Ministry of Economics

Republic of Latvia

ECONOMIC DEVELOPMENT OF LATVIA REPORT

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REPORT

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Comments, questions or suggestions are welcomed:

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Dear reader!

The regular Report on the Economic Development of Latvia prepared by the specialists from the Ministry of Economics is available for your evaluation. The first Report was published in September 1994 and the following Reports since 1995 were published traditionally twice a year – in June and December. The present Report, just like the previous ones, provides an assessment of the state's economic situation and policy, as well as gives forecasts for development perspectives of the economy.

The economy of Latvia keeps successfully developing in the post-crisis period. In 2012, GDP has increased by 5.2%; according to the estimates of the Ministry of Economics, GDP growth might reach 4.5% in 2013. Latvia has not only been the fastest growing economy in the European Union for the past three years but it is also considerably more sustainable and productive than expected. The export volumes of goods and services have reached the highest level ever with the total exports exceeding the highest level of the pre-crisis period by nearly 20 per cent.

Further economic growth of Latvia will be closely linked to export opportunities and situation in foreign markets. Latvian export opportunities are likely to improve and reach 4.5% in 2014 along with the gradually stabilizing economic situation in Europe. At the same time, it should be taken into account that Latvia is gradually losing the competitive advantages gained during the crisis period at the expense of cutting labour costs, and therefore the rise of demand on the markets and the ability to increase productivity are expected to play an important role in being able to increase manufacturing and export volumes in the future. The increase in productivity is one of the major challenges because it will determine, to a great extent, the rise in wages.

Sustainable development of the national economy of Latvia requires promotion of structural changes in the economy in favour of production of goods and services with a higher value added, including by increasing the role of manufacturing, modernizing manufacturing and services and export sophistication. *The National Industrial Policy* (NIP) approved on May 28, 2013 lays a foundation for the abovementioned objective by promoting cross-sectoral changes in business environment and the education system and regional investment policy to ensure a targeted transition of the economic model from low profitability products and services produced by cheap labour to a highly productive and competitive economy that can afford to pay employees decent wages.

Over the past two years, funding from the EU structural funds of more than EUR 140 million has been paid to enterprises for the purpose of modernizing and increasing their competitiveness. Approximately the same amount of funding is available for aid of enterprises in this period. For instance, a total of EUR 90 million is available for high value added projects, and therefore I encourage enterprises to actively apply for aid and increase their competitiveness. In the next EU funds period, funding will be available for the approximate amount of EUR 800 million for the activities of the Ministry of Economics aimed at business development within the framework of the NIP and Latvia should focus this funding on targeted investments in modernization and industrialization of its economy instead of mere absorption of the funding.

At the same time, in order to continue the positive changes and implement the "economic breakthrough" in practice, the government should use tax policy incentives to make it possible for entrepreneurs to invest in the development of new and profitable products and services. In this area, the work of the Ministry of Economics and of entrepreneur organizations over the course of almost one year has achieved certain results and in 2013, the CoM has approved the amendments to the *Corporate Income Tax Law* (CIT) proposed by the Ministry of Economics to encourage enterprises to make investments in research and development through evolving technologies and manufacturing new products. The CIT allowances are going to be available as of the mid-2014. It is almost impossible to achieve the level of developed countries without investments in research and development and without new and profitable products and technologies. And I am also pleased to note that the intense discussions with the Ministry of Finance have led to a decision to extend the application of current CIT allowances for new production technology equipment at least until 2020, as well as to maintain the CIT allowances for large investment projects over EUR 10 million.

This year the government approved the informative report *Latvian* E*nergy Long-Term Strategy 2030 – Competitive Energy for Society* prepared by the Ministry of Economics. It is the first energy industry document of such level in Latvia. The main objective of the *Strategy 2030* is to promote competitive economy by developing an energy policy that is well-balanced, effective, as well as economically, socially, and ecologically reasonable and based on market principles. For the first time we have a long-term planning document in the field of energy policy that outlines our strategy, objectives and directions to achieve them.

As regards the energy policy, we have also achieved a significant progress in the natural gas market liberalization to prevent dependency of Latvia on a single natural gas supply source. The Saeima has received the amendments to the *Energy Law* to implement the first stage of natural gas market liberalization, by implementing the requirements of the Third Energy Directive and ensuring third party access to the gas system of Latvia. The CoM has also been informed about the initial assessment of the second stage models of market liberalization, deadlines for preparation and the necessary amendments to the legislation to implement the requirements of the Third Energy Directive in due time and to ensure full liberalization of the gas market.

Unfortunately, the year 2013 will leave a permanent mark in the history of Latvia – a tragedy that cost many lives of innocent people. We should join efforts to prevent such accidents in the future. And therefore we should keep pursuing reforms in the construction sector and the new *Construction Law* should enter into force. The Saeima has been discussing the new Construction Law for at least five years. It was finally adopted on July 1, 2012. Significant changes lie ahead for the sector with an aim to improve the construction quality and to and make the specialist-built structures safe for people both on paper and in reality. A particular focus and considerably stricter requirements have been set for planning and construction of buildings of public importance. As regards violations in the construction process, we have finally specified clear responsibility, including material responsibility of every person involved. The old construction regulation was in force when the tragedy in Zolitude happened, and therefore the sector no longer should operate by the previous rules. In order for the new Construction Law to come into force, the Ministry of Economics has prepared CoM regulations, envisaging major amendments to the construction regulation aimed at strengthening the quality, safety and liability requirements in the sector. Compared to the effective regulation, the CoM regulations prepared and submitted for coordination contain significantly reinforced construction quality and safety requirements, imposing stricter professional requirements for specialists and introducing a new system in certification and responsibility.

One of the main objectives in 2013 was the implementation of the state and local government companies' reforms to finally introduce quality and professional management of these companies according to internationally recognized principles of good corporate governance, as well as to promote compliance with the conditions for business activities of public persons. On September 19, the Saeima approved the first reading of the new *Draft Law on the Management of Capital Companies and Capital Shares of Public Persons* which lays down the conditions for further management of capital shares and capital companies of public persons. The new law has been developed to introduce common management standards, transparency in management of state and local government capital companies, thus improving the total return of these companies on the government and local government budgets and the economy as a whole.

The implementation of the *Remigration support measure plan* has been successfully launched in 2013 with an aim to provide coordinated and quality public and local government services to those people who have decided to return to Latvia. All institutions have a lot of work to do; however, we have laid the foundation for the state to be ready to work on and provide practical support to those people and their families who have left the country and wish to return to Latvia, who consider the option of returning and are ready to do so. Additional funding in the amount of approximately LVL 140 thousand has been allocated in the budget of this year for the diaspora organizations, children camps, Latvian language learning and other measures.

The latest World Bank research *Doing Business 2014* has ranked Latvia 24th among 189 countries. It means that Latvia has moved up by one position, compared to the previous research. Latvia is ranked 9th among the European Union member states in the ease of doing business. The World Bank has recognized Latvia to be one of the TOP 30 leaders that have implemented major reforms to improve the business environment in more than three areas over the past two years.

Latvia has improved its ranking in the criteria for the ease of starting a business, dealing with construction permits, getting credit and trading across borders. Yet, in order to improve the quality of Latvian business environment as fast as possible it is essential to continue reforms in the judicial system, particularly the area of commercial dispute proceedings and simplification of the insolvency procedure. It is also necessary to reduce the bureaucracy burden on tax administration and the time required for these procedures as soon as possible. The quality and speed of implementation of the reforms will determine further competitiveness of Latvian business environment and economy.

In order to achieve the set objectives, we will continue engaging in active dialogue with entrepreneurs and non-governmental organizations representing them.

The present Report provides information about the main economic and social indicators, development of economic sectors and global economic environment, the economic policy of the government for fostering growth and employment, as well as the key instruments for implementing the policy, including utilisation of the EU structural funds. In the conclusion of the Report, the authors provide recommendations regarding improvement of the national economic policy.

The Cabinet of Ministers has not assessed all issues discussed in the report, therefore some conclusions on economic growth of the country and proposals for further activities reflect the opinion of experts from the Ministry of Economics.

I hope that the Report will be useful for economists and entrepreneurs, as well as for everyone interested in the economic development of Latvia, and that it will encourage an exchange of ideas between public institutions, various organisations and interest group representatives, as well as other stakeholders.

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

December 2013

Daniels Pavļuts,
Minister of Economics
December 2013

CONTENTS

ABBREVIATIONS

Abbreviations

CC	Competition Council
CF	Cohesion Fund
CHP	Combined Heat and 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
CIS	Commonwealth of Independent States
CLC	Central Land Commission
CoM	Cabinet of Ministers
CPI	Consumer Price Index
CRPC	Consumer Rights Protection Centre
CSB	Central Statistical Bureau
EAGGF	European Agricultural Guidance and Guarantee Fund
EC	European Commission
ECC	The European Consumer Centre of Latvia
ERDF	European Regional Development Fund
ESF	European Social Fund
EU	European Union
EU-15	European Union Member States before the enlargement on May 1, 2004
EU-27	European Union Member States after the enlargement on January 1, 2007
EU SF	European Union Structural Funds
FDI	Foreign Direct Investment
FIFG	Financial Instrument For Fisheries Guidance
FOB	Price of the goods, including value, and transport and insurance costs to the border of the exporting country

FTA	Free Trade Agreement
GDP	Gross Domestic Product
HPP	Hydroelectric Power Plant
ICT	Information and Communication Technologies
IDAL	Investment and Development Agency of Latvia
IGC	Intergovernmental commission
IMF	International Monetary Fund
JSC	Joint Stock Company
LGA	Latvian Guarantee agency
LLC	Limited Liability Company
LNAB	Latvian National Accreditation Bureau
LTDA	Latvian Tourism Development Agency
LVS	Latvian Standard
NEC	National Economy Council of the Ministry of Economics
NPP	Nuclear Power Plant
NSFD	National Strategic Framework Document
OP	Operational Programme
PJ	Petajoule
SEA	State Employment Agency
SJSC	State Joint Stock Company
SMEs	Small and Medium-Sized Enterprises
SMM	Small and Medium-Sized Merchants
SOLVIT	EU Internal Market Problem Solving System (SOLVIT Network)
SRS	State Revenue Service
TPI	Trade Protection Instruments

Country Abbreviations

AT	Austria
BE	Belgium
BG	Bulgaria
CR	Croatia
CY	Cyprus
CZ	Czech Republic
DE	Germany
DK	Denmark
EE	Estonia
EL	Greece
ES	Spain
EU	European Union
FI	Finland
FR	France
HU	Hungary

IE	Ireland
IT	Italy
LT	Lithuania
LU	Luxembourg
LV	Latvia
MT	Malta
NL	The Netherlands
PL	Poland
PT	Portugal
RO	Romania
SE	Sweden
SI	Slovenia
SK	Slovakia
UK	United Kingdom

1. Economic Situation: Brief Overview

The extensive inflow of foreign capital from 2005 until 2007 fostered a significant increase in private consumption and investments in Latvia. The average annual growth rate of GDP was 10.3%, which was one of the highest in the EU. In 2008 and 2009, the inflow of foreign capital halted due to the global financial crisis and the recession began. During the crisis, the GDP decreased by ¼, external debt almost doubled, the number of employed decreased by 16%, and the real wages dropped by 12 per cent.

Since the end of 2009, the economic recession in Latvia has stopped and growth has resumed. In 2011 and 2012, the GDP has increased by more than 5%. Despite the strained global economic situation, national economy of Latvia kept growing also in 2013. Contrary to the previous years, domestic demand contributed the most to the growth in 2013. In the three quarters of 2013, the GDP exceeded the level of the corresponding period of 2012 by 4.2%. Although the economy of Latvia has been the fastest growing economy in the EU in the recent years, the GDP still is by 10% lower than before the crisis – at the end of 2007.

Overall, the Ministry of Economics forecasts that **the economic growth in Latvia might reach 4.5% in 2013.**

Table 1.1

Latvia: Key Economic Development Indicators

	2008	2009	2010	2011	2012	2013e	2014f
	(changes in comparison with the previous year, %)						
Gross domestic product	-2.8	-17.7	-1.3	5.3	5.2	4.5	4.5
Private consumption	-5.8	-22.6	2.3	4.8	5.8	5.9	4.8
Public consumption	1.6	-9.4	-7.9	1.1	-0.2	3.1	3.0
Gross fixed capital formation	-13.8	-37.4	-18.1	27.9	8.7	1.1	3.1
Exports	2.4	-13.1	12.5	12.4	9.4	1.0	3.0
Imports	-10.2	-31.7	11.8	22.3	4.5	-0.9	3.1
Consumer prices	15.4	3.5	-1.1	4.4	2.3	0.0	2.0
	(% of GDP unless indicated otherwise)						
General government sector balance	-4.2	-9.7	-8.1	-3.6	-1.4	-1.3	-0.9
General government debt	19.8	36.9	44.4	41.9	40.6	38,0	40.0
Export-import balance	-13.6	-1.5	-1.4	-4.8	-3.9	-2.3	-2.6
Changes in the number of employed (aged 15-74 years)	-0.2	-13.9	-6.4	1.3	1.6	2.4	2.0
Unemployment rate (share of unemployed persons to the economically active population aged 15-74 years, %)*	7.7	17.5	19.5	16.2	15.0	12.0	9.6

e- evaluation, f – forecast

Exports of Latvian goods and services have been growing fast since 2010 and have become the driver of the economy. Export volumes have already exceeded the pre-crisis level by 20%. In 2013, the increase in exports has become moderate due to the low demand on external markets – in the three quarters, export volumes were by just 1.4% higher than a year ago. In 2013, the overall growth of exports of goods was positively influenced mainly by the increase in export volumes of machinery production, wood and timber products, as well as agriculture and food products. Exports of metals and its articles have decreased significantly due to the termination of activity of JSC "Liepājas metalurgs".

Further growth opportunities of exports will be affected by changes in external demand and competitiveness of Latvian producers. It should be taken into account that the improvement of Latvian competitiveness so far has occurred mainly due to the cuts of labour costs, however, further improvement of competitiveness will depend on the ability to raise productivity.

Import volumes shrank rapidly along with the dropping domestic demand during the crisis. Recently, the gradually increasing economic activities on the domestic market have caused a gradual increase in demand for imports as well. However, the dynamics of imports has been moderate in 2013. In the three quarters of 2013, compared to the corresponding period of 2012, imports have dropped by 1.2%. It has been mainly due to the decrease in certain product groups like mineral products and transport vehicles, as well as the drop in imports volumes of services. In the three quarters of 2013, the goods and services external trade balance has been at 2.5% of GDP, i.e. nearly two times lower than a year ago. The improving export-import balance has a positive influence on the current account of payment balance. The current account deficit in the three quarters of 2013 has been at 1.4% of GDP, which is considerably lower than in the pre-crisis period. It should be noted that **Latvia has low current account deficit since 2010, thus proving external balance of Latvian economy**.

Positive tendencies are observed also in the domestic market. An increase in employment and a gradual rise in wages foster an increase in private consumption. In the three quarters of 2013, private consumption has been by 5.7% higher than in the corresponding period a year ago. However, the overall private consumption lags behind the level of the 4th quarter of 2007 when it started to decline by nearly 12.5%.

The improving budget situation fosters an increase in public consumption. In the three quarters of 2013, public consumption has been by 2.8% higher than in the corresponding period of 2012.

As regards absorption of the EU structural funds, including public investments in infrastructure and enterprise investments in production equipment, in 2011 and 2012, investments increased rapidly. The increase in investments was based to a great extent on investments in such sectors as energy, wood processing and production of metal articles. In early 2013, the amounts of investments dropped due to completion of a number of large investment projects launched in the previous year. Yet, investment dynamics became more active in the second half of 2013 – the investment amount in Latvian national economy reached the level of the previous year constituting 21% of GDP in the three quarters.

Despite the substantial increase in 2011 and in 2012, the investment level is still nearly half of the level of 2007. The low level of bank lending is still one of the factors hindering investments. It should be noted that the state plays a major role in the investment process. In weak lending situation, the state provides significant support for private investments through the EU structural funds co-financing.

After the substantial decrease in incoming foreign direct investments (FDI) during the crisis, they have resumed increasing. In 2011, the economy of Latvia has experienced a nearly fourfold increase in the net incoming FDI flows, reaching 5.2% of GDP. The intensity of incoming FDI remained relatively high in 2012 as well – they constituted 3.2%, while in the 9 months of 2013 – 2.3% of GDP.

Positive export tendencies foster the growth of manufacturing. Production volumes in manufacturing increased rapidly from 2009 to the end of 2012 and the growth rates exceeded the overall growth of the national economy. Manufacturing was the main driver of national economic growth in the post-crisis period.

The weak demand in export markets in early 2013 slowed down the growth of manufacturing. In the first half year, production volumes were by 2.6% lower than a year ago. However, the situation in the sector gradually improved in the second half of the year. In the 3rd quarter, compared to the 3rd quarter of 2013, production volumes of manufacturing have increased by 2.5 per cent.

In addition to the weak demand in export markets, the results of manufacturing were significantly affected by the termination of operations of JSC *Liepājas metalurgs*. In the eleven months, production volumes in metal processing were by 55% lower than a year ago.

The year 2013 was less successful than 2012 also in the chemical industry and pharmacy sector. Although these sectors have been gradually improving and production volumes have been growing over the past few months, the overall volumes in the eleven months fall behind the level of the corresponding period of 2012.

The rest of major manufacturing sectors have been growing at a steady pace in 2013. The largest manufacturing sectors in Latvia – the food industry and wood processing constitute nearly a half of the total output of manufacturing and in the eleven months of 2013, production volumes of both sectors were by 5.2% and 1.6% higher, respectively, than in the corresponding period of 2012.

In 2013, production volumes have increased very fast in manufacture of computers, electronic and optical products, as well as manufacture of electric equipment. These sectors have stable export opportunities in 2013, as well as the demand for products of these sectors is increasing fast on the domestic market. Last year, production volumes have increased at a stable pace also in the light industry, publishing, manufacture of non-metallic minerals, manufacture of machinery and equipment, as well as manufacture of transport vehicles.

Further growth of manufacturing will be affected by the increase in domestic demand and the improving economic situation in export partner countries of Latvia.

The increase in revenues from exports has a positive impact on the sectors operating mainly in the domestic market. The volumes of services provided in the trade sector increased by 7.3% in 2012, but in the three quarters of 2013 – by 5.3% in comparison with the corresponding period of the previous year. After the substantial decline during the crisis, the construction sector resumed growth in 2011. In 2012, the construction sector grew by 14.5%, while in the three quarters of 2013 – by 9.2%.

Yet, the volumes of other commercial services increased by 7.3% in the three quarters of 2013. The increase was mainly fostered by growth in arts, entertainment and recreation service sectors, the real estate sector and financial and insurance operation sectors.

In 2013, the volumes of public services sectors also increased and in the three quarters of 2013 they were by 4.6% higher than in the corresponding period a year ago.

After the deflation caused by the crisis when the 12-month consumer price inflation decreased to -4.2% in February 2010, prices started increasing again. In 2012, the 12-month consumer prices increased by 1.6%; the increase was mainly determined by the rise in administratively regulated prices, as well as the increase in food prices and transport costs. Global fuel price dynamics also had a major impact. **In 2013, consumer price dynamics was explicitly moderate** due to the reduced pressure of external factors. In December, consumer prices were by 0.4% lower than a year ago. In 2013, price changes were mainly affected by the drop in prices for food products, fuel and heat energy. It should be noted that global food prices in December, were by 3.4% lower than in December 2012. In December, also global oil prices were by 3.4% lower than before the year. Thus, fuel prices in Latvia shrank by 3.8% in December 2013.

The Ministry of Economics expects **the average consumer price level in 2014 to be higher than in 2013**. It is related to the gradual drop in the impact of inflation-reducing supply side factors (global food prices and fuel prices are most likely to increase).Pressure on consumer prices will be created also by the rise in wages, slight increase in taxes on goods (auto gas and tobacco) and opening of electricity market for households. The introduction of the euro is also expected to cause a slight increase in inflation (by 0.2-0.3 percentage points). In 2014, moderate inflation is expected and the average annual inflation could reach 2 per cent.

After facing the financial market crash at the end of 2008 and at the beginning of 2009 the **monetary indicators of Latvia have been gradually stabilising**. The amount of loans granted anew has been increasing since 2010, as well as the quality of credit portfolio has been improving and the amount of deposits attracted by banks has also been growing.

However, overall, the balance of loans still is decreasing. At the end of the 3rd quarter of 2013, compared to the corresponding period of the previous year, they have shrunk by 7.9%. The balance of commercial loans and industrial loans has also dropped in this period. The balance of consumer credits and mortgages also keep reducing.

The quality of the credit portfolio continues improving – in the 3rd quarter of 2013, the amount of loans with overdue payments in the total loan portfolio was 17% – by 2.8 percentage points lower than a year ago. This is the lowest indicator since the end of 2008 when the amount of loans with overdue payments was 15%.

The amount of deposits attracted by banks keeps growing – at the end of the 3rd quarters, it constituted LVL 12.9 billion or by 8.7% more than a year ago.

The fiscal situation in the country is also gradually improving. Deterioration of the economic situation in 2008 and 2009 considerably worsened the fiscal situation. In order to prevent the situation in the financial sector from going out of control, Latvia has carried out comprehensive budget consolidation. Overall, fiscal consolidation measures with fiscal impact of 16.9% of GDP have been carried out from 2008 to 2012. As a result of budget consolidation implemented by the government, the budget deficit decreased gradually and in 2012, it was just 1.4% of GDP. Since the general government budget deficit was considerably below the Maastricht criterion of 3% in 2012, **the European Commission has abrogated the *Decision 2009/591/EC on the existence of an excessive deficit in Latvia.***

According to the forecasts, the general **government budget deficit is expected to be 1.3% of GDP in 2013**. The government budget for 2014 was approved with a deficit of 0.9% of GDP. The general government deficit is expected to be below 0.9% of GDP in 2015 and 2016.

In order to ensure development of sustainable and counter-cyclical fiscal policy, the Saeima has adopted the EU *Fiscal Discipline Treaty* which entered into force on March 6, 2013. The Law stipulates binding fiscal conditions for the annual government budget and the medium-term budget. In order for these systemic new approaches towards development of fiscal policy and observing discipline to be sustainable without being constantly amended or even cancelled, amendments to the Constitution (*Satversme*) have been prepared and are still being considered by the Saeima commissions.

The resuming economic activities have a positive impact on the situation in the labour market – employment is increasing, unemployment is gradually decreasing. At the same time, certain population groups, especially people with low education and qualification level, older people, as well as the youth barely feel the improvement.

In 2012, the number of the employed increased by 1.6% and the average annual number was 875.6 thousand. Despite the increase in employment, the annual unemployment rate still is relatively high – on average 15 per cent.

In 2013, the situation in the labour market continued improving. In the 3rd quarter, the total number of employed reached 906.1 thousand which is by 1.3% or approximately 11.4 thousand more than in the 3rd quarter of 2012.

The unemployment rate in the 3rd quarter of 2013 dropped to 11.8% which was by 1.9 percentage points lower than a year ago.

The relatively high unemployment rate is still mainly related to cyclic factors; yet, signs of structural unemployment are becoming more marked. There is a risk that some of the currently unemployed will not be able to find a job in a long-term, as sectors that recover faster from the crisis are neither the ones that were offering vacancies before the crisis nor those where people lost their jobs during the crisis.

The number of the employed is expected to grow and the unemployment is expected to drop in 2014. According to the forecasts of the Ministry of Economics, the number of the employed might increase by 2% or 18 thousand, while the unemployment rate might drop below 10 per cent.

Further development of the economy of Latvia will be still closely related to the export possibilities, and therefore **the highest risk to the growth of Latvia is related to global economic development.**

Export possibilities of Latvia are expected to improve slightly in 2014 along with the gradually stabilizing economic situation in trade partner countries of Latvia. However, the domestic demand will play a major role in the growth in 2014 just like in 2013. The improving situation in the labour market will foster the domestic demand. According to the forecasts of the Ministry of Economics, **the overall economic growth of Latvia may reach 4.5% in 2014.**

The growth of the economy of Latvia in the medium-term will depend to a great extent on two factors. Firstly, on the solutions that the euro zone countries will manage to adopt for tackling the current tension in the financial sector in order to avoid possible economic stagnation. Secondly, on how efficient the structural policy implemented by the Latvian government for the improvement of economic competitiveness will be under the conditions of limited access to finance, including state budget.

The more rapid development scenario expects that **the growth rate of GDP in Latvia may reach growth of 4-5% per year.** The slower development scenario assumes that the economy of Latvia will recover much slower from the consequences of the crisis due to the remaining weak growth in Europe and due to being unable to improve competitiveness of tradable sectors.

2. Development of the World Economy[1]

The global economy has been growing faster in the second half of 2013 mainly due to the growth in the developed countries. Yet, the economic activities slowed down in the developing countries. Although the developing countries are still growing relatively fast, their contribution to the global economic development has decreased. According to the IMF estimates, the global economy in 2013 has increased by 3% and might reach 3.7% in 2014.

Table 2.1

GDP Growth
(per cent in comparison with the previous year)

	2011	2012	2013	2014f
World including:	**3.9**	**3.2**	**3.0**	**3.7**
USA	1.8	2.8	1.9	2.8
Japan	-0.6	2.0	1.7	1.7
EU including:	1.7	-0.3	0.0	1.3
Eurozone countries	1.5	-0.6	-0.4	1.0
CIS	4.8	3.4	2.1	2.6
China	9.3	7.7	7.7	7.5

Source: *The World Economic Outlook October 2013, International Monetary Fund* ; f – forecast.

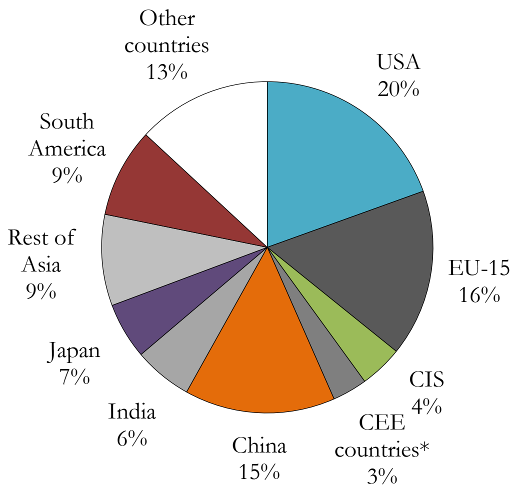
The **USA** economy kept growing at a steady pace in 2013. Fiscal policy challenges had no particular impact on the economic growth tendencies. The GDP dynamics accelerated in late 2013 mainly due to strong macroeconomic policy incentives and financial stabilization measures. The increase in private consumption, investments and exports has a positive impact on the growth. The growth rates are expected to increase in 2014 due to the mitigating fiscal consolidation, favourable monetary policy, improvement of household balance and the growing housing market. The risks of the growth slowdown are related to cutting budget expenditure and increasing taxes that may have a stronger influence on the domestic demand than expected.

Asian countries have overcome the global crisis more successfully than the countries of other regions. Yet, recently, growth rates in the Asian region have been slightly lower than expected. It is mainly related to the slowdown of economic growth rates in China that affects manufacturing activities in the developing countries of this region. However, the overall financial conditions are still favourable and foreign demand is expected to gradually stabilise. Although, there still are some growth risks, the development prospects remain positive.

Growth in the **CIS countries** is slowing down due to the weak global environment. Domestic investments are at a low level as well. In some countries, the growth is hindered by a limited supply. There is a need for reforms to promote the growth potential of the region, while a number of economies need to reduce macroeconomic imbalance.

Figure 2.1

Breakdown of the World's GDP by Groups of Countries in 2012
(structure, GDP by purchasing power parity units)



Source: *The World Economic Outlook October 2013, International Monetary Fund.*
* Central and East European countries – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Malta, Poland, Romania, Serbia, Montenegro, Slovakia, Slovenia, Turkey

Economic activities have been gradually growing in the **European Union**. Although the overall economic situation is improving, the development trends still differ from country to country. For instance, the growth in the new EU Member States is tended to be faster than average in the region.

[1]The preparation of the section is based on periodicals *International Monetary Fund- World Economic Outlook, October 2013; European Commission- European Economic Forecast, Autumn 2013; European Central Bank- Monthly Bulletin, December 2013.*

Yet, the Baltic States have shown the fastest economic growth rates in the EU. Meanwhile, economic activities keep dropping in Southern European countries (Greece, Italy, Spain and Cyprus). Further development of these countries will largely depend on the government budget consolidation and the ability to ensure stability of the financial sector in these countries.

Economic policies have managed to eliminate significant risks in **the euro zone** countries and stabilized financial markets. The growth has resumed, though it is weak. Faster recovery of the euro zone economy is hindered by the high government debt level and slow recovery of the financial sector of the euro zone countries.

The unemployment rate remains high in the region, while inflation falls behind the average medium-term targets of the European Central Bank, thus increasing the concerns about possible deflation.

Table 2.2

The Main Macroeconomic Indicators of the EU Member States

(per cent)

	GDP growth			Consumer prices			Unemployment		
	2012	2013f	2014f	2012	2013f	2014f	2012	2013f	2014f
EU	**-0.4**	**0.0**	**1.4**	**2.6**	**1.7**	**1.6**	**10.5**	**11.1**	**11.0**
Austria	0.9	0.4	1.6	2.6	2.2	1.8	4.3	5.1	5.0
Belgium	-0.1	0.0	1.1	2.6	1.3	1.3	7.6	8.6	8.7
Denmark	-0.4	0.3	1.7	2.4	0.6	1.5	7.5	7.3	7.2
France	0.0	0.2	0.9	2.2	1.0	1.4	10.2	11.0	11.2
Greece	-6.4	-4.0	0.6	1.0	-0.8	-0.4	24.3	27.0	26.0
Italy	-2.5	-1.8	0.7	3.3	1.5	1.6	10.7	12.2	12.4
Ireland	0.2	0.3	1.7	1.9	0.8	0.9	14.7	13.3	12.3
United Kingdom	0.1	1.3	2.2	2.8	2.6	2.3	7.9	7.7	7.5
Luxemburg	-0.2	1.9	1.8	2.9	1.8	1.7	5.1	5.7	6.4
The Netherlands	-1.2	-1.0	0.2	2.8	2.7	1.7	5.3	7.0	8.0
Portugal	-3.2	-1.8	0.8	2.8	0.6	1.0	15.9	17.4	17.7
Finland	-0.8	-0.6	0.6	3.2	2.2	1.9	7.7	8.2	8.3
Spain	-1.6	-1.3	0.5	2.4	1.8	0.9	25.0	26.6	26.4
Germany	0.7	0.5	1.7	2.1	1.7	1.7	5.5	5.4	5.3
Sweden	1.0	1.1	2.8	0.9	0.6	1.3	8.0	8.1	7.9
Bulgaria	0.8	0.5	1.5	2.4	0.5	1.4	12.3	12.9	12.4
Czech Republic	-1.0	-1.0	1.8	3.5	1.4	0.5	7.0	7.1	7.0
Croatia	-2.0	-0.7	0.5	3.4	2.6	1.8	15.9	16.9	16.7
Estonia	3.9	1.3	3.0	4.2	3.4	2.8	10.2	9.3	9.0
Cyprus	-2.4	-8.7	-3.9	3.1	1.0	1.2	11.9	16.7	19.2
Latvia	5.0	4.0	4.1	2.3	0.3	2.1	15.0	11.7	10.3
Lithuania	3.7	3.4	3.6	3.2	1.4	1.9	13.4	11.7	10.4
Malta	0.8	1.8	1.9	3.2	1.1	1.8	6.4	6.4	6.3
Poland	1.9	1.3	2.5	3.7	1.0	2.0	10.1	10.7	10.8
Romania	0.7	2.2	2.1	3.4	3.3	2.5	7.0	7.3	7.1
Slovakia	1.8	0.9	2.1	3.7	1.7	1.6	14.0	13.9	13.7
Slovenia	-2.5	-2.7	-1.0	2.8	2.1	1.9	8.9	11.1	11.6
Hungary	-1.7	0.7	1.8	5.7	2.1	2.2	10.9	11.0	10.4

Source: *European Commission- European Economic Forecast, Autumn 2013*
f – forecast.

An essential precondition for further growth in the euro zone is improvement of lending conditions and business and consumer confidence, as well as its positive impact on consumption and investments. The implemented structural reforms and measures to balance economy will have a positive effect in the long-term.

Although the overall level of economic activities in the EU in the 2nd-3rd quarter of 2013 remained at the level of the previous year, the **largest trade partners of Latvia** showed a positive GDP dynamics.

In 2013, the growth in **Lithuania** was mainly driven by domestic demand. The increase in wages, the decrease in inflation and unemployment and the improving confidence had a positive impact on private consumption. The improving confidence has fostered an increase in investments.

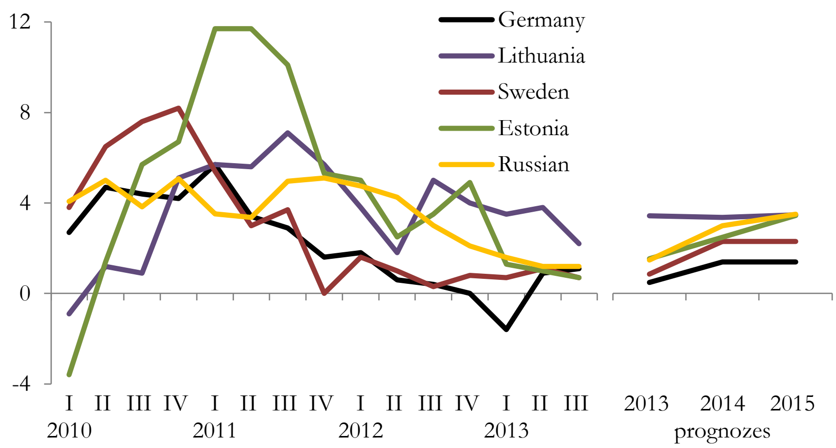
Overall, the growth in Lithuania is expected to be at 3.4% in 2013, while it may reach 4% in 2014-2015. The risks include a slowdown of Russian economy that may affect the trade dynamics.

The growth in **Estonia** slowed down in early 2013. The domestic investment dynamics was decreasing mainly due to the drop in public investments due to the completion of several environmental projects and most of the EU co-financed projects. Yet, the weak domestic demand significantly hindered the private investment activities. Export volumes of Estonia also were dropping, particularly in the service sector, which is mainly related to the low domestic demand in Finland, as well as the transition of the oil trade related transit form the Baltic States to new Russian ports. It should be noted that the increasing employment and wages along with a weaker productivity dynamics affected the competitiveness of Estonia.

The economic growth of Estonia is expected to be at 1.3% in 2013. Yet, the economic growth of Estonia is expected to be at 4% in 2014-2015 due to the resuming investments and foreign demand.

Figure 2.2

Economic growth of partner countries of Latvia
(GDP growth rates, compared to the corresponding period of the previous year)



Source: *Eurostat*, National Statistics Service of Russian Federation, IMF forecasts

The economy of **Germany** kept growing at a moderate pace. Although it increased at the end of the year, the overall GDP in 2013 exceeded the level of the previous year by just 0.5%, which was mainly determined by the drop in economic activities at the beginning of the year. Domestic demand was the key driver of the growth. Private consumption and changes in stocks provided a considerable contribution to GDP growth in 2013, while the investment dynamics was rather moderate. Faster growth is expected to resume in 2014-2015.

In early 2013, the economic growth rates in **Sweden** were faster than expected; however, the growth slightly slowed down in the 2nd quarter due to weaker household consumption and a drop in exports. The increasing domestic demand and investments are expected to boost the growth in the second half of the year. Overall, the growth is expected to be slightly above 1% in 2013; however, it may exceed 3% in 2014-2015 along with the growing domestic demand.

The growth significantly slowed down in **Russia** in 2013 mainly due to the drop in domestic demand and particularly – investments. The net exports also decreased. The unemployment rate still remained low, while employment slightly increased. The growth rates are expected to be significantly lower in 2013 than in the previous years (below 2%). Yet, the growth in Russia will approach its potential (above 3%) in the coming years partially due to favourable oil prices. Further growth of Russia as one of the largest oil and gas exporter will depend to a great extent on price fluctuations of these goods in the world.

3. Growth

3.1. Gross Domestic Product and Aggregate Demand

3.1.1. Development Trends

The global financial crisis severely affected the economy of Latvia; yet, a gradual growth has been observed since late 2009. Due to the restored competiveness during the crisis, export has become the main driver of recovery of the Latvian economy. Although economic perspectives of Latvia were assessed rather cautiously in early 2012 due to the concerns about the high uncertainty in foreign markets, particularly, in the euro zone, Latvian economy was relatively resistant to external collapses. Overall, the GDP in 2012 exceeded the level of 2011 by 5.2%.

Despite the strained global economic situation, the national economy of Latvia kept growing and the GDP increased even faster than expected. In the three quarters of 2013, the GDP exceeded the level of the corresponding period of 2012 by 4.2%. Latvia has been the fastest growing economy in the EU over the past few years. Comparing to the lowest level in the 3rd quarter of 2009, the GDP has been by nearly 20% higher in the 3rd quarter of 2013, currently approaching 91% of the pre-crisis level.

Figure 3.1

GDP Dynamics

(Seasonally adjusted data, 4th quarter of 2007 = 100)

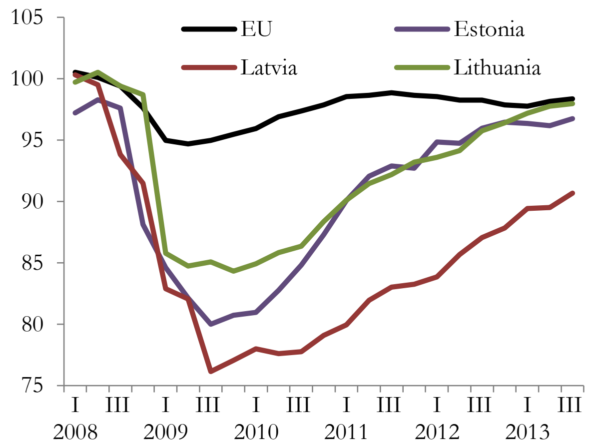


Table 3.1

GDP by Expenditure Items

changes compared to the previous year, percentage

	2008	2009	2010	2011	2012	2013f
GDP	-2.8	-17.7	-1.3	5.3	5.2	4.4
Private consumption	-5.8	-22.6	2.3	4.8	5.8	5.9
Public consumption	1.6	-9.4	-7.9	1.1	-0.2	3.1
Gross fixed capital formation	-13.8	-37.4	-18.1	27.9	8.7	1.1
Exports	2.4	-13.1	12.5	12.4	9.4	1.0
Imports	-10.2	-31.7	11.8	22.3	4.5	-0.9

In 2012, the exports of goods and services in actual prices exceeded the level of 2011 by 9.4%. Almost a half of the total increase in Latvian export in 2012 was related to the markets of EU countries less affected by the crisis – mainly Poland, Denmark, Estonia, and United Kingdom. Export to the CIS and other world countries in terms of volumes have also increased rapidly, which means that entrepreneurs are accessing new markets. In 2012, the overall exports of goods and services exceeded the pre-crisis level by 20 per cent.

The increase in export had a positive impact on the growth of tradable sectors, particularly on the growth of the key export industry – manufacturing.

As previously expected, the exports dynamic is moderate in 2013 due to the low demand in foreign markets. In the three quarters of 2013, the exports of goods and services increased by 1.4%. The situation in JSC "Liepājas metalurgs" has also a significant impact.

Increased profits from exports have fostered the growth of domestic demand in the post-crisis period. Domestic demand has been increasing since 2010.

In 2012, domestic demand was by 5.4% higher than in 2011.

Table 3.2

GDP by Expenditure Items by Quarters

changes compared to the respective period of the previous year, percentage

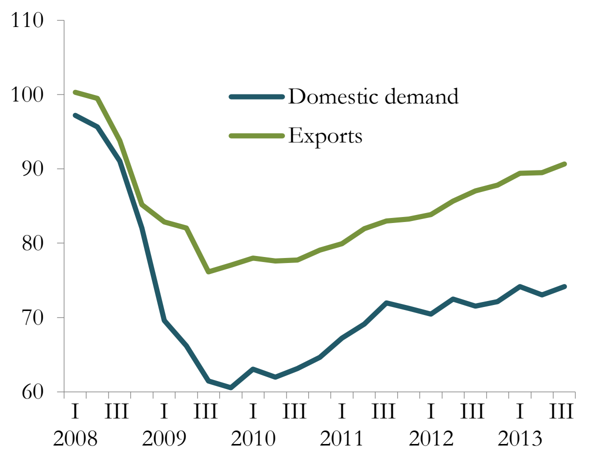
	2011				2012				2013		
	I	II	III	IV	I	II	III	IV	I	II	III
GDP	2.7	5.8	7.3	5.1	7.1	4.9	4.6	4.6	3.8	4.3	4.5
Private consumption	3.7	5.3	6.0	4.3	5.7	7.4	5.4	4.5	5.9	6.5	4.9
Public consumption	1.4	1.7	2.8	-1.1	0.7	0.5	-1.7	-0.2	1.1	5.8	1.4
Gross fixed capital formation	31.4	28.8	27.6	26.0	35.7	16.4	-1.9	1.0	-12.0	1.1	3.0
Exports	14.5	15.3	10.3	10.2	12.4	5.9	9.4	10.1	3.6	2.4	-1.3
Imports	24.4	26.4	21.6	18.0	11.2	6.2	-0.4	2.5	2.2	-4.2	-1.4

In 2013, the growth of exports slowed down and domestic demand provided a larger contribution to the growth. In the three quarters of 2013, compared to the corresponding period of 2012, domestic demand has increased by 3.7%. Comparing to the lowest level during the crisis – in the 4th quarter of 2009, domestic demand has increased by 12% in the 3rd quarter of 2013.

Figure 3.2

Quarterly Changes in GDP and Major Expenditure Items

(4th quarter of 2007 = 100, seasonally adjusted data)



The gradually increasing economic activities in the domestic market are fostering the demand for import goods and services.

In 2011, import increased by 22.3%, while in 2012, the import volumes of goods and services were by 4.5% higher than in 2011.

In early 2013, import volumes of goods and services increased at a moderate pace. Since the 2nd quarter of 2013, compared to the corresponding period of the previous year, import volumes have been gradually shrinking. Overall, imports of goods and services have decreased by 1.2% in the three quarters of 2013. The decrease was to a great extent caused by the drop in volumes of certain product groups, for example, mineral products and vehicles, as well as the drop in the import volumes of services.

During the crisis the export-import balance of Latvia improved significantly. In 2007, the export-import balance still exceeded -20% of GDP, but since 2009 the export-import balance has stabilized.
In the three quarters of 2013, the export-import balance was -2.9% of GDP.

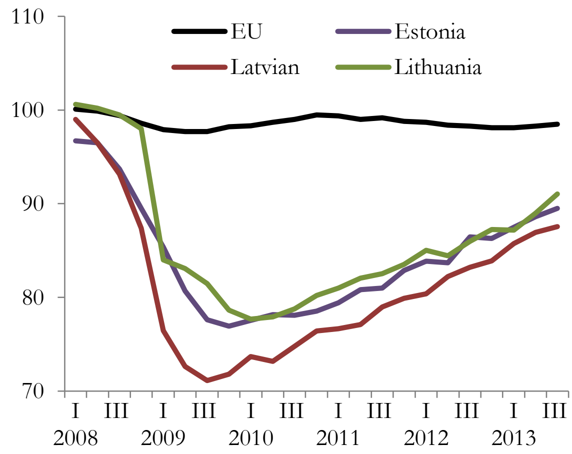
3.1.2. Private and Public Consumption

Since 2010, **private consumption** has been growing again along with the improving situation in the labour market, and it already increased by 4.8% in 2011.

Figure 3.3

Changes in Private Consumption by Quarters

(Seasonally adjusted data, 4th quarter of 2007= 100)



In 2012, the growth of private consumption was fostered by the increasing employment and wages. In 2012, private consumption exceeded the level of 2011 by 5.8 per cent.

Private consumption kept growing also in 2013. In the 3rd quarter of 2013, compared to the 3rd quarter of 2012, private consumption increased by 4.9%. Despite the gradual rise in lending volumes and the gradual rise in deposits, the rise in these indicators in the total increase in private consumption is rather low. The growth of private consumption is still fostered by the gradually increasing employment and wages.

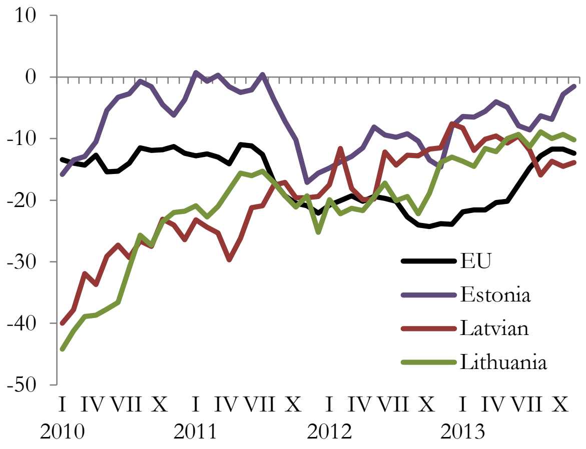
Consumer confidence is also improving. In general, consumer confidence in Latvia exceeded the average consumer confidence in the EU in 2012. Overall, consumer confidence has improved by nearly 12 points in 2012. The improvement was largely based on more optimistic consumer reviews regarding the overall economic situation in the country and the financial situation in their families. In spite of general consumer optimism, they were concerned about potential increase in prices and unemployment.

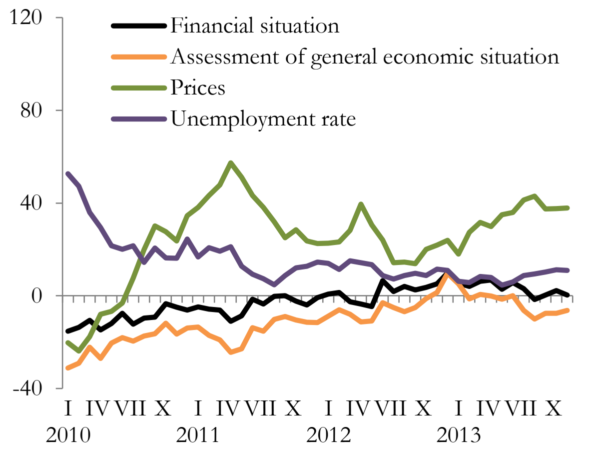
Consumer confidence continued improving also in early 2013. However consumer confidence has been deteriorating since June 2013. It was mainly based on more pessimistic consumer reviews regarding the overall economic situation in the country in coming months, financial situation in their families and unemployment, as well as potential rise in prices due to the expected introduction of the euro as of January 1, 2014.

Figure 3.4

Consumer Confidence Indicator*
(response balance, seasonally adjusted data)

Consumer Confidence in the Baltic States and EU-27	Consumer evaluation for the upcoming 12 months





* The consumer confidence indicator is calculated as the average balance amount of responses to 4 questions regarding the financial situation, general economic situation, evaluation of unemployment and savings for the following 12 months.

The volumes of **public consumption** or public services shrunk fast during the crisis. In 2011, public consumption was by 14.4% lower than in 2007. The drop was due to the introduction of state budget consolidation measures.

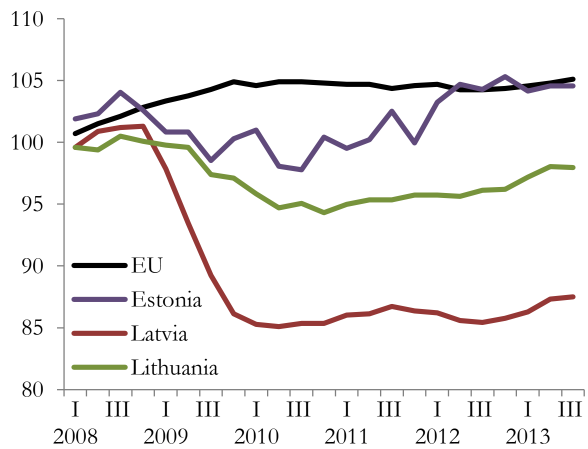
It resulted in reduced share of public consumption in the GDP. In 2008, public consumption accounted for 20% of GDP.

In 2012, the volumes of public services were by 0.2% lower than in 2011, constituting just 16% of GDP. Although the economic situation was improving, the government commitment to keep on reducing the budget deficit limited rapid increase in expenditures also in 2012.

In the three quarters of 2013, compared to the corresponding period of 2012, the volumes of public services have increased by 2.8 per cent.

Figure 3.5

Public Consumption Changes by Quarters
(4th quarter of 2007 = 100, seasonally adjusted data)



3.1.3. Investments

The dynamics of investments is characterized by an explicitly cyclic nature. During the global financial crisis investment activities decreased in almost all EU Member States.

Investors' sensitivity to economic fluctuations was to a great extent determined by the worsening financial situation of companies due to a rapidly narrowing market. From 2008 to 2010, investments in the EU Member States decreased on average by 13.5%, i.e. almost ten times faster than GDP. Although the level of investment volumes in 2010 was lower than in 2008 in almost all EU countries, the changes in investments differed from country to country. The decrease of investment volumes in the Baltic States and Ireland has exceeded the EU average almost four times.

Investment activities grew rather fast in Latvia and other Baltic States along with the stabilising economic situation. In 2012, investments in national economy of Latvia increased by 39.1%, in Estonia – by 52.6% and in Lithuania – by 16.3%, compared to 2010. The Baltic States took the leading position among the EU member states in terms of the growth rates of investment volumes.

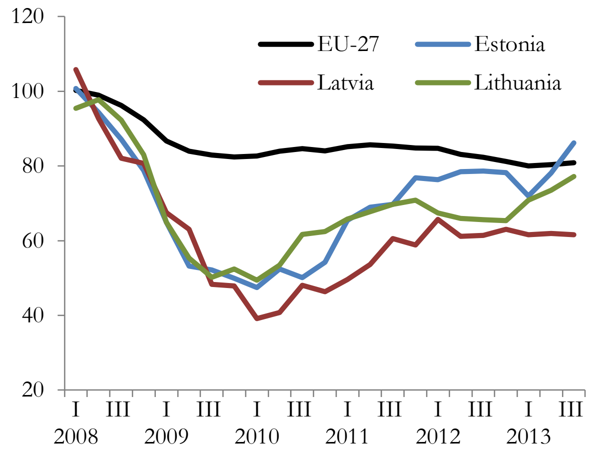
Investments kept growing at a high pace in the first half of 2012, while the dynamics of investments already was markedly moderate in the second half of the year. Such dynamics of investments was expected because the rapid increase in the volumes in 2011 and in early 2012 was to a great extent related to the low base effect.

Overall, in 2012, investment volumes exceeded the level of the previous year by 12.3% and constituted 23.5% of GDP. Over the past two years, investments in national economy of Latvia exceeded the volumes of 2009-2010 by 1.2 times. On average, quarterly investment volumes were half of the level in 2007.

Figure 3.6

Changes in Investment Volumes

(4th quarter of 2007=100)



In the 1st quarter of 2013, investment volumes were by 12% lower than a year ago, which was mainly determined by completion of the large investment projects implemented last year. Yet, in the 2nd and 3rd quarter of the year, investments in national economy of Latvia exceeded the level of the previous year by 1.1% and 3.3%, respectively. Overall, the investments in the three quarters of 2013 were by just 1.8% lower than a year ago.

Table 3.3

Gross Capital Formation

	2008	2009	2010	2011	2012	2013 I-IX
			changes in per cent			
GDP	-2.8	-17.7	-1.3	5.3	5.2	4.2
Gross Capital Formation	-17.1	-45.1	-6.3	38.6	-3.9	-5.9
– gross fixed capital formation	-13.8	-37.4	-18.1	27.9	8.7	-1.8
			% of GDP			
Gross Capital Formation	31.2	20.5	19.8	24.9	25.5	22.7
– gross fixed capital formation	29.7	21.6	18.2	21.3	22.8	20.9
– changes in inventories	1.6	-1.1	1.6	3.6	2.7	1.8

The state has been playing an important role in the investment process over the past few years. The state provides a significant support to private investments through the EU structural funds co-financing under weak crediting conditions.

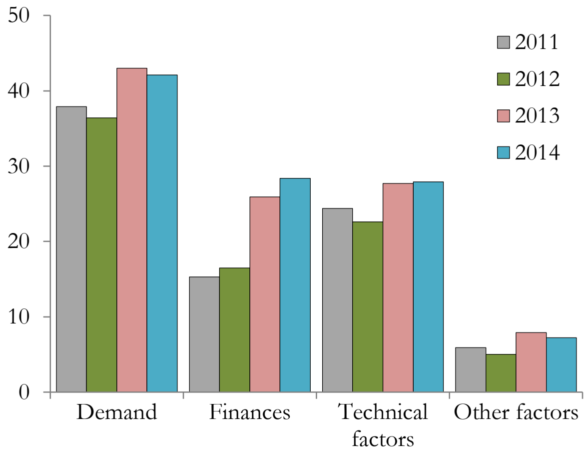
Although the amount of public investments decreased during the economic recession, its share in the total investments in the economy of Latvia increased, reaching 20.4% in 2010, i.e. by 6.4 percentage points more than in 2007. In 2011, public investments increased by 24.9%, contributing

5 percentage points to the total increase in investments. In 2012, the amount of public investments was by 1.5% higher than a year ago and constituted 18.6% of the total investments in national economy of Latvia. Yet, in the three quarters of 2013, public investments increased by 12%, while private investments decreased by 4 per cent.

Increase in investments is prevented by the still weak lending and the awaiting behaviour of entrepreneurs, considering the uncertain external situation. Survey results of enterprise managers show that the increase in demand is the main factor promoting investments. Although the demand factors have been marked as the main drivers for investment followed by financial and technical factors, the role of "access to finance" factors in promoting investments has significantly increased in 2013. Also in 2014, financial rather than technical factors might promote investments.

Figure 3.7

Factors Affecting Investments in Manufacturing*



* Business and consumer surveys of the European Commission

It should be noted that technical factors have been the main drivers for investments followed by demand factors in the EU countries over the past few years.

The capacity load level in manufacturing has been gradually increasing since the beginning of 2010. At the end of 2012, it has reached 71.6%, but at the end of 2013, it has increased to 72.2%, which is by just 0.2 percentage points lower than at the end of 2007. It indicates that the current manufacturing volume is approaching its potential. An increase in demand, as well as entrepreneurs' positive future expectations may foster not only an increase in the capacity load, but also an increase in investments. Positive trends in the investing process to a great extent are expected to depend on access to credit resources and other external financing sources and on the desire to strengthen the positions in foreign and domestic markets including by technologically renewing the existing capacity loads.

Structure of investments by sectors[1] Although the total investment volumes still are below the level of the pre-crisis period, investment activities have been increasing since the end of 2010, while the dynamics, if considered by sectors, appear to be very different.

