market. The market surveillance not only allows the authority to detect and prevent infringements of the *Competition Law*, but also allows to establish the existing administrative obstacles, to develop and submit to the responsible institutions suggestions for improvement of the competition situation, and to inform the society on the competition situation on specific markets. The most significant market surveillances completed in the second half of 2015 included market surveillance of burial services, actions of procurement groups (see Box 6.24), ketchup and tomato sauce retail and medical services.

Development of Competition Culture

To promote competition in all sectors of economy, the CC helps to eliminate and prevent administrative obstacles for free competition and educates entrepreneurs and the general public about competition rights and the role of competition in ensuring the public well-being. The CC also cooperates with competition supervisors and international organisations of other states, thereby participating in the formation of the international competition policy and using the information and experience shared by other states for efficient protection of the competition in Latvia.

To reduce administrative obstacles, which may arise for free competition of companies due to normative acts, the CC examines draft normative acts and gives its own opinion, if it concludes that the normative act can cause

unjustified harm to competition and, respectively, it shall be corrected. For example, the CC provided its opinion on the amendments to the Law On Value Added Tax to prevent that cultural events organised by private persons are discriminated compared to the events organised by public persons.

The CC pays special attention to informing and educating the public, thereby promoting intolerance towards infringements of competition rights, and as far as possible eliminating instances when companies violate the law due to ignorance. To explain aspects of application of competition rights to different target audiences, which are significant for them, the CC has organised seminars, conferences and other activities, which allow to meet with listeners, speak about current issues and answer questions. The most significant activities include communication activities to explain the new *Unfair Commercial Practice Prohibition Law* and demonstration of the necessity of the impact assessment of decisions on competition.

Furthermore, at the beginning of December, the CC, in cooperation with the State Chancellery, organised a conference *State Administration Promoting Competition: Contribution to the Development of National Economy* for national and municipal decision-makers.

In general, strengthening its good management practices within the authority, in the second half of 2015, the CC prepared three guideline documents: for preparation of merger reports of companies, for application of the *Unfair Commercial Practice Prohibition Law*, as well as for assessment of impact on competition.

6.12 Policy for Export Promotion and Attraction of Foreign Investment

To achieve Latvia's "economic breakthrough" included into the *National Development Plan* and to successfully implement the goals included into the *National Industrial Policy Guidelines* (see section 6.3), the Cabinet of Ministers in its session of 28 May 2013 supported the ***Guidelines for Promotion of Export of the Latvian Goods and Services and Attraction of Foreign Investment for 2013-2019***.

Raising of competitiveness of the Latvian companies, targeted activities for the attraction of foreign direct investment and support for merchants in acquiring external markets are the main directions of conduct mentioned in the guidelines, which will ensure the development of Latvia as a beneficial investment environment, promote its recognition on an international level, and facilitate the entry of the Latvian companies into external markets.

These guidelines define the main goals, principles and directions of operation for the export policy and promotion of foreign direct investment (FDI) attraction for the next seven years. For successful implementation of guidelines, it is important to create a unified and

dynamic cooperation model for all involved parties, which would include public and municipal institutions, private sector and scientific institutions.

Concrete measures in these directions of operation are implemented in compliance with the *Plan for Tasks and Activities Provided in Guidelines for Promotion of Export of the Latvian Products and Services and Attraction of Foreign Investment in 2013-2019*, which is added to the document of guidelines.

Attraction of Foreign Direct Investment

FDI attraction policy is aimed at raising the competitiveness of Latvia as an attractive investment environment, considering the aspects, which are significant for investors: macroeconomic indicators of states, the business environment – simplicity of bureaucratic procedures and the stability of tax policy, availability of an appropriately qualified labour force, market potential, accessibility of the necessary infrastructure, available support instruments and incentives. It is important to attract foreign investment in sectors that ensure shift in the economy structure in

favour of external-demand-oriented¹ sectors, especially in sectors that are defined as medium-high and high technology sectors².

FDI is significant for promotion of further growth of the Latvian economy, both by the acquisition of different manufacturing and management skills and by the creation of new jobs, which ensure the possibility to implement new technologies and preconditions for technology transfer, promotes the country's integration in international trade and company involvement in the chains of production sales.

Priority in the foreign investment attraction process must be the geographically closest neighbouring countries, in which Latvia is already well-known, and thus no additional resources have to be invested in informative activities; economically stable and developed countries, where the development potential and needs of economy sectors are appropriate for the prospective Latvian cooperation opportunities; and countries with the globally largest investment outflows (USA, France, Germany, United Kingdom, Japan, China, Russia, India).

In order to successfully compete in the investment attraction market and improve progress of local and foreign investment projects, important for the state, starting from 2010 the IDAL implements the investment attraction methodology *Polaris*, which provides for a unified and coordinated conduct of ministries, municipalities, infrastructure companies and public companies in the implementation of strategically important local and foreign investment projects, as well as the involvement of the private sector, universities and scientific institutions.

Within the framework of the "POLARIS process", in the nine months of 2015, agreements on cooperation in the attraction of foreign investment were concluded with 6 municipalities – with Ropāži, Carnikava, Alūkne, Preiļi, Pļaviņas, and Koknese municipalities.

Taking into consideration the limited resources, for attraction of FDI in 2013-2015, activities were directed towards a small number of target countries (Nordic countries, Germany, United Kingdom) and separate target sectors (metal processing and mechanical engineering, wood industry and information technologies, including creation of shared service centres).

Along with the existing tax incentives, in order to promote investing activities and create an attractive environment for business in Latvia, on 13 March 2013 the Cabinet of Ministers approved *Regulations on the Sub-activity "Support to Create New Jobs" of the Addition*

1.3.1.1.6 of the Operational Programme "Human Resources and Employment", which is focused on increasing the number of well-paid jobs, and growth of the value added and export. Until the beginning of 2016, six supported projects are being implemented with the total amount of project costs of 24.4 million euros, where the financing of the EU's structural funds makes 6.5 million euros. Agreements on the project implementation with two project implementers were terminated because project goals were not achieved. The projects that are being implemented are related to combined office administrative services. Currently, based on the submitted final reports, it can be concluded that 342 jobs will be created within the framework of the programme by investing 2.4 million euros from the ESF and by attracting about 3.3 million euros of financing from the project implementers (accurate information will be available upon evaluation of the final reports).

For promotion of investment attraction the Saeima adopted amendments to the *Law on Corporate Income Tax* on 6 November 2013, which suggest extension of the state support programme *Tax Privilege for Initial Long-term Investment Made in the Framework of Project of Supported Investment* until 31 December 2020, at the same time increasing the minimum required sum of investment to 10 million euros. In order for entrepreneurs to be able to submit investment project applications for receiving support in 2015, the Cabinet of Ministers approved amendments to Regulations of the Cabinet of Ministers No. 78 of 24 January 2012, *Procedure for Approval and Implementation of Supported Investment Project* on 19 May 2015, expressing these Regulations in a new version and providing that the legal framework included in this version shall be coordinated with the new EU-level legal framework for state support, which came into force on 1 July 2014. By 1 December 2015, the Cabinet of Ministers has supported 26 large investment projects, with the total sum of investment of 300.4 million euros. The majority of them or 24 out of 26 of the supported investment projects will be implemented in the manufacturing sector, whereas two investment projects - in the sector of information communication technologies.

Detailed information on the attracted foreign direct investment is provided in section 4.3.3 of the report.

Export Supporting Instruments

Latvian exporters have access to a wide range of direct services for export support, which include consultations on issues related to export, among them consultations on foreign markets, specific trade requirements and searching for business partners. Seminars about export skills and informative seminars about external markets are also organised, and identification and promotion of export and investment projects is implemented.

In order to promote the growth of external competitiveness of the Latvian companies, in the three quarters of 2015 the IDAL organised 48 trade missions of different sectors and scope, with the participation of

¹ External-demand-oriented sectors: agriculture, extractive industry, manufacturing industry, transport and storage, information and communication services.

² Medium-high and high technology sectors: manufacturing of pharmaceutical products, computers, electronic, optical equipment, aircraft and its equipment, and medical instruments, as well as manufacturing of chemical substances, weapons, electric equipment, mechanisms and working machines, automobiles, ships, railway and other types of transport (excluding aircraft) and repairs and installation of equipment and devices (NACE version 2 20, 25.4, 27, 28, 29, 30 (excluding 30.3), 33)

440 businessmen, including 7 visits of the highest state officials, with the participation of 202 businessmen. Seven of the trade missions were organised to new markets – Azerbaijan, Uzbekistan, Kazakhstan, India, Singapore, Shanghai (China) and the United Arab Emirates. In this period, 18 sectoral national stands were organised at international exhibitions abroad, with the participation of representatives of 157 companies. 61 individual business visits were organised for Latvian businessmen in foreign countries. In addition, the IDAL supported the organisation of 286 visits.

Latvian external economic representative offices and the IDAL provide services for merchants, using the “one stop shop” principle, thereby these representations ensure individual business visits for entrepreneurs, provide support for participation of companies in international exhibitions abroad, process export requests and projects, and ensures processing of requests for consultations and information in the area of attraction of foreign investment.

The use of export support instruments continued in 2015 for mitigation of negative consequences of embargo for import of food products, introduced by the Russian Federation, by providing merchants with support in acquisition of new markets.