The overall investing process was weak in 2010, particularly in services sectors. Investments in services sectors were by 31% lower than a year ago, while investments in the goods production sector decreased by 20%. At the same time, an increase in investments was observed in agriculture (by 19.6%), energy (by 47%), transport and storage sector (by 8.1%), and information and communication services (by 8.2%). Yet, investments in manufacturing were by 5.5% higher than in 2009.

Stabilization of the economic situation has positively affected the investment process in Latvia. It was recovering rather rapidly. In 2011, investments in goods production sectors were by 48% higher than a year ago. It was mainly due to the substantial investments in the energy sector and manufacturing. Yet, investments in services sectors increased by 17% and constituted almost 60% of the total investments in national economy of Latvia.

According to provisional data, in 2012, the overall investing activities were slightly more moderate than a year ago. In 2012, investments in the economy of Latvia were by 12.1% higher than a year ago. Investments in services sectors increased by 20% which was mainly determined by the huge investments in transport and storage sector, as well as real estate transactions. Investments in the given sectors increased correspondingly by 30.3% and 52.7% constituting one third of the total investments in the services sectors. The considerable increase in real estate transactions was due to investments for the purpose of improving infrastructure of several public utilities companies. In 2012, more rapid dynamics of investments was observed also in public services sectors. For instance, investments in education were by 24% higher than a year ago.

Investments in goods production sectors have increased by 1%, constituting 38% of the total investment volume in national economy of Latvia. In 2012, considerable investments were made in the electricity, gas supply, heating and air conditioning sector. Investments in this sector constituted 10.3% of the total investment volume in the national economy of Latvia. Investments in water supply, sewerage, waste management and remediation activities have increased nearly by one and a half time.

[1] Investments in sectors are presented according to the non-financial investment statistics.

Table 3.4

Dynamics and Structure of Investments by Sectors *

	Growth rates				Structure			
	2010	**2011**	**2012***	**2013* I-IX**	**2010**	**2011**	**2012***	**2013* I-IX**
Agriculture and forestry	19.7	59.1	20.7	-19.3	5.1	6.4	6.9	6.1
Manufacturing	5.6	41.7	2.5	-40.7	13.0	14.3	13.1	10.6
Construction	-33.2	21.3	-36.0	16.1	8.0	7.6	4.3	2.6
Trade	-24.2	24.6	18.4	-30.5	8.0	7.7	8.2	6.0
Transport and communications	8.1	48.2	30.3	-17.0	11.5	13.3	15.5	15.2
Other commercial services	-32.2	-3.5	36.4	4.4	25.4	19.1	23.3	15.5
Public services	-44.3	22.4	-4.1	5.5	18.5	17.6	15.1	26.2
Other industries	-9.2	71.0	10.2	-12.0	10.5	14.0	13.7	18.0
Total	**-18.1**	**27.9**	**8.7**	**-1.8**	**100**	**100**	**100**	**100**

* 2012 – provisional data and 2013 – estimated based on quarterly data

Investments in manufacturing have been increasing since the end of 2010. From 2007 until 2009, investments in manufacturing decreased by 64.2% due to the financial crisis. It was determined to a great extent by the decrease of investments in production of consumer goods (including the food industry – by 44%), as well as production of intermediate consumer goods (including wood processing – by 88% and manufacture of chemical substances and its products – by 77%).

Overall in 2010, investments in manufacturing exceeded the level of the previous year by 5.6%. Investments in the sectors of production of non-durable consumer goods and investment goods were increasing most rapidly. The wood processing sector, paper industry and publishing, as well as manufacture of pharmaceuticals had the largest contribution to the increase in investments in manufacturing. Positive investment trends in 2010 were observed also in metal processing and manufacture of vehicles.

Table 3.5

Dynamics and Structure of Investments in Manufacturing *

(per cent)

	Growth rates				Structure			
	2010	**2011**	**2012***	**2013* I-IX**	**2010**	**2011**	**2012***	**2013* I-IX**
Food industry	-6.1	60.1	46.6	-49.3	13.4	17.7	30.9	26.0
Light industry	-30.0	83.1	-20.8	-36.0	1.7	1.6	1.3	1.4
Wood processing	139.6	147.0	-28.6	-41.3	19.1	31.0	26.7	26.0
Paper industry and publishing	152.6	44.5	0.2	125.6	5.9	3.0	1.8	6.9
Chemical industry and related industries	16.3	6.9	-19.8	-38.1	13.5	8.5	7.4	7.6
Production of other non-metallic mineral products**	-51.9	-78.5	8.4	6.2	17.9	6.5	4.7	8.3
Production of metals and metal articles**	130.1	157.5	-37.8	-72.6	15.2	20.4	15.4	7.0
Production of machinery and equipment	90.1	173.7	5.1	-11.4	3.6	1.4	1.3	1.9
Production of electrical and optical equipment	15.8	106.9	66.2	-32.0	1.9	1.8	2.6	3.3
Production of vehicles	43.2	148.2	18.9	-34.0	3.5	4.4	4.1	4.6
Other industries	-23.7	255.3	-7.2	10.9	4.3	4.0	3.8	7.0

* 2012 – provisional data and 2013 – estimated based on quarterly data
** estimation of the Ministry of Economics

In 2011, investment activities in manufacturing increased rapidly. Compared to 2010, investment volumes increased by 41.7%. More than a half of the investments in manufacturing were made in wood processing and manufacture of metals.

According to provisional data, a total of LVL 438.8 million or 13% of the total investment volume in the national economy of Latvia have been invested in manufacturing in 2012 which is by 2.5% more than in 2011.

Most considerable investment activities in manufacturing were observed in the first half of 2012. Investment amounts in almost all industry sectors either increased or remained at the level of the corresponding period of the previous year, except manufacture of paper and paper products, manufacture of vehicles and manufacture of construction materials. It should be noted that investments in the first two sectors increased considerably in 2010 and 2011. Yet, investment volumes in manufacture of construction materials have decreased annually by almost 20% since 2008 due to deterioration of the situation in the real estate market. As the situation improved, investment volumes in manufacture of construction materials increased by 8.4%, constituting 4.7% of total investments in manufacturing in 2012. Positive investment dynamics have been observed since 2012 in manufacture of machinery and equipment, manufacture of electronic and optical products and manufacture of vehicles. In 2012, investments in these sectors constituted 10.5%, i.e. almost twice as much as in 2008.

According to quarterly statistical data, in the three quarters of 2013, investments in manufacturing were by 40.7% lower than a year ago. The lower investment volume in manufacturing, compared to the previous year, was mainly related to weaker investment activities in the food industry and wood processing in the first half of 2012. It should be noted that investment volumes in wood processing in 2011, compared to 2009, increased nearly five times, while investments in food industry nearly doubled in this period. In early 2013, investment activities in the rest of manufacturing industries were slightly weaker than a year ago. It should be noted that investment activities tended to grow in some industries in the 3rd quarter of 2013. For instance, investments in pharmacy in the 3rd quarter of 2013 were by 40% higher than a year ago, while investments in manufacture of chemical substances and chemical products and manufacture of electronic and optical products increased by 7% and 5%, respectively. Yet, investments in manufacture of furniture increased nearly three times.

Investor survey results showed that the investment structure in manufacturing mostly remained unchanged. In 2013, investments in manufacturing were mainly related to replacement of worn-out equipment and machinery and expansion of their production capacities – respectively 41% and 27% of the total investments in manufacturing. At the same time, it should be noted that investments were made with the aim to rationalise the production process.

In the nearest future, investment volumes in the economy of Latvia are likely to increase gradually. However, the dynamics of the investing process to a great extent will depend on access to financial resources, increase of the total demand, and implementation of the state support measures for fostering entrepreneurship.

3.1.4. Export and Import

Export and import of goods

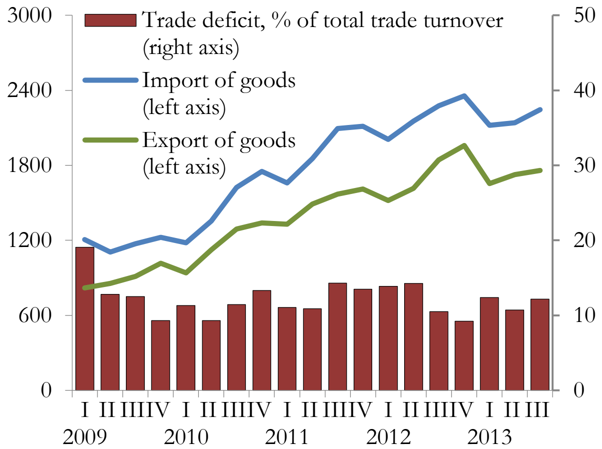
Latvian exports have been growing rather fast over the past few years. In 2011, exports of Latvian goods in current prices increased by 27.8% while in 2012 – by 15.7% (by 13.9% and 11.6% respectively). Despite the weak foreign demand, exports of goods continue growing also in 2013, though at a slower pace – in January-November, compared to the eleven months of 2012, exports in current prices have increased by 1.7 per cent.

In 2011, imports of goods in current prices increased slightly faster than exports – by 30.6%, while in 2012 – by 13.9% (by 23.2% and 5.6% correspondingly at constant prices). In January–November 2013, imports of Latvian goods have remained near the level of the eleven months of the previous year (-0.4%).

Figure 3.8

Export and Import of Latvian Goods

(million LVL and %)

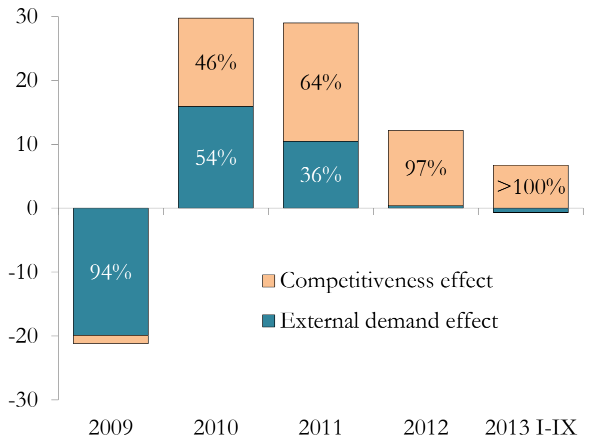


As exports increased faster than imports in 2012, the external trade deficit was decreasing as well. In 2012, it constituted about 12% of foreign trade, while in the eleven months of 2013 – 11%. Yet, in 2007-2008 it constituted over ¼ of total foreign trade.

Figure 3.9

Breakdown of export changes by analysing the constant market share

(structure of changes in Latvian export to the EU countries, per cent)

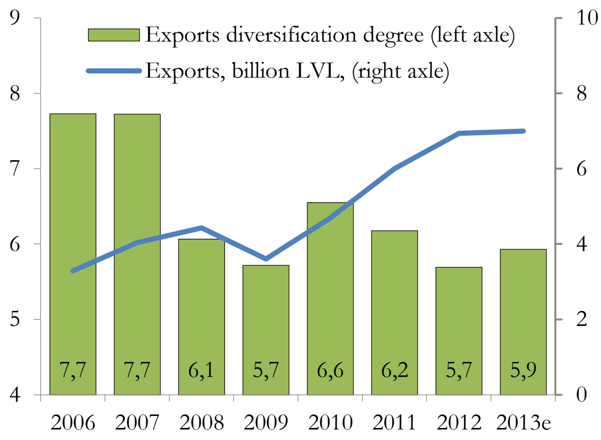


In the post-crisis period, the growth of Latvian exports was influenced equally by the improving competiveness of Latvian enterprises and the steady foreign demand. Yet, in late 2012, the deteriorating growth in the EU led to a significant drop in foreign demand and thus the growth of exports was determined by the improving competitiveness. Similar tendency remained also in 2013.

Figure 3.10

Diversification of Latvian goods exports

(index, calculated using the CN 2 classification of symbols, lower index means higher diversification degree)



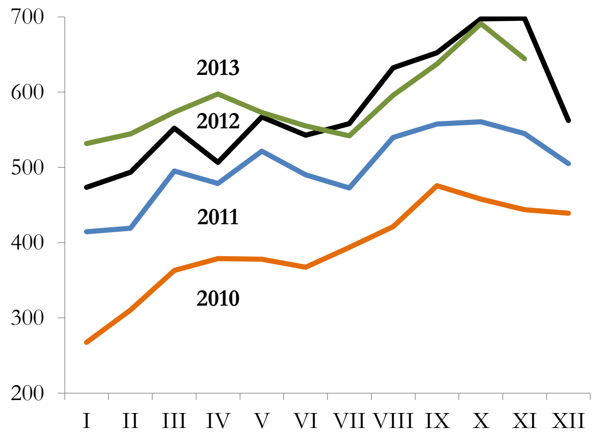
e – estimation by the Ministry of Economics

Over the past few years, the level of diversification of Latvian goods exports has considerably improved. During the years of rapid growth, certain product groups, like timber and timber articles and metals, dominated in the growth of exports. During the crisis the volumes of exports dropped in all product groups; however, the largest export groups experienced the most rapid drop in volumes, which led to improvement of the diversification index. Yet, as the growth resumed in the post-crisis period, the volumes of exports grow at a similar pace, which is a sign of a higher level of diversification. It should be noted that recently this index in Latvia has become equal to the average level of the EU-15 countries and is considerably higher than that of Lithuania and Estonia.

Figure 3.11

Dynamics of Exports of Latvian Goods

(million LVL)



The total exports of Latvian goods in 2013 were fostered by the slight improvement of trade conditions, the import unit value index increased by 2.5%, whereas that of export – by 0.9%. Export prices grew faster for transport vehicles and their equipment, as well as for machinery, mechanisms and electrical machinery. Yet, export prices decreased for metals and metal products, as well as for mineral products.

In 2012, export volumes of goods increased in all largest product groups. The overall export growth was positively influenced to a great extent by the increase in export volumes of agricultural and food products. This product group ensured nearly half of the total increase in exports and the share of the group in the total export structure has increased correspondingly by 4.1 percentage points and constituted 20.5%. Exports of machinery and metal processing product group have also considerably increased. Both of the product groups constituted correspondingly 20% and 11% of the total export increase.

In January-November 2013, slower growth of exports was influenced by the considerable decrease in volumes of metals and products of metals and transport vehicles. Yet, the highest increase was observed for machinery, wood and products of wood, and agriculture and food products groups.

Table 3.6

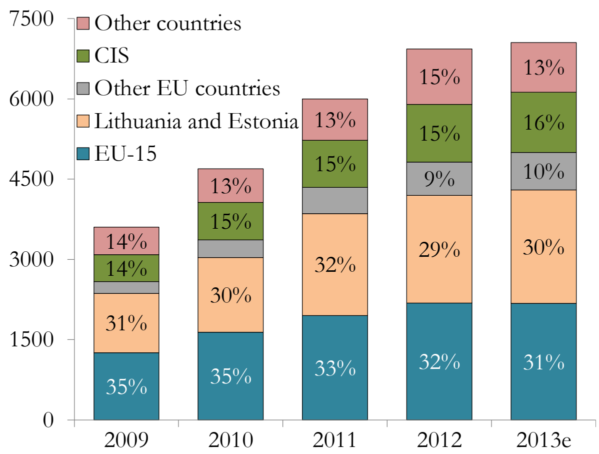
Exports by the Main Commodity Groups
(%, in current FOB prices)

	2012		2013 I-XI	
	structure	changes compared to the previous year	changes compared to the respective period of the previous year	contribution to changes in volumes
Total including:	**100**	**15.7**	**1.7**	**1.7**
agriculture and food products	20.5	44.9	2.1	0.4
wood and wood products	14.9	2.1	9.5	1.4
metal and metal articles	13.7	24.6	15.1	2.1
machinery products	14.0	11.8	-22.1	-3.1
products of chemical industry and related industries, plastics	9.5	4.5	3.0	0.3
minerals	8.7	10.0	2.7	0.2
vehicles	4.7	16.5	4.6	0.2
light industry products	5.4	-6.6	-17.9	-1.0
other goods	8.7	16.4	13.5	1.2

Exports to the EU Member States increased by 10.8% in 2012. The growth in exports of agriculture and food product group constituted about a half of the increase. Yet, in January-November 2013, exports to the EU Member States increased by 3.7%. Exports of machinery products have increased the fastest in this period.

Figure 3.12

Structure of Latvian Exports by Groups of Countries
(million LVL)



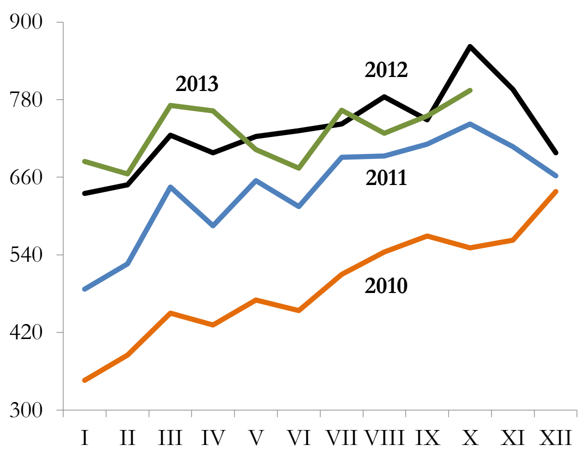
e – estimation by the Ministry of Economics

In 2012, exports to the CIS countries increased by 22.1%. Yet, in January-November 2013, exports of goods to the CIS countries increased by 4.2%. The growth in exports of agriculture and food product group contributed the most to this increase.

The increase in imports of goods in 2012 was mainly influenced by the increase in imports of machinery products, mineral products and agriculture and food products, altogether constituting 2/3 of the total increase in imports. Yet, in January-November 2013, the increase in imports of chemical products, light industry products, and agriculture and food products had a positive impact on the growth of imports of goods.

Figure 3.13

Dynamics of Imports of Latvian Goods by Months
(million LVL)



Import from the EU countries in 2012 has increased slightly faster than the total growth of imports (increase by 14.7%), while in the eleven months of 2013, imports from the EU countries have grown by 2 per cent.

Table 3.7

Imports by the Main Commodity Groups
(%, in current CIF prices)

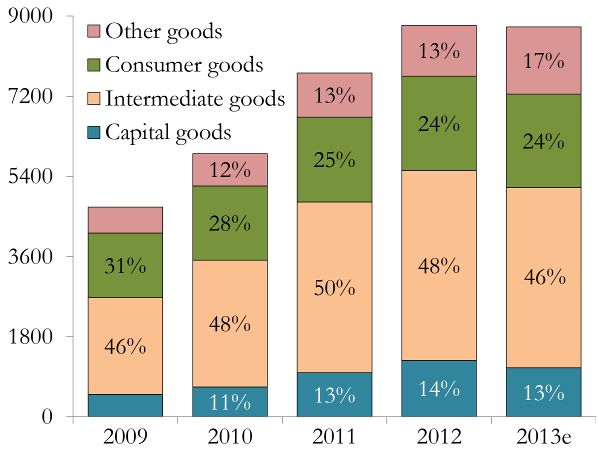
	2012		2013 I-XI	
	structure	**changes compared to the previous year**	**changes compared to the respective period of the previous year**	**contribution to changes in volumes**
Total including:	**100**	**13.9**	**-0.4**	**-0.4**
machinery products	18.3	20.1	0.6	0.0
mineral products	17.7	16.1	-3.2	-0.6
agriculture and food products	15.4	16.3	2.2	0.3
products of chemical industry and related industries, plastics	14.0	7.0	6.5	0.9
metal and metal articles	10.4	8.6	-14.3	-1.5
vehicles	8.6	9.1	-16.4	-1.4
light industry products	5.5	16.5	10.7	0.6
wood and wood products	1.6	21.1	26.2	0.4
other goods	8.5	13.9	8.4	0.7

Import from the CIS countries has increased faster due to a rapid increase in import of mineral products and transport vehicles in 2012. Yet, in January-November 2013, imports from these countries have significantly dropped along with the decreasing imports of metals and metal product group and imports of mineral products.

Until 2009, the share of import of capital goods shrunk along with the decreasing investments, yet, an opposite tendency has been observed in the post-crisis period, since 2011, namely, import of capital goods and intermediate goods has been growing faster, while the share of import of consumer goods has been dropping.

Figure 3.14

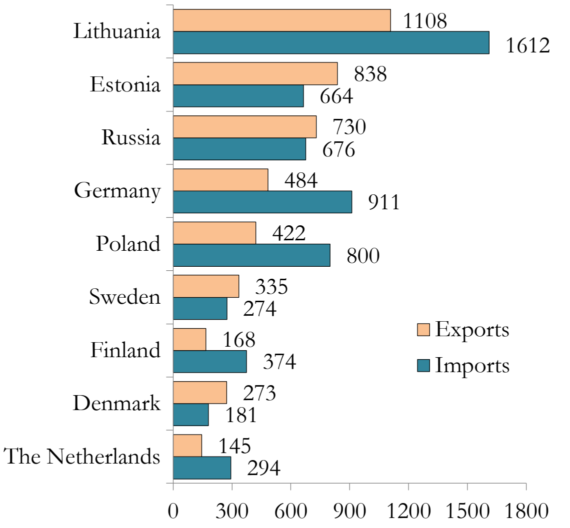
Imports by Classification of the Broad Economic Categories
(related to the basic sections of national accounts, CIF prices, million LVL)



e – estimation by the Ministry of Economics

Figure 3.15

Foreign Trade Turnover of Latvia in January-November 2013 with major partner countries
(million LVL, exports in current FOB prices, imports in current CIF prices)



* countries where the foreign trade turnover with Latvia constitutes more than 3% in the total share.

The biggest **trade partners** of Latvia in the eleven months of 2013 have been Lithuania – 19% of the total foreign trade turnover, Estonia, Russia and Germany – each 10%, Poland – 8%, Sweden and Finland – each 4%, and Denmark and the Netherlands – each 3 per cent.

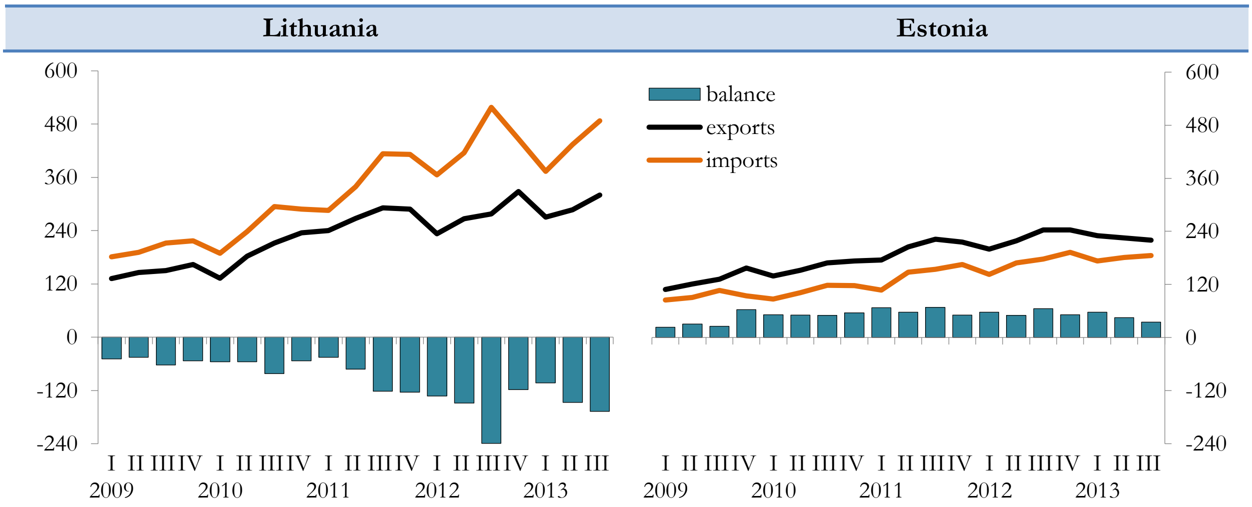
Latvian neighbours **Lithuania and Estonia** traditionally are the largest trade partners of Latvia. As imports considerably increased during the rapid growth period, an explicit deterioration of the Latvian trade balance with both countries was observed. Yet, in the second half of 2008, the balance with Lithuania and Estonia started improving gradually.

Recently, the trade balance with Estonia has remained steadily above 10% of the total trade turnover, while the balance with Lithuania slightly decreased mainly due to faster imports of mineral products and agricultural and food products in 2012-2013.

The main groups of products exported to both Baltic States still are agricultural and food products, as well as machinery products, however, the largest share in imports from Lithuania and Estonia constitute mineral products and agriculture and food products.

Figure 3.16

Foreign Trade Turnover of Latvia with Lithuania and Estonia
(million LVL)



Exports and imports of services

The decrease in exports of services during the crisis was considerably smaller than that of exports of goods. In 2011-2012, exports of services are growing similarly to exports of goods at a stable pace. The positive balance of services in 2011 covered approximately 60% of the negative trade balance of goods. Yet, taking into account the improvement in the trade balance of goods, the positive balance of services in 2012 covered nearly 70% of the negative trade balance of goods.

Furthermore, in the three quarters of 2013, the positive trade balance has increased due to the growing exports of services and the dropping imports.

The revenues from transit transport still constituted a half of the exports of services. The increase in exports of this service group ensured the largest part of the total increase in exports of services in 2012. Yet, in the three quarters of 2013, the total volume of transit has dropped due to the decrease in the volume of transit of all transport types.

Both in 2012 and in January-September 2013, export groups of commercial services and travel exports have been growing at a steady pace.

Table 3.8

Exports and Imports of Services
(per cent)

	2012				2013 I-IX			
	structure		changes compared to the previous year		structure		changes compared to the respective period of the previous year	
	exports	imports	exports	imports	exports	imports	exports	imports
Services – total including:	**100**	**100**	**10.3**	**8.2**	**100**	**100**	**4.1**	**-1.1**
Transport services	**50.4**	**32.5**	**10.7**	**13.4**	**46.2**	**31.9**	**-6.9**	**-2.8**
– sea transport	13.4	7.3	14.5	4.1	12.0	7.4	-8.7	-1.5
– air transport	7.7	11.1	7.8	19.1	7.6	11.2	-2.1	-1.1
– rail transport	13.2	4.8	8.4	3.2	11.5	3.9	-15.3	-18.6
– road transport	15.0	9.0	11.0	21.4	14.0	9.2	-0.3	2.1
– other transport	1.2	0.2	13.3	19.8	1.0	0.2	-3.0	6.8
Travel	**16.5**	**26.0**	**5.3**	**-3.6**	**17.6**	**26.8**	**9.9**	**-0.3**
Other services	**33.1**	**41.4**	**12.3**	**12.8**	**36.2**	**41.3**	**19.2**	**-0.3**
– communication services	2.8	4.9	34.9	7.8	2.9	4.1	11.4	-19.3
– construction services	2.8	4.2	58.1	72.6	2.9	2.8	28.3	-42.4
– insurance and financial services	7.0	4.2	1.3	-11.8	7.6	6.3	18.9	48.5
– information and computer services	4.3	4.5	20.3	7.6	5.0	4.8	23.8	5.4
– other commercial services	15.1	22.1	8.1	12.8	16.5	21.8	17.5	2.6
– other services	1.1	1.5	-4.8	25.6	1.3	1.5	27.4	1.7

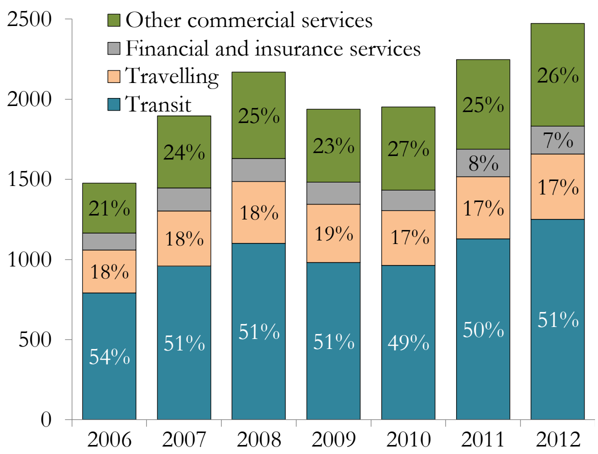
Exports of services to the EU Member States constitute about a half of the total exports of services of Latvia. In 2012, export volumes of services to the EU Member States increased similarly to the total exports of services. This tendency remained also in the three quarters of 2013 and exports of services to the EU countries increased by 5.5%. Transit exports and exports of commercial services constitute the largest share in exports of services to the EU Member States.

The export volumes of services to the CIS countries increased slightly slower than the total exports of services in 2012, while in the three quarters of 2013, exports of services to the CIS countries has dropped by 4.3%. The volumes of exports of transit services and exports of commercial services have decreased, while revenues from tourists from the CIS countries have increased.

In 2012, services exports to Lithuania (by 41%) and Estonia (by 27%) significantly increased. Also in the three quarters of 2013, services exports to Estonia have grown by 8% and to Lithuania – decreased by 9%. The main services export groups to both countries are related to tourism, transit, trade intermediation and construction.

Figure 3.17

Exports of Services by Items
(million LVL)



3.2. Contribution of Sectors

3.2.1. Structure of the Economy and Development Tendencies of Sectors

The decreasing labour costs during the crisis fostered competiveness of Latvian producers leading to export growth and thus also to development of tradable sectors. From 2010 to 2012, production volumes have been increasing faster in the key export sector – manufacturing than the overall growth of national economy, as the sector has become the main driver of the growth of national economy.

Also, the growth of other tradable sectors, for example, agriculture, forestry, transport and storage resumed faster than in other sectors of national economy in the post-crisis period.

As a result, the structure of national economy has changed. In 2012, compared to 2008, the share of tradable sectors (agriculture, forestry, manufacturing, transport services sectors) increased by over 10 percentage points. In 2012, the share of these sectors reached 37 per cent.

Table 3.9

Structure of the Economy

(by value added, per cent)

	2000	2005	2008	2010	2011	2012	2013 e
Agriculture, forestry, and fishery	4.5	3.9	3.0	5.0	5.1	5.0	4.7
Manufacturing	14.4	12.9	10.8	13.3	14.1	14.5	13.9
Other industries	4.2	3.3	4.3	5.3	5.1	5.0	4.7
Construction	6.8	7.0	10.1	5.3	5.5	6.2	6.5
Trade, accommodation, and catering	18.5	21.6	18.8	17.3	17.6	17.9	17.8
Transport and storage	9.5	10.5	8.1	11.4	12.3	12.1	11.3
Other commercial services	25.1	25.7	28.4	27.3	26.3	26.1	27.6
Public services	17.0	15.1	16.5	15.2	14.0	13.2	13.4
Total	**100**	**10**	**100**	**100**	**100**	**100**	**100**

e – estimation by the Ministry of Economics

The increase in the total export revenue has progressively fostered the domestic demand and thus also the development of more domestic market-oriented sectors. Since the second half of 2010, the increasing employment has been fostering domestic consumption, which has a positive impact on the growth of sectors – the retail trade turnover is rising and the commercial services sector is growing at a steady pace.

Narrowing export possibilities in 2013 affected the growth of tradable sectors, while domestic market-oriented sectors saw a stable growth.

Table 3.10

Dynamics of GDP

(in % compared to the corresponding period of the previous year)

	2008	2009	2010	2011	2012	2013 I-IX
Agriculture, forestry	-2.9	9.9	2.1	-1.1	-0.9	-2.9
Manufacturing	-8.4	-17.7	16.7	11.7	9.4	-0.8
Other industries	15.6	-7.8	1.9	-1.3	-2.6	-1.3
Construction	-3.5	-32.1	-31.1	11.0	14.5	9.2
Trade and accommodation	-7.0	-25.0	-0.1	9.4	7.4	5.4
Transport and storage	-0.5	1.2	0.8	8.1	3.6	1.6
Other commercial services	5.6	-15.8	0.1	2.7	4.3	7.3
Public services	-0.1	-9.3	-8.1	0.6	-0.6	4.6
GDP	**-2.8**	**-17.7**	**-1.3**	**5.3**	**5.2**	**4.2**

In 2012, production volumes of **agriculture and forestry** basically remained at the level of the previous year. The development trends differ from subsector to subsector, though. In 2012, production volumes of agriculture products increased by 17.4% mainly due to the high harvest. Yet, there was a drop in volumes in forestry. It was based on several factors, for example, the decrease in the volume of wood cut in national forests, slowdown on wood processing growth rates and the low demand in foreign markets, which was proven by a drop in exports of round timber by almost 17 per cent.

In the three quarters of 2013, volumes of agriculture and forestry were by 3% lower than a year ago.

In 2012, despite the deteriorating economic situation in foreign markets, **manufacturing** kept growing at a steady pace – production volumes increased by 9.3%. Considering the share of the sector in national economy, the increase in production volumes ensured more than ¼ of the total economic growth in 2012.

In early 2013, the weak demand in foreign markets slowed down the growth of manufacturing. In the first half year, production volumes were by 2.6% lower than a year ago. Yet, the situation in the sector improved gradually in the second half of the year. In the 3rd quarter of 2013, compared to the 3rd quarter 2012, volumes of manufacturing have increased by 2.5 per cent.

Table 3.11

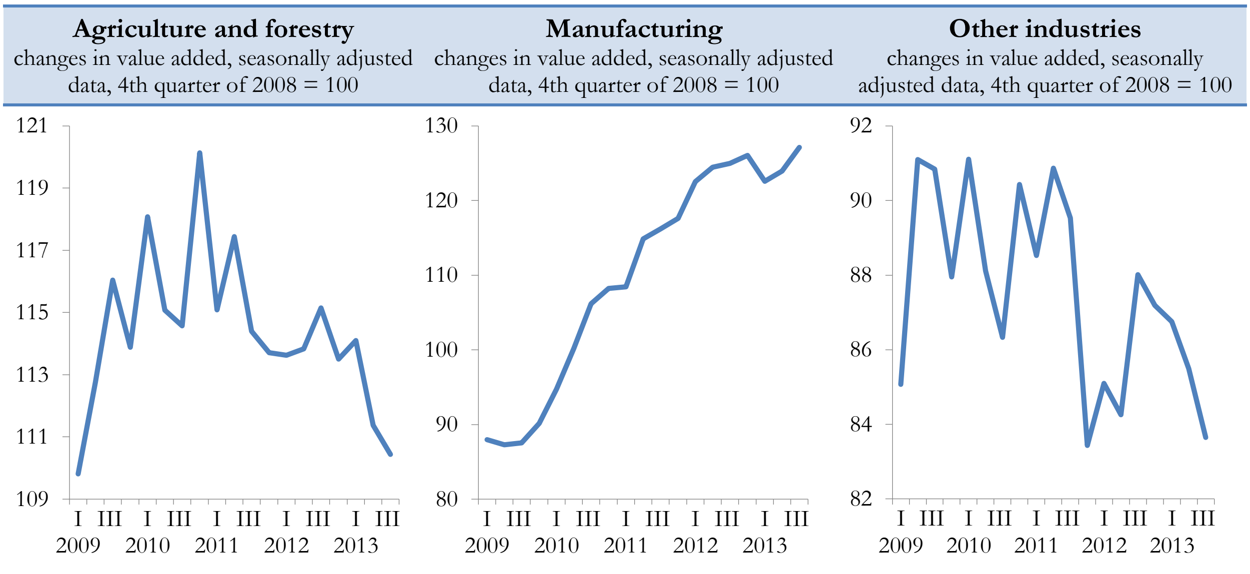
GDP by quarters

(changes compared to the corresponding period of the previous year, in %)

	2011				2012				2013		
	I	II	III	IV	I	II	III	IV	I	II	III
Agriculture, forestry	-0.2	2.4	-0.9	-6.5	0.9	-4.0	2.1	-2.9	0.1	-4.6	-3.5
Manufacturing	14.2	14.9	9.8	8.8	16.4	9.0	7.2	6.2	-4.8	-0.6	2.5
Other industries	-1.4	3.3	4.8	-8.5	-3.4	-6.3	-2.9	1.5	-1.4	1.4	-3.9
Construction	-21.6	-0.9	19.6	25.9	28.5	26.9	8.3	9.3	9.8	5.3	11.6
Trade and accommodation	10.2	8.4	10.1	8.9	7.1	5.8	7.1	9.3	5.0	6.0	5.2
Transport and storage	8.4	8.3	7.6	8.1	3.1	7.6	3.4	0.2	3.2	-1.0	2.8
Other commercial services	1.1	4.5	2.7	2.6	2.7	2.7	6.9	5.0	8.3	7.4	6.3
Public services	0.9	0.9	1.7	-0.5	1.4	-0.1	-3.3	-0.5	2.7	6.4	4.1
GDP	**2.7**	**5.8**	**7.3**	**5.1**	**7.1**	**4.9**	**4.6**	**4.6**	**3.8**	**4.3**	**4.5**

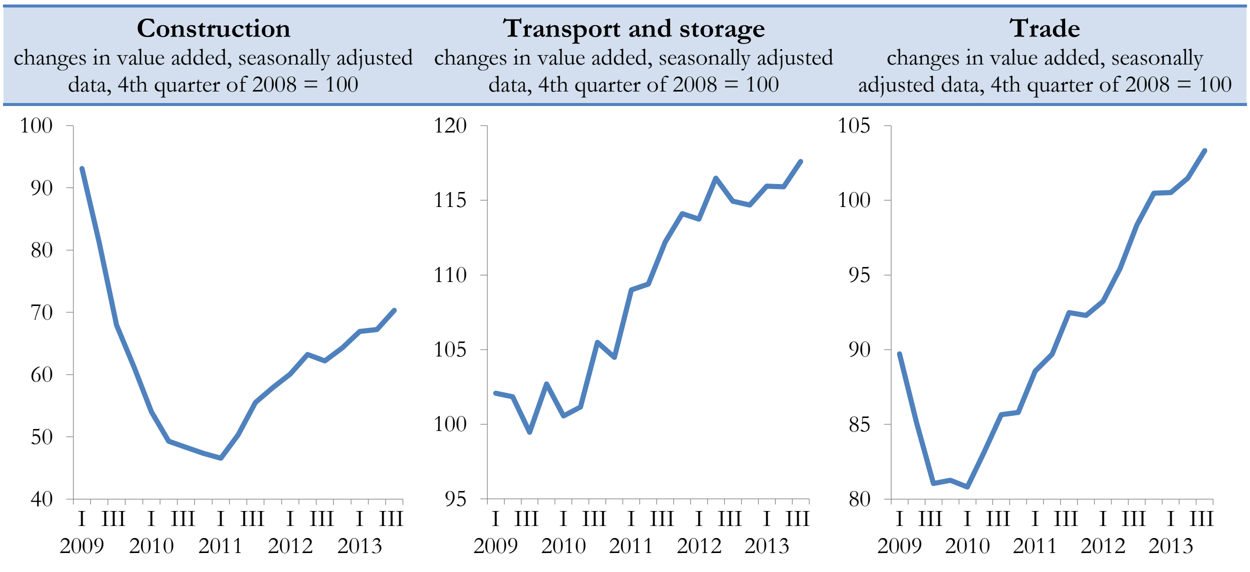
In 2012, production volumes **in other industries** (electricity, gas supply and heat supply) were by 2.6% lower than in 2011. The volumes of the sector were dropping also in 2013 – in the three quarters, they were by 1.3% lower than in the corresponding period of the previous year. Changes in the production volumes in the sector were mainly related to weather conditions, since lower volumes of electricity and heat energy were produced in comparison with the previous periods.

Figure 3.18



The construction sector keeps recovering from the sharp decrease during the crisis. It is largely fostered by public contracts and the EU funds projects. In 2012, construction volumes have increased by 14.5%, while in the three quarters of 2013 – by 9.2% higher than a year ago. In 2013, construction volumes of engineering structures have contributed the most to the growth of construction – in the three quarters they have increased by 13.7%, compared to the corresponding period of 2012. At the same time construction volumes of houses has grown at a rather moderate pace – by 3.1%. Although construction volumes have been growing rather fast over the past two years, currently they are considerably behind the pre-crisis.

Figure 3.19



In 2012, the volumes of services provided in **transport and storage** sector were by 3.6% higher than in 2011, which was mainly fostered by the increase in freight turnover in railroad and ports. In 2013, the sector was growing at a moderate pace – the volumes of services provided in the three quarters were by 1.6% higher than in the corresponding period of 2012. Unlike previous trends of 2012, the growth in 2013 was to a great extent fostered by the increase in the freight turnover of motor vehicles. In the nine months, there was by 15.5% more freight carried by road than a year ago. Yet, the volumes of freight by railroad and in ports dropped by 11.9% and 7.9%, respectively.

The increasing employment and wages fosters domestic consumption, which has a positive impact on domestic market-oriented services sectors. In 2012, the volumes of services provided in the trade sector increased by 7.4% (including accommodation and catering services), and the sector ensured more than ¼ of the total growth of national economy in 2012. The sector kept growing also in 2013 – the volumes of services provided in the trade sector in the three quarters were by 5.4% higher than a year ago.

The growth of the trade sector is fostered by the increase in turnover of retail trade. In 2012, it was by 7.3% higher than in 2011. The increase in non-food retail trade turnover ensured almost 2/3 of the total increase in retail trade in 2012 (increase by 10.5%). Yet, retail trade turnover of food products in 2012 have increased by 3.1%, while fuel retail trade – by 9.6 per cent.

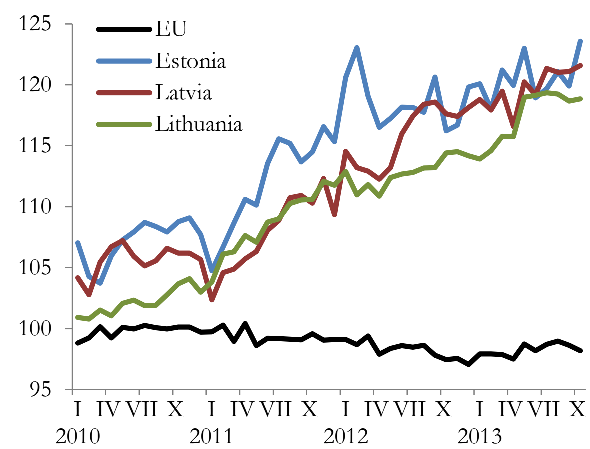
As private consumption continued growing, the retail trade turnover has been increasing in 2013. In the eleven months of 2013, compared to January-November 2012, the retail trade turnover has increased by 3.8%. After the rapid rise in 2012, the non-food retail trade turnover has been increasing at a slower pace – in the eleven months, they were by 3.7% higher than a year ago. The increase in retail trade turnover of clothing and footwear, as well as household goods and electrical goods contributed the most to the growth in 2013. Retail trade in post offices and online is growing rapidly as well.

Retail trade of food products constitutes one third of the total retail trade turnover. In 2013, compared to 2012, retail trade turnover of food products has increased at a rapid pace. In January-November 2013, retail trade turnover of food products were by 4% higher than a year ago. Yet, in the eleven months of 2013, the retail trade turnover of automotive fuel basically remained at the level of the corresponding period of the previous year.

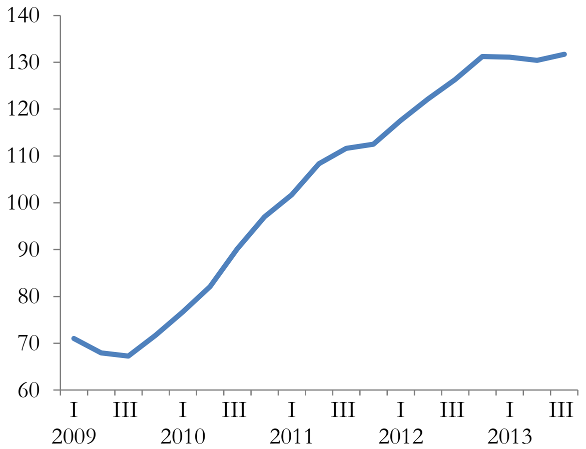
Growth trends of the wholesale trade sector to a great extent depend on the foreign trade activities. In 2012, the turnover of wholesale enterprises increased by nearly 15% (in current prices). As the growth rates of exports slowed down and volumes of imports slightly dropped in 2013, the turnover wholesale enterprises increased at a moderate pace – in the three quarters of 2013, the wholesale turnover was by 7.1% higher than in the same period of 2012.

Figure 3.20

Retail trade turnover
(Seasonally adjusted data, December 2009 = 100)



Wholesale turnover
(current prices, seasonally adjusted data, 4th quarter of 2008 = 100)



In 2012, the amount of **commercial services** increased by 4.3%. The information and communications sector has been the most successful among commercial services sectors in 2012. The amount of services provided in the given sector in 2012 was by 8.9% higher than in 2011. At the same time, no increase in the amount of services in financial and insurance activities, as well as real estate activities has been observed in 2012, as compared to 2011.

In the three quarters of 2013, the sector kept growing at a steady pace – the amount of commercial services exceeded the level of the three quarters of 2012 by 7.3%. The increase was to a great extent fostered by the growth of information and communication, art, entertainment and recreation service, as well as real estate sectors.

The growth of **public services** sectors is closely linked to the possibilities of the government budget. In 2012, the amount of public services remained at the level of the previous year. Yet, in 2013, growth has been observed in public services sectors – the amount of services in the three quarters has been by 4.6% greater than a year ago.

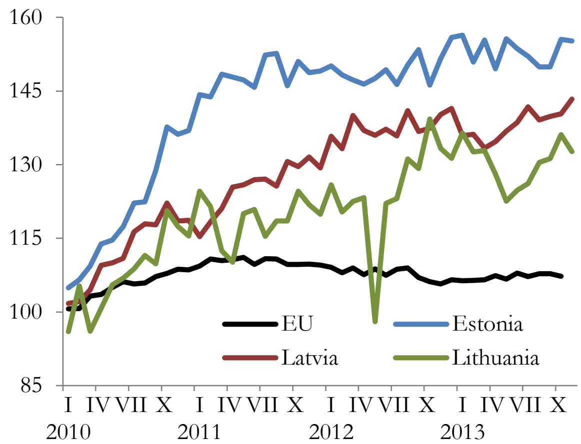
3.2.2. Manufacturing

The improving competitiveness of Latvian producers boosted the growth of manufacturing during the crisis. From 2009 to the end of 2012 production volumes of manufacturing increased rapidly. Manufacturing was growing at a faster pace than the overall national economy. In the post-crisis period, manufacturing became the main driver of the national economic growth.

Figure 3.21

Manufacturing Production Volumes

Seasonally adjusted data, December 2009 = 100



Monthly production volumes of manufacturing in 2012 were fluctuating considerably – a rapid increase in one month was followed by a slight decline – in general the sector was growing steadily. Despite the strained economic situation and even the obvious recession in several EU countries, Latvian manufacturing was resistant to external collapses. In 2012, production volumes of manufacturing increased by 9.3%. In 2012, metal processing has contributed the most to growth of manufacturing. The production volumes have increased also in manufacture of computers, electronic and optical equipment, as well as production of vehicles. A significant increase has been observed also in manufacture of machinery and equipment, as well as paper industry and publishing. It should be noted that the production volumes in these sectors considerably exceed the pre-crisis level. Yet, the production volumes in sectors like food industry and light industry have been increasing at a moderate pace in 2012.

In 2012, the turnover of manufacturing production increased steadily (an increase of 13.1%). The turnover grew mainly at the expense of the increase in production volumes, while producer prices have been growing at a moderate pace. Due to the gradually growing demand in the domestic market, the turnover of production sold in the domestic market in 2012 was by 5.5% higher than in 2011. Yet, the turnover of exported production has increased by 18%, which is a proof of the still high demand for Latvian industrial production in foreign markets.

Table 3.12

Structure of Manufacturing in 2013*

per cent

	By output	By filled number of jobs	Share of exports in the sales of the sector
Manufacturing – total	**100**	**100**	**61.8**
Food and beverage industry	24.9	21.6	36.0
Light industry	4.4	11.2	84.8
Wood processing	23.1	19.4	73.2
Paper industry and publishing	4.5	3.9	58.7
Chemical industry and related industries	7.4	6.3	74.2
Production of other non-metallic minerals	6.6	4.2	43.6
Production of metals and metal articles	10.8	11.2	66.2
Production of electrical and optical equipment	6.2	3.7	88.3
Production of machinery and equipment	2.4	2.9	74.8
Production of vehicles	4.0	3.3	92.3
Other manufacturing industries	5.7	12.4	51.1

* estimation of the Ministry of Economics

The weak demand on export markets, mainly the EU and CIS countries, slowed down the growth of manufacturing in early 2013. In the first half year, production volumes were by 2.6% lower than a year ago. However, the situation in the sector has been improving gradually since the second half of 2013 – manufacturing volumes have increased by 2.5% in the 3rd quarter, compared to the 3rd quarter of 2012. Overall, manufacturing volumes in the eleven months of 2013 have been by 0.4% lower than a year ago.

Apart from the weak demand on foreign markets, the output of manufacturing in 2013 was significantly affected also by termination of JSC "Liepājas metalurgs" activities. The volumes of manufactured products shrank by a half in the sector. At the same time, slight growth was observed in the manufacture of fabricated metal products in 2013. Overall, production volumes of metal processing in the eleven months of 2013 were by 17.3% lower than a year ago.

The year 2013 has not been as successful for the chemical industry as the year 2012. Although the situation in the sector has been improving and production volumes have been growing over the past few months of the year, the total volumes in the eleven months of 2013 were by 9% lower than the level of the corresponding period of 2012. Manufacture of chemical substances and chemical products and the pharmacy sector have been significantly influenced by the weak demand on the CIS markets where nearly 30% of the total products manufactured are sold.

The rest of major manufacturing sectors have been growing at a steady pace in 2013. The largest manufacturing sectors in Latvia – the food industry and wood processing constitute almost a half of the total output of manufacturing. In the eleven months of 2013, production volumes of these sectors were by 5.2% and 1.6%, respectively higher than in the corresponding period of 2012.

In 2013, production volumes have increased particularly rapidly in the manufacture of electrical and optical products – in the eleven months they exceeded the level of January-November 2012 by 16%. In 2013, export opportunities remained stable and the demand on the domestic market increased rapidly in this sector. In January-November 2013, production volumes increased also in manufacture of non-metallic minerals (by 5.1%), paper industry and publishing (by 4.4%), light industry (by 1.9%), manufacture of vehicles (by 1.8%) and manufacture of machinery and equipment (by 0.6%).

Table 3.13

Changes of Production Volumes in Manufacturing
(% compared to the corresponding period of the previous year)

	2008	2009	2010	2011	2012	2013 I-XI
Manufacturing – total	**-3.4**	**-20.2**	**16.5**	**11.7**	**9.3**	**-0.4**
Food industry	-2.0	-16.1	-0.1	-0.2	2.5	5.5
Light industry	-12.2	-38.6	19.4	19.4	3.0	1.9
Wood processing	-12.1	1.6	33.0	12.6	5.4	1.6
Paper industry and publishing	-3.9	-17.1	19.8	-0.5	10.1	4.4
Chemical industry and related industries	-2.0	-18.5	5.2	4.4	8.3	-9.0
Production of other non-metallic minerals	-14.4	-40.1	17.6	24.2	8.6	5.1
Production of metals and metal articles	1.4	-27.1	24.2	28.3	16.3	-17.3
Production of electrical and optical equipment	14.1	-34.8	33.2	29.6	19.9	16.0
Production of machinery and equipment	10.4	-35.5	17.8	37.1	8.7	0.6
Production of vehicles	5.8	-49.7	59.0	37.0	15.8	1.8
Other manufacturing industries	-5.5	-20.1	-4.9	9.5	26.1	-7.3

In the eleven months of 2013, the turnover of manufacturing was by 0.2% lower than a year ago. The drop in the turnover was mainly based on the narrowing sales of products in export markets (by 3%). At the same time, the turnover of manufacturing products has increased in the domestic market – in January-November 2013, it was by 4.7% higher than in the corresponding period of the previous year.

The changes in the turnover affected also producer prices, which grew at a considerably moderate pace than in the previous years. In November 2013, producer prices were by just 1.1% higher than a year ago, i.e. the prices for exported products increased by 1.4%, while the prices for products sold in the domestic market – by 0.8 per cent.

The food industry and wood processing ensured the greatest positive contribution to the total increase in the turnover of manufacturing in 2013. Meanwhile, the chemical industry and metal processing experienced the sharpest drop in the turnover.

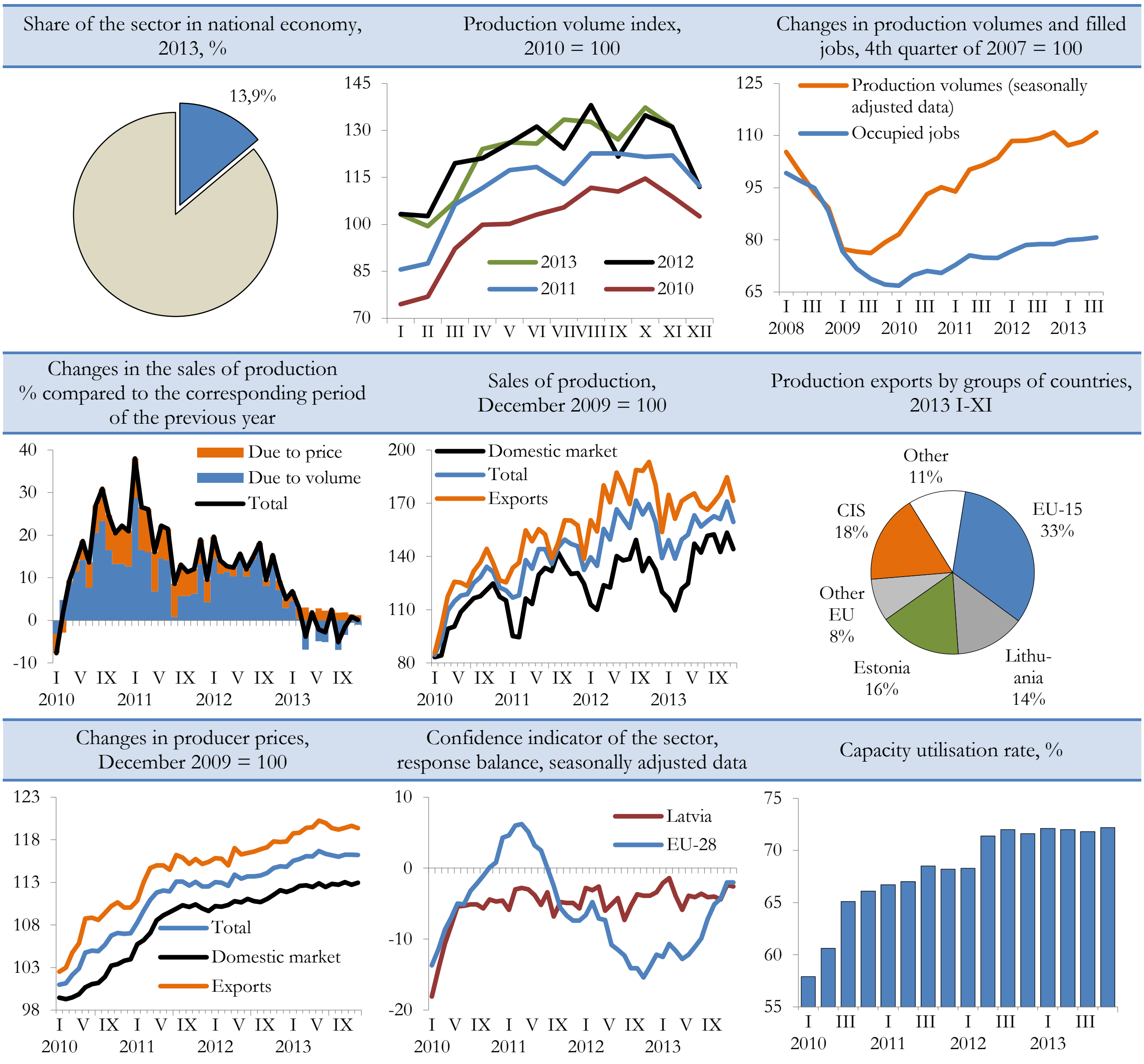
In January-November 2013, 60% of the total products of manufacturing were exported. Almost 1/3 was exported to the EU-15 markets. Yet, 30% of the exported products were sold in the neighbouring countries Lithuania and Estonia. Exports to the CIS countries constituted 17.5 per cent.