In 2015, the functioning of the Latvian external economic representative offices was ensured in Belarus, Denmark, France, Japan, Russia, China, the United Kingdom, Lithuania, the Netherlands, Norway, Poland, Ukraine, Germany and Sweden, whereas in the first half of 2015 temporary representative offices were opened in United Arab Emirates, Azerbaijan, Italy, Kazakhstan, China (the second representative office in Shanghai in addition to the one existing in Beijing), Singapore and Finland for mitigation of consequences of import embargo, introduced by Russia. These representative offices provide support for the Latvian commercial companies in creating and maintaining business contacts, and for implementation of external marketing activities, and also provide consultations on market requirements of respective foreign countries. IDAL is planning to create 7 permanent official positions in currently existing temporary representative offices.

In the nine months of 2015, the IDAL processed 628 requests/export projects. The biggest number of requests was received from the representative office of the IDAL in France – 93, the United Kingdom – 63, Sweden – 60, Germany – 57, Finland – 46 and the Netherlands – 36.

From January to 15 February 2015, the IDAL organised *Days of Latvia* in Finland, from 10 June to 17 June 2015 – *Days of Latvia* in Italy, from 20 October to 20 November 2015 – *Days of Latvia* in Belarus and from 23 November to 12 December 2015 – *Days of Latvia* in Azerbaijan. Activities of the *Latvian Days* include presentations of company products, marketing campaigns, forums, cooking master classes and other activities, which promote recognition of products of the Latvian companies in the target countries.

Sub-Activity 2.3.1.1.1 *Capturing External Markets – External Marketing* of Activity 2.3.1.1 **Capturing External Markets** is being implemented within the framework of Measure 2.3.1 *Business Support Activities* of Priority 2.3 *Promotion of Business* of the addition to the EU structural funds' Operational Programme *Entrepreneurship and Innovations*. In this activity merchants are provided with extensive support for implementation of external marketing activities – participation in exhibitions, fairs, trade missions, organisation of seminars and conferences, and starting from November 2014 – also for the assessment of the conformity of production units and products with the requirements determined in the target markets. In the nine months of 2015, the IDAL evaluated 1416 project applications.

The Council for Coordination of Foreign Economic Policies continued its operations in 2015, to harmonise cooperation of national regulatory authorities and business organisations in the shaping and the implementation of a successful foreign economic policy, in order to raise the competitiveness of the Latvian national economy and to strengthen its export capabilities. Businessmen have access to the schedule of visits of high foreign officials in 2015, where the participation of Latvian businessmen is intended. The schedule allows businessmen to plan their participation in the business delegations, while organisers of these visits can identify interest of businessmen in a timely manner.

From July 2014, when the General Administration of Quality Supervision, Inspection and Quarantine of China accepted the milk certificate submitted by Latvia, Latvian milk processors are given an opportunity to export their products to the Chinese market. Henceforth, only exchange of certificates will be required to start trading and no additional agreements have to be signed. After the verification of companies, only an approval from the Chinese part has to be received. In April 2015, the Certification and Accreditation Administration of the People's Republic of China published on its website a list of ten Latvian food producers, who are allowed to export to China several types of dairy products, for example, cheeses, milk powder, sour cream and ice-cream – AS Preiļu siers, AS Rīgas piena kombināts, AS Valmieras piens, SIA Latvijas piens, AS Cesvaines piens, AS Rankas piens, AS Smiltēnes piens, AS Smiltēnes piens Blomes pienotava, AS Jaunpils pienotava and SIA Rīgas piensaimnieks. In the nine months of 2015, the Certification and Accreditation Administration of the People's Republic of China also issued a permit to export products to China to 30 Latvian fish processing companies.

In order to promote growth of the total amount of export (especially to countries with high level of risk) and expansion of export markets, and to strengthen the position in existing export markets, short-term export credit guarantees, more closely described in section 6.8, are available.

Box 6.25**Export and Innovation Award 2015**

For the eleventh year in a row, the IDAL in cooperation with the Ministry of Economics organised the *Export and Innovation Award*, recognizing the most successful businesses and their products.

The purpose of the contest is to recognize and to award the Latvian businesses that have achieved praiseworthy results in manufacturing new and export-capable products, in supplying the domestic market with high-quality home-made products, and in implementing innovations and developing industrial design.

This year, 105 applications from companies were received in the first round of the contest. 32 of these companies were promoted to the final round in the following categories:

- the most export-capable business in the group of large and medium-sized enterprises;
- the most export-capable business in the group of small enterprises;
- the most innovative product;
- import replacement product.

The winner of the *Export Champion* title was determined by evaluating the largest Latvian exporters, based on export data and contribution to sustainable growth.

Winners of the *Export and Innovation Award of 2015* are:

- in the category the *Most Export-Capable Business* in the group of large and medium-sized enterprises:

- 1st place – [LIVONIA PRINT, SIA](#)
- 2nd place – [ATEA GLOBAL SERVICES, SIA](#)
- 3rd place – [REŠETILOVS UN CO, IK](#)

Acknowledgement:

[ABLV BANK, AS](#)
[BIO-VENTA, SIA](#)
[GRAANUL INVEST, SIA](#)
[KREISS, SIA](#)
[NORDIC HOMES, SIA](#)

- in the category the *Most Export-Capable Business* in the group of small enterprises:

- 1st place – [D DUPLEKS, SIA](#)
- 2nd place – [INFOGRAM, SIA](#)
- 3rd place – [GLAMORALLE, SIA](#)

Acknowledgement:

[EL PROD, SIA](#)
[PRECO, SIA](#)
[PREMIUM CHOCOLATE, SIA](#)
[ROTONS, SIA](#)

- in the category the *Most Innovative Product*:

- 1st place – [SAF TEHNIKA, AS](#) (Spectrum Compact microwave spectrum analyser)
- 2nd place – [VIZULO, SIA](#) (Vizulo Stork outdoor light product line)
- 3rd place – [BLUE SHOCK RACE, SIA](#) (electric cartings)

Acknowledgement:

[AFFOC SOLUTIONS, SIA](#) (AFF ŠOPS 2014 universal technology for measurements of fibre optic parameters)
[DAMSON, SIA](#) (RORBO heated floor system)
[GIGI BLOKS, SIA](#) (GIGI Bloks large-sized blocks)

- in the category *Industrial Design*:

- 1st place – [VELO SOCK, SIA](#) (bicycle indoor covers)
- 2nd place – [SHAMAN INVENTIONS, SIA](#) (Leg&Go transformable bicycle for kids)
- 3rd place – [DIZAINA PAPĪRLIETAS, SIA](#) (Flux Book leather diary)

Acknowledgement:

[NIICE VIDE, SIA](#) (“Dusis” multi-functional design furniture)
[PALEŠU MĒBELES, SIA](#) (pallet furniture)
[3 WIND KNOTS, SIA](#) (“Kāpu nokrāsas” (“Shades of Dunes”) bag collection)

- in the category *Import Replacement Product*:

- 1st place – [MILZU!, SIA](#) (MILZU! cereal flakes)
- 2nd place – [LINUM COLOR, SIA](#) (Paint Eco stains)
- 3rd place – [LAT EKO FOOD, SIA](#) (Rūdofls – mother’s delicious purées)

Acknowledgement:

[CENTRE COMPOSITE, SIA](#) (aviation engineering services)
[HEBE, SIA](#) (clothes for children)

In 2015, Rīga Stradiņš University received the title “*Export Champion*”.

To supplement the range of insurance instruments available on the financial market and to promote development of export-oriented companies, the Ministry of Economics plans to develop a medium and short-term credit guarantee programme in 2015. The programme and its implementation model will be developed in accordance with the results of market research, as well as taking into consideration experience of other countries in implementation of insurance instruments, and their achieved results – impact on the flow of export transactions and, consequently, on the development of export-oriented companies.

For the eleventh year in a row, the IDAL organised the *Export and Innovation Award*. The purpose of the contest is to recognize and to award the Latvian businesses that have achieved praiseworthy results in manufacturing new and export-capable products, in supplying the domestic market with high-quality home-made products, and in implementing of innovations and developing of industrial design. The winners of the *Export and Innovation Award* of 2015 are published in the Box 6.25.

6.13 Consumer Rights Protection and Market Surveillance

Consumer rights protection system in Latvia is constantly being strengthened and developed to ensure effective market surveillance and consumer rights protection. The Ministry of Economics is working to improve and develop the existing framework and ensure a high level of consumer rights protection.

Improvement of the Regulatory Framework

Amendments to the Unfair Commercial Practice Prohibition Law, amendments to the *Advertising Law* and *Amendments to the Latvian Administrative Violations Code* came into force on 1 July 2015, expanding the authority of the CRPC and other supervisory institutions in cases of unfair commercial practices, as well as increasing the maximum amount of fine for unfair commercial practices. Changes in legislation were drawn up to motivate entrepreneurs to implement fair commercial practices and to meet requirements for advertising, while giving merchants the opportunity to rectify a violation voluntarily without applying any penalties. The framework valid until 1 July 2015 was not effective enough to hold back violators from prohibited commercial practices, because it was more convenient to pay the fine than to execute the decisions of the supervisory authority and to suspend the unfair commercial practices. The maximum fine prescribed for prohibited commercial practices is 100 000 euro. If the violator does not comply with the decision of the supervisory authority protractedly or a material injury to consumers is established, supervisory authorities may restrict or shut down the electronic means (for example, a website or a domain name) of the implementer of unfair commercial practice, as well as to stop the operations of the implementer of unfair commercial practice or the implementer's company (department).

In order to enhance consumer rights protection by ensuring that consumers have the opportunity to exercise and protect their legitimate rights through independent, quick, effective and fair extrajudicial dispute resolution methods, the Ministry of Economics has drawn up the

Law on Consumer Extrajudicial Dispute Resolvers and Amendments to the Consumer Rights Protection Law. The *Law on Consumer Extrajudicial Dispute Resolvers* provides for establishing requirements for the extrajudicial dispute resolvers wishing to consider the disputes between consumers and sellers or service providers. The law prescribes the following requirements for the persons resolving extrajudicial consumer disputes:

- availability;
- competence, independence and impartiality;
- transparency of activities;
- efficiency of the procedure;
- fairness and lawfulness.