The rapid growth of manufacturing in the post-crisis period fosters labour demand. In 2012, compared to 2011, the number of filled jobs in manufacturing has increased by 5% or 5.5 thousand. Manufacturing has also contributed the most to the creation of new jobs in national economy in general – the sector has ensured one fifth of all new jobs in 2012. At the same time, the number of the employed in manufacturing is growing considerably slower than the output, which is a proof of an increase in productivity.

Although the growth of manufacturing was moderate in 2013, the number of jobs kept growing. In the 3rd quarter of 2013, there were by 2.4% or 2.8 thousand more filled jobs than a year ago.

Figure 3.22

Indicators Characterising Manufacturing



In the 4th quarter of 2013, the load of production capacity in manufacturing was 72.2%. It should be noted that over the past six quarters the level of the load of production capacity has not changed significantly. The evaluation of Latvian producer confidence has not essentially changed over the past few years.

The confidence indicator of manufacturing in December 2013 was -2.6 points. To comparison: the confidence indicator dropped to -5.9 points in April 2013 mainly due to uncertainty about development perspectives of the main trade partner countries.

The food and beverage industry is the largest manufacturing industry in terms of both the output and the number of jobs. Most of the total production is sold in the domestic market.

The remaining weak demand in the domestic market in the pre-crisis period fostered a gradual increase in the share of sales of production of the sector in export markets. In 2013, 36% of the total production was exported – mainly to the neighbouring countries Lithuania, Estonia and Russia. For comparison, less than ¼ of the total production was exported before the crisis.

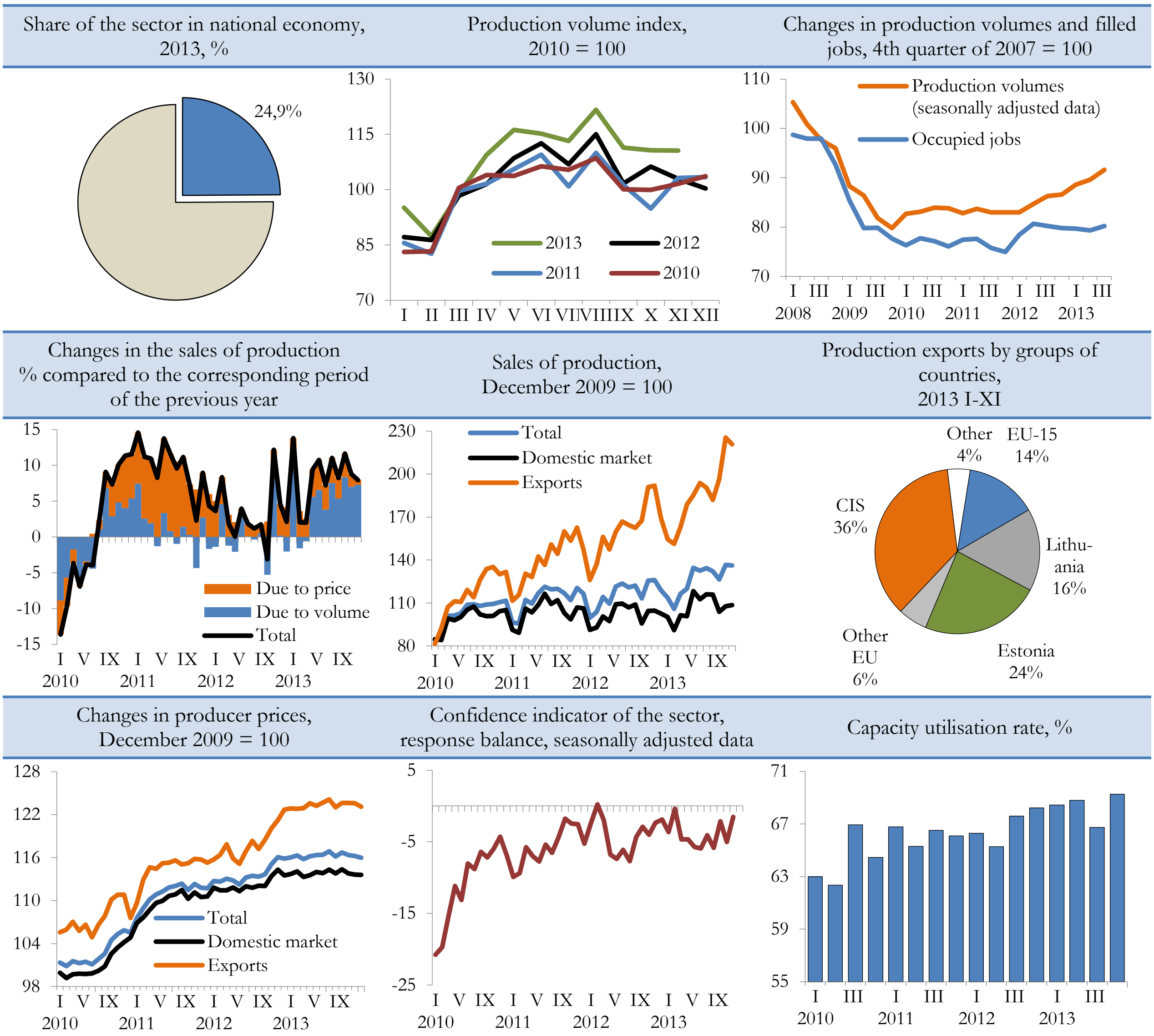
Overall, the production volumes of food and beverage industry have been growing at a slower pace than the average in manufacturing. In 2012, the production volumes in the sector increased by 2.5%, thus being by 16% lower than in 2007. In 2013, the growing demand in the domestic market and remaining export opportunities boosted a rapid growth of the sector – in the eleven months, production volumes were by 5.5% higher than a year ago.

In 2012, the turnover of the sector was by 3.1% higher than in 2011. The increase in the turnover was fostered by the rise in producer prices, particularly those of exported production. Revenues from sales increased also in 2013 – in January-November, they exceeded the level of the corresponding period of 2012 by 8.4%. Turnover of exported production in this period has increased by more than 15%, while in the domestic market – by 5 per cent.

Relatively slow recovery of the sector from the crisis affected the labour demand. In the 3rd quarter of 2013, there were more than 25 thousand jobs in food and beverage industry, which slightly exceeded the level of the 3rd quarter of 2012.

Figure 3.23

Indicators Characterising Food and Beverage Industry



The sector of **light industry** exports over 85% of the production, and therefore the growth of the sector is closely linked to changes in foreign markets.

Although in 2010 and 2011, the production volumes in light industry increased by nearly 20% annually, they still were by 1/5 lower than before the crisis in 2007.

Over the past two years, the sector has been growing at a slower pace mainly due to the deteriorating economic situation in the largest export markets. In 2012, the production volumes in the light industry were by 3% higher than a year ago. Yet, in the eleven months of 2013, the production volumes increased by 1.9%, compared to the corresponding period of 2012.

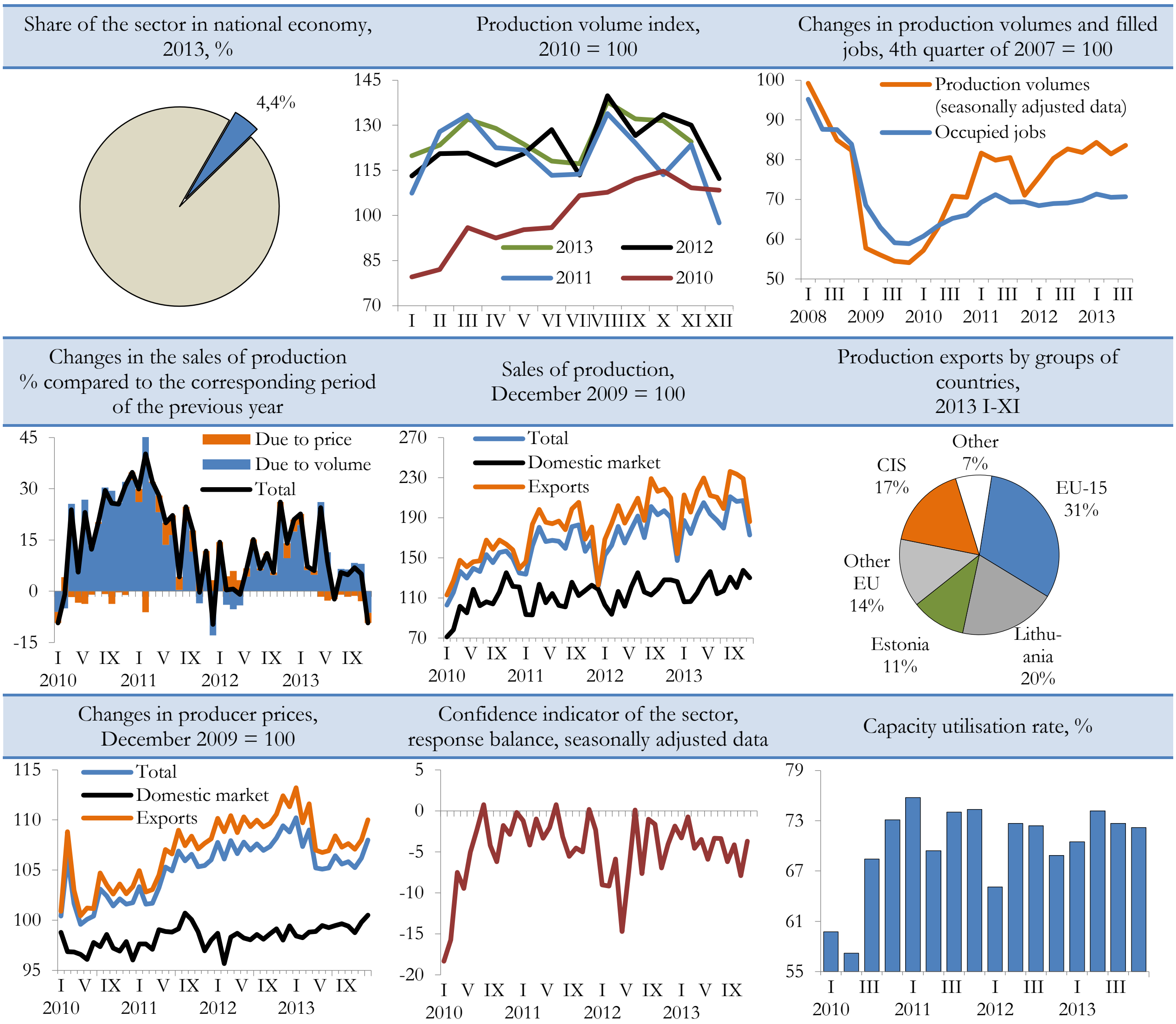
The sales volumes of production in the sector have been growing steadily over the past few years along with the increasing output. In 2012, sales of production have increased by 9.6%. The sales volumes of exported production have increased faster – by 10.4%, while revenues from products sold in the domestic market – by 5.4 per cent.

In the eleven months of 2013, the turnover of the sector was by 6.7% higher than a year ago. Revenues from export sales are still growing faster. In January–November 2013, they have increased by 7% despite the fact that producer prices for exported production were by 3.9% lower than a year ago mainly due to the weak demand in the largest sales markets.

The growth of the sector has been mainly related to the increase in productivity in the past few years, while the number of filled jobs has been growing at a moderate pace. In the 3rd quarter of 2013, there were by 2.3% more filled jobs in the light industry than a year ago. At the same time, the number of filled jobs was by 30% lower than at the end of 2007.

Figure 3.24

Indicators Characterising Light Industry



Wood processing is one of the largest manufacturing sectors, and it constitutes 23% of the total output and provides nearly 1/5 of all jobs in manufacturing.

Wood processing was one of the first sectors to resume growth after the huge decrease in manufacturing. In 2012, production volumes of the sector continued increasing and were by 5.4% higher than in 2011. The production volumes of the sector already exceed the level of 2007 by 40 per cent.

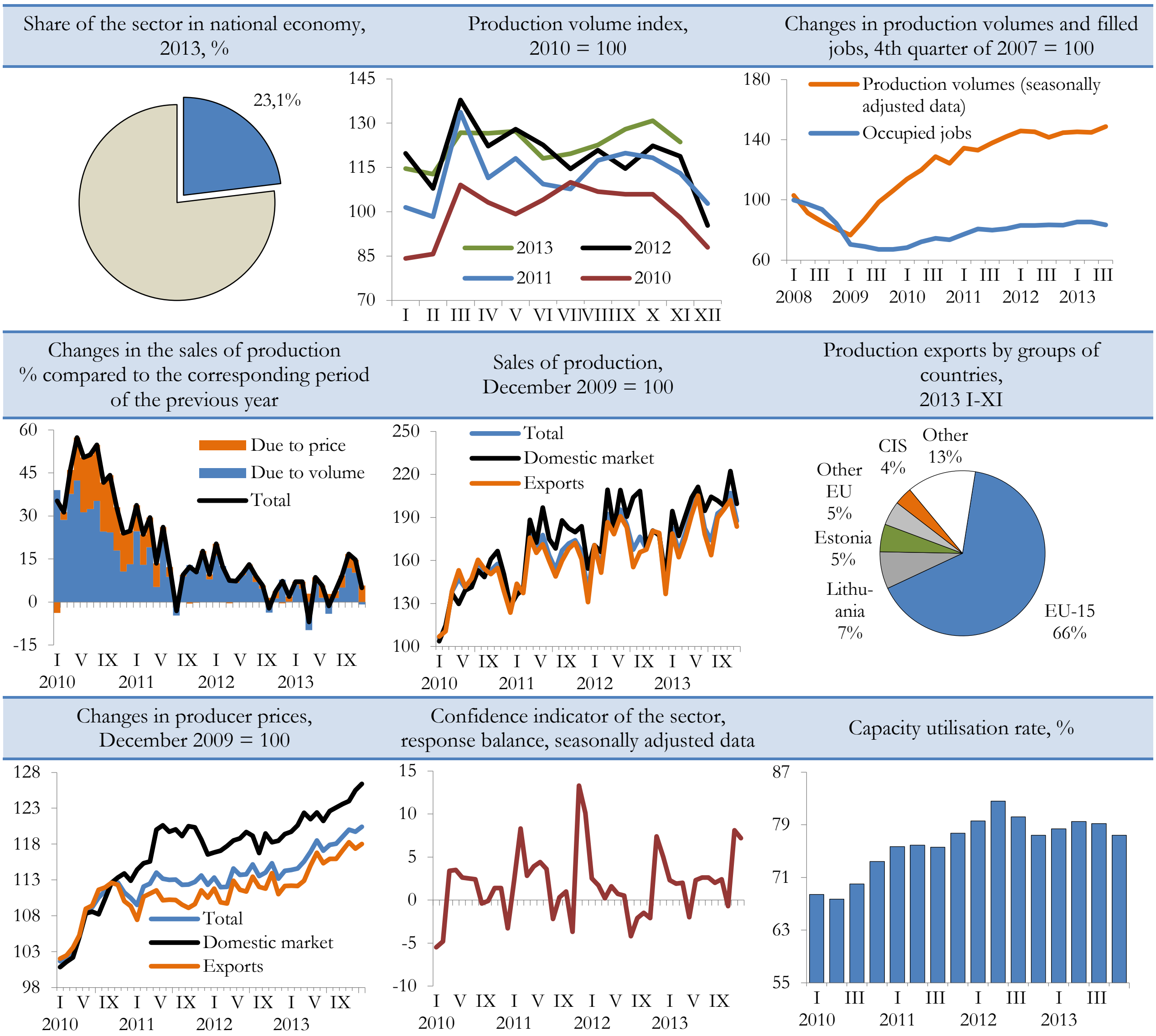
About 3/4 of the total production in the sector are exported, and the EU-15 countries are the largest export market. In late 2012 and in the first half of 2013, there was a weak demand in the largest trade partner countries. It was observed also in the wood processing output indicators. In the 1st quarter of 2013, the production volumes were by 3% behind the level of the corresponding period of the previous year. However, the situation in the sector tended to improve gradually in the rest of the year, and thus the production volumes in the eleven months of 2013 already were by 1.6% higher than a year ago.

A moderate rise in producer prices boosted revenues from sales. In January–November 2013, the turnover of the sector was by 6.2% higher than a year ago. Sales volumes in the domestic market and exports increased at a similar pace.

The significant increase in production volumes of the sector over the past few years was based on the increase in productivity. The production volumes have doubled in comparison with the lowest point of the crisis in late 2009, while the number of employees has increased by 18 per cent.

Figure 3.25

Indicators Characterising Wood Processing



Over the past few years ***the paper production and publishing industry*** has been successfully shifting to foreign markets – in 2013, almost 60% of all production has been exported which is nearly 20 percentage points higher than in 2007.

After weaker output indicators in 2011 when the production volumes in the industry basically remained at the level of the previous year, the production volumes in the paper production and publishing industry in 2012 increased by more than 10%, reaching the level of 2007. In the eleven months of 2013, the industry kept growing at a steady pace and the production volumes were by 4.4% higher than a year ago.

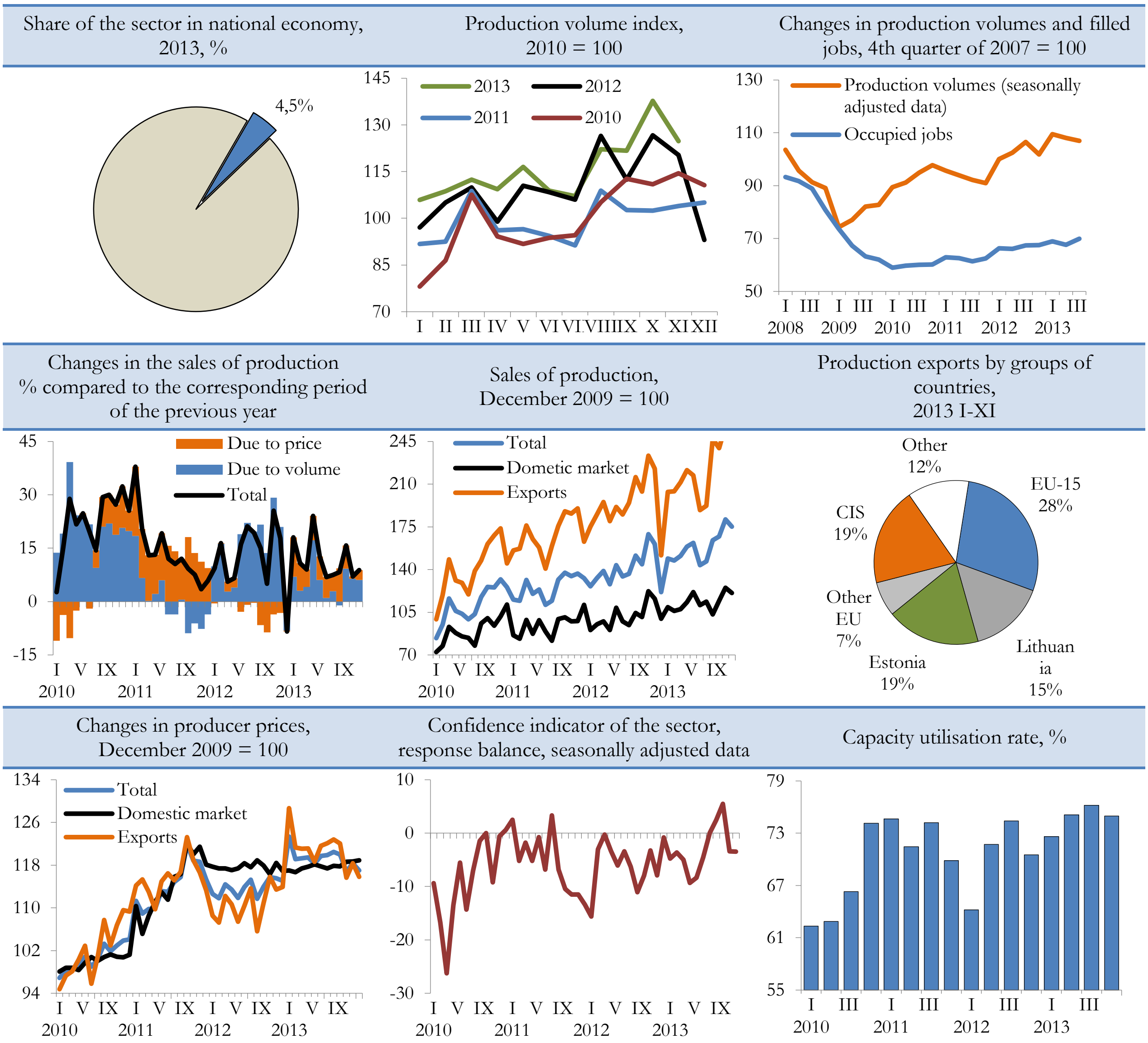
The turnover of the industry was also growing steadily. In 2012, it was by 28% higher than before the crisis in 2007. In 2013, revenues from sales in the industry kept growing – in January-November, sales volumes were by 11.5% higher than a year ago. The rise in revenues was based on both exports and the increase in turnover in the domestic market.

The increase in the turnover was boosted also by the rise in producer prices. In November 2013, producer prices were by 2.4% higher than a year ago, while the producer prices for exported production rose by 4.4% in this period.

The industry ensured nearly 4% of the total number of jobs in manufacturing. In the 3rd quarter of 2013, the number of filled jobs in the paper production and publishing industry was by 3.7% higher than a year ago.

Figure 3.26

Indicators Characterising Paper Production and Publishing Industry



The ***chemical industry*** plays a major role in manufacturing of Latvia. The industry exports more than ¾ of the production.

In 2012, the total production volumes of the chemical industry increased by 8.3%, though they still were behind the pre-crisis level. The increase in volumes was fostered by production of chemical substances and products (increase by 17%), a slight increase was observed also in production of rubber products, while production volumes of pharmacy in 2012 remained at the level of 2011.

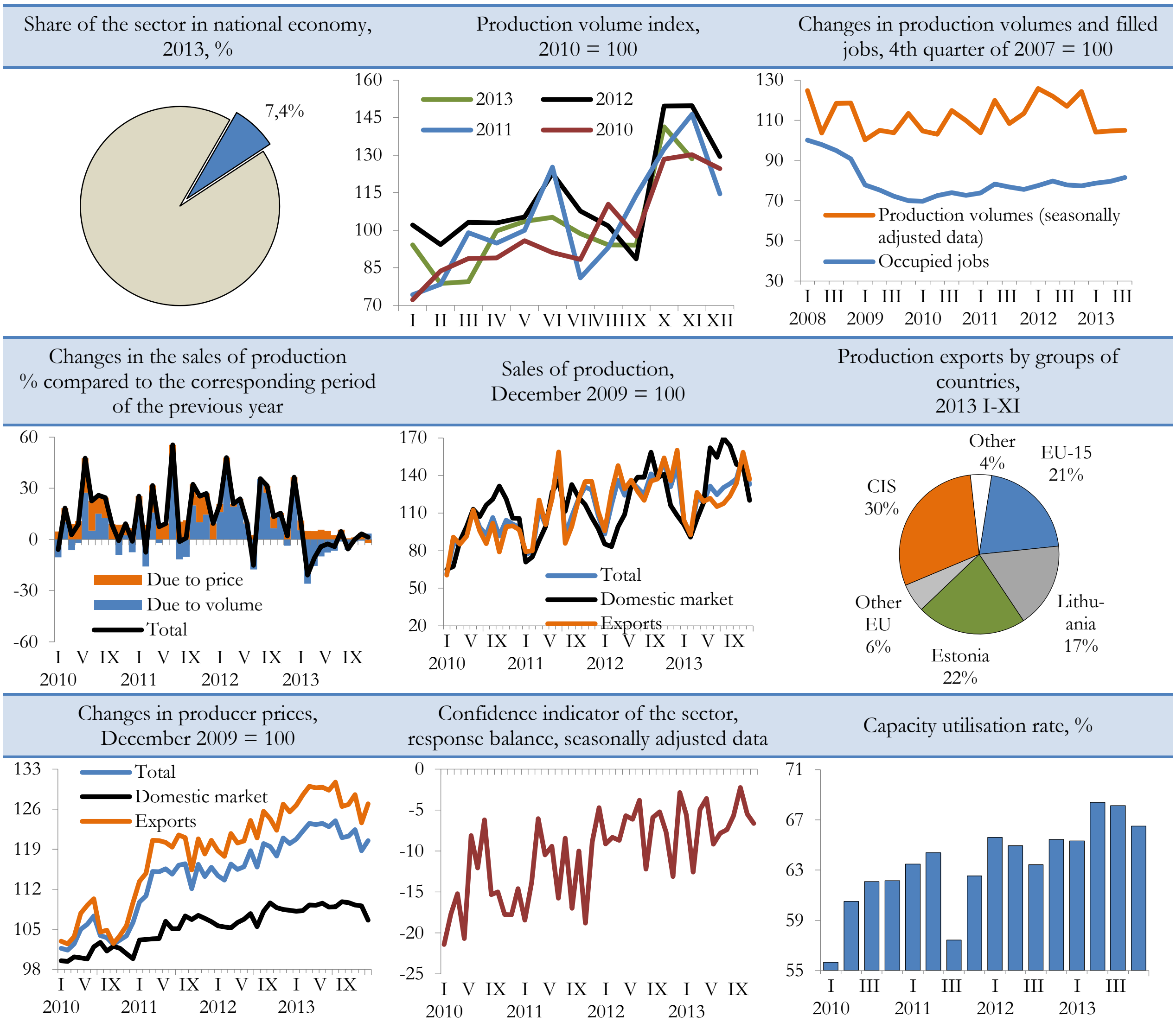
In 2013, the development of the industry was affected by the slowdown in growth rates of the largest export markets, particularly the CIS. In the eleven months of 2013, the production volumes of the chemical industry were by 9% lower than in the corresponding period of 2012. Narrowing output was observed in manufacture of chemical substances and products and pharmacy, while manufacture of rubber products kept growing at a moderate pace.

In 2012, the total turnover of the sector grew by 17.6% due to the increase in sales of exported production. In January-November 2013, the turnover of chemical industry was by 2.7% lower than a year ago due to the dropping production volumes and the slowdown in the rise in producer prices. It was determined by the decrease in the turnover of exported production (by 6.6%), yet, the volumes of production sold in the domestic market were by 10.7% higher than a year ago due to the increasing demand in the domestic market.

Despite the challenges in 2013, the number of filled jobs kept growing in the industry – in the 3rd quarter of 2013, the number of filled jobs was by 4.6% higher than a year ago.

Figure 3.27

Indicators Characterising Chemical Industry



The crisis affected ***the production of other non-metallic minerals*** more severely than other sectors of manufacturing – the production of non-metallic minerals decreased by a half along with the significant drop in the construction volumes.

The recovery of the sector after the crisis is mainly related to the ability to focus on foreign markets – mainly to the EU-15 countries and the gradually resuming activities in the domestic market. In 2012, the production volumes increased by 8.6% and in the eleven months of 2013 – by 5.1 per cent.

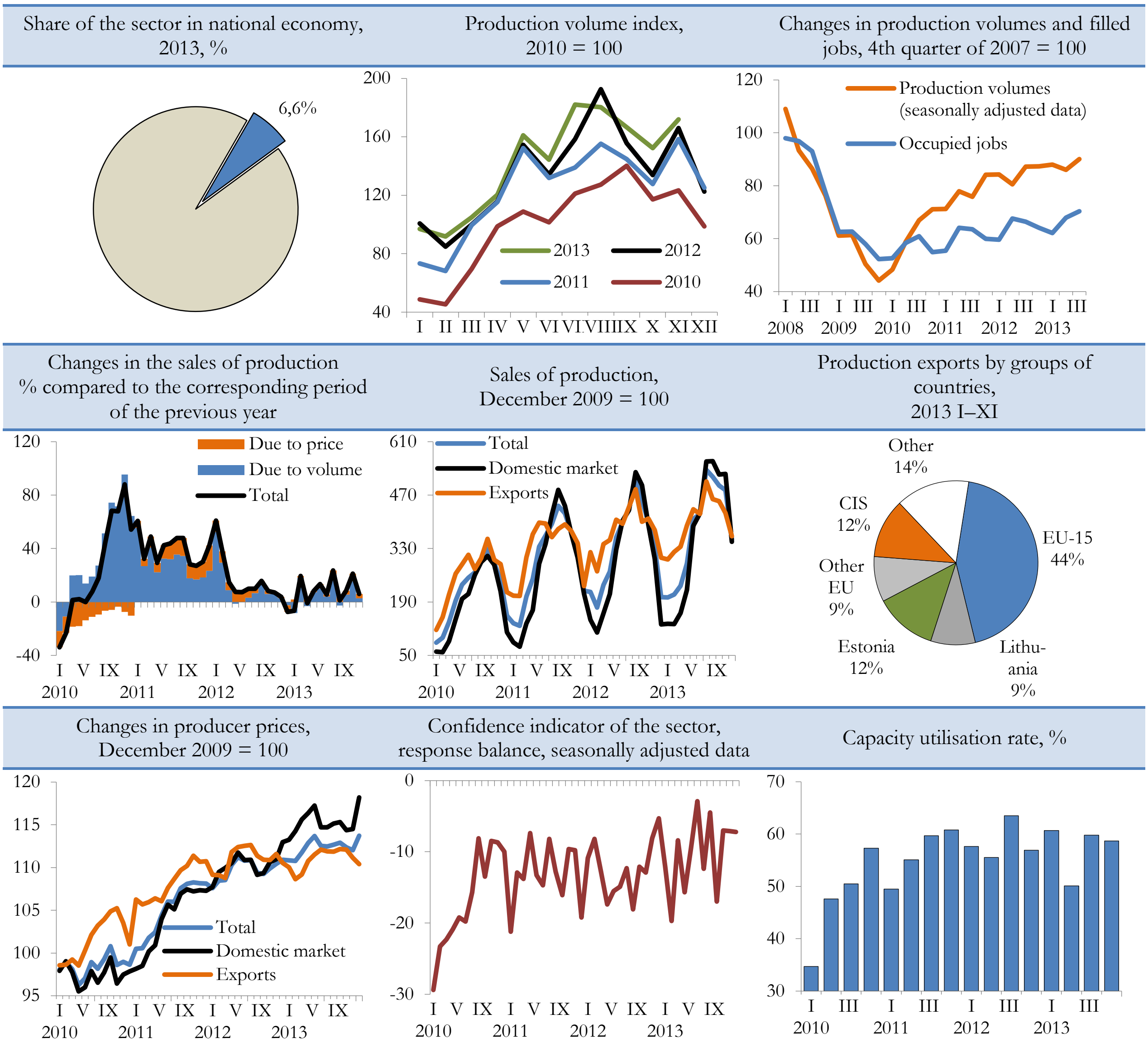
The turnover of the industry has been growing over the past few years as well. The increase in sales revenues from exports has contributed greatly to the turnover – in 2012, the revenues were one and a half times higher than in 2009. The share of exported production has nearly reached a half of the total turnover of the sector.

In the eleven months of 2013, the turnover of the sector was by 9.5% higher than a year ago. The turnover in the domestic market has increased by 13.3% due to the growth of construction sector. At the same time, the turnover in foreign markets has grown at a moderate pace, compared to the previous years – by 5%. The increase in the turnover in 2013 was affected also by a moderate dynamics of producer prices.

The sector constitutes 4% of the total number of jobs in manufacturing. The labour demand grows along with the gradual increase in the production volumes. In the 3rd quarter of 2013, there were by nearly 6% more filled jobs in the sectors than a year ago.

Figure 3.28

Indicators Characterising Production of Other Non-Metallic Minerals



Production of metal and metal articles is the third largest manufacturing sector, constituting almost 11% of the total manufacturing by output and the number of the employed.

Despite the strained economic situation in the EU, the Latvian metal processing sector kept growing fast in 2012 – production volumes exceeded the level of the previous year by 16.3%. Production volumes of the sector were nearly by 40% higher than before the crisis in 2007. The sector provided one of the greatest contributions to the total growth of manufacturing industry.

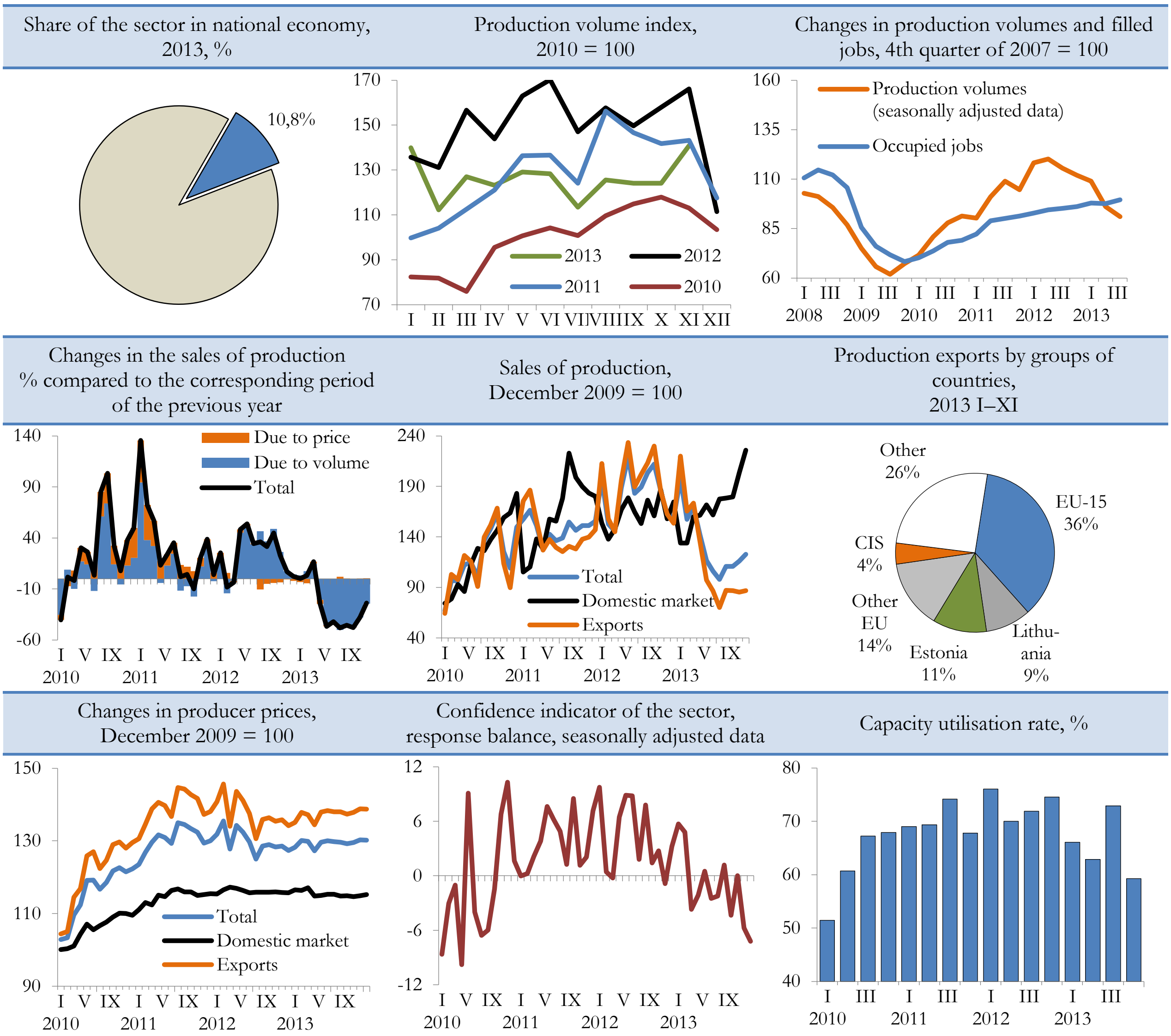
Yet, in 2013, the sector was significantly affected by the termination of activities of one of the largest manufacturing companies – JSC "Liepājas metalurgs". The volumes of manufactured products shrank by a half in the sector. At the same time, slight growth was observed in the manufacture of fabricated metal products in 2013. Overall, the production volumes in metal processing in the eleven months of 2013 were by 17.3% lower than a year ago.

The significant drop in the production volumes led to a decrease in the turnover of the sector in 2013 – in the eleven months it was by 30% lower than a year ago. The volume of production sold for exports shrank by nearly 40 per cent in this period.

The number of jobs has grown over the past few years along with the relatively rapid growth of the sector. In 2012, the number of employed in the sector was by 25% higher than at the lowest point of the crisis in 2009. Yet, termination of JSC "Liepājas Metalurgs" activities resulted in dismissal of the employees of the company, which constituted approximately 1/10 of the total number of people employed in the sector.

Figure 3.29

Characterising Production of Metals and Metal Articles



Production of electrical and optical equipment constitutes slightly over 6% of the total output of manufacturing, and it has been one of the fastest growing sectors in the past few years.

In 2012, the production volumes have increased by nearly 20%, compared to 2011, exceeding the level of 2007 by more than 50%. The increase in production volumes of electronic equipment has contributed the most to the growth of the industry, but the production volumes of computer, electronic, and optical equipment have increased slightly slower.

Overall, the industry kept growing rapidly also in 2013 – in the eleven months, the production volumes exceeded the level of the corresponding period of 2011 by 16 per cent.

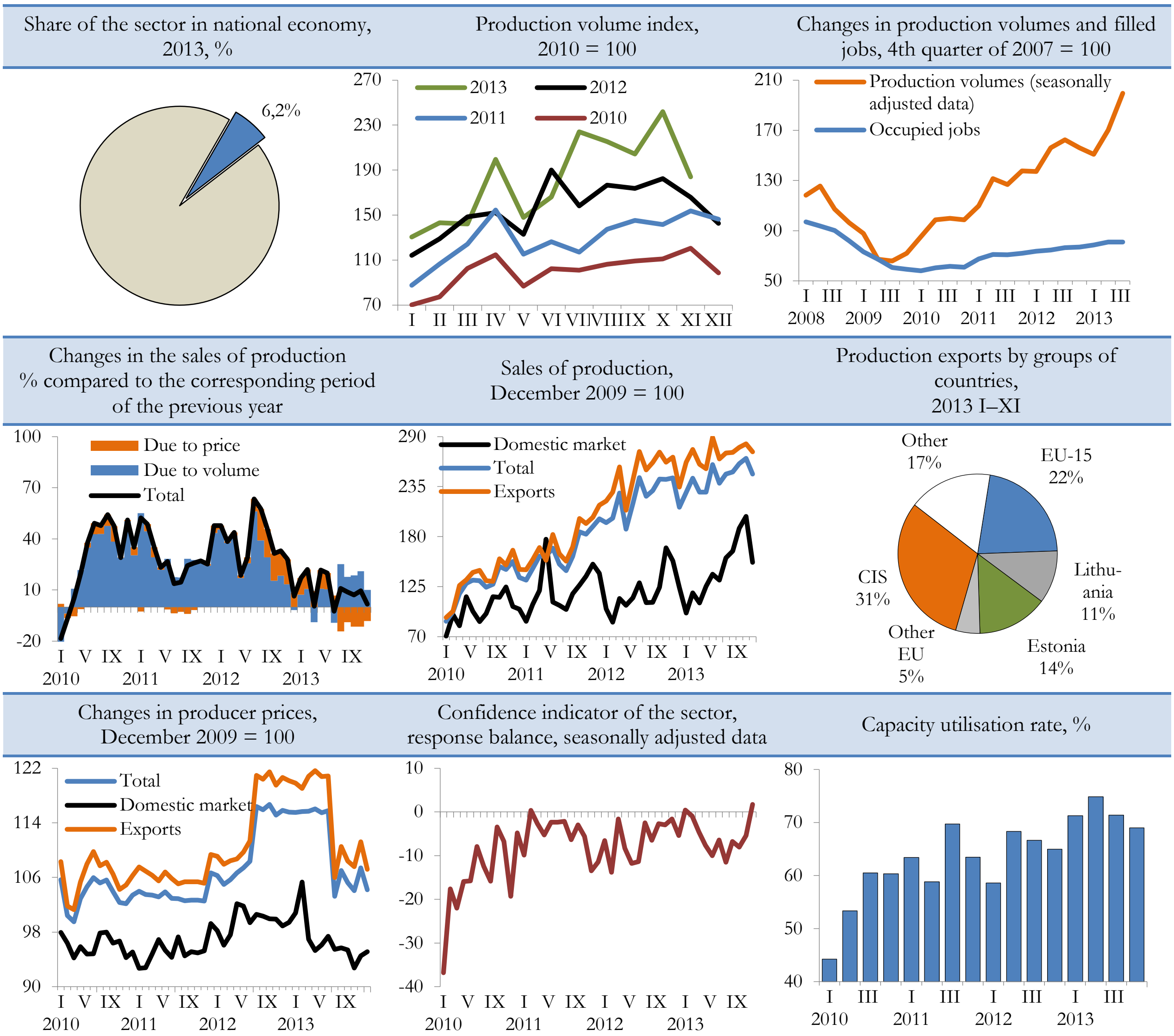
Sales revenues of the sector are increasing in line with the increase in the production volumes. From 2010-2012, the turnover of exported production has been increasing by 30% annually. Overall, the industry exports almost 90% of manufactured production.

In January-November 2013, the turnover of the industry has increased by 10%, compared to the corresponding period of the previous year. The turnover of production exported in this period has increased at a slower pace than in the previous years (increase by nearly 9%). Yet, the increase in the demand in the domestic market has fostered a rapid rise in the turnover in the domestic market in 2013 – by more than 21 per cent.

The growth has been mostly boosted by the increase in productivity, while the number of jobs has grown at a considerably slower pace. In the 3rd quarter of 2013, there were by 5.8% more filled jobs than a year ago.

Figure 3.30

Indicators Characterising Production of Electrical and Optical Equipment



The growth of **production of machinery and equipment** relies on export possibilities. Almost 75% of all production manufactured in the industry is sold in foreign markets – mainly Lithuania, Estonia, and other EU Member States. Since the industry is a supplier of means for production and of common technologies to other industries of national economy, the increasing economic activities have a boosting effect on the demand for the industry products.

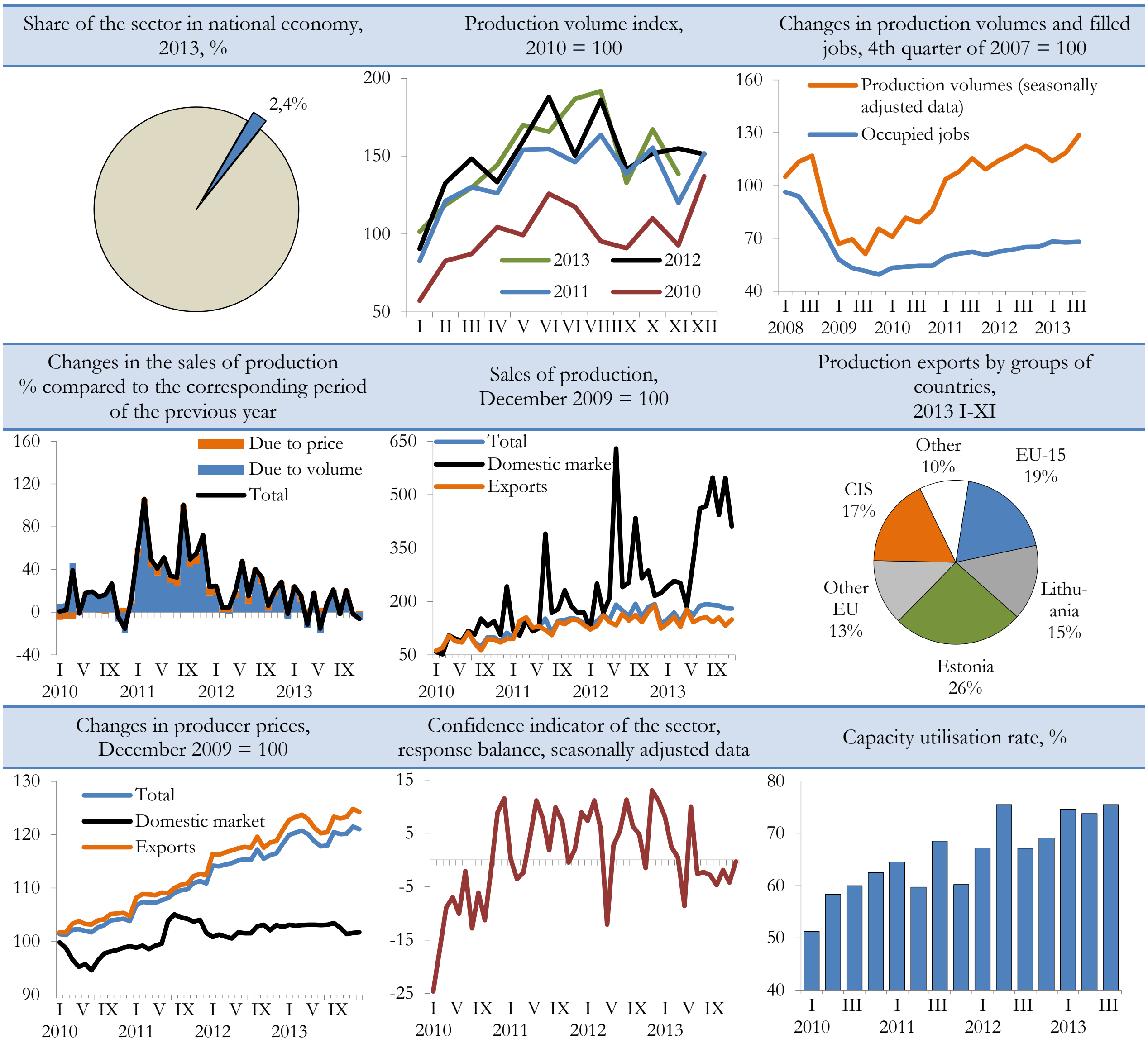
In 2012, the output of production of machinery and equipment was by 8.7% higher than in 2011, thus exceeding the pre-crisis level by 25%. In early 2013, the growth of the industry was affected by the deteriorating economic situation in trade partner countries. However, the total production volumes in the eleven months of 2013 were by 0.6% higher than in the corresponding period of 2012.

Since 2009, the turnover has significantly increased for both exported production and the production sold in the domestic market, which has been mainly fostered by the rise in producer prices for exported production. In 2012, the turnover of the industry has increased by 19.4%. Yet, in the eleven months of 2013, the turnover has been by 5% higher than a year ago. In this period, the amount of productions sold in the domestic market increased by 34% than a year ago, while sales volumes of exports have been by 2.1% lower than in January-November 2012.

Despite a slower growth in 2013, the number of the employed in the production of machinery and equipment keeps growing. In the 3rd quarter of 2013, there were by 4.6% more filled jobs in the industry than a year ago.

Figure 3.31

Indicators Characterising Production of Machinery and Equipment



Production of transport vehicles constitutes 4% of the total output of manufacturing. The industry is characterised by explicit fluctuations of production volumes since it mainly deals with new orders. As approximately 90% of production is exported, fluctuations in external demand have a significant impact on development of the industry.

The volumes of new orders in domestic and foreign markets and production volumes increased rapidly in the post-crisis period. In 2012, the production volumes increased by 15.8% and were by 1/3 higher than in 2007. The orders finished in the previous years and the weak demand in foreign markets affected the development of the industry in 2013. In 11 months production volumes in the industry were considerably slower, while production volumes were by 1.8% higher than a year ago.

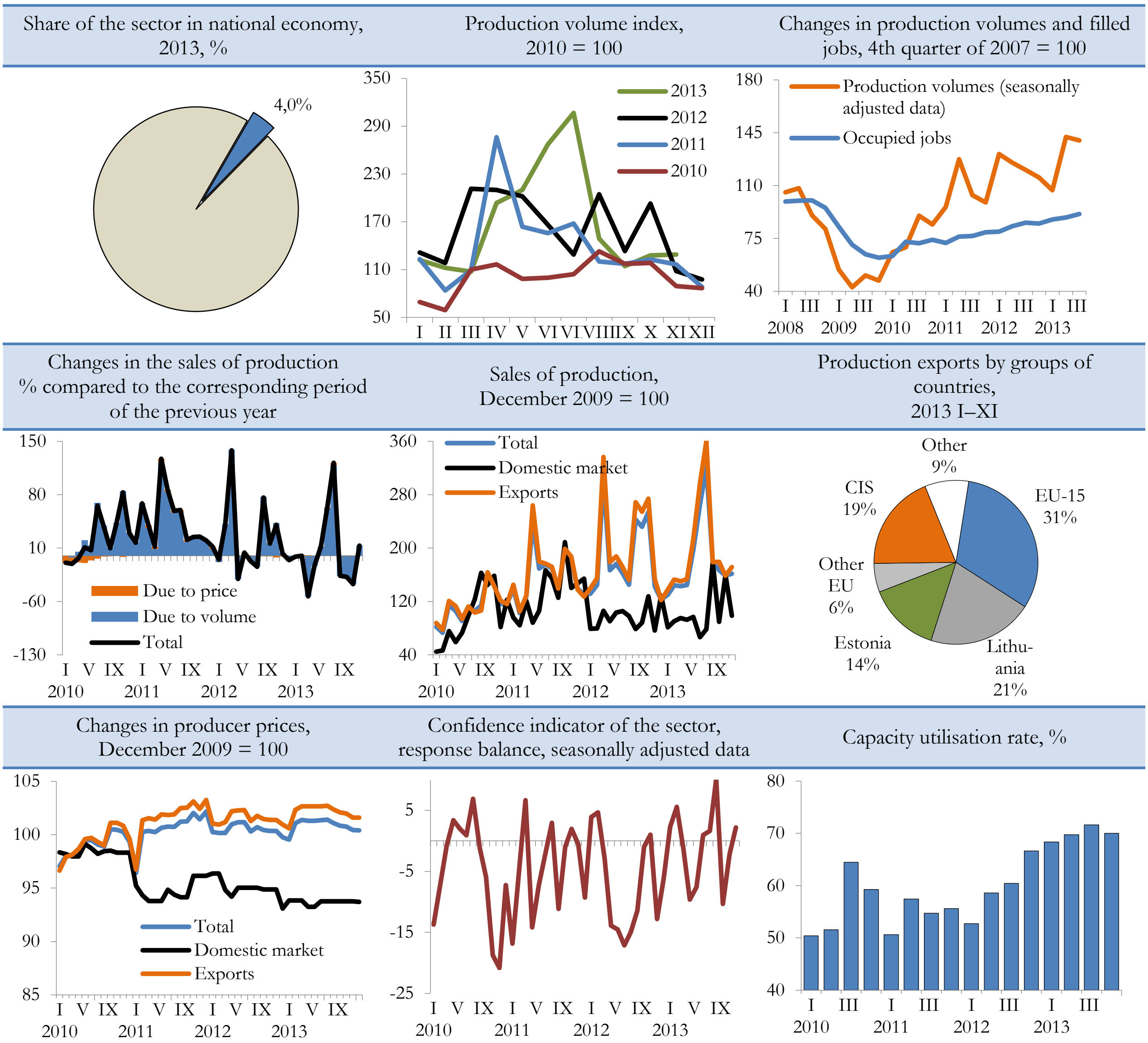
In 2012, the turnover of the exported production in the industry has more than doubled compared to 2009. As the demand in foreign market dropped in January-November 2013, the turnover of exported production was by 5.3% lower than a year ago. At the same time the turnover of production sold in the domestic market has slightly increase, thus being by 10% higher than a year ago.

Although the demand for production of the industry has been considerably fluctuating over the past few years, the dynamics of producer prices has been rather moderate.

Recently, the rapid growth of the industry has boosted the number of the employed. In the 3rd quarter of 2013, there were by 6.6% more filled jobs than in the 3rd quarter of 2012.

Figure 3.32

Indicators Characterising Production of Transport Vehicles



3.3. Forecasts

The Ministry of Economics has prepared medium-term forecasts of economic development until 2016. The basic assumptions of the more rapid and slower development forecasts are based on various global economic recovery scenarios in a medium-term and on the ability of Latvian producers to further maintain competitiveness restored during the crisis.

Forecasts of the European Commission and of the International Monetary Fund have been used for developing forecasts of the Ministry of Economics in the analysis of external markets and evaluation of global economic development tendencies.

Economic Development in 2014

In 2013, national economy of Latvia continued growing and the increase of GDP still was one of the fastest in the EU.

As forecasted previously, the low demand in foreign markets affected the export dynamics of Latvian goods and services – the growth rates have slowed down. The narrowing export possibilities have affected certain manufacturing industries. At the same time, demand has provided greater contribution to the growth. Stable growth rates have been observed in such large industries of the national economy as construction, trade, and commercial services.

Further growth of the national economy of Latvia will be still closely linked to the export possibilities, and therefore the highest risk to the growth of Latvia is related to global economic development. The export possibilities of Latvia are expected to improve in 2014 along with the gradually stabilizing economic situation in Europe.

At the same time, it should be taken into account that Latvia is gradually losing the competitive advantages gained during the crisis at the expense of cutting labour costs, and therefore the rise in demand on the sales markets and the ability to increase productivity are expected to play an important role in being able to increase the export volumes in the future.

As the situation in the labour market improves, the private consumption is also expected to continue growing. At the same time, a more rapid increase in consumption will be limited by the need to maintain competitiveness. Investments of the private sector will be influenced by the awaiting behaviour of entrepreneurs regarding future perspectives and cautious lending policy of commercial banks.

All main sectors of the national economy are likely to grow in 2014, though in some industries the growth will be slightly slower than in the previous years.

The weak demand in foreign markets will affect the growth of manufacturing, as well as the growth of transport and storage sectors. At the same time, the low demand in these sectors will be partially compensated by the increase in economic activities in domestic market.

The contribution of domestic market-oriented services sectors to the growth also rises along with the increasing private consumption. After several years of stagnation, a moderate increase is expected also in public services sectors.

According to the forecasts of the Ministry of Economics, the growth of Latvian economy in 2014 might reach 4.5% in a year. At the same time, weaker development of the global economic situation might lead to a slower increase in GDP of Latvia.

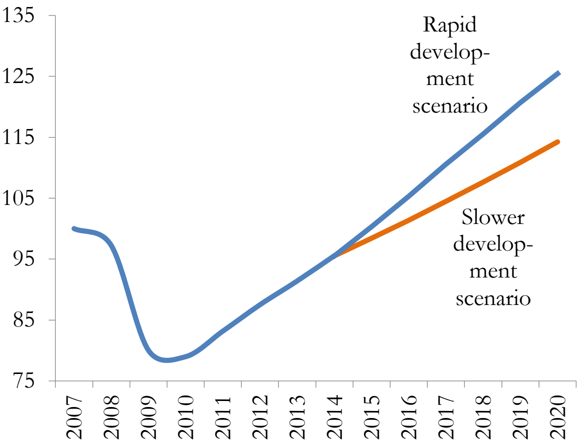
Development Perspectives in 2015-2020

The medium-term growth of the economy will mainly depend on the structural policy implemented by the Latvian government for improvement of competitiveness and the economic situation in Europe.

Figure 3.33

Forecast of Latvian GDP

(2007 = 100)



A transition to a sustainable economic model is taking place in the economy of Latvia, in which exports are the key driver of growth. One of the key issues related to the change of economic paradigm are opportunities of manufacturing industries that depend on the ability to make structural changes in the industry. It is a necessary precondition for strengthening the competitive positions of Latvia in the global market, all the while increasing profitability of total exports.

Table 3.14

Forecast of Latvian GDP by Expenditure Items

	2012 fact	2013	2014	2015-2020 (average annually)*
	growth rates, % over the previous year			
Gross domestic product	**5.2**	**4.5**	**4.5**	**3.2 .. 4.6**
Private consumption	5.8	5.9	4.8	3.0 .. 4.7
Public consumption	-0.2	3.1	3.0	2.1 .. 2.5
Gross fixed capital formation	8.7	1.1	3.1	3.0 .. 5.9
Exports	9.4	1.0	3.0	2.3 .. 4.5
Imports	4.5	-0.9	3.1	1.8 .. 4.4
	structure, %			
Gross domestic product	**100**	**100**	**100**	**100**
Private consumption	62.4	62.3	62.4	61.5 .. 62.1
Public consumption	16.0	16.9	17.1	17.5 .. 16.9
Gross fixed capital formation	22.8	22.4	22.6	21.1 .. 23.5
Changes in inventories	2.7	0.8	0.5	0.1 .. 0.0
Exports	61.6	59.6	59.0	55.8 .. 58.2
Imports	65.5	61.9	61.6	56.9 .. 60.8
Export-import balance	-3.9	-2.3	-2.6	-1.2 .. -2.5

* structure at the end of the period

The main medium-term objectives of the structural policy of Latvia are related to certain structural changes in allocating resources of the economy in favour of production of higher value added goods and services, export-oriented sectors, higher investments in new technologies, innovation and ICT, as well as improvements in the education system and supporting science. Implementation of these measures will strengthen economic growth potential, thus boosting industrial growth and increasing productivity of the national economy.

Table 3.15

Forecast of Latvian GDP by Sectors

(real growth, % in comparison with the previous year)

	2012 fact	2013	2014	2015-2020 (average annually)
Gross domestic product	**5.2**	**4.5**	**4.5**	**3.2 .. 4.6**
Agriculture, forestry	-0.9	-2.6	2.8	2.3 .. 2.4
Manufacturing	9.4	-0.3	4.6	2.9 .. 5.0
Other industry	-2.6	-1.5	1.4	2.3 .. 3.3
Construction	14.5	10.1	7.3	4.2 .. 6.4
Trade, accommodation	7.4	5.4	4.0	3.7 .. 5.3
Transport and storage	3.6	2.3	3.2	2.0 .. 3.5
Other commercial services	4.3	7.3	5.6	3.5 .. 5.2
Public services	-0.6	4.6	4.7	3.0 .. 3.5

In the post-crisis period, the flexible labour market in Latvia has been a crucial factor for ensuring the current growth. Reducing wages and employment in line with the narrowing output allowed improving competiveness of national economy. However, further growth can no longer rely on such drastic measures and an increasing emphasis will be placed on quality improvements of the labour market in order to address the main challenges to the national economic growth – demography (migration and ageing labour) and increasing labour costs. Considering the negative demographic trends, the issues regarding access to labour are going to become increasingly topical in Latvia along with the growing economy in the coming years (see Section 5.3). The lack of labour may become a factor hindering the growth in the future.

The more rapid development scenario foresees stable medium-term growth and economic development of the EU and the competitive advantages of Latvian economy are to a greater extent based on technological factors, improvements of production efficiency and innovations, and to a lesser extent – on cheap labour and low prices for resources. The more rapid development medium-term scenario foresees that the growth rates of manufacturing (and accordingly also of exports) will remain comparatively high, based mainly on both the increased competitiveness of Latvian producers and on the stable external demand.

The weaker development scenario is based on an assumption that the global economy will develop unevenly and the EU will recover slowly from the crisis. Yet, national economy of Latvia will gradually lose the competitive advantages in low-cost segments.

4. MACROECONOMIC STABILITY

4.1. Public Finances

4.1.1. Fiscal Policy and Public Debt

Deterioration of the economic situation in 2008 and 2009 affected by the global financial crisis has considerably worsened the Latvian fiscal position (see Table 4.1). In order to prevent the situation in the financial sector from going out of control, Latvia has carried out comprehensive budget consolidation. Overall, from 2008 to 2012, fiscal consolidation measures with fiscal impact of 16.9% of GDP have been carried out, out of which about 6.7% of GDP are measures on the revenue side while measures on the expenditure side constitute about 10.2% of GDP. On average, Latvia has carried out annual fiscal consolidation measures in the amount of 3.4% of GDP from 2008 until 2012.

As a result of budget consolidation implemented by the government, the budget deficit in 2010 and 2011 decreased to 8.1% and 3.6% of GDP, respectively. In 2012, it continued dropping and was 1.4% of GDP.

Table 4.1

General Government Budget

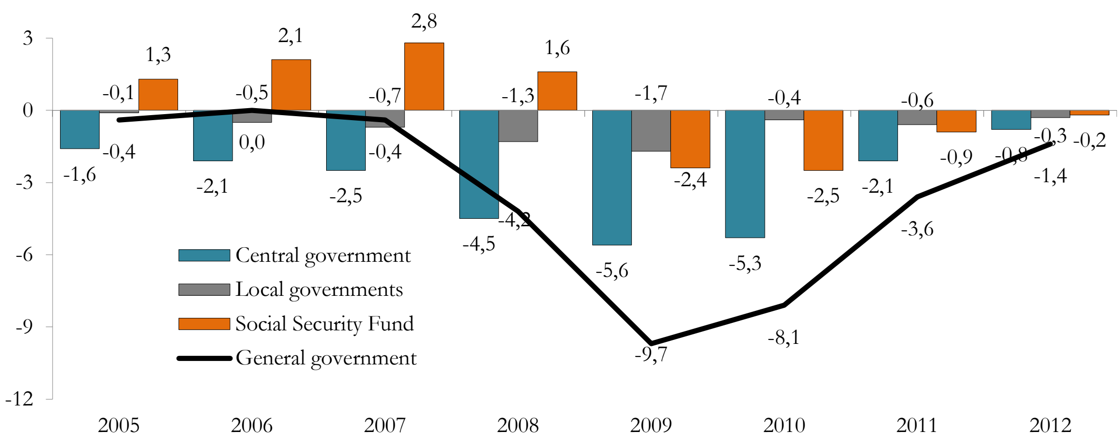
	2006	2007	2008	2009	2010	2011	2012
Revenues (million LVL)	4208.0	5235.5	5605.8	4442.6	4512.8	4978.3	5448.0
(% of GDP)	37.8	35.6	34.9	34.0	35.3	34.9	35.1
Expenditures (million LVL)	4263.2	5292.3	6286.9	5712.8	5549.6	5488.1	5657.7
(% of GDP)	38.3	36.0	39.1	43.7	43.4	38.4	36.5
Balance (million LVL)	-55.1	-56.8	-681.0	-1270.1	-1036.9	-509.8	-209.8
(% of GDP)	-0.5	-0.4	-4.2	-9.8	-8.1	-3.6	-1.4

Over the past few years, the general government budget deficit is composed of the deficit in the central government budget and the local government budget, as well as the Social Security Fund (see Figure 4.1). Until 2008, the social insurance budget had a surplus; however, deficit has appeared over the last few years.

Figure 4.1

General Government Budget Balance by Sub-Sectors

(% of GDP)

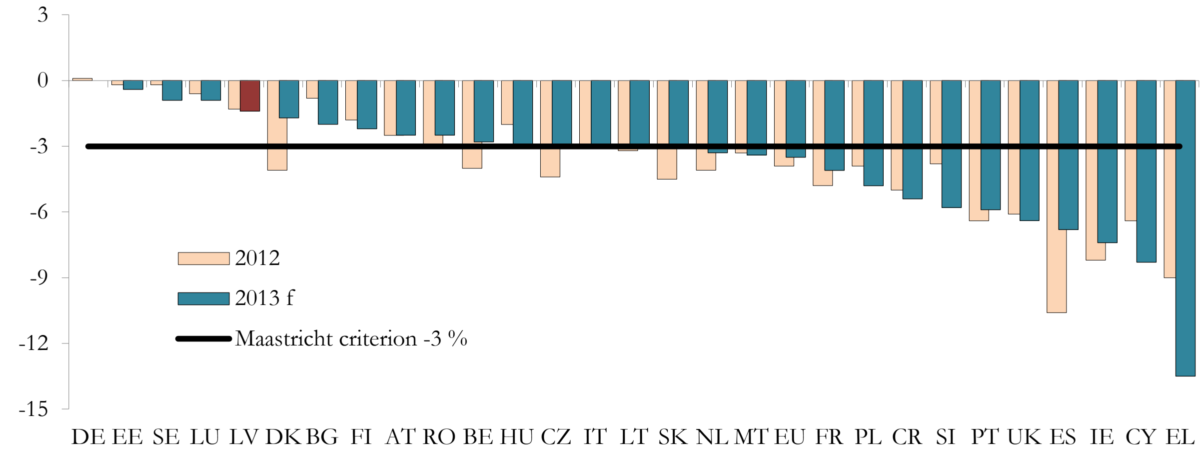


The level of the average budget deficit of the EU in 2012 was 3.9% of GDP (in 2011 – 4.4% of GDP, in 2010 – 6.5% of GDP). The budget condition of 15 EU Member States has improved in 2012, while in

1 Member State it remained the same and in 12 – deteriorated. In 17 EU Member States the government budget in 2012 exceeded the Maastricht criterion of 3% of GDP. Spain, Greece, and Ireland had the highest general government budget deficit against GDP in 2012. The budget deficit in these countries exceeded 8% of GDP. Only Germany had a budget surplus.

Figure 4.2

General Government Budget Balance in the EU Member States in 2012 and 2013
(% of GDP)



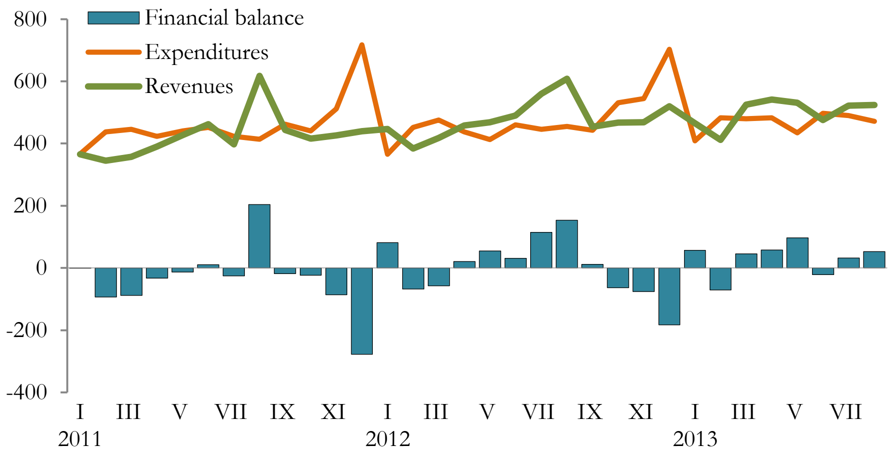
f – EC forecasts

According to the EC forecasts published in autumn 2013, the budget situation in the EU Member States is expected to continue improving both in 2013 and 2014. In 2013, the level of the average budget deficit of the EU Member States is forecasted to be in the amount of 3.5% of GDP, while in 2014 – in the amount of 2.7% of GDP. In 2013, the highest budget deficit that could exceed 6% of GDP is expected in Ireland, Greece, Spain, Cyprus, and the United Kingdom.

The Saeima approved the government budget for 2013 with a deficit of 1.4% of GDP. The priorities of the government budget for 2013 are economic growth, improvement of the demographic situation, and a rise in wages for certain categories of workers employed in the public sector.

Figure 4.3

Financial Indicators of the General Consolidated Government Budget
(million LVL)



In the nine months of 2013, revenues of the general government consolidated budget (LVL 4471.6 million) exceeded expenditures (LVL 4210.1 million), thus forming a financial surplus in the general budget in the amount of LVL 261.5 million (see Figure 4.3). However, expenditure is traditionally tended to increase in the last few months of the year – in the government budget and local government budgets, thus leading to a drop in the surplus. Considering larger contribution to the EU budget, compared to the plan, as well as the repayment of the state guaranteed loan of JSC "Liepājas Metalurgs", the Ministry of Finance forecasts that the general government budget deficit will be 1.3% of GDP in 2013.

On November 7, 2013, the Saeima approved the government budget for 2014 with a deficit of 0.9% of GDP. The priorities of the government budget for 2014 are measures to reduce income inequality, considerable tax reduction for low-income people and families with children, measure to fight against shadow economy. A number of measures are aimed at improvement of the demographic situation, it is also expected to allocate funding to increase the childcare benefits and several changes are planned to be made in the procedure for granting parent's benefits.

The Ministry of Finance expects the general government budget deficit for 2015-2016 to be below the ceiling defined in the Convergence Programme, namely, in 2015 – 0.9% of GDP and in 2016 – 0.8% of GDP (according to the *European system of national and regional accounts methodology*).

Since the general government budget deficit was considerably below 3% Maastricht criterion in 2012, the European Commission has abrogated the *Decision 2009/591/EC on the existence of an excessive deficit in Latvia*. Structural deficit has reached 0.5% level that meets the national medium-term budget balance objective of Latvia in structural terms or MTO. Thus, the mission in the coming years is no longer the reduction of structural deficit; it is now to maintain the MTO at the level, allowing deviations that comply with the *Stability and Growth Pact*.

In order to ensure development of sustainable and counter-cyclical fiscal policy, the Saeima has adopted the *Law on Fiscal Discipline* (FDL) which entered into force on March 6, 2013. The Law stipulates binding fiscal conditions for the annual government budget and the medium-term budget. The FDL covers the requirements of the *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union,* thus ensuring full compliance of the Latvian system with the EU level requirements. It is also crucial to note that the funding for the establishment of the Fiscal Council has been approved with the main aim to supervise compliance with the FDL regulations within the planning of the medium-term budget.

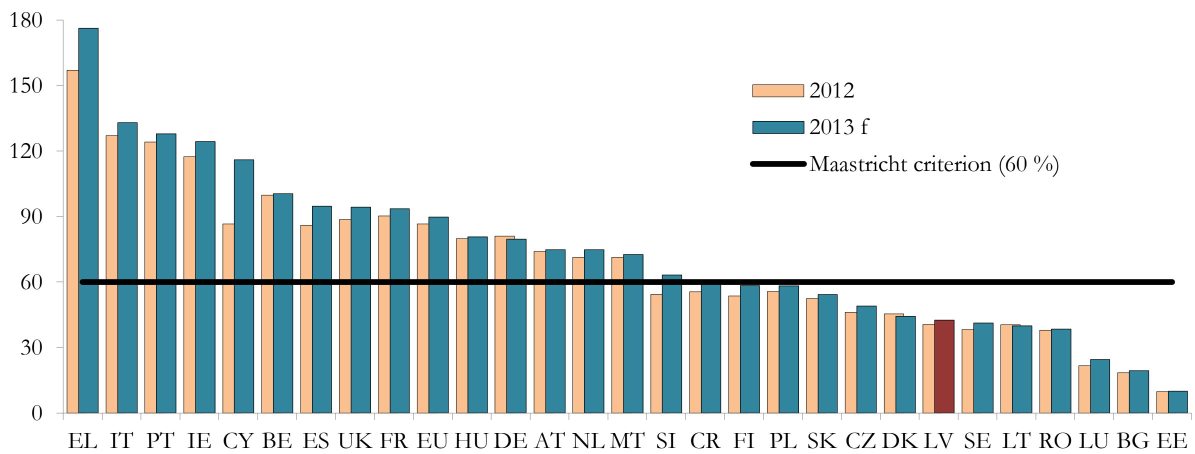
In order for these systemic new approaches towards development of fiscal policy and observing discipline to be sustainable without being constantly amended or even cancelled, amendments to the Constitution (*Satversme*) have been prepared and are still under consideration at Saeima committees.

The level of **the general government debt** in Latvia is still among the lowest in the EU (see Figure 4.4).

Figure 4.4

General Government Debt in the EU Member States in 2012 and 2013

(% of GDP)



f – EC forecasts

In 2012, the EU average public debt level was 85.1% of GDP (82.3% of GDP in 2011, 79.8% of GDP in 2010). The public debt exceeded the Maastricht criterion that is 60% of GDP in 14 EU Member States in 2012. In 2012, the highest public debt against GDP was observed in Greece, Italy, Portugal, and Ireland, while the lowest general government debt against GDP was registered in Estonia, Bulgaria, and Luxembourg. According to the EC forecasts published in autumn 2013, the average level of the general government debt in the EU will reach 89.7% of GDP in 2013 and continue increasing also in 2014.

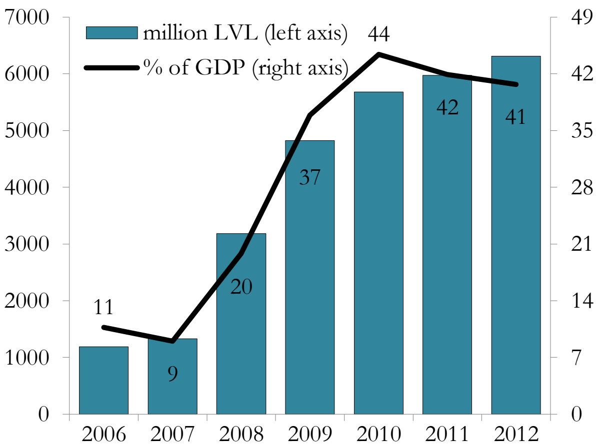
The general government debt in Latvia gradually increased until 2007. Since 2008, it has been growing rapidly to meet the financial commitments of the government and reached LVL 5682.1 million or 44.4% of GDP at the end of 2010 (see Figure 4.5). At the end of 2011, it was LVL 5974.4 million or 41.9% of GDP, but at the end of 2012, it was LVL 6309.2 million or 40.6% of GDP. The level of the general government debt is mainly influenced by the central government debt, constituting LVL 6305.8 million at the end of 2012.

It should be noted that the three-year international loan programme has been successfully completed at the end of 2011. The programme earmarked a loan of EUR 7.5 billion to Latvia. Taking into account that the economic situation and financial condition of Latvia had improved, Latvia did not need the full amount of the available financing. Latvia used EUR 4.4 billion.

After the successful completion of the international loan programme, Latvia has, on various occasions, proved its ability to attract funding on global financial markets on favourable conditions by organizing a public issue of government debt securities.

Figure 4.5

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



By carrying out timely borrowing measures under the medium-term strategy and continuing the implementation of a sustainable fiscal policy, it is possible to refinance currently assumed central government debt commitments on favourable conditions in terms of rates and deadlines, as well as achieve reduction and stabilisation of the general government debt at a sustainable level in the long-term, strictly complying with the criterion for the general government debt under the Maastricht Treaty.

Considering the planned borrowing strategy, the general government debt level in the medium-term is not expected to exceed the criterion of 60% of GDP under the Maastricht Treaty.

4.1.2. Budget Revenues[1]

After the decrease in revenues of the general government consolidated budget during the economic downturn in 2009 and 2010, budget revenues started to increase again as the economic activities gradually resumed in 2011. **Revenues of the general government consolidated budget** have increased in 2012 along with the growing economy, constituting LVL 5742.8 million in 2012, which is by 12.9% higher than in 2011.

In the eleven months of 2013, revenues of the general government consolidated budget was LVL 5404 million, which was by 3.5% higher than in the eleven months of 2012.

Almost ¾ of all tax revenues consist of tax collections. The rest of budget revenues largely consisted of income from non-tax income and foreign financial assistance.

In 2012, tax revenues constituted LVL 4289 million, which is by LVL 410.7 million or 10.6% more than in 2011. The increase in employment taxes provided the most considerable contribution in 2012. The increase in employment taxes was fostered by the rise in employment and wages – revenues from mandatory state social insurance contributions and personal income tax increased, as well as indicators of retail trade turnover improved, thus ensuring an increase in the value added tax revenues.

In the eleven months of 2013, compared to the corresponding period of 2012, increased by 5% and was LVL 4113 million.

In 2012, revenues from **employment taxes** increased by 8.6% along with the increasing number of employed and wages, compared to 2011.

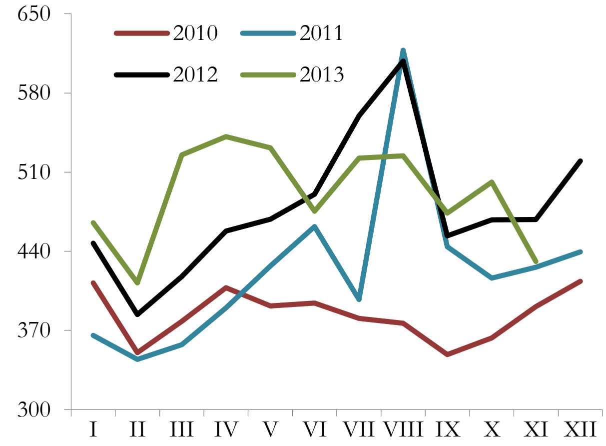
In 2013, revenues from employment taxes continued increasing, and in the eleven months, they increased by 5.1%, compared to the eleven months of 2012. Employment taxes constituted a half of all tax revenues.

[1] According to official data of monthly reports of the Treasury

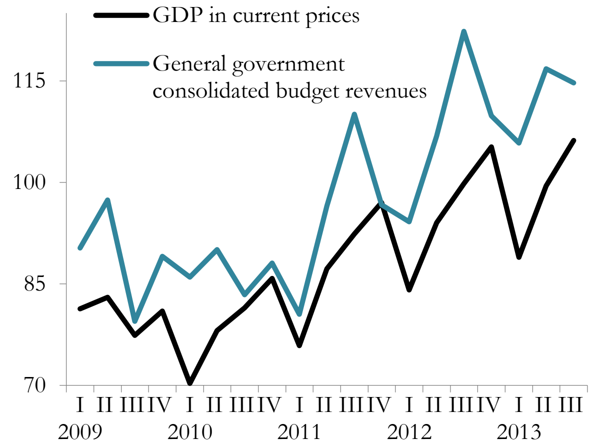
In 2012, revenues from personal income tax constituted LVL 871.6 million, which was an increase of 10%, compared to 2011.

Figure 4.6

General Government Consolidated Budget Revenues
(million LVL)



GDP in Current Prices and General Government Consolidated Budget Revenues
(4th quarter of 2008 = 100)



In the eleven months of 2013, revenues from personal income tax constituted LVL 841.9 million, which was by LVL 48.6 million or 6.1% more than in the eleven months of 2012.

Table 4.2

Budget Revenues
(% of GDP)

	2008	2009	2010	2011	2012	2013 I-III
General government consolidated budget revenues	**35.6**	**36.2**	**36.0**	**35.6**	**37.0**	**37.5**
I Tax revenues	**29.4**	**26.9**	**26.7**	**27.2**	**27.6**	**28.2**
1. Indirect taxes	*10.5*	*10.1*	*10.2*	*10.2*	*10.5*	*10.8*
– value added tax	6.9	6.1	6.5	6.7	7.2	7.4
– excise tax	3.4	3.9	3.6	3.4	3.2	3.2
– customs duty	0.2	0.1	0.1	0.1	0.1	0.1
2. Income taxes and property taxes	*10.0*	*7.6*	*7.8*	*7.7*	*7.9*	*8.2*
– corporate income tax	3.1	1.5	0.9	1.4	1.6	1.6
– personal income tax	6.4	5.6	6.2	5.5	5.6	5.8
– real estate tax	0.4	0.6	0.7	0.8	0.8	0.8
3. Social insurance contributions	*8.7*	*8.9*	*8.6*	*8.6*	*8.5*	8.6
4. Other taxes	*0.3*	*0.2*	*0.2*	*0.6*	*0.6*	0.7
II Other revenues	**6.2**	**9.3**	**9.3**	**8.5**	**9.4**	**9.3**

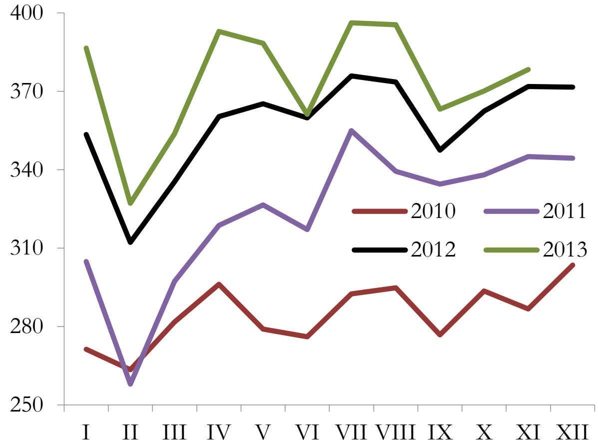
On January 1, 2013, the personal income tax standard rate was reduced from 25% to 24%. Yet, the rate of the personal income tax relief for dependants was increased on July 1, 2013 (from LVL 70 to LVL 80 per month).

In 2014, the tax rate reduction model is expected to be changed in the field of personal income tax, as well as the personal income tax rate is expected to be 24% in 2014, 23% in 2015 and 22% – starting from 2016, including other changes, for example, a fairer and more reasonable regulation is expected to be introduced regarding natural persons alienating sole real property; it is also expected to introduce an anti-tax evasion regulation and to apply general tax rate also to income equivalent to pensions, etc.

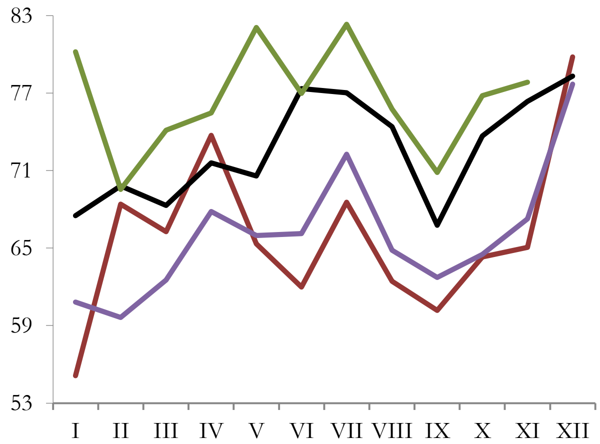
Figure 4.7

Tax Revenues by Months
(million LVL)

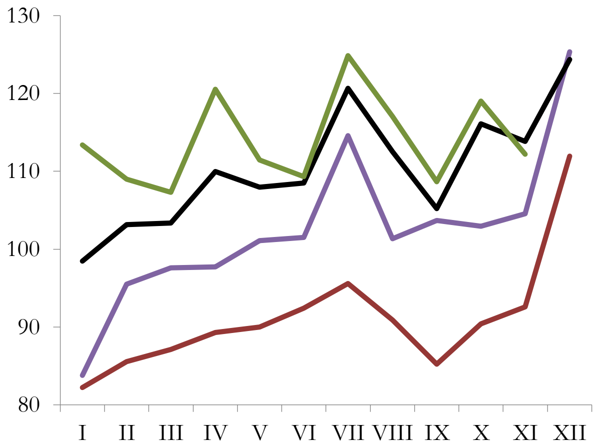
Total Tax Revenues



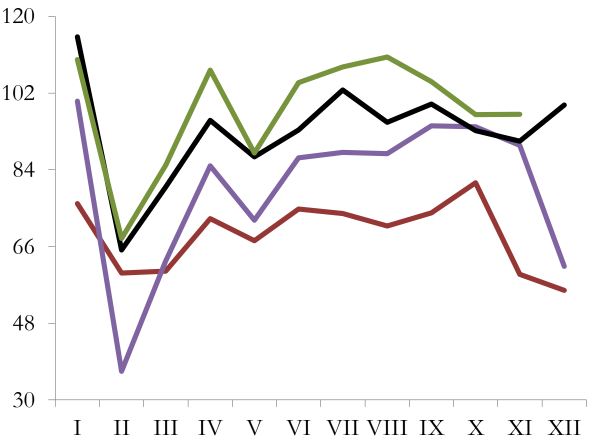
Personal Income Tax



Mandatory State Social Insurance Contributions
(excluding resources of state funded pension schemes)



Value Added Tax



Excise Tax

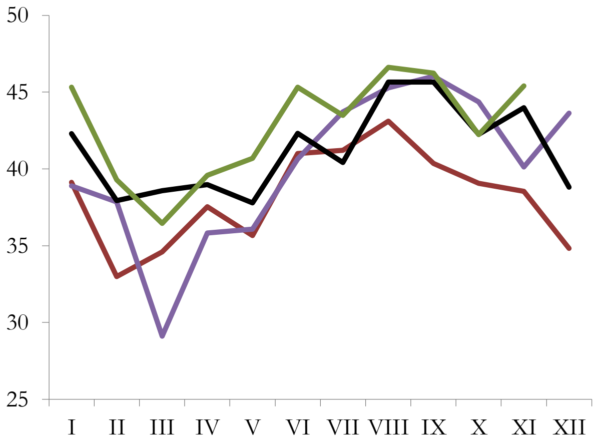
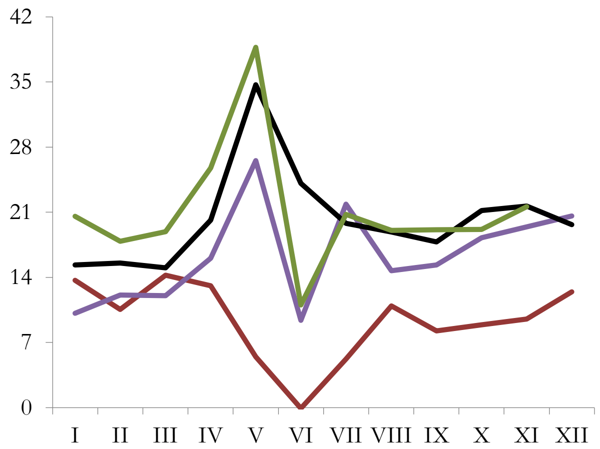
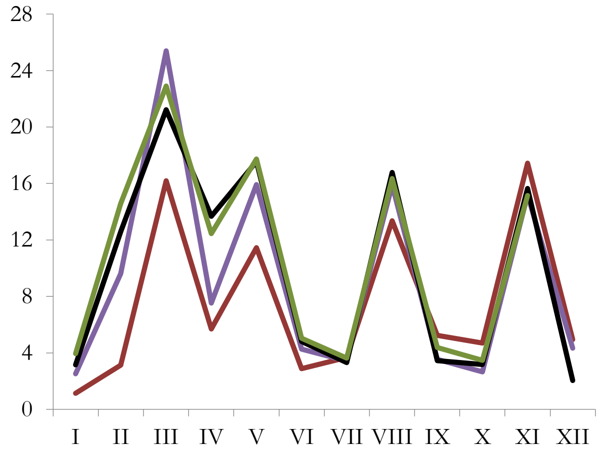


Figure 4.7 continued

Corporate Income Tax	Real Estate Tax



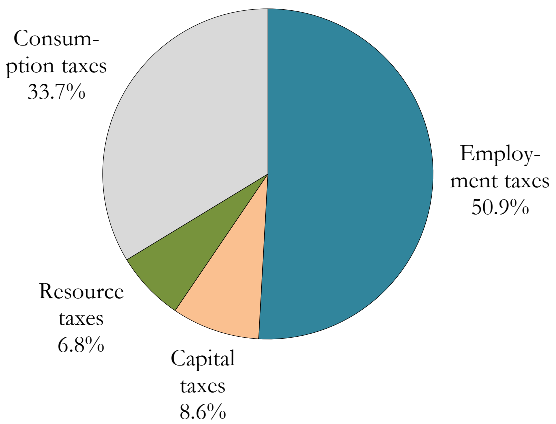


The employment tax reform is aimed at reaching employment tax rates equal to those in Estonia and Lithuania in terms of costs to keep Latvia competitive among the Baltic States with regard to investments and jobs. The reduced overall tax burden will reduce also the risk of poverty and structural unemployment, as well as shadow economy and motivation to avoid paying taxes.

In 2012, revenues from mandatory state social insurance contributions amounted to LVL 1324 million or 7.7% more than in 2011.

Figure 4.8

General Government Consolidated Budget Tax Revenues by Tax Groups in January-November 2013
(%)



In the eleven months of 2013, revenues from mandatory state social insurance contributions kept growing and were LVL 1252.7 million, which was by 4.4% more than in the corresponding period of 2012.

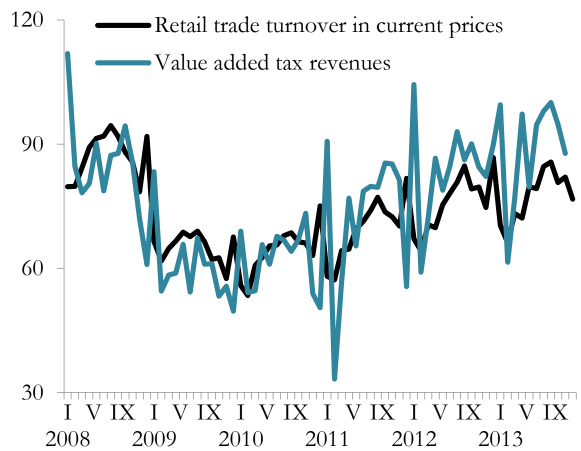
As regards the mandatory state social insurance sector, in 2014, it is expected to define the rate of the mandatory state social insurance contributions at 35.09%, out of which 23.59% shall be paid by employer and 10.5% – by employee, as well as to apply the mandatory state social insurance contributions to deemed interest of board members of capital companies (except micro-enterprise taxpayers).

Revenues from **consumption taxes** constitute 1/3 of all tax revenues. The increase in private consumption and thus the increase in retail trade turnover in 2012 allowed collecting by 13.3% more taxes than in 2011.

In the eleven months of 2013, revenues from consumptions taxes were by 5.4% higher than in the corresponding period of 2012.

Figure 4.9

Retail Trade Turnover in Actual Prices and Revenues from Value Added Tax
(December 2007 = 100)



In 2012, revenues from value added tax constituted LVL 1116.6 million and increased by 16.5%, compared to 2011.

In the eleven months of 2013, revenues from value added tax constituted LVL 1079.7 million, which is by 6.1% higher than in the corresponding period of 2012.

As of July 1, 2012, the value added tax standard rate is reduced from 22% to 21% to improve competiveness and lessen the inflation pressure, as well as bring Latvia closer to the applicable rates in other Baltic States (in Lithuania – 21%, in Estonia – 20%).

The new *Law on Value Added Tax* came into force on January 1, 2013. The new law envisages no significant changes and the application of the value added tax basically remains the same. Changes in the law are mainly editorial adjustments of the effective provisions of the *Law on Value Added Tax,* specifying or explaining the terminology used in the law, preventing any possible interpretations, and specifying administrative procedures. The rules of the *Directives of the European Council* have also been introduced with an aim to change the current regulations for issuing VAT invoices and determining locations of vehicle rental.

As regards the VAT sector in 2014, it is expected to remove a number of VAT pre-tax deduction limitations, to change the VAT application to real estate operations, to introduce VAT guarantees in oil product transactions, etc.

The excise duty revenues from consumption were growing at a slower pace in 2012 (alcoholic beverages, tobacco and other excise goods). In 2012, the excise duty revenues amounted to LVL 215 million, which was by LVL 1.6 million or 0.8% more than in 2011.

In the eleven months of 2013, the excise duty revenues from consumption increased by 2.7%, compared to the corresponding period of the previous year.

As regards excise duty on consumption goods in 2014, it is expected to change the excise duty on tobacco products, by increasing the tax on cigarettes, cigars and smoking tobacco. The excise duty on these product groups is expected to be increased annually until 2018.

The share of **capital taxes** in the total tax revenues in 2012 amounted to 8.4%. The capital tax levy has increased the most among the tax groups in 2012. Overall, in 2012, the capital tax levy was by 17.8% higher than in 2011.

In the eleven months of 2013, the capital tax levy has increased by 3.7%, compared to the corresponding period of 2012.

The fast increase in the capital tax levy may be explained by the low base effect. The significantly narrowing business activities and the increasing number of insolvent enterprises during the crisis led to a considerable drop in the corporate income tax levy. The increase in real estate tax within budget consolidation, on the other hand, had a relatively lesser impact because of the small share of this tax.

In 2012, revenues from corporate income tax have increased by LVL 47.4 million or 24.1%, compared to 2011. Revenues from real estate tax, on the other hand, have increased by LVL 7.2 million or 6.5% amounting to LVL 117.4 million in 2012, compared to 2011.

In the eleven months of 2013, revenues from corporate income tax amounted to LVL 232.6 million, which is by 3.7% more than in the corresponding period of 2012, while revenues from real estate tax increased by 3.7%, amounting to LVL 120.6 million in the eleven months of 2013, compared to the eleven months of 2012.

The amendments to *Corporate Income Tax Law* envisages that as of January 1, 2013, dividends paid out to non-residents (capital companies) and dividends received from non-residents are not subject to the corporate income tax. This provision does not apply to payments from low-tax and tax-free countries. As of January 1, 2014, interest payments to non-residents and payments for the use of intellectual property are not a subject to corporate income tax. It will be possible to cover losses of the taxation period incurred starting from 2008 for indefinite period of time.

As regards the corporate income tax in 2014, a number of changes are expected to be introduced to promote investments and contributions to research and development, for example, to extend the opportunity to apply a tax allowance to new technological equipment for manufacturing, to extend the application period of tax rebates for investments in supported projects, etc.

Several amendments are also expected to be introduced in the *Corporate Income Tax Law* and in the field of micro-enterprise tax.

In 2013, the *Law on Real Property Tax* has been amended with an aim to grant local governments the right to define a tax rate in the amount of 0.2 to 3% of the real property cadastral value by way of binding regulations. The tax rate may exceed the 1.5% only if the real property is not managed in accordance with the procedure specified in laws.

In 2014, several changes are expected in the area of real property tax, for example, to remove the tax exemption from State protected cultural monuments, to amend the procedure for determining taxpayer as a real estate owned by and belonging to state or local government, etc.

The resource tax group is the smallest tax group constituting 6.8% of all tax revenues in 2012. In 2012, resource tax revenues have increased slower than those of other groups – by 4.8%, compared to 2011.

In the eleven months of 2013, resource tax revenues have increased by 3.9%, compared to the level of the corresponding period of 2012.

As of January 1, 2014, several changes are expected in the area of natural resources tax, for example, introduction of new natural resources tax objects and increase in the natural resources tax rates (on extraction of natural resources, disposal of waste, air and water pollution, on goods harmful to environment, etc.).

In 2012, revenues from the excise duty for oil products and natural gas were LVL 279.7 million – by 4.3% more than in 2011. However, revenues from the natural resources tax increased by 18.4% in the same period.

In the eleven months of 2013, revenues from the excise duty for oil products and natural gas have increased by 3.7%, compared to the level of the corresponding period of 2012, while revenues from the natural resources tax have increased by 9.3 per cent.

As of January 1, 2014, the excise duty rate for natural gas used in industrial manufacturing is expected to be reduced in the field of excise duty for oil products and natural gas, while excise duty for petroleum gas and other gaseous hydrocarbons is to be increased.

4.1.3. Budget Expenditures

After the sharp cuts in expenditures during the economic crisis, the government consolidated budget expenditures slightly increased in 2011 (by 2.3%). It was mainly based on the increased capital expenditures in both government and local government budgets in relation to active use of the EU funds.

The government consolidated budget expenditures continued growing also in 2012, though considerably slower than revenues. In 2012, the total government consolidated budget expenditures amounted to LVL 5723.6 million, which is by LVL 191.4 million or 3.5% higher than in 2011.

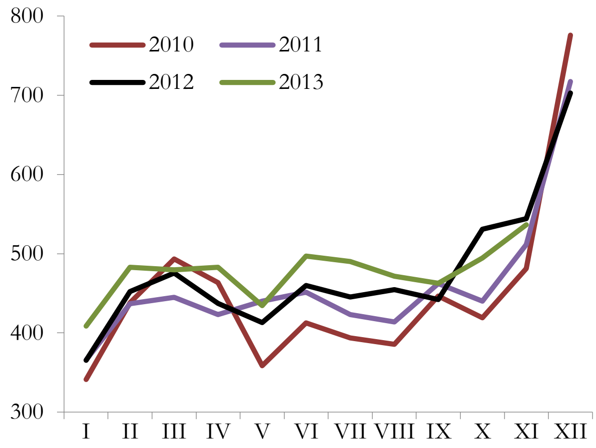
In the eleven months of 2013, expenditures of the government consolidated budget continue increasing, and have increased by 4.4% reaching LVL 5241.1 million, compared to the corresponding period of 2012.

In 2012, in comparison with 2011, the **expenditures for subsidies and grants** increased by 4 per cent.

It should be noted that the expenditures for subsidies and grants increased also during the economic crisis. It was to a great extent related to the increasing number of the unemployed and paid unemployment benefits, costs of severance pays to dismissed workers in the public sector, as well as social benefits.

Figure 4.10

General Government Consolidated Budget Expenditures by months
(million LVL)



In 2012, the expenditures for subsidies and grants constituted 45.3% of all budget expenditures, which is by 7.6 percentage points more than at the beginning of the crisis.

In the eleven months of 2013, the expenditures for subsidies and grants have increased by 1.6%, compared to the corresponding period of 2012.

Capital expenditures were the first to be cut during the crisis. Already in 2008, capital expenditures were lower than a year ago and were significantly cut in 2009 and 2010 as well. Since 2011, capital expenditures have been increasing due to active implementation of the EU funds. Since 2011, capital expenditures have been increasing due to active implementation of the EU funds. In 2012, capital expenditures were by 1.2% higher than in 2011.

Despite the increase over the past few years, the share of capital expenditures in the total expenditures has not been considerably changed, compared to 2008 – in 2012 they constituted average 10% of the total government budget expenditures.

In the eleven months of 2013, capital expenditures have increased by 5.5%, compared to the corresponding period of the previous year.

Current expenditures were reduced the most during the crisis. In order to cut the government consolidated budget expenditures, public administration and certain sectors went through optimization by reducing the number of employees in ministries, along with a number of public agencies and hospitals. In 2008, current expenditures constituted more than a half of all budget expenditures, while in 2012 the share thereof constituted just 43.7 per cent.

It should be noted that the current expenditures have not significantly increased in 2011 or 2012.

In the eleven months of 2013, the current expenditures have increased by 7%, compared to the corresponding period of the previous year. Such a rapid increase was mainly due to the gradual rise in the government expenditure since these expenditures faced the sharpest cutting during the crisis.

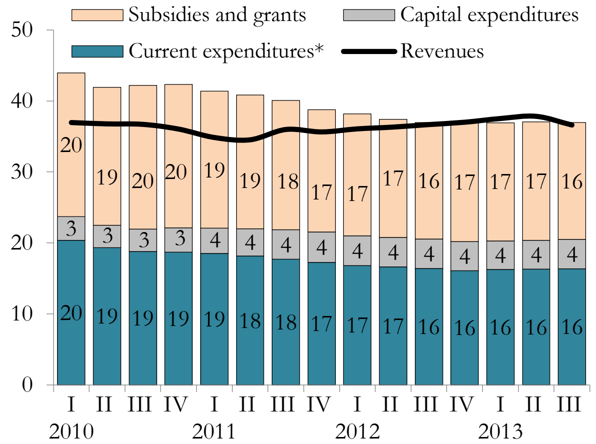
According to the expenditures by functional categories, the highest share in 2012 was in social protection, economic affairs, education and expenditures for general government services. However, the lowest share of all expenditures was in defence and environmental protection.

In the eleven months of 2013, the structure of budget expenditures by functional categories has not significantly changed.

Figure 4.11

General Government Consolidated Budget Revenues and Expenditures

(moving average of 4 quarters, % of GDP)



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

Table 4.3

Expenditures of the General Government Consolidated Budget by Functions

(per cent)

	Structure					Against GDP				
	2009	**2010**	**2011**	**2012**	**2013 I-III**	**2009**	**2010**	**2011**	**2012**	**2013 I-III**
Expenditures – total	**100**	**100**	**100**	**100**	**100**	**43.0**	**42.3**	**38.8**	**36.9**	**35.3**
General public services	14.8	13.4	12.1	13.3	12.8	6.4	5.7	4.7	4.9	4.5
Defence	2.4	2.0	2.3	2.1	2.1	1.0	0.8	0.9	0.8	0.8
Public order and safety	4.5	4.4	4.4	4.5	4.8	1.9	1.8	1.7	1.7	1.7
Economic affairs	15.7	16.0	19.0	18.6	18.3	6.7	6.8	7.4	6.9	6.4
Environmental protection	2.2	1.1	2.5	2.3	2.3	0.9	0.5	1.0	0.9	0.8
Management of municipal territories and housing	2.1	2.5	3.0	3.0	3.0	0.9	1.1	1.2	1.1	1.1
Health	7.5	7.2	7.8	7.8	7.6	3.2	3.1	3.0	2.9	2.7
Recreation, culture and religion	3.4	2.9	3.2	3.5	3.6	1.5	1.2	1.3	1.3	1.3
Education	19.6	16.7	17.1	16.6	16.4	8.4	7.1	6.6	6.1	5.8
Social security	27.9	33.8	28.5	28.2	29.1	12.0	14.3	11.0	10.4	10.3

The public demand consists of public consumption or public services, the value of which is determined by the volume of the provided public services, as well as of public investment, i.e. capital investments using the budget resources.

The public demand decreased rapidly during the crisis. The average public demand has shrunk by 18.6% from 2008 to 2012, currently reaching approximately 80% of the pre-crisis level.

Table 4.4

Public Demand

	% of GDP				Changes in comparison with the previous year, %			
	2009	2010	2011	2012	2009	2010	2011	2012
Public demand	**23.8**	**22.1**	**22.0**	**20.3**	**-12.5**	**-9.3**	**5.1**	**0.2**
Public consumption	19.6	18.4	17.7	16.0	-9.4	-7.9	1.1	-0.2
– central government*	10.5	10.7	10.0	8.6	-10.6	-0.5	-2.1	-5.2
– local governments	9.1	7.7	7.8	7.5	-8.0	-16.5	5.4	6.2
Gross fixed capital formation	4.3	3.7	4.3	4.2	-24.1	-15.8	24.9	1.5
– central government*	1.5	1.2	1.8	2.0	-25.4	-26.1	68.5	10.5
– local governments	2.7	2.5	2.4	2.3	-23.3	-10.0	4.6	-5.1

* including Social Security Fund

4.2. Prices

4.2.1. Consumer Prices

After the deflation, caused by the crisis when the 12-month consumer price inflation decreased to -4.2% in February 2010, prices started increasing again. In 2011, the 12-month consumer price inflation was 4%, while in 2012 – 1.6%. The inflation was mainly determined by the rise in prices for natural gas, food products and fuel. Oil price dynamics in the world also had a major impact. The average annual price level in 2012 was by 2.3% higher than a year ago.

In 2013, despite the growth in Latvia that has been the fastest among the EU member states, consumer prices remained growing at a moderate pace, below the traditional level of seasonal fluctuations. The decrease in prices seen in December 2013, compared to the corresponding period of the previous year, was the sharpest since summarizing the statistical data in 1991, without taking into account the deflation of 2009. Price changes in 2013 were mainly determined by the price drop for transport, heat energy and food products, as well as by the rise in costs of services. The global food and fuel price dynamics also had a major impact.

In December 2013, consumer prices decreased by 0.4% (the 12-month inflation), while the average annual price level in 2012 was at the level of the previous year.

Table 4.5

Consumer Price Changes by Months

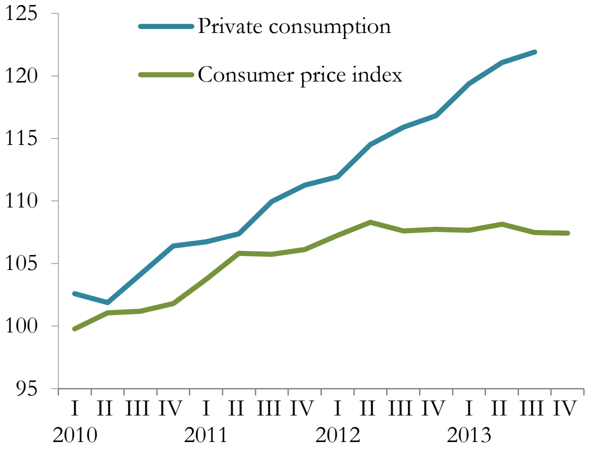
(per cent)

		Compared to the previous month	Compared to the respective month of the previous year	Average during the year
2012	August	-0.3	1.7	3.1
	September	0.5	1.8	2.9
	October	0.0	1.6	2.7
	November	-0.1	1.6	2.5
	December	0.0	1.6	2.3
2013	January	-0.2	0.6	2.0
	February	-0.1	0.3	1.8
	March	0.5	0.2	1.5
	April	0.0	-0.4	1.2
	May	0.1	-0.1	1.0
	June	0.2	0.2	0.9
	July	-0.3	0.3	0.8
	August	-0.8	-0.2	0.6
	September	0.3	-0.4	0.4
	October	0.3	0.0	0.3
	November	-0.5	-0.4	0.1
	December	0.0	-0.4	0.0

Figure 4.12

Private Consumption and Consumer Price Index

(4^{th} quarter of 2009 = 100)



Factors influencing prices in 2013 were:

– the drop in the world price for oil products in March-April and October was faster than the rise in prices at the beginning of the year and in July and significantly affected the dynamics of fuel prices in Latvia. However, the prices in Latvia decreased faster as there was no considerable rise in prices in July and August, as well as the prices for energy resources in Latvia market depend on the euro and USD exchange rate fluctuations. In a year, the fuel prices in Latvia decreased by 3.8%, thus reducing the overall price level by 0.2 percentage points. The world fuel prices dropped by 3.4% in a year. Overall, prices in the transport group have dropped by 2.1%, thus reducing the total level of prices by 0.3 percentage points;

– since administratively regulated prices were not increased in 2013, a drop has been observed in the prices related to housing maintenance. The drop in prices was influenced by the decrease in prices for natural gas, which led to a drop in prices for the heat energy by 8.5% as well, thus reducing the overall price level by 0.4 percentage points. Yet, the prices for solid fuels increased significantly (by 7%);

– prices for food products decreased by 0.6%, thus reducing the overall price level by 0.15 percentage points. Changes in prices for food products depend mainly on global price fluctuations. It should be noted that the world prices for food products decreased in a year, which was influenced by a sharp drop in the prices for cereals in July-September and a drop in sugar prices. In December 2013, world prices for food products were by 3.4% lower than in December 2012. It was largely reflected also by the prices in Latvia as the drop in prices for bread and cereal products had the most significant impact, while prices for eggs also dropped significantly. Dairy products had the greatest upward impact on the total price level in the food product group. The drop in coffee and tea prices (by 10.7%) also had a considerable impact on the food group. The average price for coffee worldwide decreased by 15%, while tea prices dropped by more than 30%;

– the prices for services increased by 1.2%, thus raising the total price level by 0.33 percentage points. The rise in prices in the services group was mainly based on the increase in prices for some services related to housing maintenance (rent, repairs, cleaning, water supply, etc.), health care-related services, catering, and hairdresser and beauty services.

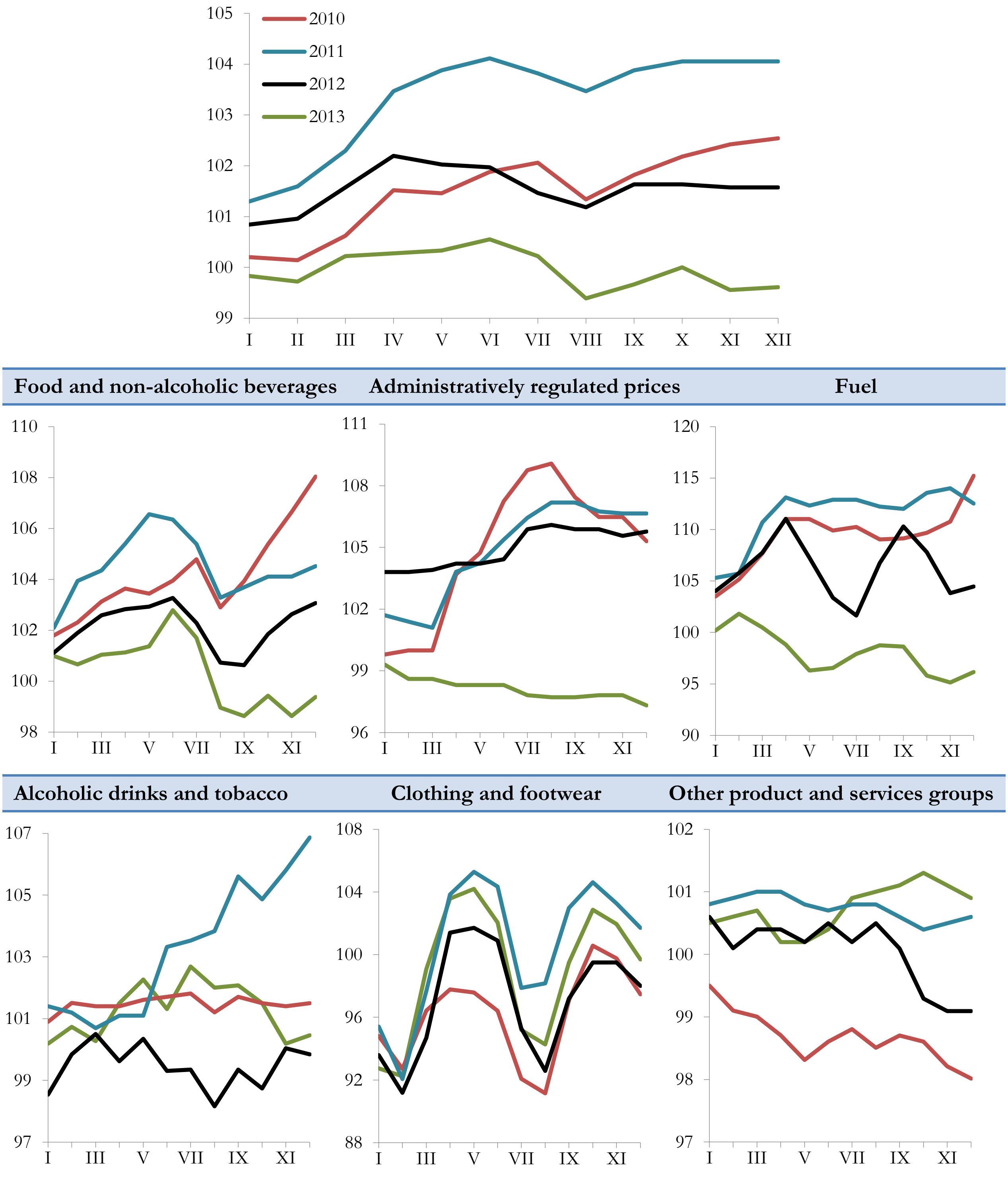
In 2014, the consumer prices are expected to increase. It will be determined both by supply and demand side factors. The improving situation in the labour market fosters private consumption, while electricity prices are going to rise as of April 1, 2014 due to the opening of electricity market for households. The introduction of the euro is also expected to have a certain upward impact on the total price level by 0.2-0.3 percentage points. According to the forecasts of the Ministry of Economics, the overall inflation in 2014 will be moderate. While the annual average inflation might reach 2% on a condition that the world food and fuel prices maintain current tendencies and no sharp rise is expected.