By meeting the statutory requirements, extrajudicial dispute resolvers will have the opportunity of being included in the list maintained by the CRPC, which will serve as a proof that the particular extrajudicial dispute resolver is sufficiently competent and impartial to consider disputes between consumers and sellers or service providers. It is planned that information on extrajudicial consumer dispute resolvers will be published on the CRPC website. The *Amendments to the Consumer Rights Protection Law* provide for establishing the Consumer Dispute Resolution Commission as one of the extrajudicial dispute resolvers. The Commission will work with the CRPC as an independent authority and provide for consideration of disputes arising out of contractual obligations of consumers and sellers or service providers (individual disputes of consumers) in fields, where there are no other extrajudicial dispute resolvers meeting the requirements of the *Law on Consumer Extrajudicial Dispute Resolvers* and included in the list, or the dispute resolvers of the particular field refuse to resolve the dispute. The law also prescribes that the experts from consumer and merchant non-governmental organizations will take part in the decision-making process, thus ensuring maximum objectivity in the settlement of a dispute.

In general, the commission will have the following advantages:

- disputes will be resolved more quickly (within 90 days) in contrary to the present situation, where disputes are resolved in the framework of administrative procedure that can last for up to 3 years;
- it is planned to involve experts of the particular field (representatives of the consumer and

merchant non-governmental organizations) in the settlement of disputes;

- dispute resolution process will be less formal and focused on the parties reaching an agreement on the dispute;
- the process will be free of charge (at the moment, depending on the situation, the inspection of the goods has to be carried out by the consumer or the merchant).

Box 6.26

Improved Requirements for the Consumer Credit Providers

Draft law *Amendments to the Consumer Rights Protection Law* was adopted at the Saeima on 28 May 2015, which provides for a ban on the conclusion of credit agreements from 11PM to 8AM, limitation of the total cost of credit for the consumer (0.55% – 1-7 days, 0.25% – 8-14 days, 0.2% – 15-30 days, 0.25% – more than 30 days), restriction to repay the credit in one instalment, if the term is longer than 30 days, restriction of the growth of the default interest rate (36% per annum above the borrowing rate), limitation of all credit-related costs to 100% of the amount of the credit granted and prohibition to prescribe a bill of exchange as a means of payment. The essence of the amendments is that the interest, including default interest, the fees related to postponing the credit maturity date and other costs associated with the credit together may not exceed 100% of the amount of credit initially issued. Such a restriction will ensure that consumers do not get into an excessive debt, when it is constantly increasing. Limitation of the total costs of credit will ensure that consumers, who repay the credit honestly by the maturity date, do not overpay for the loaned amount to cover the credits of consumers, who do not repay their credits, while in case of limited profit conditions, credit providers will be forced to assess consumers' paying capacity more strictly and not to issue credit to those with insufficient paying capacity. The restriction to repay the credit in one instalment will ensure that the consumers are provided with credit repayment schedules, which, in turn, will increase the likelihood that credit is repaid by the maturity date. By contrast, limitation on the default interest will ensure that the default interest rate does not increase too rapidly and in a situation, where the consumer has defaulted, they would still be able to repay the credit and to fulfil their obligations towards the credit provider. The law will come into force on 1 January 2016.

The consumer's right to turn to the CRPC will not change, and they will be able to receive advice and assistance in resolving disputes as before. The new extra-

judicial consumer dispute resolution procedure will be applicable as of 1 January 2016.

Box 6.27

Conference Alternative Consumer Dispute Resolution in Latvia

Free-of-charge conference "*Introduction of Alternative Consumer Dispute Resolution Mechanisms in Latvia*" organised by the CRPC took place on 10 December 2015, during which the participants were introduced to the amendments to the *Consumer Rights Protection Law* on compliance of the goods and services with the provisions of the agreement (valid as of 1 January 2016), the *Law on Consumer Extrajudicial Dispute Resolvers*, alternative dispute resolution mechanisms, looked at the potential benefits and risks of their introduction, as well as discussed the establishment of the Consumer Dispute Resolution Commission and its operations within the framework of the CRPC. The main findings of the conference were as follows – all parties agree that the current individual consumer dispute resolution system is not effective, therefore changes are required. At the same time, for the new system to function successfully, communication of all parties – consumers and merchants, as well as extrajudicial dispute resolvers – aimed at a compromise and constructive dialogue is required. Similarly, one of the major challenges is to increase awareness of all parties in relation to material changes in the consumer protection system.

Measures in the Field of Consumer Protection During the Latvian Presidency of the Council of the EU

During the Latvian Presidency, a political agreement was reached between the Council, the EC and the European Parliament on the proposal for a directive of the European Parliament and Council on package travel services and supported travel services, which aims to improve the internal market activity and achieve a high level of consumer protection. The directive will improve the provisions in relation to the purchase and provision of package travel and related travel services, as well as obligations arising from contracts concluded between travellers and service providers (organizers, wholesalers, merchants). The revised directive will expand the current protection of the traditional travel packages (in relation to

different types of combinations of travel services), as well as cover the tours and packages that are combined and purchased on-line (dynamic packages, related travel services). The European Parliament completed the legislative procedure with its vote on 24 November 2015. The requirements of the directive will have to be introduced in the national framework within two years after the directive enters into force.

On 13 February 2013, the EC proposed a legislation package on product safety and market surveillance, which includes the proposal for a regulation of the European Parliament and Council relating to market surveillance of products and the proposal for a European Parliament and Council regulation on safety of consumer goods. Unfortunately, due to the politically contested issue, which requires a mandatory indication of the country of

origin on the labels of non-food products, further progress of the package has been stalled in the Council of Europe, the Member States being unable to agree on a compromise with regard to the principle of the country of origin in the draft *Product Safety Regulation*. Work on the *Product Safety Package* was continued during the Latvian Presidency. After publishing the EC study on the impact of mandatory labelling of the country of origin, this issue was discussed for the first time at ministerial level at the Competitiveness Council of Ministers of May 28, but an agreement was not reached in the Council, because the results of the study did not influence the different views of the Council with regard to the principle of mandatory indication of the country of origin of goods on labels included in the package. The Competitiveness Council of Ministers concluded that it is impossible to reach a compromise within the framework of this package, and the European Commission should decide on the future of the package and further progress to secure future development of the product safety and market surveillance framework.

Consumer Rights Supervision

The Consumer Rights Protection Centre (CRPC) is the main co-ordinating body in the field of supervision of consumer rights protection laws and regulations, the operations of which are aimed at ensuring effective protection of consumer rights and interests. In order to ensure the performance of functions, the CRPC implements activities related to monitoring of the consumer rights protection (in the field of protection of consumers' economic interests and supervision of the respect for consumer rights in the draft agreements and agreements concluded by consumers with producers, sellers or service providers), considers consumer complaints, informs and advises consumers and entrepreneurs, implements monitoring activities in relation to unfair commercial practices, e-commerce and advertising, 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.

Within the framework of its activity, the CRPC provided consumers and legal entities with 27,712 consultations in the first nine months of 2015. Compared to the corresponding period of the last year, the number of consultations provided by the CRPC has increased slightly – by 176 consultations. When asking for advice, consumers most often inquired about issues related to their rights, if a product of low quality is purchased or a service of low quality is received. Most of the questions are about shoes, mobile phones, electrical appliances, distance contract services, and airline services. Similarly, consumers are interested in what to do if the goods/services are not delivered/provided on time. Many consumers are interested in the issues that are not the competence of the CRPC or for which the CRPC has no right to adopt a binding decision, but only to provide advice, in particular on the quality of electronic

communications, insurance indemnities, as well as utilities and food.

In the first nine months of 2015, the CRPC received 1,803 consumer complaints. Compared to the corresponding period of the last year, the number of complaints considered has increased by 69 complaints or 4%. Most often, consumers complained about the acquisition of goods and services that do not comply with the provisions of the agreement. A large number of complaints have been received about commercial practice, advertising and e-commerce, as well as non-compliance with the principle of legal equality of contracting parties. Most of the complaints about goods are related to electrical appliances, mobile phones and shoes. As for services, most of the complaints are about airline services, tourism services, distance contract services, rent and municipal services.

The following priority areas for monitoring have been set for the **CRPC consumer rights supervision** in 2015: commercial practice in building management, electricity services offered to consumers, security guarantees provided by the complex tourism service providers and the terms of the contract proposed to consumers, offering of nutritional supplements, situation analysis and monitoring in the electronic environment, offering of guarantees, as well as monitoring of the new distance contract regulation, comparison of prices of credit service on websites, case study by offering cosmetic products, on-line stores offering building materials, on-line collective shopping, consumer crediting, monitoring of the activities of debt recovery service providers, issuance and renewal of licenses of consumer credit providers and extrajudicial debt service providers, prevention of cross-border infringements in the field of consumer rights protection, as well as adjudication of the administrative offence cases.

In the nine months of 2015, 110 proceedings on violations of the collective interests of consumers had been initiated, including the fields of commercial practice, advertising, e-commerce, and contract provisions.

The proceedings were mostly initiated on the commercial practice implemented and contract provisions in the field of crediting services, offering nutritional supplements, in the field of e-commerce, for the failure to provide security guarantees for the money paid by the customer, contract provisions in the field of complex tour services, commercial practice implemented and contract provisions in the field of electronic communications services. Licensing and license renewal of credit providers, not complying with the status of a credit institution, and debt recovery service providers is being continued, and regular supervision of entrepreneurs is being carried out.