In 2012, compared to 2011, the average price level in the EU increased by 2.6%. Just like in Latvia, it was determined by the rise in prices for food products and energy.

In December 2013, compared to December 2012, the price level in the EU increased faster than in Latvia by 1%, while the price level was tended to drop in all countries. The price inflation dropped most rapidly in Hungary, Bulgaria, and Croatia. The highest inflation rate in November 2013 was in Estonia and the Great Britain, while deflation – Greece, Bulgaria, Cyprus, and Latvia.

Figure 4.13

Consumer Price Index by Groups and Sub-Groups
(December of the previous year = 100)

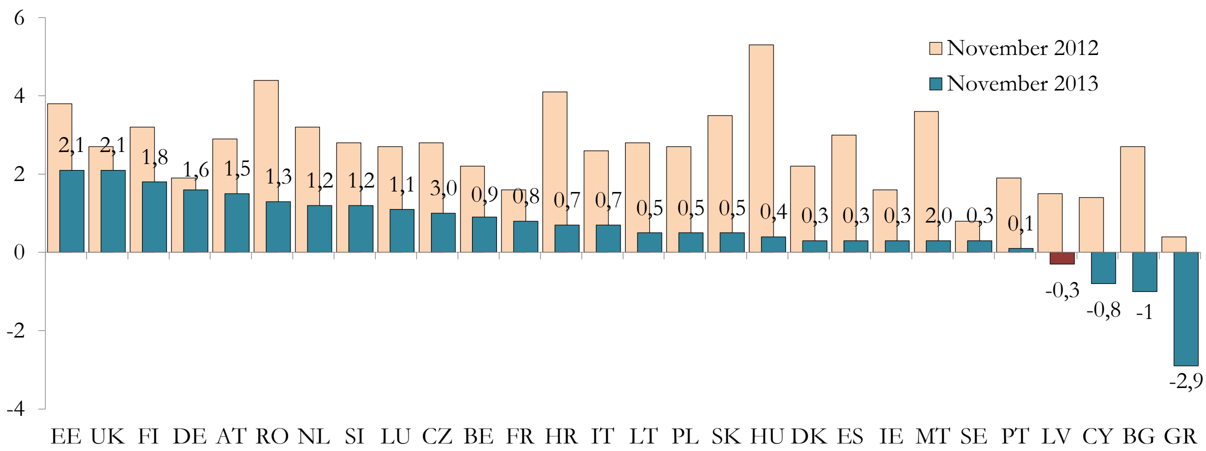


If comparing the Baltic States, the highest increase in consumer prices in December 2013, as compared to December 2012, was observed in Estonia (by 2.1%). In Lithuania, consumer prices have increased by 0.4%. However, in Latvia, consumer prices have decreased by 0.4%. In December 2013, compared to December 2012, consumer prices continued increasing for the food product group in Estonia and Lithuania, while prices for the energy group increased only in Estonia. Considering the dynamics of prices for food products and energy worldwide, the food prices continued decreasing, while energy prices basically remained at the level of the previous year.

Figure 4.14

Changes of the Harmonised Consumer Prices in the EU Member States

(12-month inflation, %)



Source: *Eurostat*

Prices for the food product group among the Baltic States increased by 2.6% in Estonia, in Lithuania – by 0.9%, while the prices decreased by 0.4% in Latvia. Prices for energy rose only in Estonia – by 2.7%, in Lithuania the prices dropped by 1.8%, while Latvia experienced the sharpest drop in energy prices – by 3.7%. The administrative prices showed a tendency to decrease in all Baltic States. The sharpest drop was observed in Estonia – by 6.4%, in Latvia – by 3% and in Lithuania – by 0.1 per cent.

It should be noted that in December 2013, compared to December a year ago, prices in Estonia and Lithuania for the services group increased faster than in Latvia – by 2.1% and 1.2% respectively (in Latvia, the prices increased by 1%). In December 2013, prices in Latvia were mostly affected indeed by the increase in the prices for services group because apart from those two groups, a drop in prices was observed for the rest of the groups.

Figure 4.15

Harmonised Consumer Prices Index

(December 2011 = 100)

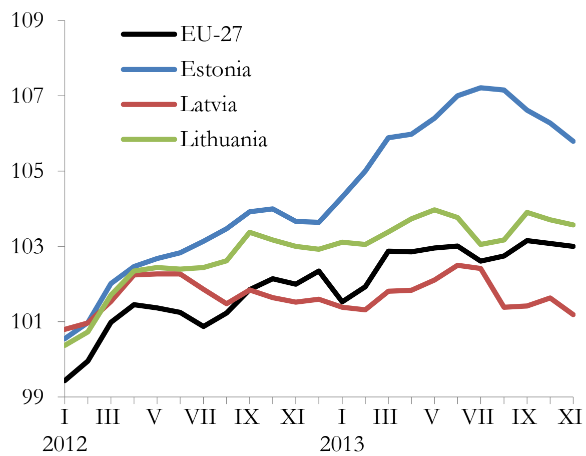
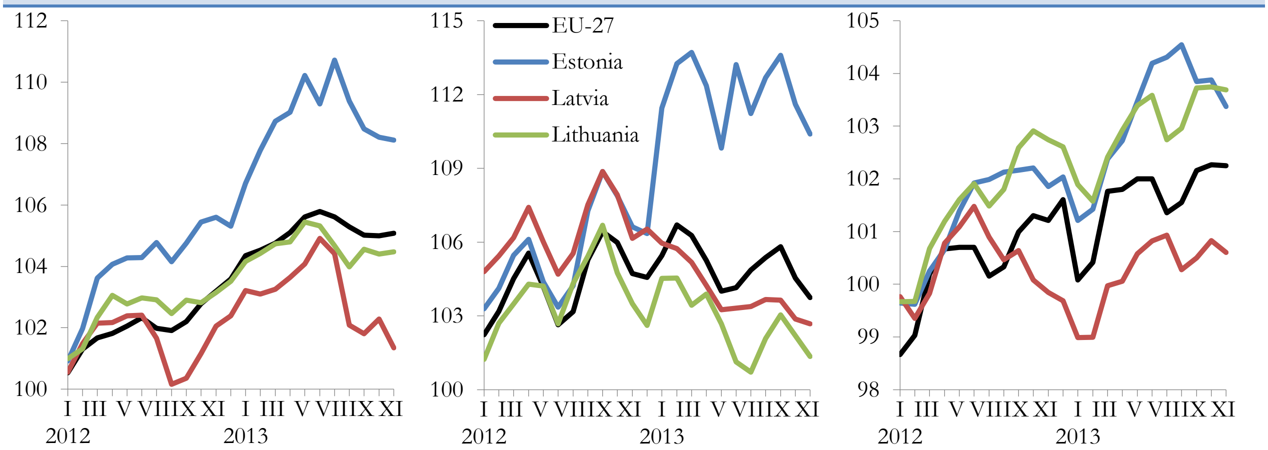


Figure 4.16

Harmonised Consumer Prices Index by components
(December 2011 = 100)

Food products (including alcohol and tobacco)	**Energy**	**Total price index excluding energy and food products** (including alcohol and tobacco)

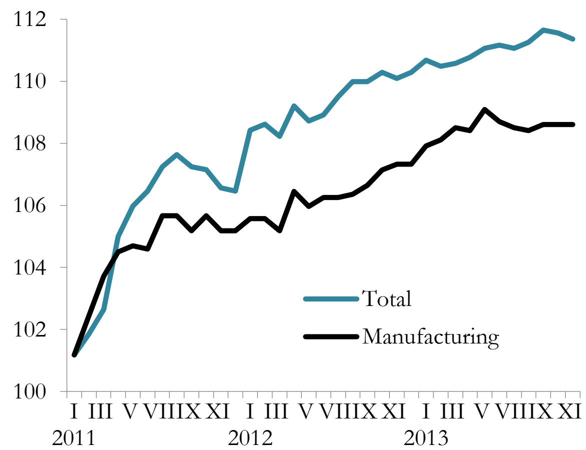


4.2.2. Producer Prices

After the rapid increase in 2010 and the first half of 2011, **producer prices** thereafter in general were moderate. In the eleven months of 2012, producer prices showed a slight, though steady growth mainly due to the rising demand in the domestic market. In 2012, compared to 2011, prices have increased by 3.6%. Prices for products sold in the domestic market have increased by 4.2% within the year, and for exported products – by 2.9 per cent.

Figure 4.17

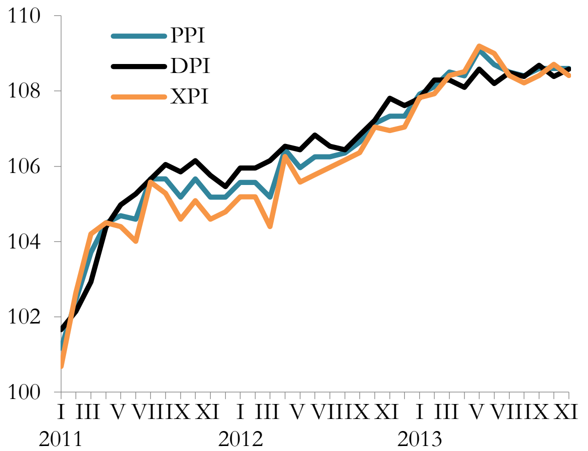
Producer Price Changes
(December 2010= 100)



In December 2013, compared to November 2012, prices have increased by 0.3%. Prices for products sold in domestic market have decreased by 0.6% within the year, and for exported products increased – by 1.3%. The most significant increase in prices has been observed for manufacture of wood and timber products (by 5.6%). The most significant increase in prices has been observed in electricity, gas supply, heat supply, and air conditioning (by 2.7%).

Figure 4.18

Dynamics of Producer Price Changes in Manufacturing
(December 2010 = 100)



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

Slightly over 60% of manufacturing products is exported therefore the overall dynamics of producer prices is to a great extent affected by fluctuations of producer prices for exported products. Yet, prices for exported products are mainly determined by the halt in price increase in the world markets for the main export goods of Latvia, including wood and timber products, metal articles and food. The rise in prices for products sold in the domestic market was affected by the stabilising domestic demand.

The overall producer price level in the manufacturing sector of Latvia in December 2013, as compared to December 2012, has increased by 1.4%. The manufacturing producer prices for exported products have increased by 1.5% in a year, while prices for products sold in the domestic market – by 1.3%. It should be noted that in 2013, compared to the previous year, a significant drop in the world prices for agricultural raw materials was observed, while the prices for manufacturing raw materials and energy remained at the level of the previous year.

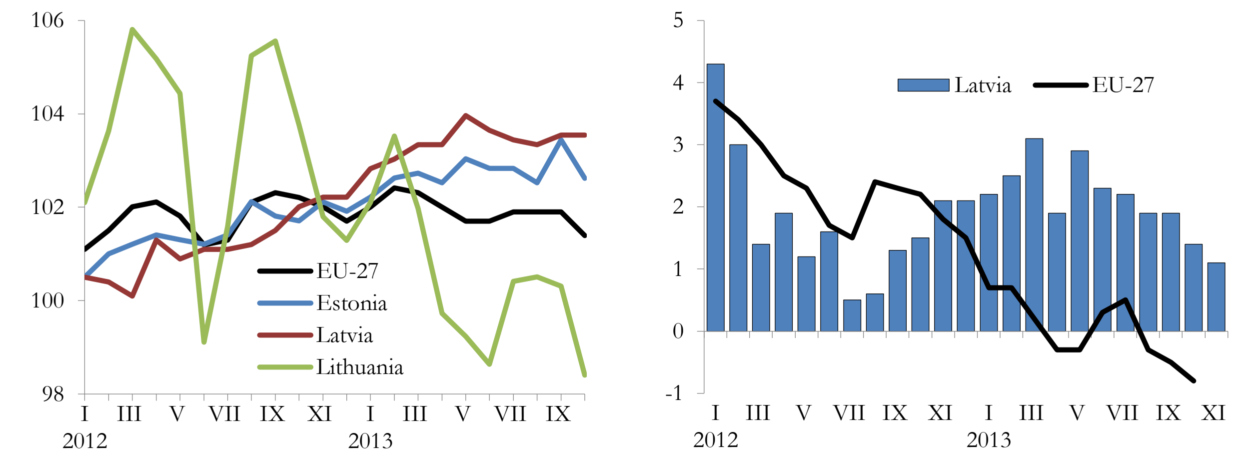
The fastest rise in producer prices in manufacturing by sectors in a year was for the manufacture of wood and products of wood (by 5.6%) and production of other non-metallic minerals (by 2.6%). The rise in producer prices in these sectors was based on the rapid increase in producer prices for exported products. It should be noted that the prices for softwood materials have also increased worldwide in 2013.

Whilst, producer prices in manufacturing dropped for the manufacture of computer, electronic, and optical products – by 16%, which was mainly based on the sharp drop in the prices in this sector in July 2013 (a rapid increase was observed in this sector in the corresponding period of the previous year) and decrease of prises in production of electrical and optical equipment – by 4.8%.

Figure 4.19

Producer Price Index in Manufacturing

December 2011 = 100	Changes in comparison with the corresponding period of the previous year,%



The producer prices in the EU have been decreasing since the mid-2011. It is mainly based on the decrease in food prices, as well as agricultural prices and prices for raw materials, which to a certain extent was due to the decreasing demand worldwide in response to the escalating debt crisis in the eurozone, worsening economic situation in other developed countries, as well as a slowdown of the world trade growth rates and uncertainty about the expected fiscal consolidation in the majority of developed countries.

Furthermore, in early 2013, the producer prices in the EU continued dropping. If comparing the Baltic States, the most rapid increase in the producer price index in manufacturing in December 2013, as compared to December 2012, was observed in Latvia (by 1.4%), and a moderate increase – in Estonia (by 0.4%). Whilst in Lithuania, produce prices decreased by 3.4 per cent.

4.2.3. Foreign Trade Unit Value Indices

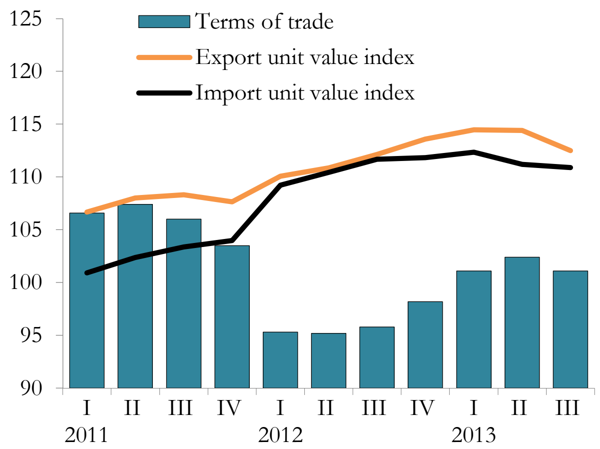
Taking into account the rapid increase in the unit value, since the beginning of 2012 the terms of trade have worsened and in the 4th quarter of 2012, compared to the respective period of 2011, the unit value for exported goods increased by 5.5% and that of imported goods – by 7.5 per cent.

At the beginning of 2013, trade condition have slightly improved, and in the 3rd quarter of 2013, compared to the corresponding period of 2012, the unit value for exported goods has increased by 0.3%, while for imported goods – by 0.7%. The average export unit value level in the 3rd quarter of 2013, compared to the 3rd quarter of 2012, was mainly raised by the increase in the unit value for transport vehicles and its equipment, wood and wood products, while the level was reduced by the drop in the unit value for herbal products, machinery and electric equipment. The unit value increase for food products and animal products had the greatest upward impact on the average unit value level, while the drop in the unit value for base metals and products of metals, machinery and electrical equipment and herbal products had the greatest downward impact on the average unit value level.

Figure 4.20

Import Unit Value Indices and Terms of Trade

(export and import unit value indices 4th quarter of 2010 = 100; terms of trade, % to the respective quarter of the previous year)

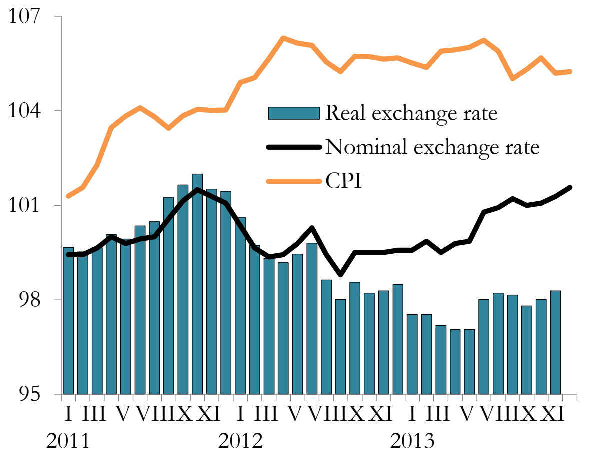


As competiveness of Latvian entrepreneurs improved, the real effective exchange rate of the Latvian lats continued decreasing in 2013. Despite the slight increase in the mid-2013, generally it is low. Due to Latvia's accession to the eurozone, the Bank of Latvia will no longer calculate and publish the real effective exchange rate of the Latvian lats as of January 1, 2014.

Figure 4.21

Effective Exchange Rate of the Lats *

(December 2010 = 100)



* Effective exchange rate of the lats has been calculated in relation to the main trading partner countries. The real exchange rate has been calculated by applying the consumer price index.

4.3. Balance of Payments

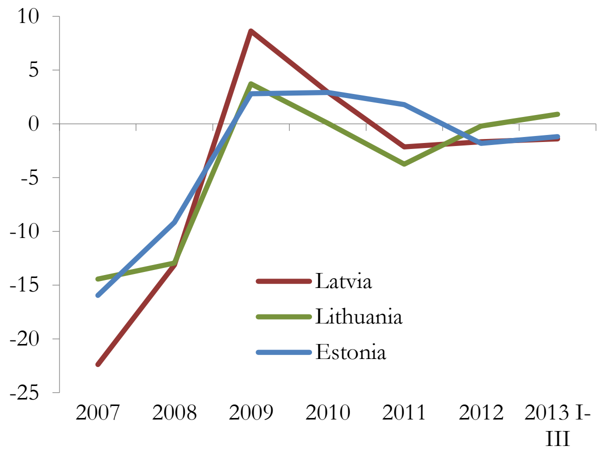
4.3.1. Current Account

The current account has remained at a slight deficit over the past two years. In 2011, the current account deficit was 2.2% of GDP, while in 2012 – 2.5% of GDP. Furthermore, in the nine months of 2013, the negative balance of the current account was 1.4% of GDP, proving external balance of the Latvian economy.

Similar trends were observed also in the dynamics of the current account of our neighbouring countries. Lithuania and Estonia, like Latvia, experienced major changes in the current account. As the capital inflow reduced and economic activities narrowed in the real sector due to the impact of the global financial crisis, the current account deficit first decreased rapidly though there has been a *surplus* in the current account since 2009. As the economic situation stabilized, another change of direction has been seen all three Baltic States and at the moment the balance of current account is at a moderate deficit in Latvia and Estonia, while in Lithuania, there is a slight surplus in the current account balance.

Figure 4.22

Current Account Balance in the Baltic States
(% of GDP)



In the three quarters of 2013, the current account deficit reached 1.2% in Estonia and 1.4% of GDP in Latvia. Yet, the balance of the current account was positive in Lithuania – 0.9% of GDP.

As the economy stabilized and the growth resumed, the current account changes are mainly based on the export and import dynamics of goods.

Figure 4.23

Current Account, Investments and Savings
(% of GDP)

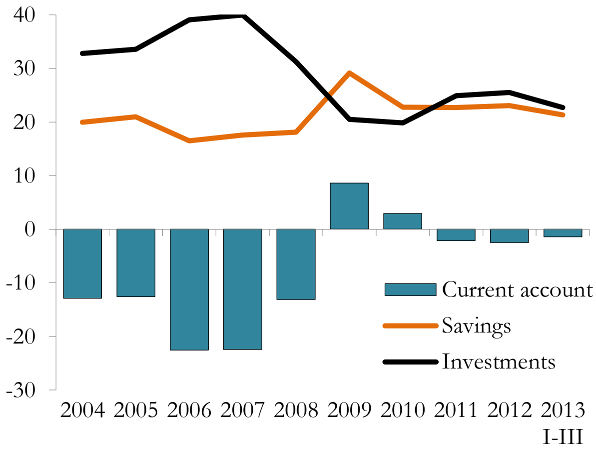


Table 4.6

Balance of Payments of Latvia
(% of GDP)

	2009	2010	2011	2012	2012 I-III	2013 I-III
A. Current account	**8.6**	**2.9**	**-2.2**	**-2.5**	**-3.3**	**-1.4**
Trade balance	-7.1	-7.1	-10.8	-10.8	-11.4	-9.8
Exports	*28.4*	*37.8*	*42.4*	*45.0*	*44.5*	*43.4*
Imports	*-35.5*	*-44.8*	*-53.3*	*-55.7*	*-55.9*	*-53.1*
Balance of services	6.0	6.1	6.5	6.8	7.0	7.3
Net revenues	6.3	0.2	-0.9	-1.8	-2.0	-1.8
Current transfers, net	3.4	3.6	3.1	2.9	3.1	2.8
B. Capital account	**2.4**	**1.9**	**2.1**	**3.0**	**3.0**	**2.5**
C. Financial account*	**-6.9**	**-2.1**	**-4.0**	**2.9**	**2.4**	**1.0**
Direct investments	0.6	1.5	4.9	3.2	3.0	1.1
Abroad	*0.2*	*-0.1*	*-0.2*	*-0.7*	*-0.8*	*-1.2*
In Latvia	*0.4*	*1.6*	*5.1*	*3.9*	*3.8*	*2.3*
Portfolio investments**	2.3	-2.8	-1.8	4.7	-0.1	0.1
Assets	*3.2*	*-0.1*	*-1.0*	*-1.8*	*-3.0*	*0.0*
Liabilities	*-0.9*	*-2.7*	*-0.8*	*6.5*	*2.9*	*0.1*
Other investments	-9.8	-0.7	-7.2	-5.1	-0.5	-0.2
Assets	*-4.0*	*-3.3*	*-1.5*	*-1.2*	*-0.4*	*-0.7*
Liabilities	*-5.8*	*2.5*	*-5.7*	*-3.8*	*0.0*	*0.5*
D. Net errors and omissions	**0.8**	**1.2**	**-0.4**	**0.2**	**0.0**	**-0.4**
E. Reserve assets	**-5.0**	**-4.0**	**4.4**	**-3.6**	**-2.1**	**-1.7**

* excluding reserve assets
** portfolio investments and derivative financial instruments

Along with increasing economic activities, the imports in current prices increased by 32.7% in 2011, as compared to the previous year, but exports – by 25.4%, while foreign trade deficit reached 10.8% of GDP, which was by 3.8 percentage points higher than a year ago, though considerably lower than before the crisis (in 2007 – 24%). In 2012, the dynamics of exports and imports was almost two times slower than a year ago. Comparing to the previous year, exports increased by 14.2% (in current prices), while imports – by 11%. It should be noted that in 2012, the volume of goods exports was 1.7 times higher than in 2007, while volume of goods imports exceeded the volume of imports in 2007 by just 9%. In the three quarters of 2013, the volumes of exports were by 3.2% higher than a year ago, but imports increased by 0.7%, while foreign trade deficit reached 9.8% of GDP.

The positive balance of services is constantly growing. In 2012, surplus of balance of services was 6.8% of GDP, which was nearly two times higher than in 2007. Also, in the nine months of 2013, the volume of service exports was almost double the volume of service imports.

The income balance is mainly influenced by the changes in revenues from non-resident deposits. The balance was positive during the crisis largely due to the losses incurred by foreign investors. As the economic activities resumed, the income balance has been negative since the end of 2010. The increase in income balance deficit was related to the increase in non-resident investment income including an increase in the amount of dividends paid to non-residents. In 2012 and in the three quarters of 2013, the deficit of income balance was 1.8% of GDP, which was influenced by the increase in non-resident investment income. It should be noted that non-resident income from investments in national economy of Latvia in 2012 was by 30% lower than in 2007, while non-resident income from dividends and distributed profit of branches reached 90% of the level of 2007.

The considerable current account deficit in the pre-crisis period reflected a significant imbalance between domestic investments and savings. The level of national savings has been increasing gradually since 2007, reaching 21.3% of GDP in the three quarters of 2013 (in 2007 – 17.6% of GDP), while the investment level in the national economy of Latvia has dropped from 40% of GDP in 2007 to 22.7% of GDP in 2012. A moderate current account deficit is a proof of a balance between savings and domestic investments.

4.3.2. Financial Flows

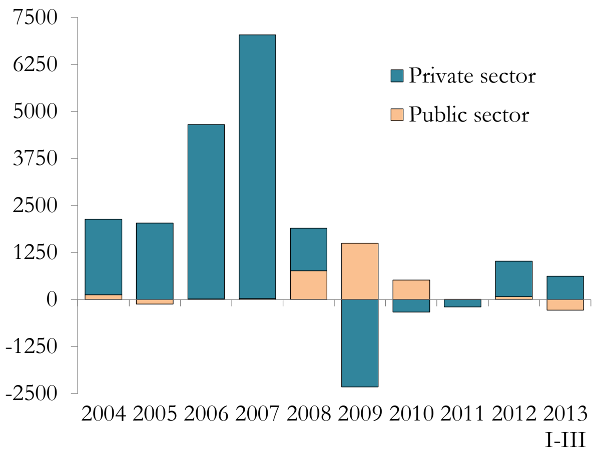
The global financial crisis had a severe impact on cross-border financial and capital flows causing major adjustments to the financial account of the balance of payments. In 2007, the surplus of financial account (excluding reserve assets) was 24.7% of GDP, while in 2009 the financial account deficit was negative at close to 7% of GDP. The financial account deficit has been dropping since 2010. At the same time, the financial flows are becoming steady, and in 2013 the range of quarterly fluctuations of financial flows is more moderate than in the previous years.

Over the past two years, the financial account balance has been mainly determined by measures to stabilize the financial sector, as well as the policy for restructuring debts and reducing debt commitments of the public sector.

Figure 4.24

Inflow of Foreign Investments in the Economy of Latvia

(million LVL)



During the previous years, foreign investments were mainly attracted by the private sector. Since 2004, the volume of foreign investments has grown rapidly and in 2007 compared to 2004 had increased almost 3.5 times. The unfavourable conditions in global financial markets weakened the intensity of the foreign investment flow. Volumes of private capital inflow decreased rapidly in 2008 (almost 7 times lower than in 2007), but since the 4th quarter of 2008, outflow of private foreign capital has been observed. Outflow of private foreign capital in 2009 intensified and was almost 2 times higher than the inflow in 2008.

In general, the decrease in liabilities of the financial account was more moderate in 2010 than it was in the previous two years; however, in the second half of 2010, for the first time since the end of 2008, capital inflow into the private sector was observed and it was influenced by the increase in reinvested profit and extensive investments in the banking sector.

In 2011, foreign private capital flows were negative mainly due to the decrease in liabilities of the banking sector. In general, the financial account balance deficit was 4% of GDP in 2011. In the 1st quarter of 2012, public debt commitments increased considerably, thus influencing the positive balance of financial account (14.9% of GDP).

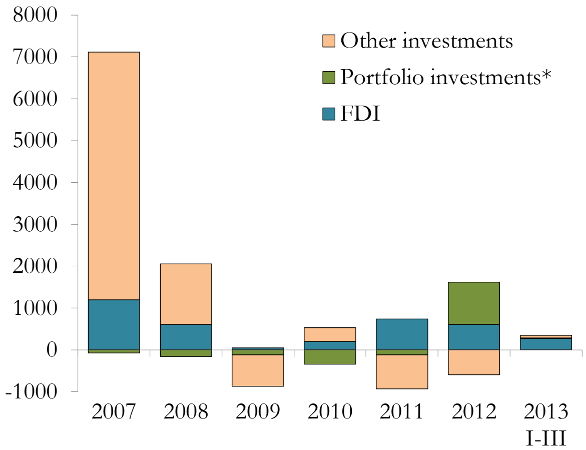
In the 2nd quarter of 2012, the financial account was negative (7.3% of GDP) due to the increase in assets and to the decrease in deposits in the banking sector. In the 3rd quarter of 2012, there was a slight financial account deficit as well (0.1% of GDP) due to positive net portfolio investment flows in the financial sector that partially compensated for the financial outflow caused by the reducing debt commitments of the public sector. Overall, the financial account balance was positive in 2012 – 2.2% of GDP.

In 2013, the quarterly fluctuations of the financial account were moderate. In the 1st quarter of 2013, the financial account was at a slight deficit of 0.3% of GDP, which was mainly determined by the decrease in liabilities of the government and private non-financial sector. Yet, in the 2nd and the 3rd quarter, the financial account was positive – 1% and 2.1% of GDP, respectively.

With the change of the dynamics and direction of foreign capital flow, its structure is also changing.

Figure 4.25

Inflow of Foreign Investments in the Economy of Latvia by Types of Investments
(million LVL)



* portfolio investments and derivative financial instruments

During the period of 2005-2007, the foreign direct investments in the inflowing foreign capital structure on average constituted almost 20%. In comparison with 2004, the volume of FDI has tripled, but in 2008 compared to 2007, the FDI stock has decreased by almost a half and covered 30% of the negative current account balance. In 2009, the incoming FDI flows were only 7.8% of the indicator of the previous year.

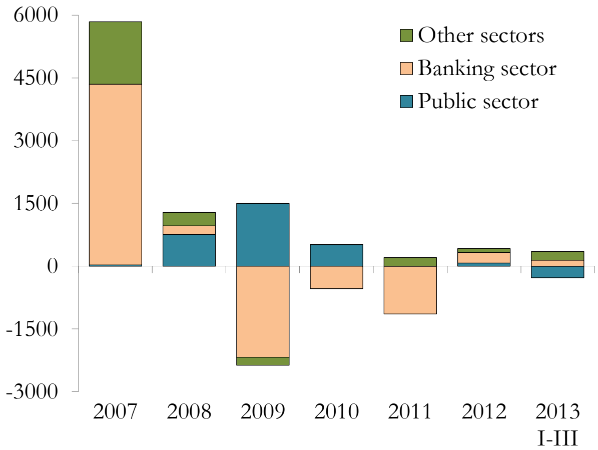
In 2010, the amount of incoming FDI flows was four times higher than in 2009 and constituted almost 1/3 of foreign investments attracted to the Latvian economy in 2010. The FDI flow intensity has been increasing since 2011. During the period of 2011–2012, the FDI constituted almost 60% of the structure of incoming foreign capital, while in the three quarters of 2013 – 78.4 per cent.

The share of portfolio investments has not been exceeding 10% of incoming financial flows over the last three years. In 2012, there was a surplus in the balance of portfolio investments (4.5% of GDP), which was mainly due to the growing external indebtedness of the public sector. Fluctuations of portfolio investment flows are considerably influenced by the activities aimed at stabilizing the balance of the banking sector, as well as restructuring the external indebtedness. In the three quarters of 2013, the account of portfolio investments had a slight surplus of 0.1% of GDP.

Significant fluctuations are observed regarding other investments that until 2008 formed a large part of the total foreign investments. These include trade loans, loans and borrowings, cash and deposits, etc. As a result of the global financial crisis, a decrease of short-term flows was observed in 2008, but in 2009 flows of other investments were negative (-9.8% of GDP), mainly at the expense of the rapid decrease in foreign liabilities of the banking sector.

Figure 4.26

Incoming Foreign Investment Flows by Sectors *
(million LVL)



* excluding foreign direct investments

In 2011, the negative balance of other investments increased, reaching 7.2% of GDP. The fluctuating indicator of the balance of other investments was mainly influenced by the decreasing deposits in the banking sector.

In the 1st and the 2nd quarter of 2012, the balance of other investments was positive at 5.1% and 0.1% of GDP, respectively, though it had a deficit further on (in the 3rd quarter – 5.7% and in the 4th quarter – 17.2% of GDP). Overall, in 2012 and in the nine months of 2013, the balance of other investments was negative at 5.1% and 0.2% of GDP, respectively. Fluctuations of the balance of other investments, like those of portfolio investments, are mainly related to the measures to stabilize the financial sector and the restructuring policy of the public sector debts.

In general, incoming foreign investment flows are gradually stabilizing, though they are considerably lower than they were before the crisis. At the moment, their fluctuations are mainly influenced by the measures to stabilize the financial sector.

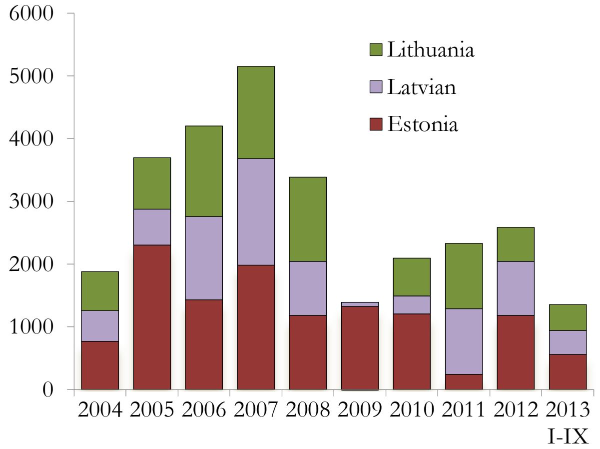
The data of the international investment balance of Latvia shows that the government gross external debt was LVL 4810.7 million (29.7% of GDP) at the end of September 2013, i.e. by 0.7% lower than a year ago. Although the government gross external debt has decreased, the total gross external debt of Latvia has also increased by 2%, constituting 133.8% of GDP at the end of September 2013.

4.3.3. Foreign Direct Investment

The intensity of FDI flows has been growing in the past few years. The FDI flows had significantly decreased due to the global financial crisis, at the same time they remained positive, thus proving the trust of foreign investors in the implemented economic stabilization policy.

Figure 4.27

Inflow of FDI in the Baltic States
(million EUR)



In the first years of the crisis, a decrease of FDI inflow was observed in all Baltic States. In Estonia, the volume of incoming FDI in 2009 was only by 8.6% lower than in 2008, and it was due to the significant investments in the financial intermediation sector, while in Latvia they were only at the level of 7.8% of the FDI attracted within the previous year. Yet, the FDI flows were negative in Lithuania. However, incoming FDI flows have been growing gradually since 2010. If compared to the previous year, the FDI volume has increased by 1.5 times in all Baltic States. Yet, in 2011 and 2012, the FDI increased by 11.2% and 11.1%, respectively.

It should be noted that strong fluctuations of FDI flows have been observed in all Baltic States over the past few years, which was mainly influenced by the activities aimed at stabilizing the financial sector. The drop in FDI flows in Lithuania was mainly determined by the large investments in oil refining sector in 2012 in relation to reconstruction of *Mažeikiai oil* Refinery Company.

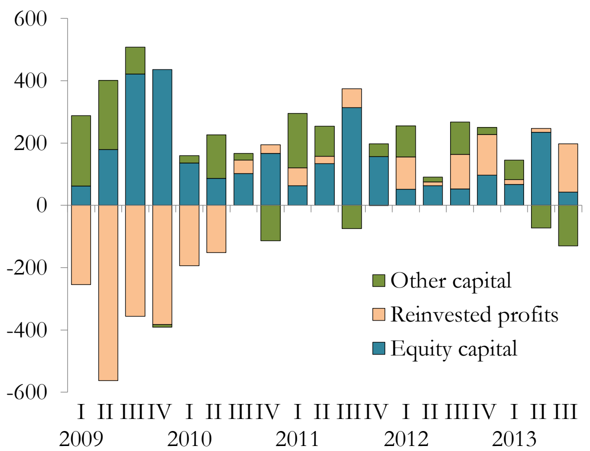
From 2010 to 2012, Estonia attracted about 38% of all FDI in the Baltic States, Lithuania and Latvia – 31%. Compared to the pre-crisis period, Latvia has slightly improved its position.

In the three quarters of 2013, the total amount of incoming FDI in the Baltic States constituted EUR 1358.6 million, while 30% of them were non-resident investments in the national economy of Latvia.

The activities of Latvian investors abroad have been increasing since 2010. Direct investments of Latvian entrepreneurs abroad have been almost three times higher in 2011, compared to 2010, but in 2012, FDI of Latvia 3.4 times exceeded the amounts of the previous year. In the three quarters of 2013, direct investments of Latvian entrepreneurs abroad were by 60% higher than a year ago, constituting 1.2% of GDP.

Figure 4.28

Foreign Direct Investments in Latvia
(received during the quarter, million EUR)



The structure of the incoming FDI by types of investments shows that direct investment enterprises have been operating with losses since the 4th quarter of

2008 until the 2nd quarter of 2010. Losses of the foreign direct investment enterprises were fully compensated by great investments in equity capital and other capital, and therefore the incoming FDI flows were positive in 2009 (LVL 47.5 million).

FDI flows experienced a rapid increase along with the economic recovery. The amount of incoming FDI in 2010 was fourfold the FDI of 2009, while in 2011, FDI flows exceeded the indicator of the previous year almost four times and reached 5.2% of GDP. The amount of FDI attracted in 2012 and in the three quarters of 2013 was slightly moderate than a year ago and reached 3.2% and 2.3% of GDP, respectively.

According to the international investment balance of Latvia, the FDI stock in the economy of Latvia reached EUR 11 298.1 million at the end of September 2013, which is by 13% more than a year ago. The share of FDI in the structure of foreign capital stock constituted 28.8 per cent.

The global financial crisis did not affect the geopolitical structure of foreign capital stock of Latvia. Mainly these are investments of the EU Member States. At the end of September 2013, the FDI of the EU Member States constituted 70% of all FDI stock, a fourth of them are investments of the new EU Member States, and almost a half of them are investments of the euro zone countries.

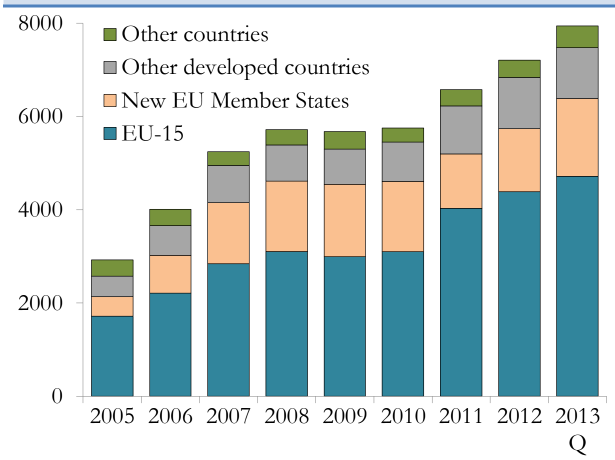
Sweden is the biggest investor in the economy of Latvia. At the end of September 2013, investments of Sweden's entrepreneurs constituted almost 22% of the total FDI stock. Mainly they are investments in financial intermediation (85% of all FDI stock in the sector). Since the end of the 3rd quarter of 2012, direct investments of Sweden have increased by 4.3%, and these investments have almost doubled in comparison with late 2010, which is mainly related to mutual transactions in the banking sector between Estonia and Sweden. Therefore, the FDI stock of Estonian entrepreneurs in Latvia has decreased by almost a half constituting 5.2% of the total FDI stock at the end of September 2013 (at the end of 2010 – 14.1%).

Large investments have been made also by entrepreneurs from Denmark, the Netherlands, Estonia, Germany, Norway, Finland, Russia, and Cyprus. Investment volumes of these countries at the end of September 2013 constituted almost 42% of the total FDI stock in the economy of Latvia.

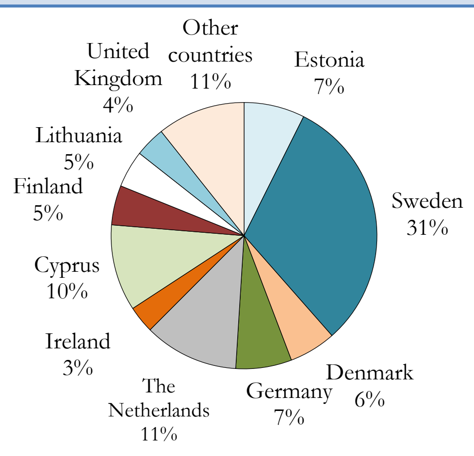
Figure 4.29

FDI Stock

By Groups of Countries
(million LVL, at the end of the period)



FDI of EU Member States
(per cent, at the end of September 2013)



The FDI are focused mainly in services sectors.

During the period of rapid growth, investments in the financial intermediation sector explicitly dominated in the structure of incoming FDI flows. The average annual amount of FDI in service sector was by almost four times higher than in manufacturing. During the economic downturn (2008-2009), the amount of annual incoming FDI flows in the financial intermediation sector decreased three times, they were negative in trade, but the decrease in investment intensity in real estate dropped by a half. Overall, the amount of annual FDI flows in services sectors shrunk by 72.8%. Yet, the amount of annual incoming FDI flows in manufacturing industries decreased by just 15% compared to the annual FDI flows of 2005-2007.

Since 2010, the structure of incoming FDI flows has levelled out, without any explicit dominance of the financial sector. It should be noted that average annual investments in service sectors have been exceeding the investments in manufacturing industries by nearly five times over the past three years.

At the end of September 2013, the FDI stock in services sectors constituted 75.7% of the total FDI stock in the national economy of Latvia, i.e. by 0.5 percentage points lower than at the end of 2007. Financial intermediation and real estate sectors constitute almost a half of the FDI stock in services sectors.

Table 4.7

FDI by Sectors
(million LVL)

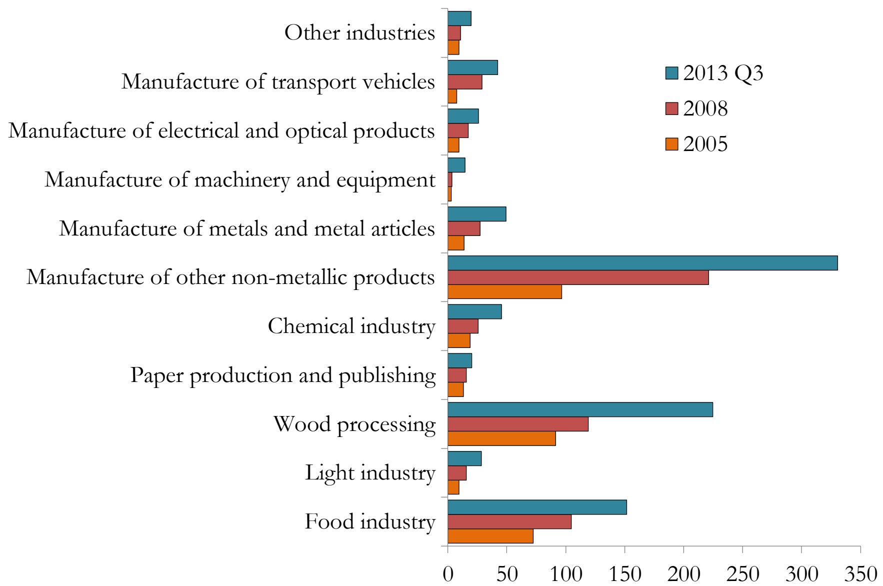
	FDI stock (at the end of the period)			Flows (average per year)			
	2005	**2007**	**2013***	**2005-2007**	**2008-2009**	**2010-2011**	**2013 I-III**
Agriculture	45.3	91.7	215.0	11.9	19.6	13.3	1.0
Manufacturing	345.0	489.2	892.1	63.5	85.5	59.9	52.1
Other industries	383.1	308.5	389.4	24.6	13.9	9.4	-14.6
Construction	123.2	360.9	377.2	69.8	25.3	0.3	10.4
Trade and accommodation	405.4	704.7	1048.2	108.4	-2.7	52.4	28.8
Transport and storage	180.6	198.2	323.5	11.9	5.8	14.8	-11.3
Financial intermediation	747.0	1751.4	1921.1	347.5	126.8	107.0	74.0
Real estate operations	198.9	465.6	978.4	78.3	36.1	171.7	0.3
Other services	494.5	877.2	1561.4	125.5	17.0	39.3	130.5

* At the end of September 2013

At the end of September 2013, the FDI stock in goods production constituted 24.3% of the total FDI stock in the national economy of Latvia. Compared to the end of 2007, they have increased by 54.5 per cent.

Figure 4.30

FDI stock in manufacturing
(at the end of period, million LVL)



A particularly rapid increase of the FDI stock in industry was observed in manufacturing from the end of 2007 until the end of September 2013 – by 94.8%. The increase of the FDI stock in manufacturing to a great extent was influenced by substantial investments in manufacture of construction materials (an increase by 126.9%) and wood processing (an increase by 90%). The share of the above-mentioned sectors in the FDI stock constituted 58.3% in manufacturing at the end of September 2013 (at the end of 2007 – 54 per cent).

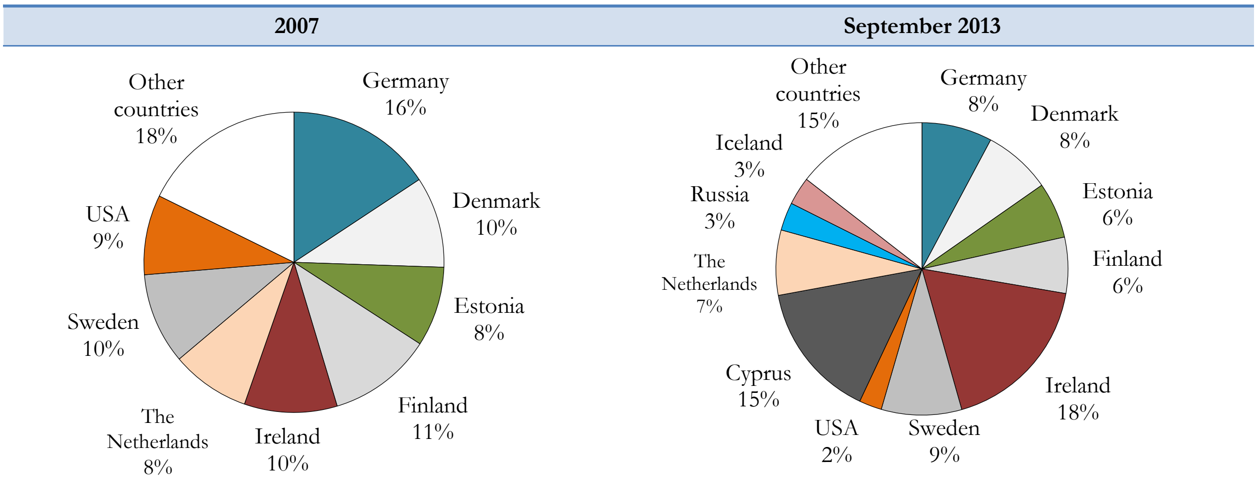
In general, having evaluated the FDI structure in manufacturing, it can be concluded that it is constantly changing. In some sectors, like the light industry, the FDI have been decreasing already since 2005, and the main reason for that was loss of competitiveness in foreign markets. Similar tendencies have been observed in several EU Member States. The FDI in this sector has been growing since the 3rd quarter of 2010. At the end of September 2013, the FDI stock in the light industry increased by 78%, compared to the end of 2010. Mainly these are investments of entrepreneurs from Sweden and Cyprus.

The FDI in food industry decreased during the rapid downturn that was mainly influenced by the low domestic and foreign demand. However, as the economic situation has improved in the past few years, the FDI stock has increased and constituted 16% of the FDI stock in manufacturing at the end of September 2013 (at the end of 2010 – 13%). The FDI in manufacture of electrical and optical products has been increasing since 2010; they increased by almost 3 times at the end of September 2013 compared to the end of 2010.

Figure 4.31

Structure of the FDI Stock in Manufacturing by Countries

(at the end of the period, per cent)



Foreign investments in manufacture of vehicles also increased. At the end of the 3rd quarter of 2013, the level of FDI stock in this sector exceeded the level of 2010 by 41%. The FDI stick in the chemical industry almost doubled.

By qualitatively evaluating the change in the structure of FDI stock in manufacturing, it can be concluded that the share of low technology industries is decreasing in favour of medium-low-technology and medium-high-technology industries.

The largest investments in manufacturing have been made by investors from Denmark, Finland, Germany, Sweden, Ireland, Estonia, the Netherlands, and Cyprus. Investments of the abovementioned countries constituted 80% of the FDI stock in manufacturing. It should be noted that by the end of 2007, none of the countries held the leading position in the structure of the FDI stock in manufacturing. Due to the financial crisis, the situation has changed significantly. At the end of September 2013, the capital of Ireland and Cyprus was dominating in the structure of the FDI stock constituting more than a third of the FDI stock in manufacturing, which was greatly influenced by the extensive investments of entrepreneurs from these countries in Latvian manufacturing. Comparing to the end of 2007, the FDI stock of Cyprus entrepreneurs in manufacturing has increased 12 times, while that of the Ireland – 3 times.

The amount of FDI stock of Germany and USA has decreased correspondingly by 7% and 47%. At the same time, at the end of September 2013, investment stock by Russian entrepreneurs in manufacturing increased almost seven times, compared to the end of 2007 and was 3.1% of FDI stock in manufacturing.

Although FDI flows in Latvian manufacturing has been relatively stable even during the rapid downturn, it should be noted that Latvia is behind Lithuania and Estonia in terms of attracting FDI to this sector. From the end of 2010 until the end of 2012, Lithuania has attracted 31% of all incoming FDI in manufacturing in the Baltic States, Estonia – 47.6% but Latvia – only 21.4%. This means that foreign investors find manufacturing in Latvia less attractive than that of neighbouring countries when comparing the Baltic States.

The Investment and Development Agency of Latvia (IDAL) plays a significant role in attracting foreign investment. The investment attraction strategy of the IDAL is focused on proper maintenance of incoming investment projects and active operations related to attraction of investment projects, by addressing the potential investors.

The IDAL continues developing its range and supply of services on the basis of FDI market needs and ensuring a link between the IDAL and investors. Latvia can offer the investors a favourable geographic location, advantages of natural resources, advantages in the sphere of science, as well as assistance of the IDAL experts in the process of project implementation.

The interest of foreign investors by submitted incoming investment projects to the IDAL: more than a half (56%) of investments projects are focused on investments in manufacturing. A fourth or 24% of all projects have been submitted for the metal processing and electronic sectors, while 19% of projects are submitted in the life science sector, wood processing and food industry. Yet, a sixth or 16% of projects are projects of service centres (both shared services, and outsourcing projects), other projects of the service sector (for example, maintenance of machinery, balneology, space aviation, education, etc.) constitute a significant share in total – 11 per cent.

Overall, 65% of potential working that are cooperating with the IDAL at the moment come from countries of Europe. Currently, Latvia is mainly evaluated by potential investors from the Great Britain, USA, Norway, and Sweden. The number of potential investment projects from Russia has decreased by a half (from 12% in 2012 to 6% in the nine months of 2013), while the interest of potential investors from China has increased four times (from 2% in 2012 to 8% in the nine months of 2013).

Incoming investment projects have been successfully serviced. In the nine months of 2013, the IDAL has worked on 141 potential investment projects, thus continuing the work on the investment projects launched in the previous period and the projects launched in 2013, as well as projects under post-monitoring. Moreover, in the nine months of 2013, 384 investment information requests have been processed, 83 proactive investment offers have been prepared, and the IDAL representations have organized visits to 67 potential investors, as well as organized visits of 110 potential investors to Latvia. As a result of the abovementioned activity, a decision on the implementation of 23 projects in Latvia has been made (for example, investments from the Netherlands, Switzerland, Germany, China in machinery, metal processing and electronics projects; investments from Russia in textile and non-textile material production projects; investments from Ukraine in a food industry project; investments from the US, Switzerland, and Germany in global business service sector projects, etc.). The implementation of these projects is expected to attract investments in the amount of at least EUR 14.3 million, thus creating over 810 jobs.

Recently, the number of positive decisions made by investors – the IDAL clients has increased rapidly, while the amount of investments in the projects has been considerably lower than in the pre-crisis period. The drop of investments is due to the impact of the crisis on investors' behaviour in relation to resource saving and cautious attitude towards large investments. Such a tendency has also boosted the growth of a new niche – outsourcing centres where companies transfer their functions to a cost-efficient location through streamlining their resources. In 2012, several positive decisions have been made in the field of outsourcing centres, mainly by Scandinavian companies. Also in 2013, two companies have made a positive decision, thus creating over 150 jobs in this sector alone.

The work with investment projects involves analysing the reasons why potential investors do not prefer Latvia on a regular basis. According to the collected information, the main reasons why investors have chosen other countries are the issue of access to employees, distance to target countries, inadequate infrastructure, including the lack of electrical capacity and roads, lack of investment incentives, as well as a range of other reasons, for example, access to finance, customs procedures, etc.

In order to improve the attraction of investments important for Latvia, the IDAL continues implementing investment attraction methodology *POLARIS process*, which envisages a unified and coordinated action of ministries, municipalities, infrastructure enterprises and public institutions in implementation of strategically important local and foreign investment projects, as well as involvement of the private sector, universities and scientific institutions in this process.

In order to ensure coordinated inter-institutional cooperation for successful implementation of investment projects in Latvia in favour of the country, the Coordination Council for Large and Strategically Important Investment Projects established on August 10, 2010 continues working based on the investment attraction strategy *POLARIS process* developed by the IDAL (see also Section 6.12).