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 the Consumer Rights Protection Centre with the European

Commission's support. In the first nine months of 2015, consumers were provided with 507 consultations about cross-border problems within the EU, and 155 complaints about cross-border problems within the EU were examined. People have turned to ECC Latvia mainly in relation to cross-border on-line purchases, airline services, road transport services (car rental), as well as tourism services.

In the first nine months of 2015, in the field of **surveillance of the goods and services market**, the CRPC commenced and continued implementation of 8 safety and compliance improvement projects in such fields as safety of construction products, toys, machinery, pressure equipment, radio and telecommunications terminal equipment, electrical equipment and general goods and services. 1,622 inspections were carried out, and 909 gas cylinder outlets were registered in the register of gas cylinder outlets maintained by the CRPC. Within the framework of market surveillance, 1,607 models of different goods were tested. To study the market situation, 238 surveys were conducted in priority directions of surveillance. 14 inspections were carried out on compliance with the procedure on indication of

prices, namely, whether consumers are given correct and clear information about the prices of goods offered.

Under the construction products safety and compliance improvement project with testing of product samples, 40 inspections were carried out on construction sites and 238 construction products of the regulated sphere were tested.

Project on the improvement of fire detection and alarm system security and compliance (PROSAFE) was launched. As a result of the surveillance, 13 units of a particular model were withdrawn from the Latvian market.

Under the national metrological supervision, in the nine months of 2015, the CRPC had carried out tests to assess the compliance of measuring instruments with the regulatory requirements at the locations of their use – 302 measuring instruments in 41 productions, sales and services companies were subjected to the national metrological supervision. Tests were carried out in two companies of the project *Metrological Supervision of Alcoholic Beverages* and one company of the project *Metrological Control of Spices, Tea and Coffee*. The register of pre-packaged products with the “e” compliance mark is being developed, and it currently includes 43 companies.

6.14 Quality Assurance

6.14.1 Quality Structural Policy

The main task of public authorities in the area of quality assurance of products and services is to promote correct application and observation of the regulation requirements in the regulated and non-regulated area, as well as to improve the regulatory framework, according to the EU requirements, taking into account the needs of the national market and national economy, ensuring the compliance of products and services, promoting the growth of competitiveness of businessmen and the reduction of cross-country trade barriers.

In Latvia, the system of quality infrastructure is mainly regulated by the *Law On Conformity Assessment*, the *Standardisation Law*, as well as the *Law On Uniformity of Measurements*, and related laws and regulations.

The main policy directions:

- ensuring and improving the conformity assessment infrastructure (incl. testing and calibration laboratories, inspection and certification authorities and environmental verifiers) according to the needs of the Latvian economy, to protect the people and the environment from non-compliant products and services, to promote competitiveness of businessmen and trust in Latvian manufacturers and service providers;
- improvement of the respective reference and advisory framework;

- ensuring of the membership of national accreditation, standardisation and metrology bodies in international organisations, by maintaining their international recognition and the compliance of the Latvian quality assurance infrastructure with the international requirements;
- maintenance and international comparison of the national base of metrology standards, to ensure traceability of necessary measurements, and to protect the population from incorrect measurements;
- promotion of the implementation of quality management, environment and other voluntary management systems in companies, to ensure production of high-value products and provision of services, as well as to promote competitiveness of Latvian merchants in international markets;
- promotion of efficient market surveillance, to ensure equal conditions for all market participants and to protect consumers from potential unfair competition of merchants.

6.14.2 Accreditation, Standardisation, Metrology

Functions and tasks of national standardisation, accreditation and metrology bodies are performed by respective bureaus of the Limited Liability Capital Company “Standartizācijas, akreditācijas un metroloģijas

centres" (*Standardisation, Accreditation and Metrology Centre*), supervised by the Ministry of Economics: the Standardisation Bureau (LVS), the Latvian National Accreditation Bureau (LATAK), and the Metrology Bureau (LATMB).

Standardisation

According to the *Standardisation Law*, the LVS, as a national standardisation institution, supervises and coordinates operations of Latvian merchants and organisations in the area of standardisation.

The main functions of the LVS are to form the collection of Latvian standards and to issue Latvian standards in cooperation with international and European standardisation organisations.

Since 2004, the LVS has been a fully-fledged member of the European Committee for Standardization (CEN) and the European Committee for Electrotechnical Standardization (CELELEC). Since 2015, the LVS has been a fully-fledged member of the International Organization for Standardization (ISO). The LVS is an associated member of the International Electrotechnical Commission (IEC).

According to the approved plans, priority lines of action of the LVS are distribution of standardisation information, supplementation and maintenance of the collection of the Latvian standards, improvement of the electronic system of sales of standards, and cooperation with international, European and national standardisation organisations.

41,914 standardisation documents, including 36 088 European standards adapted to the status of the Latvian standards, have been registered by the LVS by 1 November 2015. In the eleven months of this year, the LVS adapted 1262 European standards, and 18 standards, incl. 13 Eurocodes, were translated into Latvian. New standardisation technical committees were established: Management of Projects, Programmes and Portfolios of Projects Committee, Electronic Invoices Committee, and Modelling of Information of Structures Committee. A new national standard LVS 1046:2015 *Requirements for content and detailing of structural design documents and drawings* has been developed and approved.

The LVS website www.lvs.lv regularly publishes information on the latest news of standardisation in Latvia and in the world, including also an annual activity report for 2014. Two new subsections were created in the *Standardisation* section of the website: *Trainings* and *Horizon 2020*, the content of which is intended for experts of committees, students, businessmen and other target groups.

A website, supervised by the LVS: <http://viedoklis.lvs.lv>, for commenting draft standards, continues to operate. On the website, businessmen, industry experts and any interested person have the possibility to express their opinion on draft Latvian and European standards.

Different standardisation services are provided to 4150 legal and natural persons via LVS information system.

To ensure the link between legislation and standards, and to facilitate the search for information, an agreement was concluded with the Official Gazette "*Latvijas Vēstnesis*" on exchange of information and creation of mutual links on the website www.likumi.lv and on the website of the Standardisation Bureau www.lvs.lv, as well as information on applicable standards in connection with the Latvian legislation.

LVS office rooms provide a standards reading room service, which allows any interested person to study Latvian, international and European standards free of charge, as well as provide free online availability of the Latvian standards at the National Library of Latvia.

To facilitate student access to the necessary technical documents during their studies, online reading of the Latvian standards was provided in the libraries of Riga Technical University and Rēzekne Higher Education Institution. The online standards reading service is also available to employees of the Consumer Rights Protection Centre, the State Construction Control Bureau and students of the Fire Safety and Civil Protection College and to businessmen in rooms of the Zemgale Regional Competence Development Centre.

Additional information on standardisation is available on the LVS website www.lvs.lv.

Accreditation

The LATAK ensures the operation of the national accreditation authority in accordance with the *Regulation No 765/2008* of the European Parliament and the Council.

The LATAK maintains the compliance of the accreditation system to the European Accreditation (EA) Multilateral Agreement (MLA) in seven areas:

- accreditation of testing laboratories (ISO/IEC 17025), including accreditation of medical laboratories (ISO 15185);
- accreditation of calibration laboratories (ISO/IEC 17025);
- accreditation of product certification bodies (ISO/IEC 17065);
- accreditation of bodies certifying individual persons (ISO 17024);
- accreditation of inspection bodies (ISO/IEC 17020);
- accreditation of management system certification bodies (ISO/IEC 17021);
- accreditation of verifiers of greenhouse gas (GHG) emission reports and tonne-kilometre reports (ISO 14065).

Accreditation as a competence and trust certifying tool is established in more than 120 national regulations. In addition, the LATAK ensures accreditation of verifiers of eco-management and audit schemes (EMAS) in accordance with the *Regulation (EC) No 1221/2009* of the European Parliament and of the Council of 25 November 2009 on the voluntary participation by organisations in a *Community eco-management and audit scheme* (EMAS).

To constantly ensure compliance with the set requirements and harmonise accreditation procedures among EA members, LATAK employees participate in all EA's technical committees and working parties, Council meetings of the Multilateral Agreement and EA General Assemblies, as well as EA's comparative evaluations of national accreditation bodies of other states.

LATAK employees also participate in meetings organised by the Forum of Accreditation and Licensing Bodies (FALB) and in comparative evaluations of FALB of other states in the EMAS area, as well as meetings and trainings in the area of Good Laboratory Practice organised by the Organisation for Economic Co-operation and Development and the European Commission.

The LATAK has contributed to the participation of national laboratories in international interlaboratory comparative testing programmes and organised proficiency tests.

Training seminars are organised for conformity assessment bodies and the involved LATAK experts.

Growth in the number of accredited institutions in the last years is an evidence of the importance of the accreditation process and stability in the conformity assessment area. More and more new bodies choose to certify their competence by accreditation. Many bodies extend the scope of their activities. Currently, the accreditation status is maintained for 277 accredited bodies.

At the same time, accreditation is maintained for two laboratories in the Russian Federation, one laboratory in Kazakhstan and three laboratories in Azerbaijan. In addition, within the framework of interstate cooperation, cooperation is maintained with national accreditation institutions of Georgia, the Russian Federation, Belarus, Moldova and Ukraine.

In nine months of 2015, the LATAK mastered the following new areas of accreditation:

- testing and assessment of verification of electrical safety and compliance of functions of radiological devices (regulated area, Cabinet of Ministers Regulations of 19 August 2014 *Regulations Regarding Protection Against Ionising Radiation in Medical Radiation*;
- accreditation of industrial energy auditors (regulated area, Cabinet of Ministers Regulations of 12 March 2013 *Regulations on Industrial Energy Audit*);
- photometric, colorimetric measurements for luminaries (in non-regulated area);
- standards *ISO 9001:2015* and *ISO 14001:2015*.