4.4. Financial and Capital Markets

4.4.1. Monetary Policy and Exchange Rate

The main goal of the monetary policy of the Bank of Latvia is to maintain price stability in the country. The Bank of Latvia is independent in making and implementing its decisions, and it is not subordinated to the decisions or instructions of the government or governmental institutions. The Bank of Latvia is under the supervision of the Saeima.

Latvia has been a member of the European Central Bank (ECB) since joining the EU; yet, the introduction of euro on January 1, 2014 will make it a member of the *Eurosystem*. The primary objective of the *Eurosystem* is to maintain price stability. It is intended to support the common economic policy of the Union. The *Eurosystem* acts in accordance with the principles of an open market economy with free competition, favouring an efficient allocation of resources. On June 5, the ECB published its *Convergence Report 2013* assessing the economic and legal convergence of Latvia. All in all, Latvia is within the reference values of the convergence criteria. The Convergence Report on Latvia published by the European Commission also concludes that Latvia is ready to adopt the euro in 2014. Thus, Latvia will become the 18th member state of the eurozone. The final decision on the accession of Latvia to the euro zone was adopted on July 9 of this year by the EU Economic and Financial Affairs Council (ECOFIN) in Brussels, supporting the introduction of the euro in Latvia as of January 1, 2014. The official euro exchange rate was determined along with the adoption of the final decision.

Since the euro is going to be introduced as of January 1, 2014, the government is already implementing various measures related to the euro introduction:

- On January 31, 2013, the Saeima adopted the *Law on the Procedure for Introduction of Euro* aimed at ensuring efficient and transparent introduction of the euro in Latvia;
- On April 4, 2013, the CoM issued the Decree on Latvia's *National Euro Changeover Plan* aimed at defining the key tasks of the euro changeover project in Latvia, implementation stages and scope of accountability, as well as define the principles and scenario of euro changeover to ensure successful introduction of the euro in both private and public sectors;
- On May 1, 2013, the information campaign of introduction of the euro in Latvia was launched;
- From July 2013 to December 2014 the recommended dual *display period* of *prices* was determined and the campaign *Fair Euro Introducer* was implemented;
- From October 1, 2013 to June 30, 2014 the dual *display period* of *prices* was determined;
- As of January 1, 2014 the euro is introduced in Latvia.

Until the introduction of euro, Latvia will coordinate monetary policy instruments and procedures for monetary operations and will adapt the management of foreign currency reserves of the central bank to the ECB requirements. The Bank of Latvia is already using the same indirect monetary policy instruments based on free market principles as the ECB, and after joining the *European Monetary Union* (EMU), it will be necessary only to revise the importance of individual instruments in the implementation of the monetary policy and procedural elements. For Latvia, being a member of the EMU means:

- Single currency with other EMU member states – the euro;
- Common monetary policy in the entire eurozone implemented by the ECB with central banks of the eurozone;
- Coordination of economic and fiscal policy among the member states.

In late 2012, the EU reached a political agreement on establishing of single supervisory mechanism (SSM) of credit institutions aimed at moving towards an integrated supervisory mechanism to restore confidence in the banking industry and minimize the costs of bank bankruptcies. On November 3, 2013, the Regulation on Single Supervisory Mechanism came into force. The SSM will be composed of the ECB and national supervisory authorities. After joining the eurozone, 3 largest banks in Latvia might be subjected to direct supervision of the ECB. Out of all 6000 banks in the eurozone, about 200 will be subject to direct supervision of the ECB according to approved criteria. After making the single supervisory mechanism operational, it is expected to give the European Stability Mechanism an opportunity to directly recapitalize eurozone banks facing difficulties, without burdening the eurozone countries with higher debt commitments. The ECB will fully implement its supervisory duties on November 4, 2014 or 12 months after entering into force of the regulation.

Box 4.1

The fixed national currency exchange rate policy implemented by the Bank of Latvia

Since February 12, 1994, the Bank of Latvia has been implementing fixed national currency exchange rate policy by pegging the exchange rate of the lats (LVL) to the SDR[1] currency basket (1 SDR = 0.7997 LVL). As of January 1, 2005, the peg of the lats to the SDR was replaced with the peg to the euro (1 EUR = 0.702804 LVL). The change of the lats peg was determined by the plans of Latvia to join the *European Exchange Rate Mechanism II* (ERM II) and after complying with the required criteria to join the *Economic and Monetary Union* (EMS)[2].

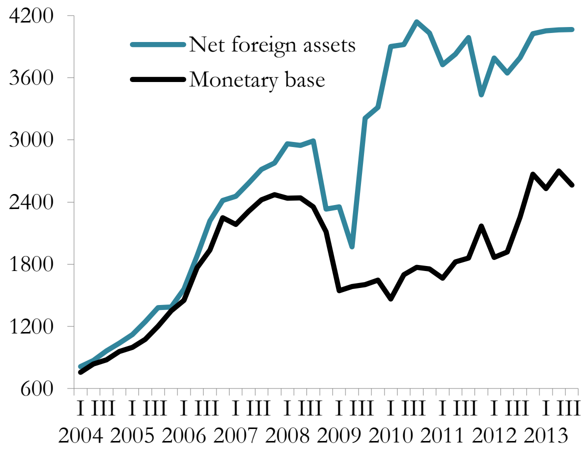
On May 2, 2005, Latvia joined the ERM II with the already existing exchange rate of the lats against euro. Within the framework of the ERM II standard fluctuations of the exchange rate in the amount of +/-15% around the central or peg rate are allowed. However, Latvia commits unilaterally to keep the exchange rate fluctuation margin within +/-1%, retaining the former range of fluctuation band of the lats, which was habitual to the financial market since 1994, when the lats was pegged to the SDR and was kept when the lats was re-pegged to the euro on January 1, 2005. The Bank of Latvia will continue implementing former policy of fixed exchange rate until the euro is introduced in Latvia on January 1, 2014.

In order to keep a fixed exchange rate, it is necessary to have a sufficient amount of foreign reserves. Net foreign reserves of the Bank of Latvia continuously cover the monetary base of Latvia (see Figure 4.33), and therefore it has been able to keep a stable exchange rate of lats even in situations of external collapses. Coverage of the monetary base (cash in circulation and deposits in the Bank of Latvia) with net foreign assets was 159% at the end of the 3rd quarter of 2013.

Figure 4.32

Net Foreign Assets of the Bank of Latvia and Monetary Base, Quarterly Profile

(million LVL, at the end of the period)



Foreign reserves of the Bank of Latvia are administered according to the guidelines developed by the Council of the Bank of Latvia, investing them in safe and liquid financial instruments. Foreign reserves of the Bank of Latvia consist of gold reserves, foreign convertible currency and SDR. Foreign reserves of the Bank of Latvia (including gold reserves, foreign convertible currency, and SDR) in late November 2012, compared to the late November 2012, have increased by 5.4%, amounting to EUR 5778.1 million. The reserves consist mainly of foreign exchange, while gold reserves constitute EUR 330.4 million.

4.4.2. Market Structure and Development

At the end of the 3rd quarter of 2013, 20 **banks** operated and 9 branches of the EU member states were registered in Latvia. 9 branches of Latvian banks are operating abroad. Banking services in Latvia can also be provided by credit institutions or their branches, which are registered in the European Economic Area countries and have submitted an application to the Financial and Capital Market Commission (FCMC).

In 2013, the banking sector has undergone several significant changes:

– commercial activity of SJSC "Mortgage and Land Bank of Latvia" to be phased-out until the end of 2013;
– the process of selling the shares of JSC "Citadele banka" (launched in the mid-2011), is suspended until the situation in international financial markets improves. The decision on suspension of sale has no impact on the operations of JSC "Citadele banka" and it continues implementing the restructuring plan;
– the sale of five corporate and mortgage loan portfolios of JSC "Latvijas Krājbanka" has been successfully completed. The sale has been commenced after initiating a liquidation process of JSC "Latvijas Krājbanka" last spring. The bankruptcy procedure of the bank is also continued to sell various assets, and legal proceedings continue in Latvia and abroad with an aim to recover a number of assets and money to settle with the creditors of the bank;

[1] Special Drawing Rights (SDR) – a special currency code in accordance with the international currency classifier ISO 4217 – XDR).

[2] Participation in the EMU has been defined in the EU Accession Treaty, but Latvia is allowed to choose the most appropriate time for the euro introduction.

– as of October 28, 2013, the licence for credit institution activity issued to JSC "GE Money Bank" is cancelled, thus completing the phase-out of its operations in Latvia. The bank is going to be reorganized into a commercial company that provides no credit institution services. The bank has fulfilled its obligations towards the depositors. On September 23, 2013, the service of current accounts of private and corporate customers, as well as deposits, savings accounts, and loans has been successfully transferred to the bank "Citadele".

In the 3rd quarter of 2013, performance indices of all Latvian banks complied with the regulatory requirements. The liquidity ratio of banks increased and remained high at 64.7% (minimum regulatory requirement is 30%). Non-resident business oriented banks are subject to a higher liquidity ratio and capital adequacy ratio requirements.

In the 3rd quarter of 2013, the average banking sector capital adequacy ratio reached 18.8% (the minimum regulatory requirement is 8%), which is the highest result over the past few years. Over the past few quarters, the return on assets (ROA)[1] and the return on equity (ROE)[2] of banks have increased and were 0.9% and 8.6%, respectively.

Bank profitability has been improved and in the three quarters of 2013, profits of the banking sector have increased by 12%, compared to the corresponding period of the previous year. Thus, 16 Latvian banks and 5 foreign bank branches operated with profit of LVL 133.6 million. It was mainly influenced by the increase in revenue from commissions and commercial transactions of financial instruments, as well as lower reserves for bad debts.

The **insurance market** kept growing at a stable pace. At the end of the 3rd quarter of 2013, compared to the corresponding period of 2012, the number of insurance companies in Latvia has shrunk. In this period, 7 insurance companies, 2 of which offered life insurance and 5 – non-life insurance, as well as 13 branches of foreign insurance companies operated in Latvia.

In the three quarters of 2013, compared to the corresponding period of 2012, the amount of gross premiums signed by insurance companies has increased by 7.3% reaching LVL 247 million. The greatest increase in the amount of gross premiums signed was observed for civil liability insurance of owners of motor vehicles and in the health insurance market, which was mainly influenced by the growing demand in public sector. The amount of paid gross compensations has increased by 15% reaching LVL 139 million. In the three quarters of 2013, insurance companies operated with a profit of LVL 4.8 million: non-life insurance companies – with profit of LVL 5.4 million, while life insurance companies – with losses of LVL 563. Overall, in the three quarters of 2013, insurance companies earned by 36% less than in the corresponding period of 2012.

Since the end of 2011, the situation in the **Latvian securities market** has significantly improved, and positive trends were observed also in 2012 as the total value of securities registered in the Latvian Central Depository increased by LVL 187 million, reaching LVL 1.8 billion at the end of the year. Overall, there were issues of 162 different securities registered in the Latvian Central Depository at the end of 2012. The situation in the securities market continued improving in 2013, and the OMX Baltic Benchmark index value was 618.8 points (as of December 5, 2013), which is by 13.1% higher than at the beginning of the year. NASDAQ OMX Riga, NASDAQ OMX Tallinn and NASDAQ OMX Vilnius index value increased within the range of 13-14 per cent.

In the 3rd quarter of 2013, compared to the 3rd quarter of 2012, the amount of central government debt securities in bank assets has increased by 0.6% mainly due to the increase in the amount of foreign central government securities. Out of other securities, the amount of shares and other variable-yield securities experienced the most rapid increase (by 66%), while the amount of issuer bonds and other fixed-yield debt securities with fixed income increased at a slightly slower pace (by 4%). Latvia's accession to the eurozone might have a positive impact on the activity in stock market. Foreign investors will be exposed to lower currency risks and costs due to exchange changeover to euro.

4.4.3. Assets, Deposits and Loans

Bank assets of Latvia have been growing gradually since the end of the second half of 2012, reaching LVL 19.9 billion at the end of the 3rd quarter of 2013, which is by 0.7% higher than a year ago. Bank credits (55.7%) constitute the largest part of bank assets. Their share has significantly reduced over the past few years (for comparison, in the 3rd quarter of 2010, bank credits constituted 70% of bank assets), while the share of securities has increased.

As the confidence in the banking sector improves and the introduction of the euro approaches, the amount of currency in circulation is significantly decreasing, constituting LVL 778.8 million in circulation at the end of the 3rd quarter of 2013, which

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

is by 26.1% lower than in the corresponding period of 2012.

The **balance of deposits** attracted by banks continues increasing – at the end of the 3rd quarter of 2013, non-bank deposits in banks have increased by 8.7%, reaching LVL 12.9 billion, compared to the corresponding period of the previous year. The balance of both resident and non-resident deposits increased equally fast (by 8.7%). Resident and non-resident deposits constituted almost equal share in the total amount of deposits. Out of non-resident deposits 13.3% are the CIS countries' deposits and 33.3% are deposits of the rest of the European Economic Area (EEA) countries, while deposits of other countries constitute the largest part (53.4%). The CIS countries' deposits have been increased the most rapidly (by 21.2%, compared to the corresponding period of 2012).

Figure 4.33

Dynamics of Resident and Non-resident Deposits in Banks
(percentage)

Regular market supervision and inspections in Latvian banks are carried out by the FCMC. Non-resident deposits are subject to a particularly strict supervision. Banks dealing with non-resident deposits are subject to stricter requirements for liquidity and capital adequacy. The ECB in its *Convergence Report 2013* has referred to risks caused by the increasing amount of non-resident deposits in Latvia, emphasizing the growing need for a wide range of policy instruments in Latvia to prevent risks to financial stability, including those risks caused by the use of non-resident deposits as a source of funding in a significant part of the banking sector.

In the 3rd quarter of 2013, the deposit currency structure continued undergoing changes. The amount of resident deposits in euro exceeds the amount of resident deposits in lats. The majority of non-resident deposits are in USD (65.7%) and the amount keeps growing, while the amount of deposits in euro is decreasing.

The **balance of granted bank loans** still continues decreasing. It is mainly related to payment of previously granted loans and write-off of bad loans. The balance of loans granted to residents' financial institutions, non-financial corporations and households decreased by 7.9% at the end of the 3rd quarter of 2013 in comparison with the corresponding period of the previous year.

The following trends have been observed in the lending sector:

– the number and amount of new loans issued are growing rapidly – in the 3rd quarter of 2013, the banking sector has issued new loans in the amount of LVL 604.8 million, which is by 1/3 more than a year ago. Out of the new loans 32% have been issued to non-residents, and the share of these loans tended to drop over the past few quarters. Yet, the share of loans issued to non-residents has slightly decreased and constitutes just 12% in the total loan portfolio of the banking sector;
– household lending is resuming gradually. Despite the negative dynamics of household loan portfolio, the amount of new housing loans is growing particularly fast this year. Overall, 11% or LVL 68.9 million of new loans have been issued to households. That is by 41.5% more than in the 3rd quarter of the previous year. In terms of amount, most new loans have been granted for purchase of housing. The amount of these loans has increased by 36.6%. Although the amount of new housing loans is increasing, the lack of first instalment or borrower's self-financing is still a significant obstacle for households to receive a loan. The amount of new loans granted to households is expected to rise along with the increasing income and purchase ability of households. Overall, the amount of loans granted to households was LVL 4344.7 million in the 3rd quarter of 2013, which is by 7.7% less than in the corresponding period of the previous year, and constituted just 39% of the total loan portfolio of the banking sector;
– in the business sector, lending is resuming. Entrepreneurs tend to invest more in development of their enterprise along with the improving economic situation. The share and the amount of new loans granted to enterprises is increasing. After the drop in the previous quarters, the amount of loans granted to enterprises in the 3rd quarter of 2013 has increased by 89.7%, constituting 36% or LVL 218.2 million of the total amount of new

loans, compared to the corresponding period of the previous year. Most of the new loans have been granted to the financial and insurance operations and trade. The amount of new loans has significantly increased also in one of the most important sectors of the national economy – manufacturing, as well as in real estate operations and trade. Overall, at the end of the 3rd quarter of 2013, the amount of loans granted to residents in the national economy constituted LVL 5245.4 million, which is by 7.6% less than in the corresponding period of 2012, and the share of these loans was nearly 47% of the total loan portfolio of the banking sector. By sectors of national economy, the balance of loans granted to construction decreased most rapidly and increased in public administration and defence. The drop in the number of loans granted to enterprises is to a great extent related to the cautious lending policy of the banks. At the same time, the World Bank and the EC have recognised the access to loans for enterprises in Latvia as one of the highest in the EU.

No significant changes in the structure of loans have been observed. Mortgages still dominate in the structure of loans granted to domestic companies and individuals; the share of mortgages in the overall loan structure has shrunk to 54.7%. The share of commercial credits and industrial credits in the total loan structure has increased to 34.5%, which is the highest indicator since 2006. The share of consumer credits in the overall loan structure has shrunk to 2.5%. Consumer crediting experienced the sharpest drop (nearly by 40%). The balance of mortgage loans is still shrinking (by 8.1%), at a slower pace though.

Lending of commercial loans (for increasing working capital) is slowly resuming. The balance of commercial loans has dropped in the second and the third quarter of 2013. No significant changes have been observed in the balance of industrial loans (for acquisition of fixed assets) in the past few years.

Table 4.8

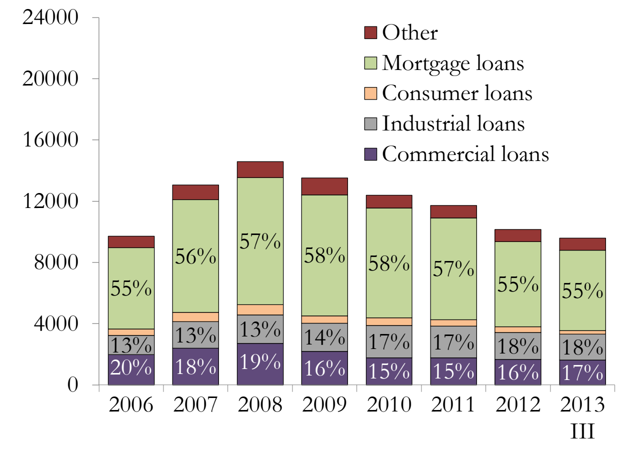
Monetary Indicators of the Latvian Banking System

	2007	2008	2009	2010	2011	2012	2013 X
at the end of the period, million LVL							
Net foreign assets	-4482.8	-5914.6	-3022.0	-1219.8	-224.8	613.7	967.2
Net domestic assets	10654.0	11846.1	8842.3	7609.8	6710.9	6161.7	5600.2
Domestic loans	13018.2	14279.7	12204.3	11215.1	11045.4	9593.3	8991.8
to the government (net)	-87.4	-370.0	-1474.6	-1430.8	-663.8	-903.8	-961.7
to companies and individuals	13105.6	14649.7	13678.9	12645.9	11709.2	10497.1	9953.5
Other assets (net)	-2364.2	-2433.6	-3362.0	-3605.3	-4334.5	-3431.6	-3391.6
Broad money M2X	6171.3	5931.4	5820.3	6390.0	6486.1	6775.4	6567.4
Cash in circulation (without vault cash balance)	900.0	866.1	667.3	807.4	1040	1082.4	778.8
Deposits of individuals and companies, including:	5271.3	5065.3	5153.0	5582.7	5446.1	5693.0	5788.7
overnight deposits	2864.9	2308.0	2206.2	2782.1	3109.2	3586.6	4002.5
time deposits	2406.4	2757.3	2946.8	2800.6	2336.9	2106.4	1786.2
Changes in % compared to the previous year							
Domestic loans (compared to 2012 X), including:	31.8	9.7	-14.5	-8.1	-1.5	-13.1	-8.4
to companies and individuals	34.0	11.8	-6.6	-7.6	-7.4	-10.3	-7.3
Broad money M2X	12.6	-3.9	-1.9	9.8	1.5	4.5	0.1
Cash in circulation (without vault cash balance)	-7.1	-3.8	-23.0	21.0	28.8	4.1	-26.1
Deposits of individuals and companies	16.9	-3.9	1.7	1.1	-2.5	4.5	5.1
GDP (at current prices)	**32.3**	**9.3**	**-18.7**	**-2.2**	**11.7**	**8.7**	**4.5**

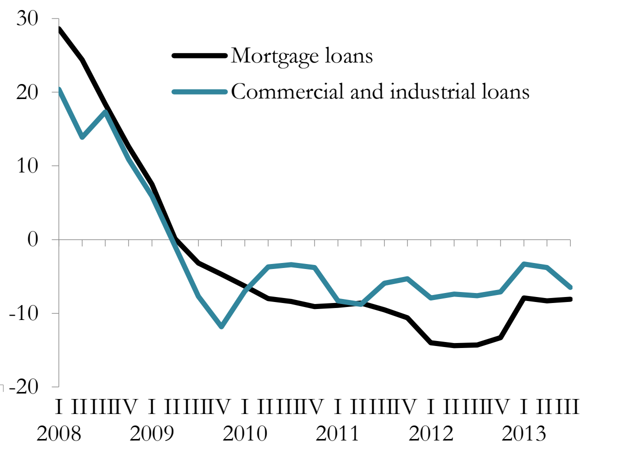
The largest share of loan balances is still related to real estate transactions (32% of the total loans granted to the sectors of the economy). A relatively high share of granted loans is also observed in manufacturing (13%), trade, accommodation and catering sectors (13%), as well as the construction sector (6%).

Figure 4.34

Amount and Structure of Loans Granted to Resident Financial Institutions, Non-Financial Corporations and Households
(end of the period, million LVL)



Loans Granted to Resident Financial Institutions, Non-Financial Corporations and Households
(changes in comparison with the respective quarter of the previous year, %)

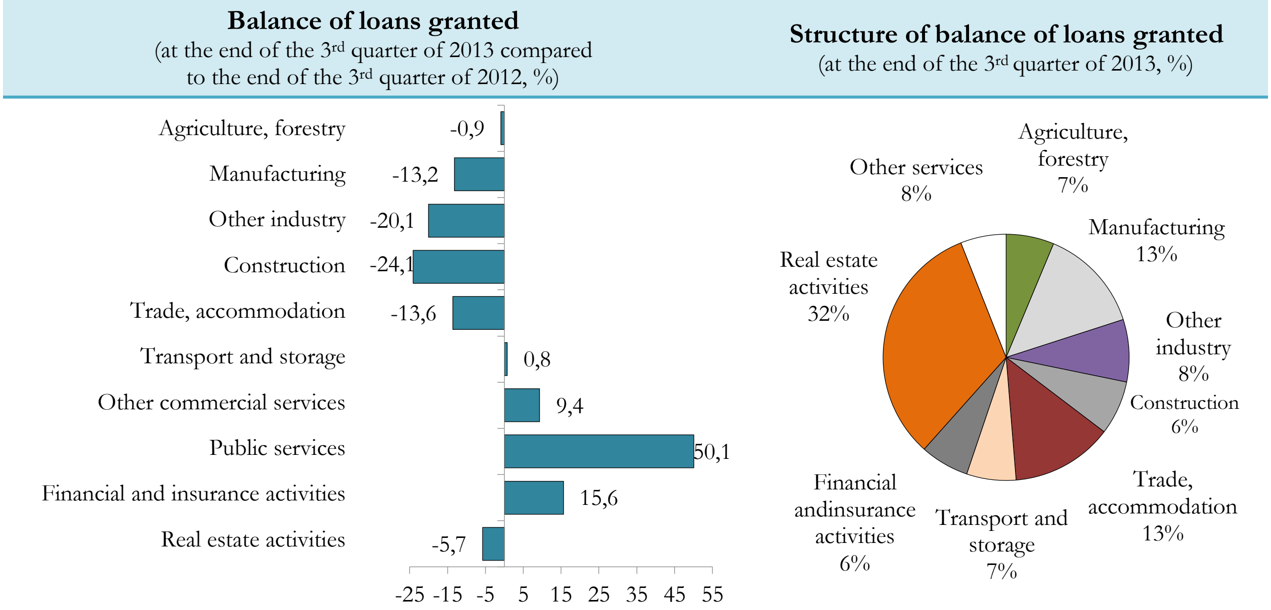


The quality of banks' loan portfolio continues improving, and the amount of loans with overdue payments in the total loan portfolio was 17% in the 3rd quarter of 2013, which is the lowest indicator since the end of 2008. Comparing to the corresponding quarter of the previous year, the amount of loans with overdue payments has been dropped by 23.7%. It was mainly determined by the decrease in the amount of loans with overdue payments from above 90 days by 27%, which is a positive trend considering that these loans constitute more than a half of all the loans with overdue payments. The amount of loans with overdue payments up to 30 days increased in this period. The improving quality of banks' loan portfolio is mainly related to writing-off bad debts, which is an increasing tendency. Since the beginning of 2013, the banking sector has written off debts in the amount of LVL 105.5 million, which is by 55.6% higher than in 2012. Yet, it should be taken into account that debt recovery continues also in case of writing-off the loan. The quality of corporate and household loans has improved along with the recovering growth of national economy.

In 2013, the banks continued to cooperate with the clients facing difficulties to repay the loans. The share of restructured loans and loans currently being recovered in the total banks' loan portfolio is decreasing. At the end of the 3rd quarter of 2013, restructured loans and loans currently being recovered constituted 19% of the total loan portfolio. The share of restructured loans in the total banks' loan portfolio dropped to 10%, while the share of loans currently being recovered – 9% of the total banks' loan portfolio.

Figure 4.35

Loans to Residents by Sectors of Economy



The weighted average **interest rates** on short-term loans in euro and lats granted to companies and individuals have slightly dropped since early 2012. However, fluctuations were minor and reached 5.5% and 3.5%, respectively (the 3rd quarter of 2013). Fluctuations of interest rates on long-term loans granted in euro and lats have been more marked over the past few years and dropped to 7.9% and 7.3% in the 3rd quarter of 2013.

Figure 4.36

Loans with overdue payments

(thousand lats)

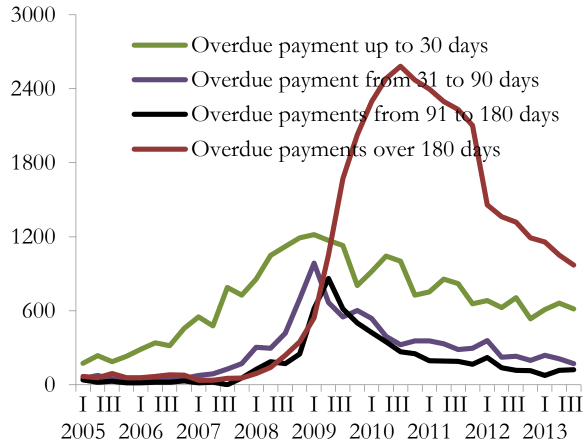
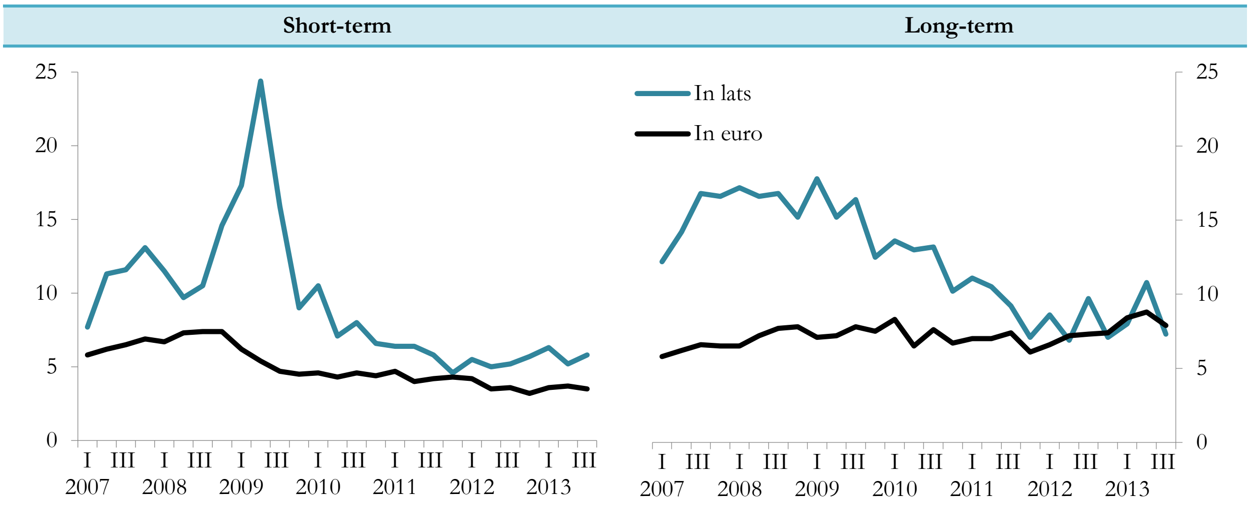


Figure 4.37

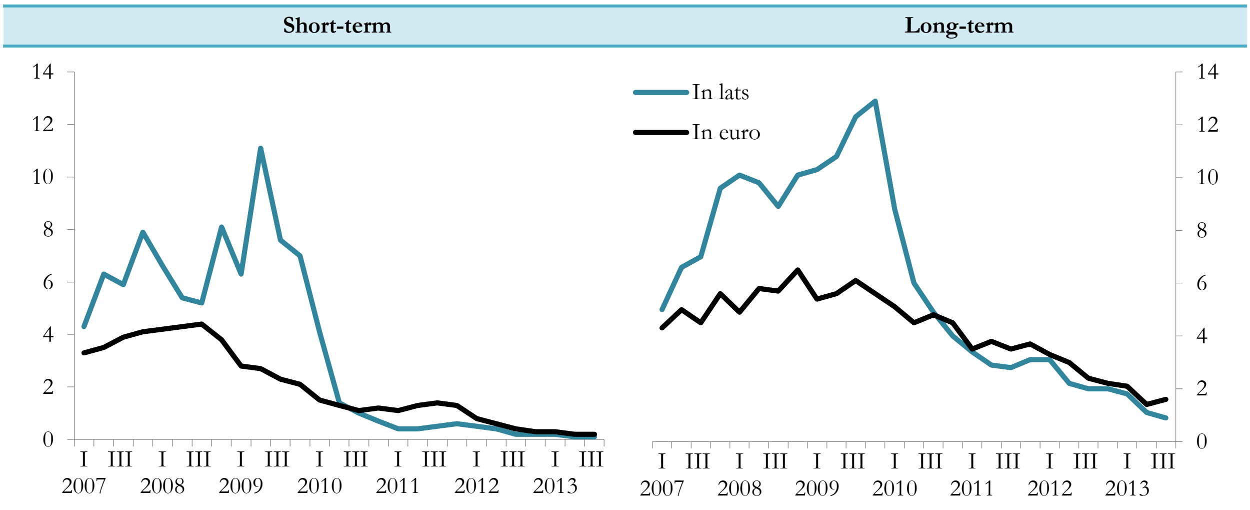
Weighted Average Interest Rates for Loans Granted in Credit Institutions, Quarterly Profile, %



The interest rates on short-term and long-term deposits attracted in LVL and EUR by credit institutions have reached the lowest indicators since 2010. The interest rates on short-term deposits attracted in LVL and EUR were 0.2% and 0.1%, respectively, while the interest rates on long-term deposits were 1.6% and 0.9%, respectively.

Figure 4.38

Weighted Average Interest Rates for Deposits Attracted by Credit Institutions, Quarterly Profile, %



5. Labour market

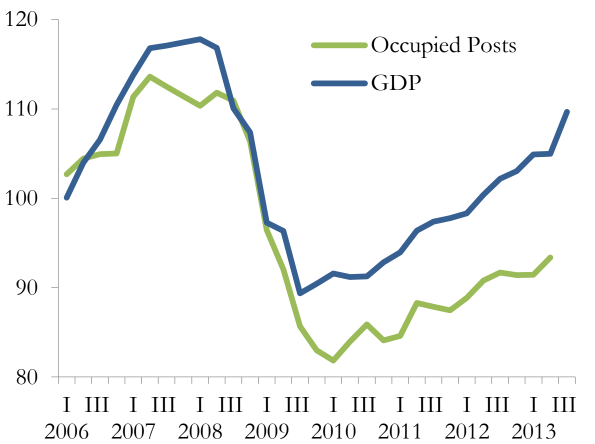
5.1. Employment and Unemployment

The gradual increase of economic activities has a positive impact on the labour market – the employment rate is growing and the high unemployment caused by the crisis is decreasing. At the same time, certain population groups, especially people with a low level of education and qualification, elderly people, as well as the youth barely feel the improvement.

Figure 5.1

GDP and Occupied Posts

2005 Q4 = 100



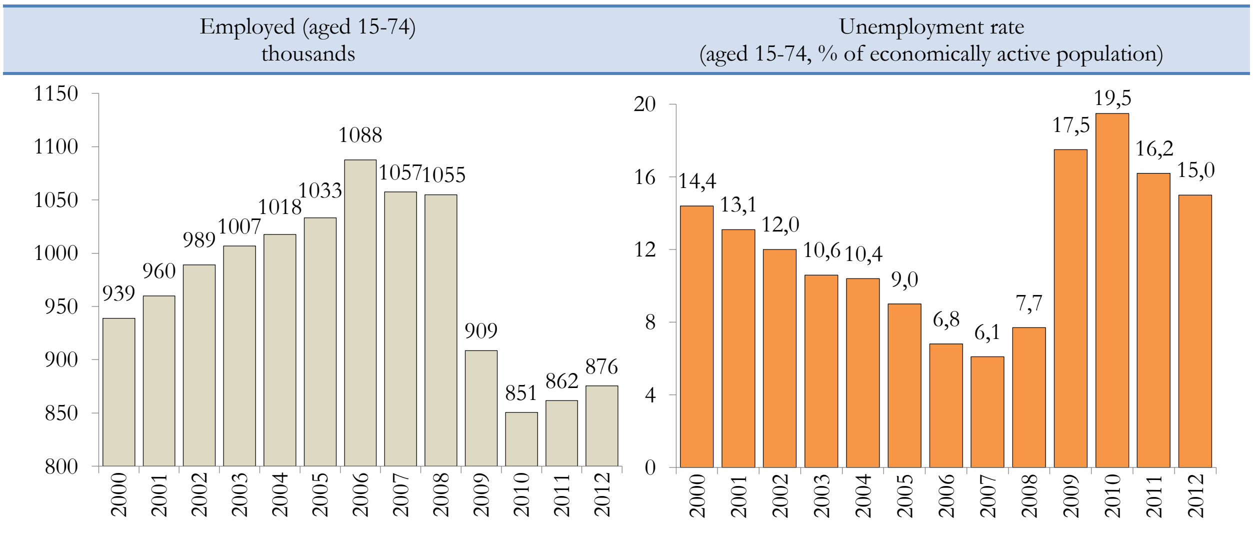
According to the Labour Force Survey data, the number of employed has increased by 1.3% in 2011 compared to 2010. The unemployment rate has decreased significantly – in 2011 it was 16.2%, which was by 3.3 percentage points lower than in 2010.

Similar trends remained also in 2012. In 2012, the number of the employed increased to 875.6 thousand which is by 1.6% or by approximately 14 thousand more than in 2011. Yet, the employment rate reached 56.1% and was by approximately 2 percentage points higher than a year ago. The number of economically active population has increased significantly slower – by just 0.2%. A more rapid increase was hindered by negative demographic tendencies – a decreasing number of working-age population. The unemployment rate in 2012 was 15%, by 1.2 percentage points lower than a year ago.

The registered unemployment rate has dropped along with the decrease in the overall unemployment rate. In late December 2012, the registered unemployment dropped to 10.5% – there were 104.1 thousand registered unemployed which is by 26.2 thousand less than in December. The highest registered unemployment rate remains in Latgale region (21.1%), while the lowest – in Riga (6.4%).

Figure 5.2

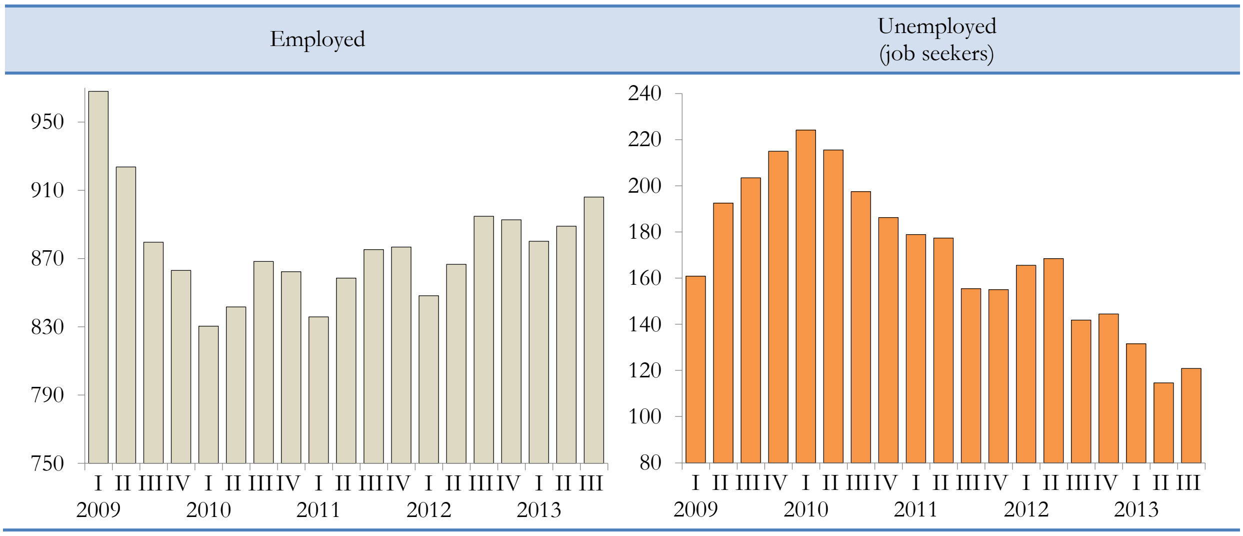
Employment and unemployment in Latvia from 2000 till 2012



Significant improvements in the labour market have been observed also in 2013. In the 3rd quarter of 2013, the unemployment rate has dropped to 11.8% which is by 1.9 percentage point lower than a year ago. Overall in the 3rd quarter of 2013, the number of the employed reached 906.1 thousand or by 11.4 thousand (1.3%) more than in the 3rd quarter of 2012. At the same time, the number of economically active population keeps dropping. In the 3rd quarter of 2013, the number of economically active population decreased by approximately 1% compared to the corresponding period of 2012.

Figure 5.3

Employment and unemployment
(thousand)

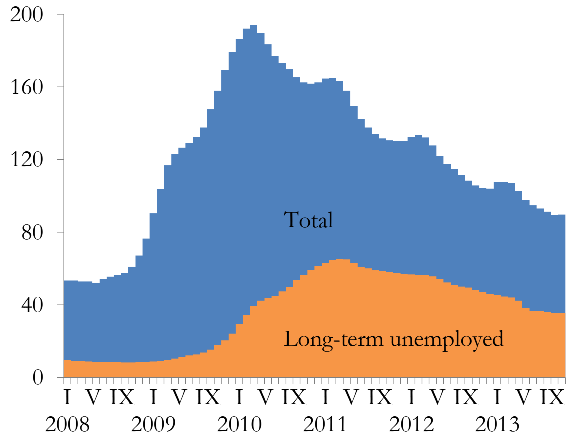


The current unemployment rate is mainly related to cyclical unemployment, i.e. the significant drop in production volumes and services provided during the crisis. Therefore, all of the measures related to the promotion of economic activities and entrepreneurship foster an increase in the labour demand and employment growth. At the same time, there is a risk that some of the currently unemployed will not be able to find a job for a longer period resulting in structural unemployment, as sectors that recover faster from the crisis are neither the ones that were offering vacancies before the crisis nor those where people lost their jobs during the crisis. The economy is going through structural changes and mismatch may occur between the labour supply and demand – skills of job seekers do not match the employers' requirements.

The number of long-term unemployed increased along with the overall unemployment rate during the crisis. The number of long-term unemployed has a tendency to drop along with the growing economic activity. At the end of October 2013, there were 35.4 thousand long-term unemployed registered at the SEA, which was by 12.8 thousand or 26% less than at the end of October 2012. Although the situation is improving gradually, the share of long-term unemployed still is high – approximately 28% of the total number of registered unemployed. It should be noted that high long-term unemployment may cause an increase in the structural unemployment, as the longer such people are jobless, the higher is the risk of losing working skills and competences.

Figure 5.4

Registered Unemployed
(thousands)

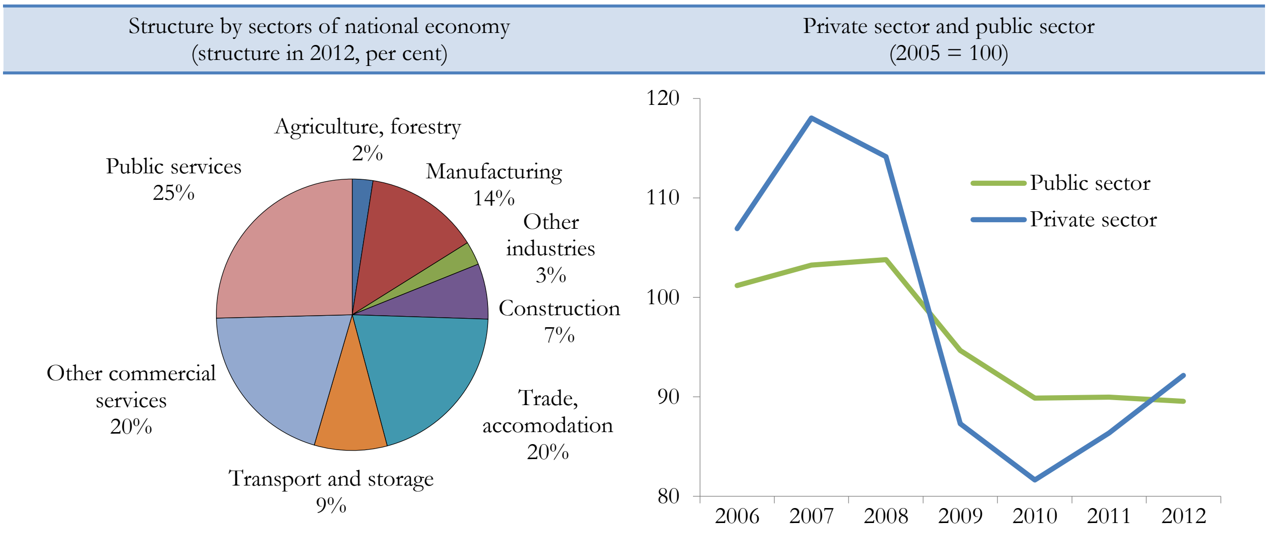


At the same time, the balance between the labour force demand and supply is influenced not only by labour force education and skills but also by wages, and therefore vacancies stay open even under high unemployment conditions.

The number of jobs has been growing at a steady pace since the mid-2010 along with the improving economic situation. According to the CSB data, the total number of jobs has increased by 36.5 thousand or 4.5% in 2012 compared to 2011. At the same time the number of vacancies increased by 22.5% or approximately 0.6 thousand jobs.

Figure 5.5

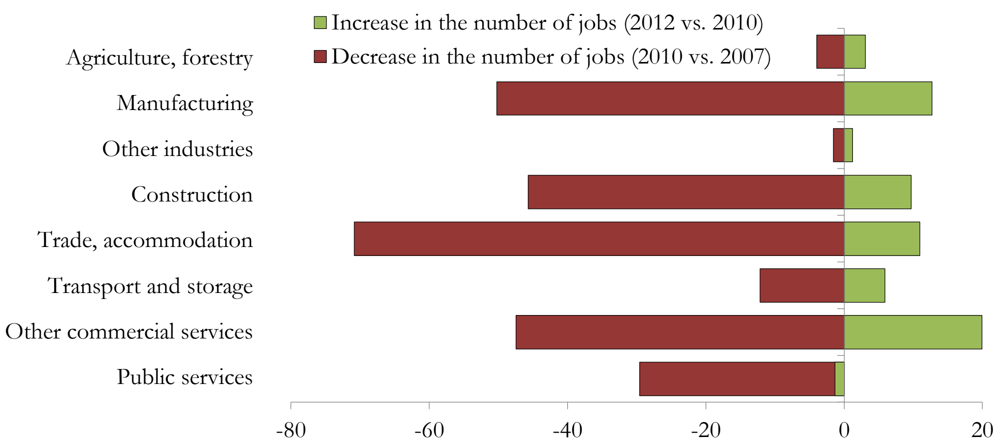
Number of Jobs



The number of jobs kept growing also in 2013 – in the 3rd quarter of 2013, the number of occupied posts has increased by 24.8 thousand or 2.8% compared to the 3rd quarter of 2012, while the number of vacancies has increased by 0.4 thousand or 11.9 per cent.

Figure 5.6

Changes in the Number of Jobs by Sectors of National Economy
(thousand, 2007-2012)



In 2012, the number of filled positions increased in almost all sectors. The highest increase in the number of filled positions in 2012, compared to 2011, was in construction (by 9.4%), agriculture (by 8.5%). The number of filled positions in manufacturing has increased by 5%, while the lowest increase has been observed in other industries and trade. Yet, the number of filled positions in public services sector dropped by 1 per cent.

In the 3 quarters of 2013, the most rapid increase in the number of jobs was still observed in construction – in the 3rd quarter, the number of occupied posts increased by almost 5 thousand or 8.2% compared to the corresponding period of the previous year. A significant rise in the number of jobs was observed also in manufacturing – the number of occupied posts increased by 2.4% or 2.8 thousand.

Over the past few years, the number of jobs in the private sector has increased significantly. After the drop in the number of jobs by 30% during the crisis, it has increased by nearly 13% in 2012, compared to 2010. In the 3rd quarter of 2013, compared to the corresponding period of 2012, the number of occupied posts in the private sector has increased by 4%. At the same time, the number of jobs has increased at a relatively slow pace – the number of occupied posts has increased by just 0.1% since 2010 (3 quarters of 2013 vs. according period of 2010).

5.2. Labour Costs and Productivity

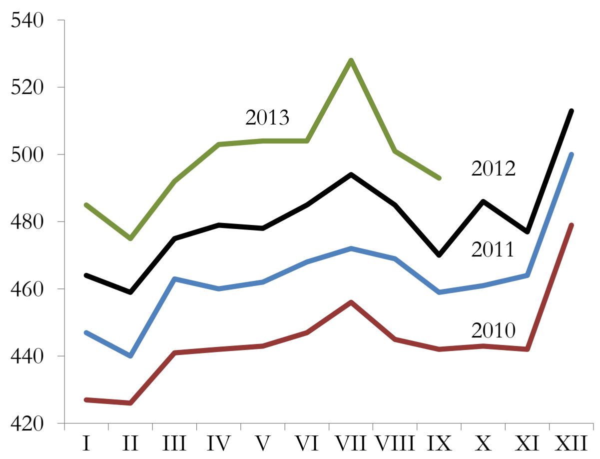
The economic recession caused a decrease in the number of employed and wages alike. As the economic situation has stabilized, wages have resumed growing since the end of 2010.

The average gross wage in 2012 was LVL 481, which is by 3.7% higher than in 2011 and was by just 0.4% higher than in 2008. In 2012, the average gross wage in the public sector was LVL 515, which was by 4.5% higher than in 2011, but by 9.2% lower than in 2008. It should be noted that the drop in wages in the public sector was considerably higher than in the private sector during the crisis, mainly due to the necessity to limit state budget expenditures. The average gross wage in the private sector in 2012 was LVL 463, which was by 3.5% higher than in 2011 and exceeded the level of 2008 by 5.7%. In 2012, the average gross wage in the private sector was by 11% lower than in the public sector, contrary to 2008, when the average gross wage in the public sector was by 29.5% lower.

Figure 5.7

Average Gross Monthly Wage of the Employed

(in lats)



In 2013, the average gross wage continued growing – in the three quarters, compared to the corresponding period of 2012, the gross wage has increased by 4.6%, amounting to LVL 498.

In the three quarters of 2013, the gross wage increased faster in the private sector – by 4.8%, while the gross wages grew at a moderate pace in the public sector – by 4.5%. At the same time, the average gross wage in the public sector was by 10.7% higher than in the private sector, amounting correspondingly to LVL 532 and LVL 481.

Figure 5.8

Average Gross Monthly Wage of Employed in Public and Private Sectors

The dynamics of wages in 2013 differed from one sector of national economy to another; however, the average gross wage increased in all sectors.

In the three quarters of 2013, the most rapid rise in wages was observed in the mining industry (13.1%), public administration (8.6%), financial and insurance services sector (7%), construction (6.7%) and trade (6.5%). The highest level of wages still remained in the financial and insurance services sector – average LVL 1078 per month in the three quarters of 2013.

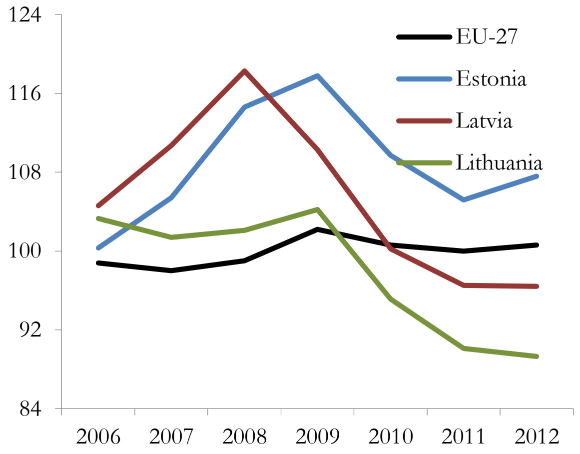
The average gross wage in the key exports sector of Latvia – manufacturing continued growing in 2013, yet slower than 2012.

In the three quarters of 2013, the average gross wage in manufacturing increased by 4 per cent.

Adjustments in product and labour markets caused by the crisis eliminated the gap between productivity and labour costs resulting in gradual improvement of Latvia's competiveness in foreign markets, as evidenced by the dynamics of the production unit labour costs (ULC)[1].

Figure 5.9

Changes of Real ULC in the EU and Baltic States
(2005 =100)



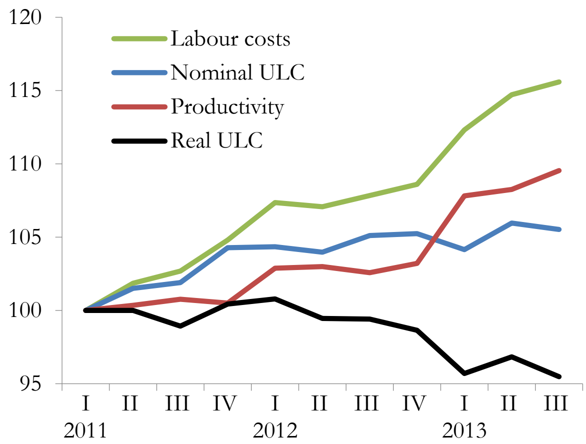
Unlike the years of rapid growth, the ULC dynamics since 2008 to a great extent are related to the cyclical factors or crisis consequences. It should be noted that product markets are much more sensitive to cyclical fluctuations than labour markets. In 2008, compared to 2007, the GDP decreased by 3.3%, although the number of employed remained at the level of the previous year while wages increased. Labour costs continued growing in 2008 (by 15.7%) and productivity decreased by 4.2% resulting in an increase in nominal ULC by 20.7 per cent.

The significant adjustments in the labour market in 2009 affected the dynamics of both productivity and labour costs. Compared to 2008, productivity has decreased by 5.3%, as GDP decreased faster than the number of employed. However, labour costs decreased by 12.7% in 2009, compared to 2008, thus resulting in a drop in the nominal ULC by 7.9 per cent.

The dynamics of the nominal ULC in 2010 were mainly determined by relative changes in the wages and the number of employed. The high unemployment rate and budget consolidation measures still put a pressure on wages. However, taking into account the low competition of Latvia in the single EU labour market, the changes already were rather moderate. Therefore, the decrease in the ULC, as well as the increase in productivity was to a great extent based on changes in the number of employed. The nominal ULC in 2010 were by 10.4% lower than in 2009.

Figure 5.10

Changes of Labour Costs in Latvia
(1st quarter 2011= 100)



In 2011 and 2012, labour costs increased faster than productivity along with the resuming economic growth, thus nominal ULC in 2011 increased by 2% and in 2012 – by 2.8%. Labour costs increased faster than productivity also in 2013, and therefore nominal ULC increased by 2.2% in the three quarters of 2013.

The dynamics of ULC and productivity over the past few years show that ULC will continue increasing along with the growing economic activities.

The dynamics of nominal ULC in the medium-term is mainly affected by structural factors, while the influence of cyclical factors (for example, economic fluctuations in foreign trade countries) is expected to be lower. In 2012, labour costs per one employee in Latvia were 36% of the average EU level. Therefore, the equalization of wages (convergence) is an objective process to be taken into consideration in future, and the gap between productivity and the dynamics of wages is likely to remain in the coming years. A more rapid increase in wages might be related to the increase in the minimum wage, the wish of entrepreneurs to hire highly qualified employees, the dropping unemployment rate, etc. On the other hand, the increase in wages might cause a negative impact on competitiveness, giving a strong incentive for innovations and investments in new technologies to reduce the costs and increase productivity of production resources.

[1] ULC is defined as a relation between labour costs and labour productivity. If the productivity is growing faster than wages, the ULC decreases, which means that competitiveness of the state costs increases and vice versa.

5.3. Labour Market Forecasts

Labour market forecasts for the period until 2020 have been developed in line with the economic development scenarios (see Chapter 3.3).

The situation in the labour market has improved, along with the increasing economic activities. The positive trends are expected to continue – wages and job opportunities are going to increase.

Overall, the employment will increase at a steady pace in 2014, but it is likely to be slower than in 2013. In 2014, the number of the employed might rise on average by 2% or 18 thousand, compared to 2013. At the same time, the employment rate will be slightly above 60%. Overall, the number of the employed will increase to 914 thousand in 2014.

The number of jobseekers in 2014 might decrease by 20% (24 thousand) – to about 97 thousand and the average annual unemployment rate drop to 9.6 per cent.

According to the medium-term forecasts of the Ministry of Economics the labour demand will continue growing. At the same time, the employment is likely to increase slower than the growth, as the output will be mainly based on the increase in productivity.

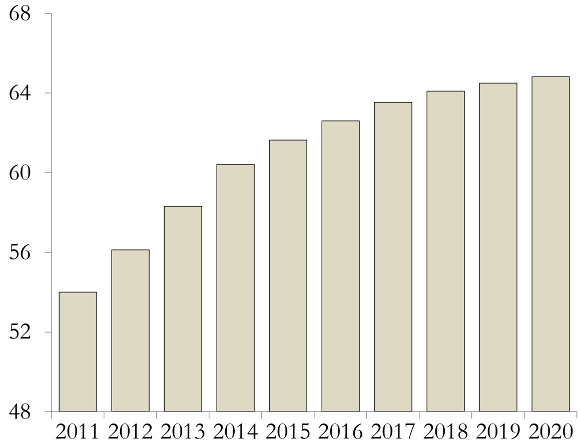
The number of the employed is expected to increase on average by 4.4% or by approximately 40 thousand until 2020 compared to 2013. The most rapid increase in employment is expected until 2016, while the employment growth rates will gradually slow down within the next couple of years mainly due to supply factors – negative demographic tendencies. In 2020, the number of the working population might reach 935 thousand and its share in the total population (aged 15-74 years) will approach 65 per cent.

Unemployment will also continue declining in the medium-term. Until 2016, the unemployment rate might drop to 8% and labour force shortage will become a topical issue. In total, the unemployment rate might drop to approximately 6-7% by 2020.

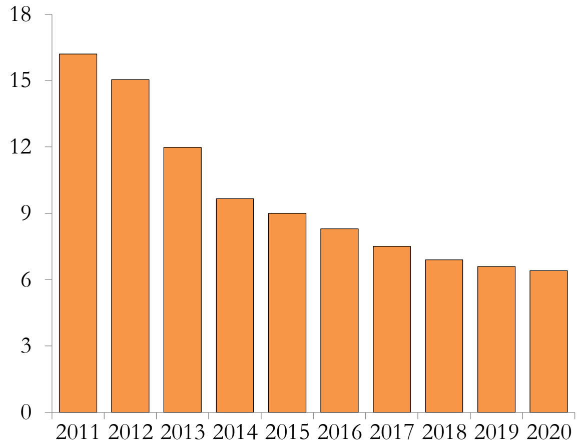
In 2013, majority of economic sectors experienced strong growth that was reflected in the increase of employment. Similar tendencies are likely to be observed also in 2014.

Figure 5.11

Employed rate
(per cent)



Unemployment rate
(per cent)

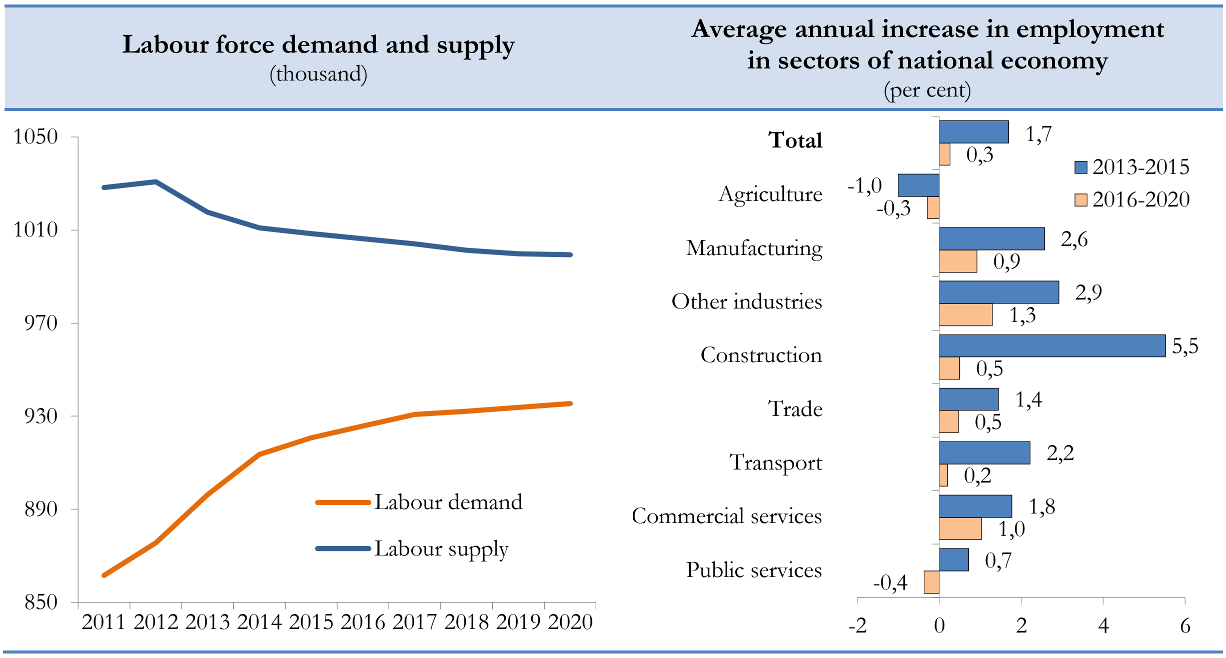


The most considerable increase in the number of employed in 2014, compared to 2013, is expected in commercial services sectors (by 4.6 thousand or 2.7%) and manufacturing (by 3.3 thousand or 2.6%). A significant increase in employment is expected also in the construction and trade sectors.

At the same time, the role of domestic demand-oriented sectors in the labour market will also increase. The growth of tradable sectors will be mainly based on the increase in productivity which is crucial for competiveness, and therefore the employment might grow relatively slower in these sectors.

The number of the employed will increase in the majority of sectors by 2020. The most considerable increase in employment will be observed in manufacturing, commercial services sector, trade and construction.

Figure 5.12



At the same time, the number of the employed is expected to drop in primary sectors – mainly agriculture and forestry, as well as public services sectors. The drop in the labour demand in agriculture is mainly related to improvement of the agriculture sector – formation of agricultural cooperatives and large farms, introduction of systemised production organisation, introduction of complex technological solutions in the production process.

Overall, the medium-term and long-term situation in the labour market will be determined by several important factors. The biggest uncertainty is related to further development of global economic environment – stagnating external demand might affect successful recovery of the labour market. Although the situation in the euro zone and Europe as a whole in has become stable, Europe is unlikely to return to the pre-crisis economic growth rates. At the same time, weaker growth and intensifying protectionism in Russia causes additional risks as it is the second largest market of Latvian products, right after the EU.

Internal challenges in Latvia, however, are mainly related to a gradual population decrease (particularly, working-age population), as well as general labour force ageing tendencies.

According to the estimates of the Ministry of Economics, the number of the working-age population (aged 15-74 years) will drop by about 7% until 2030 in comparison with 2012. At the same time, the demographic burden will increase by about 15%. Significant changes are expected also in the structure of the population age – the share of elderly people in the total number of population will increase in the future.

In general, these tendencies will escalate the problem of labour shortage until 2030 that might cause various disproportions in the labour market.

5.4. Employment Policy

The quantitative target set by Latvia in the context of the implementation of the *Europe 2020 Strategy* is to reach an employment rate of 73% (see Chapter 6.1.) by 2020 in the age group of 20-64. To reach this target, policy directions are planned on both, the labour supply and labour demand side.

The key elements of the employment policy of Latvia:

– fostering labour demand – stimulating economic activities and entrepreneurship, including labour tax reduction, combating undeclared employment, state-provided indirect and direct support measures for entrepreneurs, measures to eliminate administrative barriers, implementing support measures for micro-

enterprises, business incubators, etc. (see Chapters 6.7 and 6.8);
– strengthening labour supply – improving competiveness of the unemployed and persons at risk of unemployment in the labour market, including improving skills according to the labour market demands, lifelong learning measures, consultations on business start-ups, etc.;
– fostering the match between labour demand and labour supply, including improving the educational system, involving employers' organisations in improving education quality, forecasting conformity of labour demand and supply, educating the labour market participants, including pupils and students about the labour market and career issues.

Demographic trends show a decline in the working-age population in Latvia, and therefore **the issues of access to labour force** (see also Chapter 5.3) will become urgent in the upcoming years along with the growing economy and its changing structure. The labour demand increases along with the improving economic situation and some fields already are faced with lack of specialists. The future lack of labour force might become a factor affecting the growth. It may give rise to the need for attracting foreign workers. The objective of Latvia is to fill in the vacant positions with Latvian nationals who have left the country instead of immigrants from other countries. Therefore, the migration policy should encourage people and their families living in an country other than Latvia for various reasons but are willing to return to their home country to either live and work in Latvia or develop business ties with Latvia, for example, to start own business (return migration policy).

In August 2012, a working group was created for the development of a **remigration** support plan by the initiative of the Minister for Economics aimed at covering the wide range of return migration issues and promoting cooperation of institutions involved in the process, as well as identifying the existing measures and developing new ones to create favourable conditions for remigration. The working group involved representatives from state and local government authorities, trade unions, organizations of entrepreneurs and Latvians abroad.

The proposals of the working group for remigration support measures were passed on for public discussion held in November 2012 on the public online discussion platform *www.musuvalsts.lv*.

After evaluating all of the received proposals by the working group, the Ministry of Economic prepared the *Informative Report on Proposals for Remigration Support Measures* (approved by the CoM on January 29, 2013) reflecting the remigration support measures to create favourable conditions for remigration proposed by the working group.

In 2013, the Ministry of Economics in cooperation with the involved institutions continued working on specific remigration support measures incorporated in the *Remigration support measure plan for 2013-2016* (approved at the meeting on July 30, 2013, CoM Decree No. 356).

The Plan is aimed at supporting and assisting those nationals of Latvia living abroad and their families who are considering a possibility or have already decided to return to and work in Latvia, or want to establish their own company or develop business ties with Latvia. The plan is not aimed at encouraging all nationals of Latvia living abroad to rush back to Latvia without careful consideration of the situation of employment and wages here.

The measures have been incorporated in the Plan according to the eight directions of support measures identified in the informative report:
– ensuring the one-stop agency principle – providing information and consultations, also remotely, about moving to and living in Latvia, helping to navigate the required steps in various public authorities to nationals of Latvia living abroad or their family members;
– access to the labour market information – improvement and promotion of the CV and Vacancies database of the State Employment Agency; the CV and Vacancies database contains comprehensive latest information about needed specialists/ vacancies in Latvia, etc.;
– attracting high-skilled workers – support for attracting high-skilled specialists (attraction of scientists and academic personnel living aboard) including to promote return of high-skilled youth having education acquired abroad, to revise requirements and the list of professions where the state should repay study loans for persons working in these professions, etc.;
– learning the Latvian language – provide support for Latvian language learning after returning to Latvia to all family members of Latvian nationals, developed Latvian language learning materials, including electronic learning materials;
– expanding cooperation with the diaspora (developing and maintaining business ties) – measures to inform the diaspora members about the latest developments in Latvia and support for entrepreneurs, consultations on business start-up possibilities, etc.; surveyed entrepreneurs and professionals of Latvian

diaspora abroad and promoted their involvement in the development of national economy of Latvia; collecting and sharing experience stories about returning and cooperation with the diaspora, etc.;
- support to pupils returning to/integrating in the education system of Latvia, as well as their parents – improving and expanding the existing support mechanism for pupils returning from abroad, provided adaptation measures for pupils in education institutions;
- promoting accessibility of public authorities and capital companies – promoted transparent personnel selection procedures, including assessing justification of requirements (for example, foreign languages) for job candidates and their suitability for the job duties, as well as providing an opportunity for those living abroad to participate in job interviews (in public administration institutions) through *Web* communication options;
- expanding the range of persons eligible to apply for the status of a repatriate – so that persons who have left the country after May 4, 1990 and have been living abroad for at least 10 years would be eligible to obtain the status of a repatriate (a draft *Repatriation Law* has been developed and submitted to the Saeima).

The plan also envisages the required funding for implementation of the measures, the sources of financing, expected result-based indicators, deadlines for implementation of measures, as well as responsible and involved institutions.

In 2013, the implementation of measures incorporated in the Plan was launched – mainly measures to provide those living abroad with sufficient access of important information about the living and working conditions, as well as business opportunities in Latvia. The CV and Vacancies portal of the State Employment Agency has been improved and promoted among the diaspora, as well as, within the EURES activities, specialists from the State Employment Agency have provided consultations to nationals of Latvia living abroad on working and living conditions in Latvia. Information is offered about services provided by Latvian state and public government authorities that may be important to persons returning to Latvia. A section *Returning to Latvia* has been crated on the state and public authorities' portal *Latvija.lv* in cooperation with the Ministry of Environmental Protection and Regional Development and the State Regional Development Agency. This section will contain the information prepared by authorities. In order to strengthen the ties of Latvians living abroad with Latvia and to promote participation of Latvians living abroad in the economic growth process of Latvia, meetings with representatives of the diaspora have been held within visits of officials and other events to discuss the current issues in Latvia, including employment and business opportunities, as well as the first World Latvian Economic and Innovation Forum was held on July 2-4, 2013 by the World Free Latvian Association, the Latvian Chamber of Commerce and Industry and the Ministry of Foreign Affairs.

The Ministry of Education and Science organized the first teachers' seminar to identify and discuss issues encountered by teachers working with children who are integrating in the education system of Latvia – children returning to Latvia after a long absence and/or children belonging to other nationality and to find methodological tools for problem-solving. Such seminars are planned to be held also in 2014. As a result, public methodological materials will be developed.

In order to encourage Latvian nationals living abroad to apply for a job in public administration, the State Chancellery and the Ministry of Economics have addressed public administration authorities, encouraging them to ensure remote job interviews with job applicants, for example, through *Skype*.

The remigration support measure plan proposes no solutions to all issues in the Latvian economy and society that have been neglected for years. It is aimed at providing practical support to persons who have emigrated from Latvia and their families but wish and are ready to return to Latvia or want to reinforce the ties with Latvia while living in their home-country.

In order to further reduce the economic factor-driven emigration of the Latvian people, a wide range of measures should be implemented. The policy on improving economic and social situation in Latvia is included in a number of national development planning documents – *Sustainable Development Strategy of Latvia until 2030*, *the National Development Plan for 2014-2020,* etc.

The State Employment Agency (SEA) is the institution implementing the state policy in the field of unemployment reduction and support to the unemployed and job seekers. For the purpose of influencing the labour market, it uses both active and preventive labour market measures, thus promoting competitiveness of the target group of the measure in the labour market.

The key target audience of the employment measures implemented by the SEA are the unemployed registered at the SEA. Although some measures are targeted for other person groups, overall, its activities are oriented towards providing service to the unemployed.

The dynamics of the registered unemployment rates complies with the economic development rates in the country. The number of unemployed registered at the SEA and the registered unemployment rate has been dropping steadily over the past few years.

The total funding for active labour policy measures has been increasing rapidly over the past few years. In 2008, a total of LVL 11 million was used for these measures, in 2009 – LVL 32 million, in 2010 – LVL 64 million. Along with the dropping number of the unemployed, the same trends have been observed also in relation to the funding for labour market measures. Yet, in 2011, the utilised funding has reached LVL 50 million, in 2012 – LVL 31 million, and in the first half year of 2012 – LVL 15.3, while most of it – about 4/5 – is financing from the European Social Fund.

Considering the recent situation in the labour market, the employment policy is now focused on training-oriented measures instead of socially-oriented measures. Most of the financing is granted for the measures to improve skills, which involve professional training, retraining, and promotion of qualification, measures to promote competitiveness and career consultations. In the first half of 2013, a total of 54% of financing granted for active labour market measures have been used for these purposes.

A significant part of the financing has also been granted for paid temporary work and subsidized employment –31% and 13% respectively have been used in this period. The rest of the financing is used for measures to promote lifelong learning, measures for business or self-employment start-ups, and measures to promote regional mobility of persons employed by merchants.

Overall, more than a half of the financing is spent on training-oriented measures – professional training, retraining and promotion of qualification and informal education; training at the employer; lifelong learning measures for employed persons.

Currently, the SEA is implementing the following **active employment measures**:

– professional training, retraining, and promotion of qualification;
– measures for specific groups of persons;
– measures to improve competitiveness;
– paid Temporary Public Work (in 2010 and 2011 this measure completely replaces the measure *Work practice with a grant*);
– measures for business or self-employment start-ups;
– complex support measures;
– promotion of regional mobility of persons employed by merchants;
– training at the employer (the measure has been temporarily suspended to improve conditions for its implementation).

During the years of economic growth, the demand for active employment measures decreased, however, in 2009 due to the significant rise in unemployment, it increased considerably. The demand remained at a high level also in the following years, though it has started to drop. In 2009, a total of 244.3 thousand unemployed were involved in the active employment measures, but in 2010 – 299.2 thousand, while in 2011 – 249.6 thousand unemployed and in 2012 – 206.1 thousand unemployed, and in the three quarters of 2013 – 147.7 thousand persons (one unemployed person may participate in several activities).

The majority of the unemployed are involved in the measures to improve competitiveness. In the three quarters of 2013, the number of such unemployed persons was 78 thousand. The rest of the measures in this period were implemented to the following extent: 11.5 thousand unemployed (including persons transferring from the previous year) were involved in professional training, retraining, and promotion of qualification, informal education – 18.1 thousand unemployed and job seekers, practical training in priority sectors – 21 unemployed, measures for specific person groups – 1.9 thousand persons, paid temporary public work – 26.1 thousand, measures for business or self-employment start-ups – 302 unemployed, the SEA inspector assistant training and practice – 154 persons, complex support measures – 12.6 thousand, and measures to promote regional mobility of persons employed by merchants – 125 persons.

Education programmes offered to the unemployed within the training measures are selected according to the proposals of the Training Commission or a written request of an employer.

A limited number of labour market measures can be used to reduce the mismatching labour market by professions. Out of all implemented measures, the measure *Professional Training, Retraining, and Promotion of Qualification* can be used directly to reduce the mismatching labour market. Within the framework of the measure the unemployed have an opportunity to obtain new professional knowledge, thus acquiring or improving professional qualification. At the moment, the unemployed are offered to acquire knowledge for medium-level qualification.

The rest of training measures are support for obtaining additional knowledge to improve competitiveness in the labour market. Informal education programmes are aimed at both the unemployed and job seekers. Yet, lifelong learning measures for employed persons are aimed at employed people over the age of 45 years (on certain conditions persons aged 25 to 44 years), except public civil servants. Within the framework of the measures, existing qualification knowledge is improved by offering an opportunity to improve professional knowledge with the necessary social and professional basic skills like computer skills, foreign languages and obtaining a driving licence of certain category. Since implementation of the training at the employer's workplace revealed risks that may have a negative impact on the labour market, the measure has been temporarily suspended until improvement of the conditions.

The SEA implements **preventive unemployment reduction measures:**

– career consultations;
– training programmes for involvement of adults in lifelong learning.

In terms of the number of clients whom the service has been provided to, career consultations is the most important preventive unemployment reduction measure. In 2009, career consultation services were provided to 55.1 thousand people, in 2010 – 78.4 thousand, in 2011 – 47.7 thousand, while in 2012 – 67.1 thousand, and 59.4 thousand of them were unemployed and job seekers. In the three quarters of 2013, consultations have been provided to 35.9 thousand, 31.2 thousand of them were unemployed and job seekers.

A training-oriented measure *Training Programmes for Involvement of Adults in Lifelong Learning* was launched in 2010. The target group includes employed and self-employed persons (except employees of the public civil service) who have reached the age of 45, but have not reached the age for granting the state old age pension (on certain conditions persons aged 25 to 44 years). In 2010, 5155 unemployed persons started the training, in 2011 – 15 638 persons (incl. 4715 transferred from 2010), and in 2012 – 7187 persons (incl. 4727 transferred from 2011) and in the three quarters of 2013 – 5128 persons (incl. 1322 transferred from 2012).

Considering the changes in the labour market, a number of new active labour market measures have been launched in 2013.

The implementation of the measure *Promotion of Regional Mobility of Persons Employed by Economic Operators* was launched in the first half of 2013. The measure is intended to provide support at the initial period of employment to those unemployed who have found a job in another city/county, by covering the transport and apartment rent costs for the first four months from the establishment of employment legal relationship.

In summer 2013, the pilot project *Practical Training of the Unemployed in Priority Sectors* was launched, providing practical training at an employer. Training is provided in four sectors identified in cooperation with entrepreneurs – manufacturing, transport and logistics, tourism, and information and communication technologies. This pilot project gives the employers an opportunity to train and employ employers according to the specific nature and requirements of their enterprise.

An unemployed profiling system has been developed for the work with the unemployed to provide customized services to each unemployed.

Along with the existing youth-oriented measures: *Job for Youth* and *Support for Youth Volunteers*, a new measure *Youth Workshops* has been launched in the first half of 2013. The measure is aimed to encourage unemployed youth aged 15 to 24 years who have not acquired vocational education and have never been employed to choose the area of their education for future working life. The measure gives the youth an opportunity to try hand at three vocational education programmes, being engaged in each education programme for three weeks to get an insight in its specific nature.

The labour market measures have been focused on specific target groups also in 2013.

Since it is possible to involve a rather limited number of participants in the measure *Training Programmes for Involvement of Adults in Lifelong Learning,* the criteria for involvement in the measure have been narrowed down to support the persons at the highest risk of unemployment. Therefore, the eligibility age for application for the measure has been raised to 45 years. Persons aged 25 to 44 years may apply for the measure on certain conditions.

Particular attention will be dedicated to the youth unemployment issues in the coming years as Latvia will take active part in the implementation of the EC initiative *Youth Guarantees*. The measures to implement youth guarantees in Latvia are planned to take place from 2014 to 2018. The estimated funding for the implementation of youth guarantees measures is EUR 63 million.

The youth aged 15 to 24 years who are not working or studying will be eligible for the necessary support in a form of labour, training or education measures. Within the youth guarantee young people from the target group are expected to receive support for involvement in the labour marker not later than four months after dropping out of school or obtaining the unemployed status.

The **social dialogue** is important in implementing the employment policy. The institutions participating in the employment partnership – Employers' Confederation of Latvia, Free Trade Union Confederation of Latvia, local governments of Latvia, and Latvian Association of Local and Regional Governments – are involved in improving the social dialogue at both the national and regional level.

An important aspect is **safety at work** ensuring conditions for safe and healthy work environment.

In order to ensure gradual reduction in the number of fatal accidents at work, thus promoting a safe and healthy working environment in enterprises, prolongation of working life and improvement of the entire public welfare level, the Cabinet of Ministers on April 20, 2011, approved the *Plan of Labour Protection Development for 2011–2013*. It sets several objectives: improving the labour protection policy planning, increasing the capacity and efficiency of the national control and supervision mechanism, introducing the "preventive culture" into the society and enterprises, ensuring economic impetus and state support to the employers.

In late 2012, the Cabinet of Ministers approved amendments to a number of occupational safety legislation documents to reduce the administrative burden on occupational safety. They envisage reducing the time required for occupational safety specialists and the minimum amount of basic training – 60 hours as of July 1, 2013. As of January 1, 2013 the enterprises of dangerous sectors with 6 to 10 employees will be subject to simplified requirements for occupational safety specialists.

Reduction of administrative burden was continued also in 2013. At the end of the year, the CoM approved amendments to the procedure for investigation of accidents at work, by simplifying the conduct of investigations for employers and the State Labour Inspectorate.

Latvia has a relatively high rate of **undeclared employment** in certain sectors, increasing unfair competition and reducing the social security of employees.

The government has developed and approved directions of actions to reduce both undeclared employment and shadow economy and ensure fair competition for 2010–2013. The measures to reduce undeclared employment are implemented in the following key directions: effectivization of the control mechanism for the undeclared employment; reduction of unfair competition; revision of the penalties policy with regard to undeclared employment; informing and educating the society about the negative consequences of undeclared employment.

The key directions of combating the shadow economy and ensuring fair competition are tax policy, reducing the administrative burden, supporting the honest entrepreneurs, and promoting a transition to legal economy, improving the capacity of controlling institutions, elaborating the laws and regulations, penalties policy, work with the society, and eliminating the shadow economy in risk sectors.

The education system plays an important role in the context of labour market development, particularly emphasizing the significance of **lifelong learning**. Introduction of the lifelong learning principle is emphasized also in the *National Reform Programme of Latvia for the Implementation of the Europe 2020 Strategy*.

Latvia has decided to foster continuous improvement and development of public knowledge, skills, and competences providing lifelong learning available to ensure that 15% of the population (aged 25–64 years) would be continuously involved in educational process in 2020.

The lifelong learning principle is going to be implemented in several directions:

- developing the national qualification framework structure, and adjusting its levels to the European qualification structure;
- ensuring evaluation of knowledge, skills, and professional competence acquired outside the formal education;
- offering a second chance education as a compensating mechanism to reduce the number of early school leavers;
- supporting qualification improvement of employees according to employers' requirements that are necessary for the employed training within the framework of the sectors;
- implementing training programmes for involvement of the employed adults in lifelong learning.

6. Economic Policy and Priorities of Structural Policy

6.1. *Europe 2020 Strategy* and the *National Reform Programme of Latvia*

6.1.1. *Europe 2020* Strategy and its Progress

On March 3, 2010, the European Commission published a communication *"Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth"*, which outlines the European Commission's vision on the *Europe 2020 strategy*.

On June 17, 2010, the European Council formally approved the *Europe 2020 strategy* and its key elements: EU-level headline targets for 2020, the *Integrated Guidelines* (developed according to the Articles 121 and 148 of the Treaty on the Functioning of the EU, which set the main directions of economic and employment policies, as well as serve as a base for development of National Reform Programmes of the EU Member States) and agreed that the EU Member States in cooperation with the European Commission must develop National Reform Programmes and submit them to the European Commission by the end of April 2011 together with the *Stability* or *Convergence Programmes* (developed and implemented for fulfilling requirements of the Stability and Growth Pact).

The surveillance of implementation of the *Europe 2020 strategy* consists of two pillars (see Figure 6.1) – macroeconomic and thematic surveillance (National Reform Programmes of the EU Member States for the implementation of the *Europe 2020 strategy* and their conformity with the *Integrated Guidelines* are being assessed), as well as fiscal surveillance (the *Stability* and *Convergence Programmes* of the EU Member States and their conformity with the *Stability and Growth Pact* are being assessed).

Since January 1, 2011, **the European semester** is held every year to evaluate the overall economic situation in the EU and Member States, as well as to provide recommendations to the EU Member States for the implementation and strengthening of their economic policy.

The *Europe 2020 strategy*, National Reform Programmes, *Stability* and *Convergence programmes* of the EU Member States are the core elements of the coordination and surveillance of the EU Member State economic policy at the EU level within the European semester (see Figure 6.2). Multilateral surveillance of both programmes is carried out at the EU level, based on which the European Commission is entitled to give a policy warning, if the economic policy of any particular EU Member State is not in line with the EU *Integrated Guidelines* and targets set at the EU level. The National Reform Programmes are linked also to the EU budget as a part of the measures is co-financed from the EU budget.

Figure 6.1

Surveillance mechanism of the National Reform Programmes, *Stability* and *Convergence Programmes* of the EU Member States

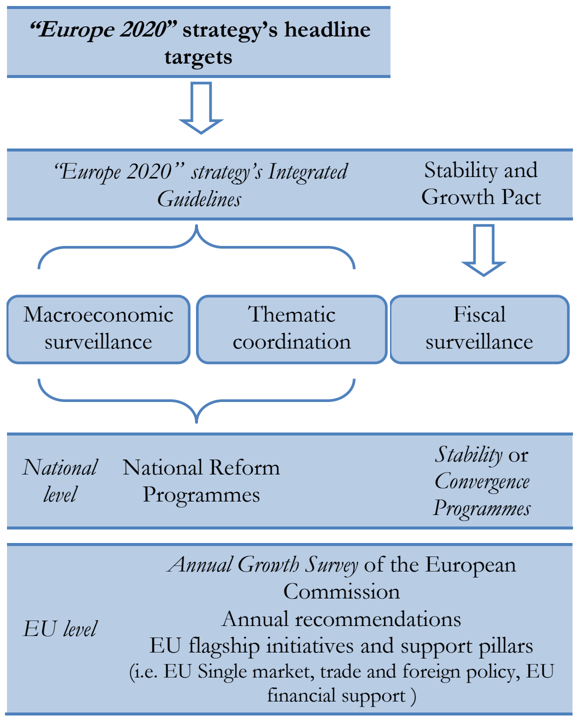
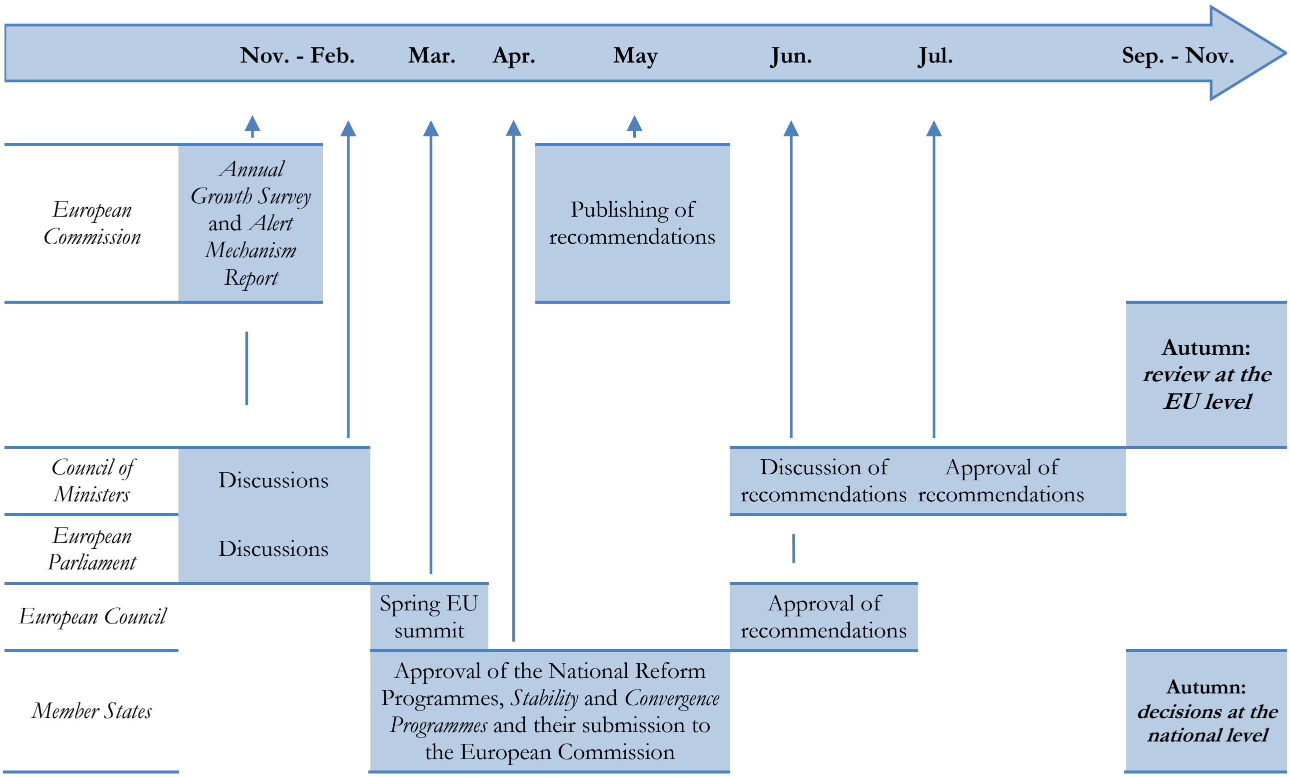


Figure 6.2

The European semester and monitoring of national programmes of the EU Member States



Box 6.1

***<u>Annual Growth Survey</u>* 2014**

On November 13, 2013, the European Commission presented the *Annual Growth Survey 2014* along with other key documents, namely the *Single Market Integration Report*, the *Alert Mechanism Report*, as well as *Joint Employment Report*. It should be noted that the *Annual Growth Survey 2014* differs from the previous reports with the EC assessment on progress in implementation of the EU Council country-specific recommendations, as well as the *Joint Employment Report* contains a scoreboard of key employment and social indicators.

In the *Annual Growth Survey 2014* the EC states that the economic forecasts confirm signs of a slow recovery in the EU. After five years of very limited or negative growth, the EU has experienced positive growth in the second quarter of 2013. The recovery is expected to continue and to become more robust in 2014.

Europe has reached a turning point in the crisis but the incipient recovery is still modest and fragile, and the global economic context presents uncertainties, such as reduced demand in emerging economies. Risks linked to lack of confidence about banking sector resilience and to high sovereign debt are still present. The legacy of the crisis, deleveraging needs in the public and private sector, fragmentation of financial systems and credit markets, sectoral restructuring and adjustment and high levels of unemployment will continue to weigh on growth in the coming period. Its impact will gradually subside as accumulated macroeconomic imbalances are corrected. Improvements in the labour market will take time to materialise, with unemployment expected to remain unacceptably high in many parts of Europe for some time to come, and the broader social situation remains depressed.

Taking into account the abovementioned, the EC considers it crucial to stay the course of the policy response deployed in *Annual Growth Surveys* in the recent years. While maintaining the same medium-term priorities as last year, the EC is proposing to adapt their implementation to the changing economic and social circumstances. The EU and its Member States should thus pursue and in some cases reinforce their focus on making progress in the following five priority areas:

– pursuing differentiated, growth-friendly fiscal consolidation;
– restoring normal lending to the economy;
– promoting growth and competitiveness for today and tomorrow;
– tackling unemployment and social consequences of the crisis;
– modernising public administration.

The *Annual Growth Survey* of the European Commission (see Box 6.1) is an important element of the European semester as the publication of the survey launches the European semester with discussions at different levels of the EU Council. As a result of these discussions, the EU Member States agree on the main priorities of economic policy to be taken into consideration when updating National Reform Programmes, *Stability* or *Convergence programmes*.

New economic and fiscal policy surveillance rules (so-called "six-pack") consisting of five regulations and a directive came into force on December 13, 2011. By adopting these new rules in the EU, in addition to the excessive deficit procedure*,* a macroeconomic imbalances procedure is established to identify timely (using scoreboard of the alert mechanism) and to correct macroeconomic imbalances (for example, high current account deficit, etc.) – see Box 6.2. Since the National Reform Programmes of the EU Member States are oriented towards implementation of key structural reforms, they help eliminating timely excessive budget deficit and macroeconomic imbalances.

Box 6.2

Alert mechanism and scoreboard

The EC publishes annually the *Alert Mechanism Report*, which analyses the EU Member States according to certain indicators and thresholds (scoreboard):

- 3 year backward moving average of the current account balance as per cent of GDP, with a threshold of +6% of GDP and -4% of GDP;
- net international investment position as per cent of GDP, with a threshold of -35% of GDP;
- 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 euro-area countries and +12% for non-euro-area countries;
- 3 years percentage change of the real effective exchange rates based on HICP/CPI deflators, relative to 35 other industrial countries, with thresholds of -/+5% for euro-area countries and -/+11% for non-euro-area countries;
- private sector debt in % of GDP with a threshold of 160%;
- private sector credit flow in % of GDP with a threshold of 15%;
- 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 the unemployment rate, with a threshold of 10%;
- annual changes in total liabilities of financial sector with a threshold of 16.5%.

In case, if any of the EU Member States violates the threshold of any of the indicators, the EC carries out in-depth analysis and publishes the *In-Depth Review*.

In the *2014 Alert Mechanism Report,* the EC has identified 16 EU Member States that should be analysed in the *In-Depth Review*:

- Spain and Slovenia should be analysed to check whether the excessive imbalances still persist;
- France, Italy and Hungary should be analysed to see the impact of implemented measures on the elimination of imbalances;
- Belgium, Denmark, Malta, the Netherlands, Finland, Sweden and the United Kingdom should be analysed to check whether imbalances persist, increase or decrease;
- Germany experiences excessive current account surplus that exceeded the threshold according to the scoreboard;
- For Luxembourg the EC identified an excessive current account surplus and dependence on one particular sector;
- For Croatia the EC identified recession, weak external sector and high debt level.

None of the Baltic States showed excessive macroeconomic imbalances, despite the fact that two indicators were above the threshold according to the scoreboard – it was net international balance and three-year average unemployment rate. Assessment of the progress made by the Baltic States and changes in the macroeconomic imbalances scoreboard allowed the EC to conclude that the net international investment balance was rapidly decreasing and the largest part of debt was generated by foreign direct investments. As for the three-year average unemployment rate, the EC recognizes that although it remains relatively high still, it is tended to drop rapidly from year to year.

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*** (the NRP of Latvia) was approved by the Cabinet of Ministers on April 26, 2011 along with the *Convergence Programme of Latvia for 2011-2014*. Both programmes were submitted to the European Commission on April 29, 2011.

The NRP of Latvia describes the medium-term macroeconomic scenario, reflects key macro-structural bottlenecks to the economy of Latvia and main measures to tackle them, as well as quantitative targets of Latvia for 2020 in the context of the *Europe 2020 strategy* and main measures to achieve them.

The aim of Latvia is to foster growth and employment, thus ensuring growth of GDP in the amount of 4-5% in the medium term and a high employment rate in the amount of 73% by 2020.

The NRP of Latvia reflects quantitative targets of Latvia for 2020 in the context of the *Europe 2020 strategy* (hereinafter – quantitative targets of Latvia). The quantitative targets have been defined based on the medium-term economic growth scenario, as well as the sustainable growth targets of Latvia set out in the *Latvia 2030 Strategy* and reflected also in the *National Development Plan of Latvia for 2014-2020 (NDP 2020)* approved by the Saeima on December 20, 2012.

According to the quantitative targets of Latvia, it is planned to achieve employment rate of 73%, an increase of investments in research and development (R&D) to 1.5% of GDP, an increase of the share of people having completed tertiary education to 34-36%, reduce the share of early school leavers to 13.4%, reduce the share of persons at-risk-of-poverty to 21%, increase the share of renewable energy in the total gross energy consumption to 40%, etc.

According to the European semester process, on April 29, 2013, the Cabinet of Ministers approved the second ***Progress Report on the Implementation of the National Reform Programme of Latvia*** and the updated *Convergence Programme of Latvia for 2013-2016*. Both abovementioned documents have been submitted to the EC.

The Progress Report on the Implementation of the NRP of Latvia contains the updated medium-term macroeconomic scenario described in the NRP of Latvia and evaluates the implementation progress of the NRP of Latvia*,* particularly emphasizing fulfilment of the EU Council recommendations, as well as it provides a detailed description of the NRP of Latvia policy directions, including the progress towards achievement of the quantitative targets of Latvia within the *Europe 2020 strategy*, and reflects information about the use of the EU funds in the current and in the 2014-2020 planning period.

After having assessed the updated National Reform Programmes, *Stability* or *Convergence Programmes* submitted by the EU Member States and the progress made towards their implementation, on July 9, 2013, the **EU Council approved the country-specific recommendations for the EU Member States**, including Latvia for 2013-2014 which are as follows:

- Reinforce the budgetary strategy to ensure that the deviation from the medium-term objective only reflects the incremental impact of the systemic pension reform. Within this strategy, reduce taxation of low-income earners by shifting taxation to areas such as excise duties, recurrent property taxes and/or environmental taxes. Maintain efforts to improve tax compliance and combat the shadow economy. Continue strengthening the fiscal framework through effective implementation of the *Fiscal Discipline Law* and multi-annual budgeting;
- Continue to use micro and macro prudential policies to prevent possible vulnerabilities that could arise from future credit growth and non-resident banking activities;
- Tackle long-term and youth unemployment by increasing coverage and effectiveness of active labour market policies and targeted social services. Improve the employability of young people, for example through a *Youth Guarantee*, establish comprehensive career guidance, implement reforms in the field of vocational education and training, and improve the quality and accessibility of apprenticeships;
- Tackle high rates of poverty by reforming social assistance for better coverage, by improving benefit adequacy and activation measures for benefit recipients. Reinforce the delivery mechanisms to effectively reduce child poverty;
- Implement the planned reforms of higher education concerning, in particular, the establishment of a quality-rewarding financing model, reform of the accreditation system, consolidation of the institutions and promotion of internationalization. Take further steps to modernise research institutions based on the on-going independent assessment;
- Continue improving energy efficiency, especially of residential buildings and district heating networks; provide incentives for reducing energy costs and shift consumption towards energy-efficient products. Improve connectivity with EU energy networks and take steps towards liberalisation of the natural gas market, including provision of clear rules for third-party access to storage capacities;
- Complete pending reforms to improve the efficiency and quality of the judiciary and reduce the backlog and length of proceedings, including as regards insolvency. Put in place a comprehensive human resources policy and take steps to implement the mediation laws and streamline the arbitration court system.

These recommendations for Latvia are a key element in identifying national priorities, developing and implementing the necessary reforms and policy measures, as well as in successful implementation of the *National Reform Programme of Latvia* and *Convergence Programme of Latvia*.

Taking into account the scope, impact, implementation costs and the need to discuss certain recommendations (for example, regarding education reforms, poverty reduction, energy and improvement of the judiciary) with representatives of social partners, non-governmental organisations and the society, they are unlikely to be implemented within a year.

It should be noted that bilateral meetings are held between the EU Member States and the European Commission on a regular basis regarding implementation of the National Reform Programmes, *Stability* or *Convergence Programmes* and the EU Council Recommendations for the EU Member States. In 2013, three bilateral meetings have been held between Latvia and the European Commission. The economic situation in Latvia, progress in implementation of the EU Council recommendations for Latvia in 2013 have been discussed during these meetings.

According to the EC assessment published in the Annex to the *Annual Growth Survey 2014*, Latvia has made positive progress towards fulfilment of the EU Council recommendations. The excessive budget deficit procedure in Latvia was abrogated in June 2013. The budget for 2014 is the first to be implemented based on the new *Fiscal Discipline Law*. The Saeima has approved measures to reduce labour taxes. As for the banking sector, the EC believes that Latvia should continue monitoring activities of non-resident banks despite the fact that Latvia is implementing special regulatory measures to supervise deposits of non-resident banks. The EC emphasises that despite significant reforms launched in education, it is implementing these reforms at an unsatisfactory pace. The EC shows a positive attitude towards reforms of the judiciary, including reorganizing of the courts, reforms of the civil procedure, the progress of the *Draft Mediation Law*, the *Draft Arbitration Law* and the *Amendments to the Insolvency Law*. According to the EC, Latvia needs to implement measures aimed at improvement of natural gas infrastructure and market liberalization, particularly to ensure well-regulated third-party access to supply networks and storage capacities. The EC shows a positive attitude towards the progress made in the field of energy efficiency. The EC finds the progress made in the field of social assistance reform to be slow.

The Ministry of Economics will continue supervising the implementation of measures and information on the implementation progress will be included in the *2014 Progress Report on the Implementation of the National Reform Programme of Latvia within the Europe 2020 Strategy*.

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

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

As an EU Member State, Latvia has access to the financial support from the EU Structural Funds (SF) and the Cohesion Fund (CF), which are instruments for implementing the EU regional cohesion policy.

<u>**Programming period 2007-2013**</u>

In the programming period of 2007-2013, the SF support is mainly aimed at educating the population, technological excellence and flexibility of enterprises, as well as at development of science and research in order to promote knowledge-based economy and strengthen other prerequisites for sustainable economic development and general living conditions for people in Latvia.

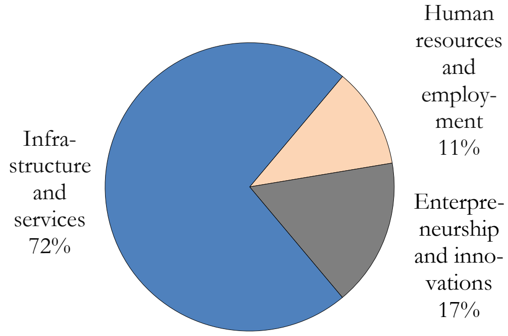
Programming of the SF and the CF resources is implemented on 3 levels: the EU level strategy or *Community Strategic Guidelines*, strategy of the Member States or the *National Strategic Framework Document* (NSFD), and *Operational programmes* (OP) of the Member States.

NSFD, which is the basis for allocation of the SF and CF funding in the amount of EUR 4.53 billion available for Latvia within the planning period of 2007-2013, was approved by the Cabinet of Ministers on June 19, 2007. On September 20, 2007, it was also approved by the EC.

Figure 6.3

Breakdown of Funding among OPs in the Programming Period 2007-2013

(per cent)



According to the Decision of the EU Council of Ministers on the EU Multi-Annual Financial Framework for the programming period of 2007–2013, Latvia has received EUR 4.53 billion or LVL 3.18 billion for implementing the cohesion policy objectives through the EU funds (the European Regional Development Fund – hereinafter the ERDF; the European Social Fund – hereinafter the ESF) and the CF.

Breakdown of the funding among OPs from the total EU funding of EUR 4.53 billion in the programming period of 2007-2013:

– 1. OP *Human Resources and Employment* (ESF) – EUR 583 million or LVL 409 million. With the amount of overcommitments EUR 711 million or LVL 500 million;
– 2. OP *Entrepreneurship and Innovations* (ERDF) – EUR 736 million or LVL 517 million. With the amount of overcommitments EUR 830 million or LVL 584 million;
– 3. OP *Infrastructure and Services* (ERDF+CF) – EUR 3.2 billion or LVL 2.25 billion. With the amount of overcommitments EUR 3.82 billion or LVL 2.69 billion.

Table 6.1

EU Fund Financial Progress in the Programming Period 2007-2013 till September 30, 2013

	Funding of the EU funds	Concluded contracts		Paid to the funding beneficiaries		Received EC's repayments (incl. advances)	
	million LVL	million LVL	%	million LVL	%	million LVL	%
ESF	409.8	434.9	106.1	359.9	87.8	388.8	94.9
ERDF	1 692.0	1 628.9	96.3	1 086.5	64.2	1 017.6	60.1
CF	1 082.1	945.9	87.4	626.1	57.9	615.2	56.9
Total	**3 184.0**	3 009.7	94.5	2 072.6	65.1	2 021.7	63.5

As of October 31, 2013, projects to the extent of 94.5% of all financing of the EU funds available for Latvia within the given programming period have been approved, and contracts for a total of LVL 3009.7 million have been concluded. As of October 31, 2013, the funding beneficiaries have received LVL 2072.2 million.

Box 6.3

Activities under the responsibility of the Ministry of Economics

A total of LVL 524.8 million of the EU resources are available for the activities of the Ministry of Economics in the programming period 2007–2013, and this amount is distributed as follows:

1. OP *Human Resources and Employment* – LVL 35.7 million;
2. OP *Entrepreneurship and Innovations* – LVL 378.4 million;
3. OP *Infrastructures and Services* –LVL 141.4 million.

Contracts concluded until October 31, 2013 within the framework of activities under the responsibility of the Ministry of Economics:

– Within the activity *Support to Training of the Employed for Promotion of Competitiveness of Entrepreneurs – Support to Training Organized in Partnerships*, 30 contracts have been concluded for the total contract sum of LVL 21.7 million.
– Within the activity *Support to Individually Organised Trainings for Entrepreneurs*, 84 contracts have been completed for the total contract sum of LVL 1.9 million.
– Within the activity *Support to create new jobs,* 6 contracts have been concluded for the total contract sum of LVL 4.5 million.
– Within the activity *Attraction of Highly Qualified Employees*, 3 contracts have been completed for the total contract sum of LVL 100.9 thousand.
– Within the activity *Competence Centres,* 6 contracts have been concluded for the total contract sum of LVL 37.3 million
– Within the activity *Technology Transfer Contact Points*, 8 contracts have been concluded for the total contract sum of LVL 1.8 million.
– Within the activity *Development of New Products and Technologies*, 80 contracts have been concluded for the total contract sum of LVL 5.1 million.
– Within the activity *Introduction of New Products and Technologies into Production*, 118 contracts have been concluded for the total contract sum of LVL 27.2 million.
– Within the activity *Development of New Products and Technologies – Support to Strengthening Industrial Property*, 5 contracts have been concluded for the total contract sum of LVL 71.8 thousand.
– Within the activity *High Value Added Investments*, 35 contracts have been concluded for the total contract sum of LVL 69.8 million.
– Within the activity *Access to International Trade Markets – External Marketing*, 1658 contracts have been concluded for the total contract sum of LVL 6.4 million.
– Within the activity *Development of External Markets –* S*trengthening International Competitiveness of Industry Sectors*, 2 contracts have been concluded for the total contract sum of LVL 9.1 million.
– Within the activity *Support for Self-employment and Business Start-ups,* 1001 start-up projects for over LVL 14.92 million have been supported.

Box 6.3 continued

- The following results have been achieved within the financial instruments of the activity *Holding Fund*:
  1) venture capital – on January 22, 2010, a contract on establishment of venture capital fund was concluded with *BaltCap Management Latvia*. In addition to the 20 million euro invested by the Holding Fund, *BaltCap Management Latvia* invested another 10 million euro of private investor co-funding. By September 30, 2013 BaltCap Management Latvia has concluded 10 venture capital investment contracts for the amount of LVL 8.51 million;
  2) seed and start-up capital – on June 16, 2010, a contract on establishment of a seed and start-up capital fund was concluded with *Imprimatur Capital Baltics*. The total available financing for seed and start-up capital investments amounts to EUR 7.26 million (On May 10, 2013 a contract on an increase in the seed capital to EUR 6.4 million was concluded with *Imprimatur Capital Baltics*). By September 30, 2013 Imprimatur Capital Baltics has concluded 17 seed capital investment contracts for the amount of LVL 1.64 million and 3 start-up capital investment contracts for the amount of LVL 878 thousand;
  3) high risk loans – on March 26, 2010 contracts with *AS Swedbank* and *AS SEB Banka* were concluded. The programme was implemented until September 26, 2012. A total of 32 loan agreements for LVL 10.59 million have been signed within the programme;
- Within the activity *Guarantees for Improvement of Enterprise Competitiveness*, 364 credit guarantee contracts have been concluded for the total amount of LVL 85.93 million and 125 export guarantee contracts for the total amount of LVL 8.29 million.
- Within the activity *Loans for Improving Enterprise Competiveness*, until September 30, 2013, 421 loans have been granted for the total amount of LVL 184.6 million, including 103 loan agreements have been granted for LVL 88.11 million within the ERDF part of the programme (out of them 79 loan agreements have been concluded for the amount of LVL 52.89 million).
- Within the activity *Measures to Encourage Innovations and Business Start-ups*, 1 contract has been concluded for the total contract amount of LVL 2 million. Measures, seminars and competitions organized within the activity have involved 15 134 persons.
- Within the activity *Business Incubators,* 9 contracts on providing business incubation services in the regions of Latvia and 1 contract on providing business incubation services to creative industry enterprises in Riga have been concluded. 823 enterprises are supported within the activity
- Within the activity *Co-financing to the Investments in Micro, Small and Medium-sized Enterprises Operating in the Specially Assisted Areas*, 104 contracts have been concluded for the total contract sum of LVL 5.5 million.
- Within the activity *Cluster programmes,* 11 contracts have been concluded for the total contract sum of LVL 3.2.
- Within the sub-activity *Maintenance and Renewal of Town Planning Monuments of National Importance and Infrastructure Adjustment to Develop a Tourism Product*, 21 contracts have been concluded for the total contract sum of LVL 7 million (ERDF).
- Within the sub-activity *Development of Cycling Tourism Product of National Importance*, 8 contracts have been concluded for the total contract sum of LVL 3.9 million (ERDF).
- Within the activity *Improvement of Heat Insulation of Multi-apartment Residential Buildings*, 868 contracts have been concluded for the total contract sum of LVL 53.5 million (ERDF).
- Within the activity *Improvement of Heat Insulation of Social Residential Buildings*, 56 contracts have been concluded for the total contract sum of LVL 3.8 million (ERDF).
- Within the activity *Measures for Raising Efficiency of Central Heat Supply Systems,* 97 contracts have been concluded for the total contract sum of LVL 47.9 million (CF).
- Within the activity *Development of Cogeneration Power Plants Using Renewable Energy Resources,* 10 contracts have been concluded for the total contract sum of LVL 20.7 million (CF).

Financial absorption of EU funds in operational programmes *Human Resources and Employment, Entrepreneurship and Innovations,* and *Infrastructure and Services*

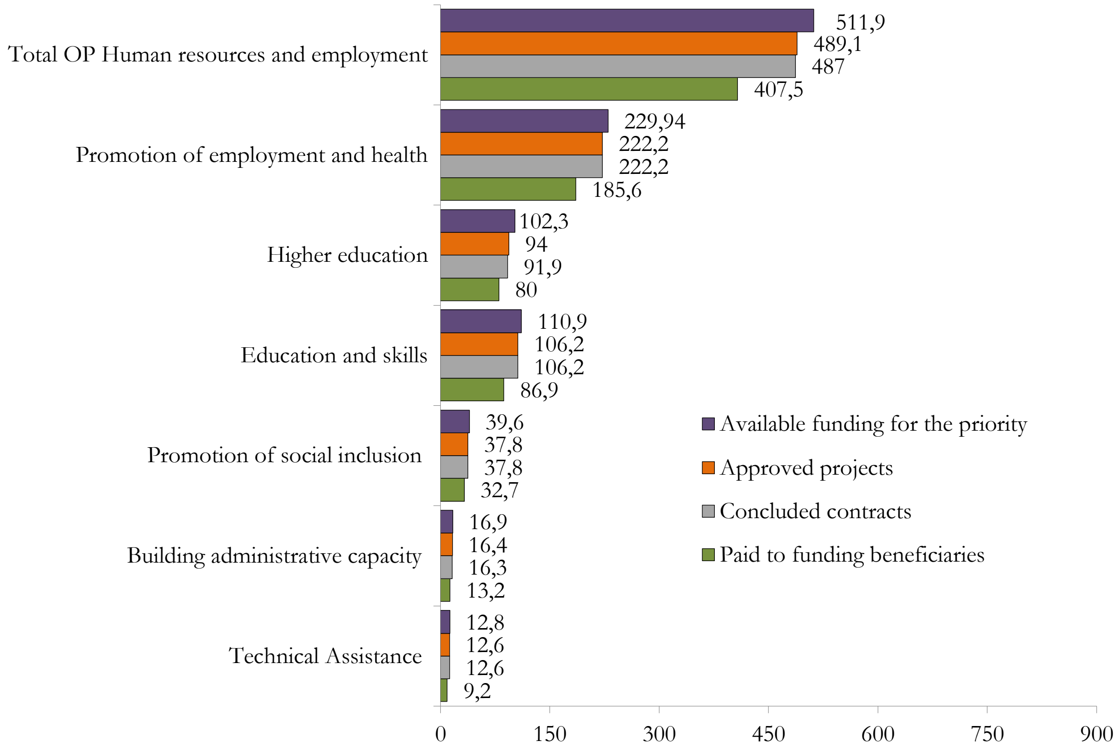
The overall implementation progress of the OP *Human Resources and Employment* until September 30, 2013 has been good, reaching the payment target by 105%. The amount of approved projects and concluded contracts is 106.8%, taking into consideration the granted overcommitments of the government budget. Yet, the total amount of funding paid to the funding beneficiaries during the reporting period has increased by 5.7%, thus reaching 87.8 per cent.

Until September 30, 2013 implementation of the OP *Entrepreneurship and Innovations* has been relatively slow compared to other OPs, the payment objective to funding beneficiaries has been achieved by 90.4%. The amount of approved projects is 84.9%, while the amount of concluded contracts is 84.2%. Yet, the total amount of funding paid to funding beneficiaries reached just 58.4% of the available public funding.