Additional information on accreditation and accredited bodies is available on the LATAK website www.latak.lv.

Priorities in activities and planned measures in the area of accreditation for 2016:

- Review and implementation of LATAK's accreditation procedures, in order to make the accreditation process more transparent and understandable for market operators;
- Implementation of LATAK's accreditation processes and support information system;
- Continuation of cooperation with supervisory authorities, professional organisations in the conformity assessment area, and with market operators.

Metrology

As of 1 July 2009, the LATMB is a Latvian national metrology body, the purpose of which is to ensure and develop credibility and traceability of measurements in the country. The Metrology Bureau fulfils the tasks set by the Law *On Uniformity of Measurements* in the area of metrology.

Within the framework of maintenance of national measurement standards, national measurement standards are calibrated in the EU's national metrology institutes (NMI).

In May 2015, national electrical measurement standards were calibrated in the Finnish NMI "Mikes".

The list of approved measurement instruments is regularly updated on the website of the Metrology Bureau www.latmb.lv. During the year, 21 certificates of approval of measurement instruments were issued.

The Regular annual report of the Metrology Bureau's quality management system was prepared in the first half of 2015 and submitted for evaluation to the Technical Committee for Quality (TC-Q) of the European Association of National Metrology Institutes (EURAMET). Instructions for improvement of the system were received as a result of presentation of the quality management system. Necessary measures to maintain international recognition of calibration and best measurement capabilities were carried out using the database (KCDB) of the International Bureau of Weights and Measures (BIPM).

15 reference standards and 4 mass comparators of SIA "Latvijas Nacionālais metroloģijas centrs" (Latvian National Metrology Centre) were calibrated.

In 2015, the Metrology Bureau continues to maintain cooperation with the EURAMET, as well as the International Organization of Legal Metrology (OIML) and the European Cooperation in Legal Metrology (WELMEC).

Additional information on LATMB can be found on the website: www.latmb.lv.

6.15 Privatisation

The aim of privatisation is to create a favourable environment for private capital operation in the interests of the development of the Latvian national economy and to narrow the activity, which is performed by the state and municipalities as merchants, by changing the owner of state or municipal property.

Taking into consideration that the aim of mass privatisation implemented in Latvia is basically achieved,

on 1 September 2005, the *Law on Completion of Privatisation of State and Municipal Property and Use of Privatisation Certificates* (Privatisation Completion Law), adopted by the Saeima, came into force, which stipulates how the privatisation process and land reform shall be completed, and how the completion of use of privatisation certificates shall be ensured (see Box 6.28).

Box 6.28

Law on Completion of Privatisation of State and Municipal Property and Use of Privatisation Certificates

The Privatisation Completion Law determines:

- term – 31 August 2006, until which every legal or natural person could propose transfer of any state or municipal property for privatisation;
- procedures, according to which a proposal for privatisation submitted by a person shall be examined, and decision for transfer of state or municipal property for privatisation shall be adopted;
- that refusal of transfer for privatisation, and preservation of property in the ownership of municipality can be applied to a property, which is necessary for the execution of state administration function, or state or municipality business activity;
- that decisions on transfer for privatisation of state or municipal property, regarding which an ownership dispute has occurred or which complies with the abandoned property status, shall be adopted after coming into force of a court judgement;
- that privatisation or alienation shall not be addressed towards the state joint stock company "Latvenergo", state joint stock company "Latvijas Pasts" ("Latvian Post"), state joint stock company "Rīga International Airport", state joint stock company "Latvijas dzelzceļš" ("Latvian Railway"), state joint stock company "Latvijas Gaisa Satiksme" ("Latvian Air Traffic") and state joint stock company "Latvia's State Forests";
- the deadline until which the persons who want to redeem the land allocated for permanent use, shall submit a land redemption request to the State Land Service (30 November 2007), the deadline until which one must submit to the State Land Service or the city municipality a plan of land borders or a certification of making a land redemption payment in privatisation certificates before conclusion of land redemption agreement (1 September 2008), as well as an application for adoption of decision concerning transfer of land into ownership for a charge (31 August 2011), and that the land purchase agreement had to be concluded until 30 December 2011, respectively;
- that privatisation certificates have no specific period of validity, however, they can be used only within the framework of the privatisation process;
- the procedure according to which allocation of privatisation certificates shall be terminated. The deadline is determined for persons - 28 December 2007, until which they could submit an application for allocation of privatisation certificates.

To ensure successful and open privatisation completion process, the Cabinet of Ministers has adopted a procedure on how the institutions, which perform privatisation and land reform, shall develop publicly available registers for privatisation proposals and land redemption.

Privatisation of State Property Objects and Land

According to the *Law on Privatisation of Objects of State and Municipal Property* privatisation of state property objects and land is performed and privatisation proposals are collected by the state joint stock company "Privatisation Agency".

A decision on a transfer for privatisation of a state property object, including capital shares and an undeveloped plot of land, is adopted by the Cabinet of Ministers, whereas the Privatisation Agency adopts decisions on transfer of a developed plot of land on which buildings and structures owned by another person are situated. The decision is adopted on the basis of a privatisation proposal submitted by any natural or legal person.

From 1 September 2005, when the *Privatisation Completion Law* came into force, to 31 October 2015, the register of privatisation proposals of the Privatisation Agency has registered 636 privatisation proposals for real estate, 57 privatisation proposals for state capital shares

and 4500 proposals for privatisation of plots of land or privatisation continuation. Since 31 August 2006, those privatisation proposals that have been wrongly submitted to other public or municipal institutions up to the date specified above, and later have been forwarded to the Privatisation Agency on the basis of the jurisdiction, are registered in the privatisation proposal register.

The Cabinet of Ministers has not yet examined 4 privatisation proposals received concerning state property objects, as their examination is currently encumbered by legal issues.

The Privatisation Agency received privatisation proposals for 79 property objects, ownership of which was not clarified. The Privatisation Agency is authorized to address a court or a notary on behalf of the Republic of Latvia to execute required operations for the recognition of these property objects as abandoned property or escheat. The Privatisation Agency has not addressed the court concerning 12 property objects, as these property objects are owned by a municipality or a

private person, or it has been determined that such structure does not exist on site. The Privatisation Agency has addressed the court concerning 67 property objects, in order to establish a legal fact and recognize objects as abandoned property, which is under the jurisdiction of the state. The legal procedure has been completed in 54 of such cases and a court judgement, satisfying an application of the Privatisation Agency and establishing a legal fact that the real estate is abandoned and is under the jurisdiction of the state, has come into force. In 13 instances the application of the Privatisation Agency has been left without examination on the basis of Section 258 of the *Civil Procedure Law*, because a dispute about rights has arisen within special adjudication procedure, therefore such dispute shall be resolved by the court, according to the procedure of claim. After the delivery of court judgements on recognition of property as abandoned, the Cabinet of Ministers prepares draft orders on transfer of property objects for privatisation or a justified refusal to transfer property objects. The Cabinet of Ministers has already adopted a decision for 25 property objects concerning transfer for privatisation thereof or refusal to do so.

In five instances the Cabinet of Ministers adopted orders on transfer of state property objects for privatisation, whereas in six instances orders on termination of privatisation of state property object have been issued by the Cabinet of Ministers, as there were no applicants for privatisation of respective objects or no applicant was approved as a buyer.

A subject of privatisation of property owned by the state (real estate, capital shares, land) can be a natural person or a legal person, which has a right to obtain movable property or real estate in Latvia. Payments for property objects shall be made in the euro currency and/or privatisation certificates.

In the period from 17 April 1994 to 31 October 2015, in total, regulations on privatisation of 2552 state property objects (excluding land) had been approved, in compliance with the procedure stipulated by the law. 94 companies have been transformed into public joint stock companies, issuing 439.14 million shares for public circulation. During this period, income of 2.383 billion euros had been obtained from privatisation of state property objects (excluding land and sales of shares obtained as a result of debt capitalization, and alienation of capital shares and apartments), including 580.44 million euros for privatisation certificates with the nominal value of 1.802 billion euros. The new owners have overtaken liabilities of privatised public companies for more than 280.86 million euros. The amount of determined investment was 214.23 million euros, however, the amount of actual investment constitutes 383.01 million euros.

Since 1997 the Privatisation Agency performs privatisation of land plots owned by the state. 5317 state-owned land plots have been privatised (purchase agreements were concluded) by 31 October 2015. The total price of privatised state-owned plots of land

constitutes 292.17 million euros, 145.63 million in money and 146.54 million euros in property compensation certificates. Income from privatisation of land plots by 31 October 2015 – 288.73 million euros, of which 146.49 million euros in money and 142.24 million euros in property compensation certificates.

The state property, which is not transferred for privatisation, can be alienated according to the provisions of the *Law on Alienation of Public Person Property* and the *Law on Management of Capital Shares and Enterprises of Public Persons*.

Procedure for Privatisation of Residential Houses

The procedure for privatisation of residential houses of the state and municipalities is stipulated by the *Law on Privatisation of the State and Municipality Residential Houses*. According to this law, the privatisation of state residential houses is performed by the state joint stock company "Privatisation Agency", whereas privatisation of municipality residential houses is performed by the commission for privatisation of residential houses in cities and regions of the republic.

By 31 October 2015, the Privatisation Agency had in its possession and management:

- 228 residential houses;
- 1242 state apartment properties of which:
 - 579 state apartment properties were located in houses possessed by the Privatisation Agency;
 - 663 state apartment properties were located in residential houses transferred into management of owners of apartment properties.

Procedure for Privatisation of State Residential Houses

In the period from 1 May 2015 to 31 October 2015, 10 notices have been sent to tenants of state apartments to be privatised, and 103 agreements on purchase of apartment property have been concluded following the procedure stipulated by the *Law on Privatisation of the State and Municipality Residential Houses*.

Procedure for Management of Residential Houses and Apartments

10 residential houses have been transferred into management of owners of apartment properties from 1 May 2015 to 31 October 2015.

22 state apartment properties have been transferred into ownership of city and regional municipalities of the republic from 1 May 2015 to 31 October 2015.

Privatisation Certificates

A privatisation certificate is a state-granted dematerialised security, which can be used only once as means of payment for state or municipality property to be privatised.

According to the *Regulations on Delegation of the Administrative Task of Privatisation Certificates Circulation* adopted by the Cabinet of Ministers on 1 April 2014, the state joint stock company "Privatisation Agency" has

been delegated to execute the state administration task in the framework of which granting, issuance, use and redemption of certificates is controlled, as well as other operations, related to the monitoring of the circulation of certificates, are performed.

Granting and use of privatisation certificates is executed according to the *Law on Privatisation Certificates*. 2.4 million people have been granted in total 112.38 million privatisation certificates by 31 October 2015. 103.58 million of these certificates have been granted for the time resided in Latvia, whereas 794.7 thousand privatisation certificates have been granted to 41.4 thousand persons for political repressions. 117.2 thousand former owners or their heirs have been granted 8.01 million property compensation certificates, including 691.7 thousand – for property preserved for state needs in privatised specialised state agricultural companies, 4896.4 thousand – for land in rural areas, 969.8 thousand – for housing properties, 816.8 thousand – for land of cities, 461 thousand – for companies and other property objects, 89.8 thousand – for property deprivation from politically repressed persons, 85.6 thousand – for illegally alienated property.

According to Section 27 of the Privatisation Completion Law, 58.2 thousand persons have lost their rights to transfer 1.64 million privatisation certificates to their account in the period from 1 December 2007.

In compliance with the *Law on Land Privatisation in Rural Areas*, by 31 October 2015, 11076 decisions had been adopted concerning disbursement of monetary compensation for former land properties in rural areas. The compensation has been paid to 8411 persons in the total amount of 25.04 million euro, redeeming 0.63 million property compensation certificates.

6.6 million euros have been disbursed to 26.24 thousand politically repressed persons. According to Section 28 of the Privatisation Completion Law, 3.48 thousand politically repressed persons have lost their rights to redeem 16.16 thousand privatisation certificates.

By 31 October 2015, 107.35 million privatisation certificates or 95.5% of the total amount of granted certificates had been used for privatisation of state and municipality property (see: table 6.9). During the privatisation process, from 1 April 2008 to 31 October 2015, 762.08 thousand privatisation certificates had been used instead of 609.14 thousand property compensation certificates.

In October 2015, owners of privatisation certificates were able to use services of 8 licensed brokerage companies for the execution of transactions on the market of privatisation certificates. In 2015, by October, the total monthly amount of transactions with privatisation certificates (purchase from natural persons and sales) executed by brokerage companies fluctuated from 1.17 thousand privatisation certificates in May to 14.51 thousand privatisation certificates in September, and from 0.16 thousand property compensation certificates in January to 1.44 thousand property compensation certificates in May.

On 31 October 2015, in privatisation certificate accounts of 379 thousand natural persons there were 2.249 million privatisation certificates or 2% of the total amount of granted privatisation certificates, including 0.104 million property compensation certificates. In privatisation certificate accounts of legal persons there were 0.321 million privatisation certificates or 0.3% of the total amount of granted privatisation certificates, including 0.008 million property compensation certificates.

On 1 January 2014, the *Amendments to the Law on Privatisation Certificates* came into force, which stipulated that servicing privatisation certificate accounts is the task of the state administration. These amendments also determined that the Cabinet of Ministers is entitled to delegate natural persons for servicing privatisation certificate accounts in instances specified in laws and regulations and according to the procedure prescribed in laws and regulations. Starting from 1 January 2014, the state joint stock company "Latvian Development Financial Institution "Altum"" was delegated to perform the task of servicing privatisation certificate accounts, which includes opening and maintenance of privatisation certificate accounts, transfer of privatisation certificates into the account and other services related to servicing of privatisation certificate accounts and circulation of privatisation certificates. Until 1 June 2014, the above mentioned service was also provided by the joint stock company "Latvijas Krājbanka", which is to be liquidated and holds a part of privatisation certificate accounts. Starting from 1 June 2014, Latvijas Krājbanka stopped providing servicing of privatisation certificate accounts; however, it has an obligation to maintain the privatisation

Table 6.8

Use of Privatisation Certificates (by 31 October 2015)		
Type of property	Number of privatisation certificates (mln)	including the number of property compensation certificates (thsd)
House properties	38.0	589.8
Companies and other properties	7.3	109.6
Capital shares (shares) including:	44.5	954.0
in the public offer	37.1	858.0
Land	17.6	5167.3
Total:	107.3	6820.7
% from the total number of granted certificates	95.5%	85.1%

By redeeming 165.73 thousand privatisation certificates granted for political repressions, by 31 October 2015, monetary compensations in amount of

certificate accounts held by it up to the moment of centralised transfer of these accounts to Altum.

Land Reform

The basic goal of the land reform is to reorganize legal, social and economic relations for the use of land and property from command economy to market economy.

The process of the land reform includes requesting and granting of the free land under the state jurisdiction, renewal of ownership and redemption (purchase) of land granted for use, as well as renewal of ownership of land intended for completion of land reform. These processes take place in relation to the land reform of rural areas and cities to be implemented in the state.

Requesting of land in cities in compliance with the Section 2.1 of the *Law on Completion of the Land Reform in Cities* was stopped already on 1 March 1999, whereas granting of land requested in compliance with Section 2.2 of this law had to be stopped on 1 July 1999, and in Riga and Daugavpils - on 1 October 1999.

According to Section 2.2 of the *Law on Completion of Land Reform in Rural Areas*, requesting of the free land under the state jurisdiction was stopped on 1 June 2006, whereas granting of the requested land for permanent use – on 1 September 2007.

In city and rural areas transfer of land into ownership for a fee has also ended, and, according to Section 23.12 of the *Privatisation Completion Law*, the land redemption (purchase) agreement with the state joint stock company "Mortgage and Land Bank of Latvia" (Mortgage Bank) on city or rural area land granted for use had to be concluded until 30 December 2011.

By adopting the last decision on recognition of ownership of land intended for completion of the land reform on 25 August 2014, the Central Land Commission (CLC) has completed the last land reform task – the process of ownership renewal in rural areas for land intended for completion of the land reform, implementation of which was stipulated in Section 16.1 of the *Law on Completion of the Land Reform in Rural Areas*.

Taking into consideration that, in order to corroborate the ownership in the land register, a land cadastral survey has to be done and a decision of the respective institution on renewal of ownership has to be obtained, CLC, the State Land Service and municipalities continue adopting decisions on renewal of ownership to former land owners or their heirs, as well as granting of land into ownership for a charge, in cases when the total area of land determined during the cadastral survey exceeds the area for which ownership of these persons is renewed. Land redemption (purchase) agreements with these persons are concluded by the Altum, which has been delegated to execute the state administration task - to conclude agreements on redemption (purchase) of

rural and city land, control execution of these agreements and transfer the unredeemed land into ownership of municipalities, according to the Cabinet of Ministers Regulations of 14 April 2015 *Procedure for Delegation of State Administration Task - Conclusion of Agreements on Redemption (Purchase) of Land, Control of Execution of These Agreements and Transfer of Unredeemed Land into Ownership of Municipalities*.

According to Section 5 of the *Law on Completion of the Land Reform in Rural Areas* and Section 7 of the *Law on Completion of the Land Reform in Cities*, the land reform was completed upon adoption of an order by the Cabinet of Ministers on completion of the land reform in the territory of the respective municipality. By 20 November 2015, the land reform was completed (i.e. an order of the Cabinet of Ministers was adopted) for 58% of city and 27% of rural territories.

By 20 November 2015, a decision about completion of the land reform was adopted by 63 cities (83%), of which an order of the Cabinet of Ministers was adopted for 45 city territories, draft orders of the Cabinet of Ministers were announced at the meeting of State Secretaries for 15 city territories and preparation of draft orders of the Cabinet of Ministers started for three city territories. No decision on completion of the land reform has been made in 13 city (17%) territories (Daugavpils, Jūrmala, Liepāja, Rīga, Aizkraukle, Cēsis, Vangazi, Krāslava, Pļaviņas, Rūjiena, Smiltene, Tukums, Viļāni), the largest of which continue granting land of equal value to former owners or their heirs, who submitted their applications to the respective municipality for restoration of their land ownership within the deadline set in regulatory enactments to have their unrestored ownership restored with regard to the land property or a part of it having value equal to the one they owned on 21 July 1940.

By 20 November 2015, 88 municipalities (80%) of rural territories notified the State Land Service about the completion of land reform, for which an order of the Cabinet of Ministers was adopted in 30 rural territories, draft orders of the Cabinet of Ministers were announced at the meeting of State Secretaries in 47 other rural territories, and preparation and sending for approval of draft orders of the Cabinet of Ministers has been initiated in 11 rural territories. Furthermore, 22 municipalities (Amatas, Babītes, Baltinavas, Ciblas, Daugavpils, Kārsavas, Kocēnu, Krāslavas, Kuldīgas, Ķekavas, Madonas, Ogres, Pļaviņu, Priekules, Priekuļu, Rundāles, Smiltenes, Tukuma, Vārkavas, Vecumnieku, Viļānu) still continue the decision-making process to terminate land usage rights of those persons, who have not redeemed their land within the deadline set by regulatory enactments, and to determine land ownership.

6.16 National Economy Council

The National Economy Council (NEC) of the Ministry of Economics is an advisory body created by the founding organisations of the NEC (Ministry of Economics, Latvian Chamber of Commerce and Industry, Latvian Association of Local and Regional Governments, Free Trade Union Confederation of Latvia, Employers' Confederation of Latvia), and it participates in the resolution of matters related to business policies and acts according to Sub-paragraphs 6.11 and 7.2 of Regulations No. 271 of the Cabinet of Ministers of 23 March 2010 *Regulations of the Ministry of*

Economics, the Agreement on cooperation in the National Economy Council concluded on 17 February 1999 and Ministry of Economics' regulations of NEC No 1-7-33 of 29 August 2013.

To contribute to the professional representation of interests of sectors, as well as to improve co-operation between the Ministry of Economics and other state bodies, the NEC invites sectoral associations representing businessmen of their sectors and their interests, as well as independent experts – economists, education and science representatives.

Box 6.29

NEC's Staff and Work Organization

Based on the decision of the Management Committee, the NEC's staff is approved by the Minister of Economics.

By the order of the NEC, the Minister of Economics expresses the NEC's opinion in the Council for Coordination of Large and Strategically Important Investment Projects and the Council for Coordination of Foreign Economic Policies, as well as in other cross-sectoral forums.

The NEC Management Committee is an advisory and coordinating body, which participates in the resolution of business policy related matters and is in charge of the evaluation and approval of the NEC's plan of work and agendas of NEC's sessions, as well as the ensuring and improvement of NEC's work efficiency.

The staff of the Management Committee is approved by the Minister of Economics. The Management Committee consists of the Minister of Economics and four representatives of NEC's founders who are also members of the NEC:

- a representative from the Free Trade Union Confederation of Latvia;
- a representative from the Employers' Confederation of Latvia;
- a representative from the Latvian Association of Local and Regional Governments;
- a representative from the Latvian Chamber of Commerce and Industry.

The NEC Management Committee may invite representatives whose competence corresponds to the matters examined during sessions (such as the Foreign Investors' Council in Latvia, the Latvian Academy of Sciences, the Cooperation Council of Farmers' Organisations, relevant public bodies and community organisations).

The NEC consists of 28 experts proposed by the NEC Management Committee, including the Minister for Economics, the NEC's Chairperson and representatives of organisations of businessmen, public structures and other organisations.

Representatives from the Foreign Investors' Council in Latvia, the Riga Technical University, the Cooperation Council of Farmers' Organisations, the partnership "Association of Latvian Markets", the Latvian Academy of Sciences and the Latvian Chamber of Crafts participate in NEC's sessions as observers.

NEC's founders decide on changes in or extension of the composition of the NEC at sessions of the NEC Management Committee.

The NEC is managed by the chairperson of the council who is elected from the members of the NEC Management Committee on a rotating basis. The mandate period is one year.

NEC's sessions are held on average once a month.

The work of the NEC is ensured by the Secretariat of the National Economic Council, whose activity is ensured by the Ministry of Economics.

In between NEC's sessions, the NEC Management Committee takes recommending NEC's decisions.

To improve the model of cooperation between the Ministry of Economics and the non-governmental sector and to arrange the advisory mechanism, on 28 April 2012 the NEC Management Committee decided on the improvement of the NEC's structure by creating six sub-committees of the NEC, whose functions and tasks are to unite the advisory committees created by the order of the Ministry of Economics, to contribute to the dialogue about significant criteria of creating policies for a business-friendly environment in Latvia between the Ministry of Economics, the Minister, other ministries and non-governmental organisations, as well as to ensure the implementation of the sustainable national economy development principle and to promote the process of sustainable development of the country and public participation in this process.

The NEC Management Committees evaluated and developed this model for the NEC to ensure discussions about important and secondary matters with regard to a comprehensive economic policy and to review them within structured sectoral committees, which are acting directly or indirectly in co-operation with the non-governmental sector.

The NEC's structure includes six committees:

- Internal Market Committee;
- Competitiveness Committee;
- Energy Committee;
- Construction and Home Policy Committee;
- Tourism Committee;
- Micro, Small and Medium-Sized Enterprises Committee.

The purpose of operations of the NEC is to shape and implement policies for a business-friendly environment in Latvia, as well as to contribute to the implementation of the sustainable national economy development principle and public participation in it, to identify circumstances hindering business and to take all necessary actions to eliminate them, to participate in the development of laws, regulations and policy planning documents promoting business, to promote innovation and foreign trade.

The NEC reviews and traces the resolution of such matters and draft regulatory documents, economic development concepts, state budget and other documents, which are important for the development of Latvian economy. The NEC prepares proposals and takes recommending decisions on these matters. The NEC maintains a dialogue between businessmen and the Ministry of Economics, as well as other public bodies and community organisations.

The decisions taken by the NEC serve as a recommendation only.

The NEC co-operates with the Cabinet of Ministers and other public bodies to achieve the inclusion of proposals necessary for the improvement of business environment into the regulations prepared by the responsible authorities.

On 21 May 2009, the NEC, the Ministry of Economics and the Ministry of Finance signed a Memorandum of Co-operation for *Growth, Competitiveness and Employment*. The purpose of the Memorandum of Co-operation is co-operation between and coordinated

activities of the NEC, the Ministry of Economics and the Ministry of Finance to promote economic growth, employment and competitiveness of Latvia, and active participation in the development and implementation of a sustainable strategy in Latvia.

To professionally represent the interests of the sectors of the national economy in an efficient dialogue with the Ministry of Economics, the NEC and other organisations of businessmen and public authorities, the Ministry of Economics has created a co-operation model with the sectors of national economy.

The NEC reviews proposals of institutions and associations representing businessmen for the improvement of legislation. Sectoral associations evaluate and express their opinions on draft laws and regulations. The Ministry, in its turn, informs those who draft laws and regulations about the proposals for the improvement of legislations, which were submitted by the NEC, as well as takes other actions to implement programmes for the development of national economy and improvement of business environment within the framework of the government declaration.

Today, the National Economy Council represents associations of 15 sectors (chemistry and pharmaceuticals, finances, transport – transit, logistics, energy, information and communication technologies, IT clusters, trade, electric engineering, electronics, light industry, wood processing, machinery and metalworking, construction, tourism, hotels and restaurants, food, printing, education and science, agriculture).

Box 6.30

The NEC on the Priorities of the Economic Policy

The NEC believes that the work on ensuring a stable macroeconomic environment and general growth in the national economy of Latvia must be continued. To promote competition in Latvia, a balanced budget should be created, surveillance of competition should be strengthened and the development of competition in all sectors of national economy should be promoted in the interests of the society, by timely identifying risk sectors, where violations of competition rights are possible and by limiting administrative and other obstacles in the way of competition.

The NEC believes that tax policies and administration, education of workforce, macroeconomic stability and unforeseeability of changes in laws and regulations continue to be problem sectors.

Pending laws and regulations should also be evaluated to identify and prevent potential violations of competition rights, technical barriers to trade and discriminatory rules in the area of free movement of goods and services and business rights. Surveillance of state aid and procurements should be improved by achieving a high level of transparency for state aid projects.

The creation of an efficient and competitive structure of sectors should be promoted; research, development and innovation, especially in the private sector, should be stimulated, measures, which would promote co-operation between education, research and national economy sectors, should be developed and implemented, ensuring a transfer of knowledge and technologies.

Faster use of structural funds, and entering into new export markets, as well as reinforcement of positions in the existing markets should be promoted. An institutional framework to promote exports should be provided and its capacity should be increased, as well as the development of foreign economic representations, the availability of financial instruments and support for companies in export marketing should be provided.

By signing a memorandum of agreement, the parties agreed to combine resources for the development of programming documents, to take actions to implement national economy development and business environment improvement programmes, within the

framework of the government declaration; the parties also agreed that sectoral associations will evaluate and express their opinions on draft laws and regulations developed by ministries.

In the second half of 2015, there were 4 sessions of the National Economy Council where the following important matters were reviewed:

- microenterprise tax regulation;
- evaluation of the business environment in the customs sector and urgent necessary actions for the ensuring of the competitiveness of Latvia, the promotion of businesses in transit sector, the development of logistic services and clearance of goods brought from third countries directly to Latvia;
- cooperation between law enforcement authorities involved in the prevention of smuggling;
- draft law *On Medium-Term Budget Framework for the Years 2016, 2017 and 2018* and draft law *On State Budget for 2016*;
- draft regulations *Sectors not Subject to the Microcompany Tax Regime*;
- progress in the implementation of the *Energy Efficiency Directive*;
- merger of the Latvian Tourism Development Agency and the IDAL;
- fulfilment of the tasks included in the informative report *On fiscal impact of employer support measures to involve into the work-based education system to the national budget*;
- report of the Latvian Chamber of Commerce and Industry on the telemetry sector and current development of smart measurement devices in the market.

7. RECOMMENDATIONS

During the post-crisis period, significant adjustments have been made to the economy of Latvia – it has become macroeconomically balanced, but it lacks incentives for creating new competitive advantages in all processes related to expansion and modernization of production.

Our competitiveness is still based on the advantages of cheap labour. However, it has to be taken into account that an increase in labour costs is inevitable in conditions of an open labour market. Thus, Latvia could lose competitiveness in the low-cost segments sooner than acquire advantages in the manufacturing of products with high added value. It is called a *bad balance*. A delay in this situation increases the probability of getting into a *middle-income trap* with minimal convergence possibilities.

Bad balance is supported and reinforced by a number of institutional and economic problems (distortions). In the case of Latvia, the most pronounced ones are the large share of shadow economy and low-quality public services, including the inefficient justice system.

Creation of the new competitiveness advantages is related to technological improvements that require innovation and investment, i.e., efficient allocation and redistribution of resources, for which a change in the behaviour of economic agents is needed. The problem is that it is difficult to achieve based solely on market forces and incentives – efficient structural policy is required.

Investment in technology and innovation, science, and education is needed for transition to higher value-added production. The current low level of innovation performance shows not only the lack of state aid, but also (and perhaps even more) the low demand of entrepreneurs for innovation. Currently, entrepreneurs are satisfied with the current *economic balance* – it is much easier to optimize taxes than to look for additional income opportunities through innovation. This reduces the efficiency of resource attraction and redistribution mechanisms (for example, national budget, investment stimulation instruments, EU structural funds, etc.), which is the major internal economic base for structural changes. Therefore it is critically important for us to find the most efficient ways of strengthening the development of knowledge-based economy, improving the competitiveness of companies in the exporting industries, increasing efficiency and innovation capacity, which cannot be achieved without an excellent business environment.

To prepare for and adapt to the major structural changes, it is necessary to carry out pre-emptive adjustments in the labour market. Reforms in the education system have to be continued, with an emphasis on increasing the quality of learning of hard and natural sciences in primary and secondary education, as well as development of adult education. It is necessary to

improve the subject content of hard and natural sciences and introduce a compulsory centralized exam in physics or chemistry in the secondary education. Also, an adult education system has to be developed based on the needs of employers with a clear funding model and introduction of work-based learning has to be ensured in vocational education.

Taking into account the aforesaid, we believe that the immediate tasks of the current economic policy are as follows:

- **in the improvement of business environment and ensuring competitiveness:**
 - to reduce the shadow economy by supporting honest entrepreneurs and creating favourable conditions for transition to the legal economy, to continue the transformation of the SRS into an institution that helps entrepreneurs;
 - to continue work in the field of justice on improving the judicial procedures and making them more efficient, including the introduction of an electronic document circulation system in judicial authorities, eliminating the weaknesses in the insolvency process, ensuring transparency and a surveillance system of these processes;
 - when setting priority of cases, to take action against the most serious violations of the *Competition Law* – prohibited agreements and abuse of market power by dominant or monopolistic businesses, preventive elimination in the form of alerting them or mediation, to take measures for the compilation of best practices and interpreting them in the field of competition law. With regard to the said violations, especially identification of cartels, it is essential to carry out preventive action, by carrying out checks in the priority markets, and implement the tolerance programme, encouraging participation of market players in the detection of violations of competition;
 - to improve the legal framework of reviewing merger reports of companies and the explanatory guidelines for the reports to ensure a better quality of public services by reducing the amount of information to be provided, raising awareness of market players, ensuring a faster and less resource-intensive reporting and evaluation process;
 - to take measures on promoting free and fair competition within the sectoral regulatory framework (including in the legislative process) and to prevent restriction of competition in the operations of public persons, including pursuant to Article 88 of the *State Administration Structure Law*, to reduce unreasonable demands, limitations,

- and other administrative barriers for companies to enter and operate in the market, which have a negative impact on competition and in the long run – on consumers;
- to promote the development of e-government and e-services. The risks of introduction of information systems and e-services projects have to be reduced, strengthening the administrative capacity and expertise of contracting authorities, as well as the monitoring of project implementation. Functionality of the e-signature has to be extended, availability of e-services has to be ensured, and the use of e-procurements has to be facilitated;
 - to improve the opportunities offered by the single state and municipal services portal *latvija.lv* by providing comprehensive information to entrepreneurs and electronic access to online public services in Latvia;
 - to introduce the one-stop shop principle in the registration of real estate data by ensuring data exchange between the National Real Estate Cadastre Information System and the State Unified Computerised Land Register;
 - to improve the mutual coherence of indicators and terms to be included in public registers and other information systems, ensuring complete and timely update of information stored in the registers to prevent non-compliance of the information in the registers with the actual situation, as well as repeated requests for information from respondents;
 - to develop a mechanism for the creation of industrial zones to ensure coordinated and result-oriented development of industrial zones in the regions to help develop business and attract new local and foreign investment;
 - to draw up a short-term planning document for the period until 2020 that would improve the legal framework of construction process, to update and develop new construction standards, including updating of the *Eurocode standards*, and improving the *Construction Information System*, thus creating preconditions for a sustainable and competitive development of the construction industry;
- **in the facilitation of innovation:**
 - to promote cooperation between scientists and entrepreneurs, supporting competence centres, in order to promote cooperation of research and industrial sectors in the implementation of industrial research, development of new products and technologies, as well as to support development of such a technology transfer system that would stimulate an increase in the income of scientific research institutions from commercialization of state-funded research, as well as promote introduction of research results in production;
 - to support development of new products and technologies, including products and technologies contributing to energy efficiency, reduction of emissions, and lower consumption of resources and raw materials, as well as to help economic operators in their efforts to expand research and to introduce new products, services and technologies into production;
 - to support the development of scientific potential more actively, by concentrating it in areas where Latvia has comparative advantages;
 - **in facilitating access to finance:**
 - to facilitate the availability of financial resources in all stages of business development, especially in business start-up phase;
 - to continue the issuance of loan guarantees. It is necessary to facilitate the opportunity for an economic operator to receive credit for commercial activities in situations where the collateral at the disposal of the economic operator is insufficient to attract the necessary amount of credit;
 - to create a risk capital instrument to stimulate investments in business development and expansion of operations. It is necessary to attract the funds of private investors to the funding of venture capital funds;
 - **in the promotion of exports:**
 - to continue supporting participation of entrepreneurs and their unions in international exhibitions and trade missions in order to facilitate entry into new markets;
 - to develop Latvian Network of Foreign Economic Representatives, providing Latvian entrepreneurs with an extensive and easily accessible range of national export support services in the export markets;
 - to make economic cooperation with Latvian priority and potential export markets more active, as well as to expand the cross-border economic legal framework;
 - to continue ensuring availability of export credit guarantees in order to improve access to markets with a higher risk level and to facilitate Latvian exports of goods and services;
 - to promote the reduction of trade barriers, including the ones encountered in the digital environment, faced by Latvian entrepreneurs in the EU's internal and external export markets, thus facilitating the export capacity of the Latvian companies;

- **in ensuring the availability of labour and improving the labour support:**
 - according to the labour market development trends, to identify the mismatch between labour supply and demand in due time, providing education policy makers with the information; to improve cooperation between various institutions in the introduction of proactive changes to the labour market;
 - to improve adult education in order to eliminate the existing discrepancies in the labour market and to reduce the risks of structural unemployment;
 - to increase the attractiveness and quality of vocational education, ensuring that it meets the labour market requirements;
 - to introduce work-based learning as a type of implementation of vocational education programmes, at the same time improving the professional expertise of internship coordinators in educational institutions and companies;
 - to pay special attention to young people who are neither studying, nor employed, by returning them to the education system for them to acquire qualifications and complete their internship;
 - to encourage employers' active participation in the improvement of the quality of education – creation of internship opportunities, development and improvement of education programmes, as well as development and implementation of measures of a more active labour market policy;
 - to establish interdisciplinary education/study programmes, reinforcing the emphasis on entrepreneurial development; to increase the role of hard sciences and natural sciences in basic and secondary education;
 - to develop 1st level professional higher education (college);
 - to review the legal framework of labour relations, extending the possible flexibility between employers and employees;
 - to promote compliance of training with the labour market needs by improving (changing) the current planning system of the labour force training, reviewing the current short-term labour market forecasting methodology and the procedure for determining training directions in order to take into account labour market medium-term forecasts, as well as the medium- and long-term objectives for development of the national economy;
- **in the improvement of energy efficiency:**
 - to make energy efficiency an objective of cross-sectoral policy, not only in the policy sectors of the industry and services, such as energy, construction, industry, internal market, etc., but also in the policy sectors of natural resources, including renewable energy resources, agricultural production and processing (agricultural policy, forest policy, fisheries policy), environmental policy, regional policy, transport, and communications policy sectors;
 - to promote and support improvement of energy efficiency in apartment buildings, public buildings, industrial buildings, creating a sustainable model of financing to improve energy efficiency of buildings;
 - to improve criteria and set targets for the construction of nearly zero-energy buildings;
 - to raise public awareness of different methods and practices of improving energy efficiency of buildings, to facilitate application of good practices related to energy efficiency of buildings in public buildings;
 - to raise entrepreneurs' awareness of benefits and best practices of energy audits and energy management;
 - to facilitate energy management in the public sector;
 - to develop a regulatory framework for introducing energy efficiency policy in Latvia and initiate a consistent implementation of this policy;
- **in ensuring efficient, secure, and sustainable supply of energy:**
 - to continue integration of the energy market of Latvia in the EU single market by improving market mechanisms and facilitating the implementation of energy infrastructure development projects, particularly the projects of common interest;
 - to continue regional cooperation within the framework of the Baltic Sea Strategy/BEMIP in order to improve the electricity and gas markets, energy security, diversification of energy supplies, usage of renewable energy, and energy efficiency;
 - to develop an economically sound and flexible policy for promoting the use of renewable energy sources in energy production.

Consistently implemented structural policy will stimulate the growth of the Latvian economy, which will form the basis for improving the standard of living of the citizens. Successful development and economic growth of Latvia will be determined not only by the work of public institutions, but also everyone's personal initiative throughout Latvia in the conditions of mutual understanding and dialogue of the public.