The most considerable delay in the plan has been observed in the activities implemented by the Ministry of Economics within the priority *Science and Innovations* and the business incubator activity which has been a subject to suspension of payments to funding beneficiaries and declaration of expenditure to the EC. The activity has been resumed. The reason for failure to absorb the funding for business incubator activity is the fact that incubated enterprises tend to use less services available within the incubator due to change in support intensity in the second year and the following years of incubation according to the effective contract provisions. A significant delay in the plan has been observed also in the sub-activity *Improvement of Information Technology Infrastructure and Information Systems for Scientific Activity* implemented by the Ministry of Education and Science.

Figure 6.4

Financial Investments of the EU funds until September 30, 2013 in the OP *Human Resources and Employment*; Public Funding
(million LVL)



Successful implementation of the activity *High value added investments* of the measure *Innovations* of the priority ***Science and Innovations*** is hindered by a huge number of rejected project applications. The Ministry of Economics has identified the risks associated with insufficient number of quality projects submitted within the activity and the non-absorption of the funding by the end of 2013. In order to reduce these risks, the provisions of the 3rd call for project proposals contain stricter requirements for financial indicators of project applicants. Considering the poor quality of project applications for business and product development plans, IDAL provides consultations and information to interested persons about the activity requirements.

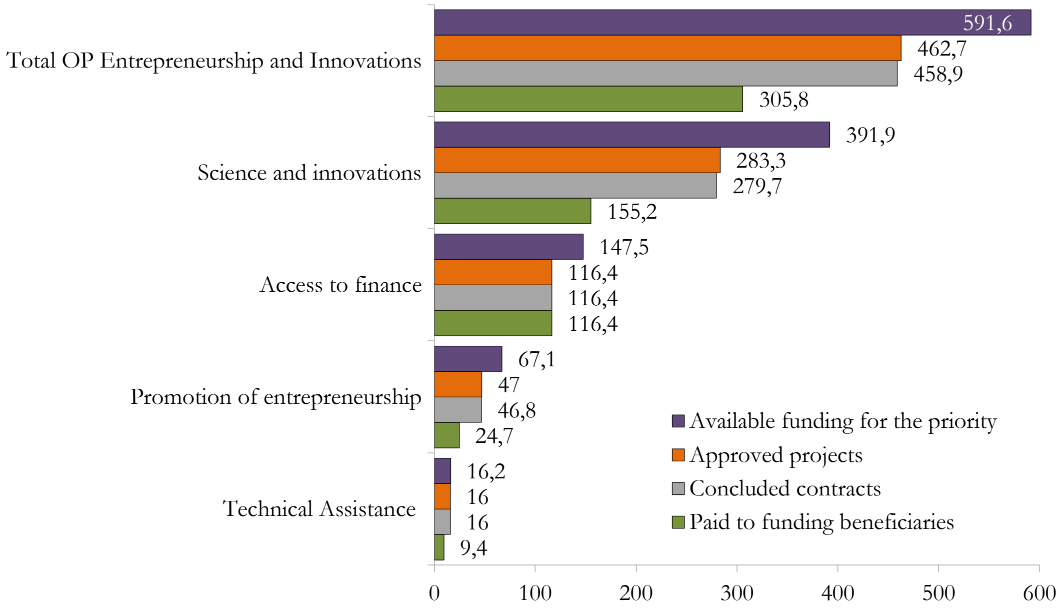
As regards the activity *SMEs new product and technology development programme* project applications are expected to be accepted also in 2014 to improve absorption of available funding. In order to promote successful implementation of the activity, IDAL has set an important task to approve high quality projects by the second half of 2014.

A total of six competence centres have been established within the activity *Competence Centres*. No new centres are expected to be established by 2015. However, after all of the six competence centres submitted updated project applications, IDAL concluded that despite the termination of the activity, competence centres were ready to implement the whole research programme according to the plan and to absorb the whole amount of available funding. The updated project applications were recognized as eligible under the regulatory framework and thus IDAL signed the amendments to the contract with all competence centres.

The priority ***Access to finance*** is aimed at promotion of access to finance for business development through comprehensive financial instruments including guarantees, loans, venture capital, and other financial instruments implemented by the Mortgage and Land Bank of Latvia and the Investment and the LGA.

Figure 6.5

Financial Investments of the EU funds until September 30, 2013 in the OP *Entrepreneurship and Innovations*; Public Funding
(million LVL)



Overall, within the OP financial instrument activities, payment objectives to final funding beneficiaries have reached 71.8% of the expected amount of payments until September 30, 2013. The most considerable progress in achieving the payment objective has been made in guarantee and loan activities – respectively 99.9% and 93.7% of the expected payments to final funding beneficiaries have been made. Failure to fully achieve the payment objectives has been observed in venture capital and mezzanine loan activities – respectively 46.9% and 27.2% of the expected payment amount.

On August 6, 2013 the LGA concluded contracts with financial intermediaries – ZGI Capital, EXPANSION Capital and FlyVap. Considering the delay in relation to the call for tender, new venture capital investments are expected to be made in late 2013. The call for microloan funds tender will be announced later than expected. The tender regulations are being developed at the moment and the call for tender is going to be announced in October 2013, while loans within the new microloan programme are planned to be issued in early 2014.

Considering the amendments to the OP made in the 2nd quarter of 2013, envisaging redistribution of funds between priorities and activities, thus ensuring efficient allocation of the remaining funds of the priority *Access to finance* to national economy of Latvia, the Ministry of Finance in cooperation with the Ministry of Economics has developed and forwarded the objectives for payments and investments in a form of venture capital, loans and mezzanine loans and provided guarantees to be achieved in 2014 for approval of the CoM.

Overall, implementation of the priority ***Promotion of entrepreneurship*** has been successful, except for the activity *Business incubators*. A remarkable progress has been made in the sub-activity *Access to International Trade Markets – External Marketing*, the activity *Measures to Encourage Innovations and Business Start-ups*, and the activity *Cluster programmes*.

Slightly over a half of the projects of the OP ***Infrastructure and Services*** has been completed (approximately 52%). However, a large part of the projects are still being implemented. Until September 30, 2013, the largest payments have been made in the following priorities *Polycentric development*, *Promotion of Territorial Accessibility, Quality Environment for Life and Economic Activity*.

The new programming period 2014-2020

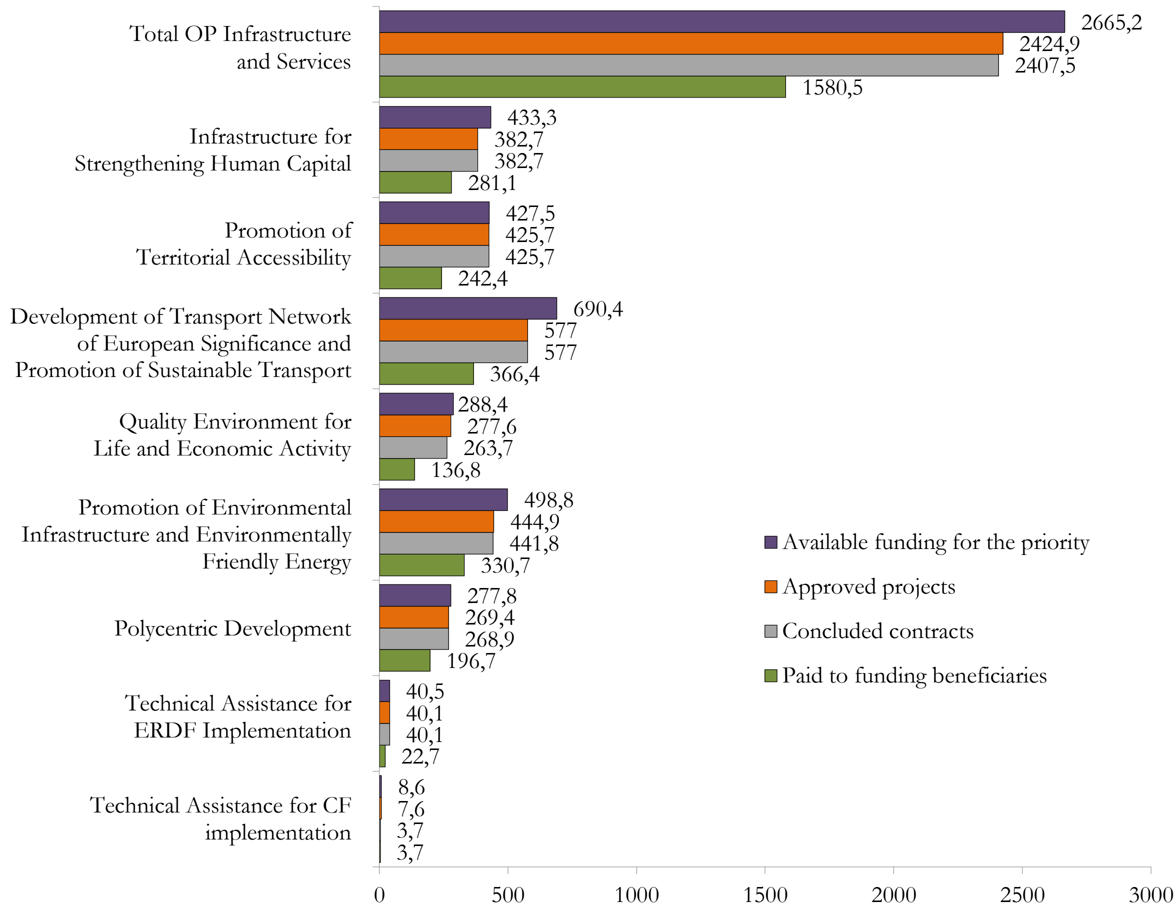
On May 3, 2013, the Ministry of Finance forwarded the EU funds draft planning documents *Partnership Contract for the European Structural Funds and Investment Funds Programming Period 2014-2020* and the OP Growth and Employment for public discussion.

In order to ensure the quality of preparation for the EU funds investment period 2014-2020, a partnership platform – Temporary supervisory committee – has been established in September 2012.

Figure 6.6

Financial Investments of the EU funds until September 30, 2013 in the OP *Infrastructure and Services*; Public Funding

(million LVL)



Draft planning documents have been prepared based on such principles as the link with the *EU 2020* and other planning documents, strategic vision based on the analysis of shortcomings and needs, efficient and sustainable growth and result-oriented solutions. The priority directions defined in the planning documents and the specific support objectives are focused on achievement of certain results that will contribute the most to the economic growth and promote achievement of the Cohesion policy objectives.

The key investments of the EU funds programming period 2014–2020 are planned to be directed for the following objectives:

- Reducing the number of population at risk of poverty by providing appropriate training, improving health condition and integration in the labour market;
- Promoting employment by integration of the long-term unemployed and the youth in the labour market;
- Reducing the consumption of primary energy by improving energy efficiency in private and public buildings, improving energy efficiency in industrial production and supporting increase in energy efficiency in public transport;
- Increasing investments in research and development by promoting attraction of private investments, as well as cooperation between research institutions and entrepreneurs;
- Improvements of ICT and transport infrastructure that has a direct impact on the economic productivity and serve as a basis for innovations and increase internal and external mobility of people and goods.

Table 6.2

Indicative Breakdown of the Funding and Total Investments of the EU Funds Planning Period 2014-2020

	Amount of the EU funding mln LVL	Structure of the EU funding per cent	Total amount of the funding mln LVL
Strengthen research, technology development and innovations	317.6	10.6	37.3
Improve the access, use and quality of information and communication technologies	135.9	4.5	159.8
Increase SMEs competitiveness	214.2	7.1	252.1
Support transition to low-carbon economy in all sectors	346.6	11.5	407.8
Promote adaptation to climate change, risk prevention and management	46.3	1.5	54.5
Environmental protection and promotion of efficient resources	352.7	11.7	414.9
Promote sustainable transport and prevent weaknesses in key network infrastructures	817.5	27.2	961.8
Promote employment and support labour mobility	142.5	4.7	167.7
Promote social inclusion and reduce poverty	280.9	9.3	330.5
Investment in education, skills and lifelong learning	353.9	11.8	416.4
Total	**3 008.7**	**100**	**3 539.7**

6.2.2. Foreign Trade Policy

In the second half of 2013, a number of important activities in the field of foreign economic relations were implemented, namely, a Roadmap for Latvia's accession talks was approved at the OECD meeting on October 15, 2013 in Paris (see Box 6.4). On November 28-29, 2013, the third EU Eastern Partnership Summit was held in Vilnius, outlining the objectives to be achieved and tasks to be done until the next summit expected to be held in Riga in 2015, while the WTO's 9th Ministerial Conference took place on December 3-6, outlining the new WTO Trade Facilitation Agreement.

Box 6.4

Latvia's progress towards joining the *OECD*

After authorising the Secretary General of the organization to launch negotiations with Latvia on joining the organization at the OECD Ministerial Council Meeting on May 30, 2013, the Roadmap for Latvia's accession talks was approved at the OECD meeting on October 15, 2013 in Paris. It sets out the plan for joining the OECD and it is a formal launch of the process of Latvia's accession to the OECD.

The responsible public administration authorities of Latvia have started to prepare initial memorandum setting out the country's opinion on all legal and political obligations stemming from each (250) OECD legal instrument, as well as assessing conformity of Latvia's legislation and policy to these obligations.

In order to fully represent the interests of Latvia in accession talks to the OECD, including to prepare the initial memorandum, organize representation and impose responsibilities for preparation of positions in the OECD committees and working groups, on November 19, the CoM has approved the decree *On the establishment of the working group for negotiations on the accession of the Republic of Latvia to the Organisation for Economic Co-operation and Development.*

On December 9-10, 2013, the visit of the OECD Secretary-General took place in Riga which is regarded as the official launch of Latvia's OECD accession negotiations.

The progress of the accession process depends on the efforts of a candidate country; however, based on the experience of countries in the previous enlargement round, the minimum time for completing the negotiations and being granted a member status is two years.

Based on the *Memorandum of Understanding on Cooperation between the Ministry of Foreign Affairs of the Republic of Latvia, the Ministry of Economics of the Republic of Latvia, the Investment and Development Agency of Latvia, the* ***Latvian Chamber of Commerce and Industry*** *and the Employers' Confederation of Latvia* signed on August 9, 2011, the Council for the Coordination of External Economic Policy has been established on

May 2012. The purpose of the Council is to ensure coordinated cooperation of the parties in successful development and implementation of economic policy to increase competiveness of the Latvian national economy.

Six Council meetings have been held so far. In 2013, information about economic interests of Latvia in the Central Asia region countries, USA and Canada has been prepared and approved; discussions on building external economic image of Latvia and necessary further action have been held; the priorities and topical issues of the forthcoming Latvian presidency of the European Council in 2015 have been evaluated, as well as the issue of development of the network of diplomatic missions until 2020 and the new policy initiative *Co-Investments to the Development of Industries* have been reviewed.

Multilateral relations

In the second half of 2013, one of the central events in the context of multilateral trading system was the 9th Ministerial Conference of the World Trade Organization (WTO) held on December 3–6 in Bali (Indonesia). During the conference and despite different priorities, the WTO member states were able to reach a compromise on three pillars of the Doha Round (DDA) negotiations – trade facilitation, agriculture and development issues. The discussion of trade ministers in Bali outlined readiness of the parties to look for possibilities to develop the multilateral trading system even further, including trade facilitation, and distribution of environmentally friendly goods, services and technology.

The given conference is remarkable for approval of accession of Yemen to the WTO, thus it might become the 160th member state of the organization in the first quarter of 2014. Completion of the work on the outstanding issues regarding market access, the accession processes of Kazakhstan, Bosnia and Herzegovina and Serbia to the WTO might also be completed in 2014.

Box 6.5

Russian tariff quota system of timber export

Within the framework of the multilateral trading system, a tariff quota system with lower export tariffs has been applied to import of certain round coniferous timber (spruce and pine) from Russia to the EU since September 1, 2012 based on historical volumes. Introduction of the system has revealed a range of issues that hinders its successful implementation. These issues are addressed within the EU Common Commercial Policy.

Since November 4, 2013, Russia has abolished the list of authorised exporters that granted the right to certain companies to export round coniferous timber to the EU within the framework of the relevant tariff quota. The current procedure no longer imposes any restrictions on companies. According to the Ministry of Economics, such step might have a positive influence on currently small increase (2012/2013) in the import volumes of round timber from Russia to Latvia.

Bilateral relationships within the framework of the EU Common Trade Policy

The EU has concluded a number of preferential agreements prescribing mutually favourable trade conditions with such partners as Andorra, the Balkan countries[1], Central American countries[2], Chile, Southern Africa, South Korea, European Economic Area countries[3], certain countries of the Economic Partnership Agreements[4], Columbia, Mexico, Peru, San Marino, Switzerland, and Turkey.

In the second half of 2013, the key advancement of the EU bilateral relationships with third countries was the launch of work of the EU and USA on the *Transatlantic Trade and Investment Partnership* (see Box 6.6).

It should be noted that negotiations on the largest free trade partnership in the world are expected to be finished in two years after the launch of negotiations.

On September 20, 2013, the EU-Singapore FTL was initialled, while a political agreement on conceptual provisions of the EU–Canada Comprehensive Economic and Trade Agreement was reached on October 18 which serves as a base to finish the work on the entire text of the agreement in the coming months. Both of these agreements will be the first to contain conditions on FDI protection, replacing bilateral agreements on promotion and protection of investments signed by the Member States and the countries above.

[1] Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro and Serbia

[2] Costa Rica, Salvador, Honduras, Nicaragua, and Panama

[3] Iceland, Lichtenstein, and Norway

[4] Antigua and Barbuda, Belize, the Bahamas, Barbados, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Trinidad and Tobago, Papua New Guinea, Madagascar, Mauritania, the Seychelles, Zimbabwe

Box 6.6

The EU-USA Trade and Investment Partnership Agreement

In February 2013, the EU and the USA expressed readiness to launch negotiations on the largest free trade partnership in the world. Three rounds of negotiations have been held so far – in July, November, and December.

The first round of negotiations was held in Washington to discuss conceptual objectives of the parties and approaches to trade liberalization in more than 20 topics of the negotiations to be included in the *EU–USA Trade and Investment Partnership Agreement*.

The second and third rounds of negotiations addressed detail proposals of the parties regarding elimination of existing obstacles in such areas as investments, services, regulatory cooperation, energy and access to raw materials, *sanitary and phytosanitary* measures, protections of intellectual property rights and sustainable development.

At the same time, the EU is holding the FTA negotiations also with India, Japan, Malaysia, Vietnam, Thailand and Mediterranean countries[1], as well as negotiations on the economic partnership agreement *(EPA)* with the majority of African, Caribbean and Pacific Group of States *(ACP)*. Thus, raising awareness of the issue of access to markets is a certain progress in relations with countries of the Common Market of the South[2] (*Mercosur*). It is not expected to sign a comprehensive FTA in the near future with countries of this block, considering the different positions of these countries regarding economic integration with the EU.

On November 28-29, 2013, the third EU Eastern Partnership Summit was held in Vilnius, outlining the objectives to be achieved and tasks to be done based on the interests of each partner country and desire to build relationship with the EU. The central event of the Summits was initialling of the EU Association Agreement and included FTAs with Georgia and Moldova. The second Business Forum of the Eastern Partnership was also held along with the Summit in Vilnius. The forum was aimed at creating a platform for exchange of experience and development of cooperation between entrepreneurs, investors, diplomats and politicians. The initiative was launched in 2011 in Poland and entrepreneurs had a positive attitude towards it.

Bilateral economic cooperation

In order to promote and deepen bilateral economic cooperation with the key trade partners, Latvia has signed bilateral economic cooperation agreements with Russia, China, Belarus, Ukraine, Kazakhstan, Azerbaijan, Georgia, Moldova, Uzbekistan, Kirgizstan, Turkmenistan, Tajikistan and Armenia. Within the framework of these agreements, Intergovernmental Commissions (IGC) on Economic, Scientific and Technical Cooperation Affairs and a Joint Committee (JC) have been established, ensuring supervision of validity of agreements and analysing opportunities for improvement of further cooperation.

The IGC meetings and the JC meetings with China (in Riga), Belarus (in Belarus), Ukraine (in Kiev), Moldova (Kishinev), Kirgizstan (Bishkek) and Georgia (Tbilisi) are expected to be held in 2014.

Box 6.7

Bilateral economic cooperation of Latvia in the second half of 2013

In the second half of 2013, the main activities were the following:

Latvia-Turkmenistan

On June 11-12, 2013 in Riga, the vice president-foreign minister of Turkmenistan acknowledged that Latvian entrepreneurs are particularly interested in cooperation with this country of the Central Asia region, especially in such areas as education, tourism marketing, construction, shipbuilding, logistics, IT, agriculture, etc. The interest of Latvia to promote economic cooperation was emphasized also by the Minister of Economics at the meeting of Turkmenistan officials during his visit to Ashgabat (Turkmenistan) on October 17-19, 2013 with an aim to attend a top level conference on *Energy Security and Sustainability – the OECD Perspective*.

Latvia-Russia

On June 20–21, 2013, the Minister of Economics was on a business visit to St. Petersburg in the framework of which he attended the *17th St. Petersburg International Economic Forum* and gave a presentation about increasing productivity to ensure global food security, as well as met the governors of Yaroslavl Oblast, Kaluga Oblast and Pskov Oblast to discuss the possibilities to expand economic cooperation.

On July 24, 2013, the 8th meeting of the working group for Economic Cooperation of Latvian–Russian IGC was held in Riga. The meeting addressed such issues as the current situation and perspectives of external trade and economic relations, cooperation in the field of investments, energy, accreditation and tourism, improvement of finance and banking sector, as well as improvement of the contractual base. On November 20, 2013, the meeting of the Latvian–Russian Business Council discussed regional cooperation, mutual trade issues, the certification procedure of food products, possibilities of speeding up the customs procedures, etc.

[1] Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Syria and Tunisia

[2] Argentina, Brazil, Paraguay, Uruguay, and Venezuela

Box 6.7 continued

On November 21, 2013, the 6th meeting of the Latvian–Russian IGC on Economic, Scientific and Technical, Humanitarian and Cultural Cooperation was held in Moscow. The meeting resulted in signing of the Latvian–Russian *Action Programme within the EU-Russian initiative Modernisation Partnership* that includes a range of cooperation projects in different areas. The aim of the Action Programme is to fully use the EU-Russian Modernisation Partnership initiative and to deepen and expand bilateral economic relations between Latvian and Russian public institutions, entrepreneurs and scientists.

A visit of the management of the Ministry of Economics and Latvian entrepreneurs to Kaluga Oblast is expected in 2014 to sign the agreement between the Ministry of Economics and Kaluga Oblast on economic cooperation and to promote cooperation of entrepreneurs from Latvia and the Kaluga Oblast.

Latvia-Armenia

The first meeting of Latvian-Armenian ICG was held on June 28, 2013 in Riga. The meeting addressed economic cooperation in the field of trade, manufacturing, business, information and communication technology, agriculture, environmental protection, regional development, finance, health care, culture, tourism and science, education, etc. the first meeting of the Latvian-Armenian Business Cooperation Council was also held a day before the ICG meeting. The council has been established to promote and expand economic cooperation between both countries, to support the ICG activities and to coordinate cooperation of Latvian and Armenian Employers' Confederations.

Latvia-Germany

On July 6-8, 2013, the President of Germany and accompanying delegation stayed on a visit to Latvia. The round table discussion of entrepreneurs from both countries took place within the visit. A total of 15 German entrepreneurs representing energy, agriculture, industrial manufacturing and engineering industry, logistics, wood processing and consultation and insurance sectors and representatives of 12 Latvian enterprises from the wood processing, logistics, engineering industry, insurance high technology, peat industry and other sectors participated in this discussion on cooperation opportunities of Latvia and Germany.

Latvia-Japan

On July 19, representatives of the most powerful Japanese business federation *KEIDANREN* were on a visit to Latvia to get acquainted with the business environment, economic development and business opportunities in Latvia. *KEIDANREN* comprises about 1300 Japanese companies and 127 state-level industrial associations. This top level business delegation was comprised of 18 representatives of international Japanese companies from such sectors as energy, IT, telecommunications, electronics, tourism, finance, insurance, construction, chemical industry, etc. The Minister of Economics and Latvian entrepreneurs met the *KEIDANREN* delegation to discuss possibilities to expand economic cooperation, particularly focusing on information about investment opportunities and projects in Latvia.

Latvia-Finland

On September 10-11, 2013, the President of Finland and Finnish entrepreneurs were on a visit to Latvia. The visit involved a round table discussion of Latvian and Finnish entrepreneurs on possibilities to expand economic cooperation.

On November 13-14, 2013, the Minister of Economics was on a business visit to Finland to attend the *5th Annual Baltic Energy Summit*. During the Summit, the minister gave an introductory speech and participated in a panel discussion on market trends and analysis. During the visit, the minister also met the Minister of Economics of Finland to discuss the current economic cooperation.

Latvia-Uzbekistan

On September 19, 2013, the 4th meeting of Latvian-Uzbekistan ICG was held in Tashkent to discuss economic cooperation of both countries, cooperation in the field of investments, transport, standardization and conformity assessment, agriculture, health, education and science, information technology, clean technology, tourism, as well as perspectives of further expansion of cooperation. Latvian-Uzbekistan Business Forum was held within the framework of the visit, during which representatives of both countries were introduced to business environment aspects in Latvia and Uzbekistan and cooperation opportunities in various sectors including transport and transit, clean and energy efficient technologies, health care, food industry and textiles. During the event, entrepreneurs and representatives of institutions from both countries showed mutual interest in development of cooperation, by implementing various joint projects. The Business Forum was attended by representatives of the public administration and companies of both countries from sectors of transport, food industry, IT, tourism, pharmacy, construction, environmental technologies and other sectors.

On October 17-18, 2013, the President of the Republic of Uzbekistan arrived on a visit to Latvia. Before the visit, a bilateral meeting of the Minister of Economics and the Minister of Foreign Economic Relations, Investment and Trade of Uzbekistan was held on October 15, 2013, as well as Latvian–Uzbekistan Business Forum, during which the *Memorandum of Understanding on Cooperation in the Field of Tourism between the Tourism Development State Agency of the Republic of Latvia and National Company "Uzbekturizm" of the Republic of Uzbekistan*, and the *Agreement between the IDAL and the Information Support & Foreign Investments Promotion Agency "Узинфоинвест" ("Uzinfoinvest")* were signed. The Business Forum was attended by over 60 Latvian entrepreneurs from food, textile, chemistry and pharmacy, construction, transport and logistics, and trade (import and export) sectors.

The Memorandum of Understanding between the Ministry of Economics of the Republic of Latvia and the Ministry of Foreign Economic Relations, Investment and Trade of the Republic of Uzbekistan on Measures to Expand Bilateral Trade Relations was signed during the President's visit. The aim of the memorandum is to expand trade relations of both countries, to increase the turnover of bilateral trade, to strengthen and maintain cooperation, and to develop close contact between entrepreneurs of both countries.

The following potential areas of mutual interest have been identified during both visits: transit and logistics, food, information and communication technologies, clean and energy efficient technologies, agriculture, education and science, chemical industry, including pharmacy, engineering industry and metal processing, manufacture of construction materials, health care, tourism, light industry, etc.

Box 6.7 continued

Latvia-Estonia

On September 26, 2013, the Minister of Economics was on a business visit to Tallinn in the framework of which the minister attended the forum Opportunities of Latvian Enterprises in Estonia organized by the ***Latvian Chamber of Commerce and Industry*** and the Estonian Chamber of Commerce and Industry. During the visit, the minister met the Minister of Estonia for Economic Affairs and Communications to discuss current economic cooperation and possibilities to expand it.

Latvia-Belarus

On October 23, 2013, the 9th meeting of Latvian-Belarusian ICG was held in Riga. During the meeting a number of agreements were reached on strengthening economic cooperation, mainly focusing on possibilities to promote implementation of bilateral economic, investment and regional development measures, as well as to promote cooperation in the field of transport, transit, communications, education, agriculture, including increase of trade volumes of food industry products, tourism, environmental protection, standardization, accreditation and certification, etc. The meeting of the Latvian–Belarusian Business Council was held along with the IGC meeting. Entrepreneurs of both countries discussed further cooperation in the field of medicine tourism, higher education, customs, international freight transport, information and communication technologies, as well as the issue of simplifying the visa regime and the process for obtaining visa. A number of agreements on promotion of cooperation in the field of transport, education and science, and light industry were signed within the framework of the visit of Belarusian delegation to Latvia.

Latvia-Great Britain

On October 24, 2013, the annual Latvian Business Forum for the Latvian economy was held in London. The Business Forum was organized by the Latvian Embassy in the United Kingdom in partnership with the Foreign Economic Mission of Latvia, and Baltic International Bank and *Bloomberg*. The Minister of Economics, the President of the Bank of Latvia, and the Minister of the United Kingdom for Trade and Investment Matters gave presentations at the forum. The forum was aimed at entrepreneurs of all sectors, while it gave an opportunity for over 100 forum participants to find out more about the latest trends in the Latvian economy and investment opportunities, as well as provided an opportunity for entrepreneurs to meet other foreign investors.

Latvia-Tajikistan

On November 20, 2013, the 1st meeting of Latvian–Tajikistan JC was held in Riga. Although mutual trade volumes of Latvia and Tajikistan are rather small, during the meeting the parties discussed cooperation possibilities in the field of investments, manufacturing, energy and construction, education, technologies, agriculture, tourism and banking. Within the visit, the Tajikistan delegation visited information and communication technology and equipment industry companies.

Promotion of access to export markets in third countries

In 2013, within the EU Market Access Strategy, 12 working groups[1] and 33 market access teams[2], continued working on identification and targeted solving of specific trade restrictions in third countries. Latvian economic and diplomatic representatives in the USA, Israel, Japan, Kazakhstan, Russian, China, Turkey, and Ukraine are actively participating in these groups and teams.

The EU, like majority of the world countries dealing with the import of goods and raw materials from other countries, uses the *trade defence instrument (TDI) system* – antidumping, anti-subsidy[3], safeguard measures of the domestic market[4].Currently, the EU has applied a total of 84 anti-dumping measures and 9 anti-subsidy measures to various products of other countries. More than a half of the given measures have been applied to China, India, Indonesia, Russia, Taiwan, Thailand, and Ukraine. At the moment, the EU applies no domestic market safeguard measures.

In anti-dumping inspections, Latvia supports open trade, access for producers and users to the necessary raw materials and intermediate consumer goods, as well as a variety of supply chains thereof. In 2013, among the TDI inspections important to Latvia are the antidumping inspection concerning import of biodiesel from Argentina and Indonesia, as well as the antidumping inspection concerning import of solar panels from China.

In order to continue the public discussion launched in 2012, the work on the initiative on improving the TDI aimed at making the EC TDI inspections more transparent and simplifying participation of interested parties in the TDI inspection procedures was continued also in 2013.

6.2.3. Internal Market of the European Union

The EU internal market currently comprises 31 countries (28 EU Member States and 3 European Economic Area countries – Norway, Iceland, and

1 Established Working Groups in sector of the EU market access – SPS/Animal products; SPS/Vegetation products; Medical devices; Electronics and information and communication technologies; Tyres; Automotive; Postal services; Distribution services; Textiles; Wine and spirits; Leather; Chemistry sector

2 EU Market Access Teams are operating in Algeria, Argentina, Australia, Brazil, Canada, Chile, China-Hong Kong and Macau, Colombia, Egypt, Iceland, India, Indonesia, Israel, Japan, Kazakhstan, Korea, Malaysia, Mexico, Morocco, New Zealand, Nigeria, Norway, Philippines, Russia, South Africa, Switzerland, Taiwan, Tunisia, Turkey, Ukraine, USA, Venezuela, Vietnam

3 Antidumping and anti-subsidy measures are aimed at protecting the EU producers against losses caused by unfair competition of third country enterprises or granted subsidies by governments.

4 Application of domestic market safeguard measures is mainly based on the increase in such import that causes losses to local producers, though it is not a sign of unfair competition

Liechtenstein) with approximately 500 million consumers. The EU internal market encompasses a territory without internal borders where free movement of goods, persons, services, and capital is ensured. After continued and serious work within the framework of the EU, a uniform formation of a set of rules has been achieved for operators of economic activity, border control has been cancelled, more competitive business environment is established, a wider choice of goods and services is provided for consumers, new jobs are created, an opportunity to live, work, study, and retire in another country is provided to residents, an opportunity to introduce a single currency has been created, as well as many other benefits have been provided. However, the potential of the internal market still has not been fully employed, and its improvement is continuing by promoting sustainable and stable development of the EU economy and prosperity of the EU residents.

In November 2013, Latvia has reduced its transposition deficit to 0.5% in the past six months, thus maintaining position among the Member States with a deficit below the average EU rate 0.6%. Latvia is also a part of those Member States that transpose directives with delayed deadline as fast as possible – average 4.4 months.

In Latvia, the process of implementing the principles of free movement of goods and services and the rights to do business established in Articles 34-36 and 49-62 of the *Treaty on the Functioning of the European Union (TFEU)* is supervised and coordinated by the Ministry of Economics, constantly identifying legal regulations that may potentially or actually hinder implementation of freedoms in the EU internal market, *inter alia*, by assessing the current draft laws and regulations.

The procedure for submitting technical regulations (*Directives 98/34/EC* and *98/48/EC*), which prescribes the obligation of the EU Member States to submit draft technical regulations to the EC and to other EU Member States, as well as to the European Economic Area countries for further assessment, serves as a preventive, single, and transparent monitoring instrument with the aim of evaluating and preventing the setting of such requirements of the laws and regulations that may create obstacles for free movement of goods and social services. Any business, not only the responsible institutions of the Member States, may take part in the harmonization process of technical regulations in order to provide its comments and objections concerning the projects prepared by other EU Member States, which may potentially influence export of production or cross-border provision of information society services of the merchant. Information on draft technical regulations announced by the Member States is freely accessible on the *Technical Regulations Information System* (TRIS) database: *http://ec.europa.eu/enterprise/tris/default.htm*. *TRIS* database is a free service, and the majority of the notified draft technical regulations are available in Latvian. In case an enterprise has any objections to draft technical regulations of other countries that might or do affect the sale of its products in the market of a particular EU Member State, the enterprise is entitled to submit its objections to the responsible ministry, the authority of which includes coordination of specific policy in Latvia. A list of contact persons in responsible ministries is available on the website of the Ministry of Economics: *http://www.em.gov.lv/em/2nd/?cat=30412*.

The principle of mutual recognition is the sole legal instrument in the non-harmonised sphere of application of national technical regulations and standards for harmonisation of draft technical regulations pursuant to the procedures set by the *Directives 98/34/EC* and *98/48/EC* in order to ensure free movement of goods. In order to improve application of the principle of mutual recognition within the administrative practice of the national competent authorities, after a suggestion of the European Commission and with the support of the EU Member States, 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* was adopted and enforced on September 2, 2008. Thereby, a substantial step was taken towards introduction of a new legal instrument at the EU level. Application of the requirements of the Regulation in Latvia and other Member States is ensured as from May 13, 2009.

The aim of the Regulation is to prescribe the procedures, whereby the principle of mutual recognition must be observed in the work of public authorities by applying the national technical regulations to the goods manufactured or lawfully released into free circulation in the European Economic Area countries, distribution of rights and obligations among the national competent authorities and economic operators within the framework of the mutual recognition procedure, as well as for the purposes of simplification of applicable administrative procedures, the Regulation stipulates an obligation for the state to establish one or more product information points for the informative support of performers of economic activity. Currently, the functions of the product information contact point in Latvia are performed by the Ministry of Economics *(e-mail: pcp@em.gov.lv)*. In 2013, the *Product Information Contact Point* has replied to requests for information on national requirements regarding various products received from merchants of 23 other EU Member States.

In order to promote business activity and innovations in the service sector, as well as gradual modernisation and simplification of state administration, one of the priorities set for Latvia within the EU is promotion of free movement of services. In the field of services, in cooperation with non-governmental organizations and public institutions, requirements of laws and regulations are regularly analysed, and proposals on necessary amendments are prepared in order to eliminate the current administrative burden for enterprises. Current administrative barriers and procedures are under revision, respectively repealing or simplifying requirements for issuing permits (licences, certificates, confirmations, and other documents), as well as making it possible to handle all the necessary procedures electronically. Procedures of extending the validity term of permits are also simplified, and the list and the number of documents to be submitted for receiving the permit is revised, requests for permits are replaced with requests for registration, procedures for re-certification of persons, as well as other administrative processes are simplified. Additionally, implementation of the one-stop shop principle still continues, thus improving access to services rendered by public administration in one place – in the single portal of state and municipal services *www.latvija.lv*.

The principle of "silence means consent" is one of tools that fosters modernization of public administration to reduce delays of public institutions in decision-making, costs and adverse effect incurred to small and medium-sized enterprises by, for example, overlapping procedures or excessive bureaucracy in relation to submission of documents. The principle defines that in case the responsible institution fails to make a timely decision on application for a permit, it shall be considered that the service provider has received the permit and is entitled to start rendering services. Many EU countries have already adopted the silence-means-consent mechanism thus trying to simplify public administration for the benefit of enterprises and population. Currently, the responsible institution of Latvia plans to make the necessary amendments to laws and regulations to apply the "silence-means-consent" principle to the issue of certain permits.

In order to ensure administrative cooperation among public administration authorities of the European Union, the European Commission has introduced the ***Internal Market Information (IMI)*** system. The *IMI system* allows fast and easy communication between the responsible institutions of EU Member States (also Norway, Iceland, and Lichtenstein) at national, regional, and local level. The *IMI system* provides an option to search the responsible institutions of other Member States for cooperation purposes and a set of prepared questions and answers to facilitate daily use of the *IMI system* for users. At the same time, the *IMI system* provides clarity of information exchange to its users, thus allowing efficient keeping up with information exchange in the system. Through the *IMI system,* the Member States can verify authenticity of documents issued in other Member States and submitted by legal entities and individuals and contact the issuing institution in case of any questions. Thus, the person submitting the documents is released from additional bureaucratic barriers to solve various issues in the Internal Market of the European Union. Currently, the *IMI system* is available in the field of the *Service Directive (2006/123/EC)*, the *Professional Qualification Directive (2005/36/EC)* the *Posting of Workers Directive (96/71/EC)*, the *Patients' Rights Directive (2011/24/EU)* and the *E-commerce Directive (2000/31/EC)*. Taking into account the obligation under the *Service Directive* – the Member States have to notify each other about services that might be harmful to human health, life, and environment, the *IMI system* includes a *Warning mechanism* that ensures successful cross-border cooperation among supervisory institutions in risk elimination. In the IMI system, 62 responsible institutions of Latvia accounting for information exchange of one or several fields are registered. At the moment, 51 responsible institutions registered in the *IMI system* are involved, 14 – in the sphere of professional qualification and 6 – in the sphere of employee secondment, 2 – in the sphere of patients' rights, 1 – e-commerce (one institution can be involved in several spheres). The *Warning mechanism* has involved 8 supervisory institutions: the Ministry of Culture, the Consumer Rights Protection Centre, the State Environmental Service, the Health Inspectorate, the Criminal Investigation Department of the State police, the Ministry of Health, the Ministry of Environmental Protection and Regional Development and the Ministry of Economics as the *Warning message* coordinators. The Ministry of Economics is the national *IMI system* coordinator in Latvia.

Since January 1, 2013, the *IMI system* in Latvia has registered 108 requests for information: 2 – in the field of services, 36 – in the field of employee secondment, 70 – in the field of professional qualification.

Since 2004, the alternative *On-line problem solving network of the European Union Internal market* established by the European Commission and the Member States – **SOLVIT coordination centre network** – is available in Latvia. The task of the *SOLVIT coordination centre network* is to find a quick and practical solution to problems in the EU internal market occurring as a result of misapplication of European Union laws and regulations by public institutions. The *SOLVIT coordination centre network* serves as a free of charge problem solving instrument before bringing a court action in situations when a citizen or enterprise has suffered from unlawful decisions made by the responsible institutions of other Member States. *SOLVIT coordination centres* are located in every Member State of the European Union (also in Iceland, Norway, and Lichtenstein). Since January 2013, the SOLVIT coordination centre in Latvia has received 48 complaints. In order to lodge a complaint with the *SOLVIT coordination centre,* the case must comply with the following criteria for case solving: (1) a decision has been made by a public institution; (2) the public institution is located in another Member State of the European Union (cross-border element); (3) the European Union law has been violated (regulations, directives, etc.). Most often, the *SOLVIT coordination centre* in Latvia has solved cases of people regarding the issue of residence permits, entrepreneurs – restrictions of free movement of services and recognition of professional qualification.

6.3. Industrial Policy

Guidelines on National Industrial policy of Latvia were (NIP) approved by the Cabinet of Ministers on May 28, 2013. They are aimed at promoting structural changes in the economy in favour of production of goods and services with a higher value added, namely by increasing the role of industry, modernizing industry and services and export sophistication. The guidelines are closely linked to long-term planning documents – *Sustainable Development Strategy of Latvia until 2030 (*Latvia 2030*), the National Reform Programme of Latvia for the Implementation of the EU 2020 strategy, the National Development Plan* etc.

In order to reach the defined aim set within the framework of the *National Industrial Policy of Latvia* the following expected results are determined:

- the share of manufacturing shall reach 20% of the gross domestic product by 2020;
- the increase in the productivity of manufacturing shall reach 40% by 2020 compared to 2011;
- the growth of manufacturing shall reach 60% by 2020 compared to 2011;
- investments in research and development shall reach 1.5% of GDP.

The NIP is based on modern, updated, and latest scientific concepts developed by economic theorists. The concept of a new industrial policy is among the most modern economic concepts in the scientific literature in the field of economics. One of its defined founding principles instead of "picking winner" is a process comprised of a dialogue between the public and the private sector aimed at revealing obstacles hindering new economic activities and proposing solutions to eliminate or overcome them.

Understanding global challenges affecting the growth of the sector is not the only key element of industrial policy. It is also important to clearly identify economic advantages of the country and functional obstacles of products, finance and labour market hindering sustainable industrial growth.

In order to identify market failures, the potential of export-capable niches and products and services with higher value added was identified, as well as in-depth analyses of producers were carried out. The analysis revealed the following key challenges to the NIP to be actively addressed by the state:

- Limited financing;
- Labour costs and competitive prices;
- Low productivity and weak innovation performance;
- Transformation of international business;
- Demographic situation (ageing labour).

Based on advantages and main challenges of Latvian enterprises, actions of the NIP are directed towards:

- Issues related to access to and skills of labour force such as: further implementation of reforms of the vocational education system and higher education system by concentrating and customizing appropriate education programmes to the labour market demands, as well as increasing the share of practical part of the programmes; continuing state support instruments aimed at improving qualification and skills of specialists working in enterprises, as well as retraining possibilities to market demanded specialties; reducing the number of students of secondary education in favour of the vocational education system;
- Issues related to development of industrial areas such as: adapting existing industrial areas; improving roads and engineering communications (electricity, water-main, sewerage, gas, lightning, etc.) to manufacturing objects; developing industrial premises and spaces in centres of international, national and regional significance;

- Issues related to access to finance such as: providing necessary funding to new, micro- and small-sized enterprises; support for current assets or initial investments; continue issuing loan guarantees; extending the CIT relief for promoting manufacturing with respect to purchasing new production equipment; developing venture capital instruments for stimulating investments in development and expanding activities of enterprises;
- Issues related to promoting innovation such as: building research and innovation capacity of enterprises; replacing the current CIT reliefs for research and development costs with new relief in the CIT Law envisaging a threefold writing-off of certain research and development costs; developing research base and excellence;
- Issues related to promoting exports such as: supporting cluster initiatives; minimizing export transaction risks; entering external markets and reimbursing certification costs.
- Issues related to costs of energy resources such as: developing support programmes for improving energy efficiency and reducing emissions in manufacturing.

A detailed plan of activities has been developed according to the proposed directions, envisaging a number of activities for each direction of action, appointing the responsible institutions for the activities and defining the expected performance of results.

The most substantial institutional solution element of the industrial policy is the promotion of the modernization of sectors, as a result of which the activities mentioned in this chapter occur – a wide analysis of the abilities and skills of the sectors has been carried out within the framework of a new, improved dialogue *(Dialogue 2.0),* including an analysis of government failures, for example, an analysis of national priority sectors at the level of enterprises (micro) and the economy (macro), as well as an examination of the existing support instruments towards the identified market failures in order to promote the support for increased sophistication of export products. Further development of the industrial police and achievement of the objectives defined in the *Guidelines on National Industrial policy of Latvia for 2014-2020* affect the development of the *Smart Growth Strategy* for promotion of transformation of Latvian national economy that combines the analysis of national economy conducted within the framework of the *Guidelines on National Industrial policy of Latvia* and the analysis of the scientific base and excellence, identifying those areas where Latvia has developed comparative advantages, as well as identifying the most challenging areas for Latvia.

6.4. Energy Policy

The main approaches to the energy policy of Latvia are directed at increasing security of the country's energy supply by encouraging diversification of supplies of primary energy resources and by creating conditions for increasing subsistence of electric energy generation, as well as by preventing isolation of the regional electric energy market through new interconnections. Creation of competition conditions for promoting the use of renewable and local energy resources and environmental protection also plays a substantial role.

The *full integration* of *Lithuania, Latvia,* and *Estonia* into the *EU and Northern energy* networks and *markets* has been an important target for the Baltic States and the whole EU.

At the moment, the key integration issues on a regional level include:

- Baltic-Finnish energy market integration and price coordination issues in certain price areas;
- technical aspects and aspects of market fluidity improvement of a closer link between the Estonian and Finnish energy systems (starting commercial operations of *Estlink II* in January 2014);
- congestion management methods in Northern countries and conclusions drawn as a result of application of the methods that might be used for congestion management in the Latvian–Estonian interconnection;
- congestion management methods in the Baltic States – the current situation and development perspectives in the future;
- joint interest projects of the Baltic States in the energy and natural gas sector;
- development of the Baltic energy market from the point of view of traders (implementation of the intraday electricity trade model in price areas of Latvia and Lithuania; complete liberalization of Latvian market on April 1, 2014, entry of Nasdaq OMX in Latvia and Lithuania in June 2014);
- improvement of the existing elements of development of the regional dimension of Pan-European electricity market models.

On June 27, 2006, the CoM approved the *Energy Development Guidelines for 2007–2016*. The Guidelines contain the government policy, development objectives and priorities in the energy field both in the medium-term and long-term period. Taking into consideration policy priorities and significant changes in the Latvian economy, a long-term policy guidance draft document of the energy sector development – *Long-term Energy Strategy 2030–competitive energy for society* – has been developed and approved at the meeting of the CoM on May 28, 2013.

Box 6.8

Energy Sector in Latvia

Both the imported (natural gas, electricity, oil products, coal, coke, etc.) and local (hydropower, firewood, charcoal, straw, biogas, bioethanol, biodiesel, peat, used tyres, municipal waste for heating, wind energy) energy resources are used in Latvia to supply fuel, electric energy and heat to sectors of the economy, commercial consumers, and residents.

A part of electricity is generated by Latvian HPPs, CHPs, biogas and wind power plants, whereas the rest is imported. Mainly, the imported fuels – natural gas and heavy fuel oil and local fuels – firewood – are used in heating energy generation.

In 2012, energy resource generation and recycled products in Latvia reached 91.9 PJ, but import of energy resources was 173.4 PJ, out of which 57.8 PJ was the import of natural gas.

In 2012, the total consumption of primary energy resources in Latvia amounted to 184.4 PJ, which was by 0.1% higher than in 2011. Self-security in the total consumption of primary energy resources was 35.5%. In the total consumption of primary energy sources, firewood with its total consumption of 46.5 PJ was the most extensively used local energy resource, electricity generated in hydropower stations and wind power stations constituted 13.8 PJ.

The key objective of the *Energy Strategy 2030* is a positive impact of the energy sector on national economy of Latvia, at the same time pursuing two sub-objectives – safe and sustainable energy supply.

The draft *Energy Strategy 2030* sets the following objectives of the energy policy:

– Competitive economy – balanced, efficient, economically, socially, and ecologically justified energy policy based on market principles ensuring further development of the economy, its competitiveness in the region and in the world;
– Sustainable energy – reduced dependency on imported energy resources, new and efficient technologies for the use of renewable resources are encouraged, measures to improve energy efficiency are implemented;
– Secure supply – stable energy supply and developed infrastructure provided to energy users.

According to the protocol decision of the CoM meeting, the Ministry of Economics has to develop new energy policy guidelines for 2014–2020 by May 1, 2014 based on the energy policy development directions laid down in the *Energy Strategy 2030*.

Electric energy market

More than 90% of electric energy generated in Latvia is generated by the JSC "Latvenergo", which also ensures electric energy import and supply to consumers. According to the electricity trade register of the Public Utilities Commission, on November 6, 2013, 57 traders have been registered for electricity trade. A total of 8 traders, who have signed a contract on the use of the system with JSC "Sadales tīkls", are actively operating in the electric energy market.

Until April 1, 2012 households and enterprises with the annual turnover or the total balance sheet below LVL 7 million and the number of paid employees below 50 had the right to buy electricity at a regulated price. About 1700 electricity users (energy-intensive and large enterprises) purchased electricity at the agreed price on such conditions thus constituting approximately 35% of the annual electricity consumption in Latvia.

By narrowing the range of associated electricity users in Latvia, users with connection voltage exceeding 400 V and the nominal current of the input protection appliance exceeding 100 A, namely, the medium large electricity users have entered the market since April 1, 2012. About 4800 users with the average consumption of 200 MWh/per year have been involved in the market thus increasing the free share of the electricity market in Latvia to approximately 66 per cent.

Taking into consideration the successful opening and conditions of the market in the past, on August 28, 2012, the CoM approved the amendments to the *Regulations Regarding the Trade and Use of Electricity* granting only users consuming electricity for household needs the rights to receive electricity at a regulated price as of November 1, 2012. Such regulation involved another 18 500 users in the electricity market, which constitutes 2.3% of all users consuming about 9% of the total consumed electricity in Latvia, thus the open electricity market share in Latvia reaches 75% of the total consumption.

On August 13, 2013, the CoM accepted for information the informative report *Complex Solution to Issues of Electricity Market* and actually approved the solutions contained in the report. Further progress and implementation of these solutions require urgent development of the legal framework. A complex solution comprises four approaches, namely, electricity market liberalization, social support to the needy population, administration of revenues from the mandatory electricity procurement, introduction of subsidized electricity tax. These priorities have been set to address the concerns about a rise in tariffs for households as a result of market liberalization. A number of measures to limit the rise in electricity prices and eliminate consequences thereof are being implemented as a part of the complex solution.

On November 6, 2013, the Saeima approved amendments to the *Electricity Market Law* envisaging opening of the Latvian electricity market by April 1, 2014. In order to succeed in achieving the target to open the household market successfully, by reducing the majority of risks associated with it, the Ministry of Economics has developed a communication plan in cooperation with industry representatives and supervising authorities to continue an informative campaign consisting of various measures to raise public awareness of opening electricity markets to households, to provide information about benefits, justification of the process and necessary practical activities.

Table 6.3

Consumption of Primary Energy Resources in Latvia, PJ

	2000	2005	2008	2009	2010	2011	2012
Total consumption* including:	**163.8**	**191.9**	**196.5**	**189.0**	**200.5**	**184.7**	**184.4**
coal and coke	3.1	3.3	4.4	3.5	4.5	5.0	3.6
peat	2.5	0.1	0.1	0.0	0.1	0.0	0.0
petroleum products	56.4	61.9	69.3	62.4	64.6	59.6	58.4
natural gas	45.6	56.9	55.8	51.4	61.3	54.0	50.8
firewood	39.7	49.4	46.0	52.6	51.4	46.9	46.5
electricity**	16.6	19.9	20.5	18.6	16.0	15.1	19.8
other energy resources***	-	0.5	0.5	0.5	2.7	4.0	5.2

* Calculations for all energy resources are based on the lowest calorific value
** Hydropower, wind energy and electric energy net imports
*** Used tyres, municipal waste for heating, charcoal, straw, biogas, bioethanol, biodiesel

A well-operating domestic electric energy market has to provide the producers with proper stimuli to invest in new types of energy production, among all electricity production from renewable energy sources. According to the provisions set in the EU *Third Internal Market Liberalization Energy Package*, without separating network services from production and trading activities (efficient separation), there is not only the risk of facing discrimination in network management, but also the risk that vertically integrated enterprises lose motivation to make proper investments in networks. Separation of ownership at the transmission level is considered the most efficient way to foster non-discriminating investments in infrastructure, fair access to the network for new participants and transparency in the market.

Since September 1, 2005, the operator's functions for the electric energy transmission system are performed by the JSC "Augstsprieguma tīkls", which has become an independent transmission system operator as of January 1, 2012. Since July 1, 2007, the operator's functions of the electric energy distribution system are performed by the JSC "Sadalestīkls".

By implementing separation of ownership of the transmission system operator, the transmission system (networks) remains a part of the vertically integrated company JSC "Latvenergo", but activities related to performing the functions of a transmission system operator (transmission service rendering, operative management of the transmission system and its connected generating units, balancing, dispatching electric energy flows, management of cross-border electric energy trade, sustainable transmission system planning, participation in the European Network of Transmission System Operators ENTSO-E, etc.) are going to be separated from the JSC "Latvenergo".

As a result, JSC "Latvijas elektriskie tīkli" – the owner of the JSC "Latvenergo" subsidiary company's transmission system assets – started operating on April 1, 2011, but JSC "Augstsprieguma tīkls" began its operations under subordination of the Ministry of Finance on January 1, 2012 as an independent transmission system operator outside the JSC "Latvenergo" group while being subordinated to the Ministry of Finance. On January 30, 2013, the certification process of JSC "Augstsprieguma tīkls" was completed as well.

The electricity market of Latvia, just like the whole Baltic energy market, is currently connected to the European energy market only through the underwater cable *Estlink* between Estonia and Finland, though its transmission capacity of 350 MW is considered insufficient.

Currently, the second interconnection between Estonia and Finland – the underwater cable *Estlink II* with transmission capacity of 650 MW has been constructed. The cable is now being tested in a reverse mode. *Estlink II* is expected to be put into commercial operation in January 2014, thus ensuring technical harmonization of electricity transmission between Estonia and Finland and eventually levelling the prices in the Estonian and Finnish *NordPoolSpot* price areas.

Despite the fact that implementation of such a project may potentially have a positive influence on integration of Estonian–Finnish energy systems and fluidity of Estonian–Finnish price areas, it does not reduce the risk of congestions in the Latvian–Estonian interconnection, which is highly seasonal issue but has a negative influence on pricing in Latvian and Lithuanian NPS price areas.

Besides, *Estlink II* load transmission from Finland to Estonia might cause extra load in the Latvian–Estonian interconnection, thus increasing the risk of congestion or line outage.

Currently, it is specifically the Latvian–Estonian interconnections that are the most loaded section of the Baltic electricity transmission network.

The third Latvian–Estonian interconnection is strategically important since it allows preventing overload of the current transmission networks and increase available transmission capacity of the Estonian-Latvian interconnection.

The current transfer capacity in the Estonian–Latvia interconnection is insufficient for the required energy trade in the Baltic region: between Estonia which has surplus electricity produced in a year and Latvia and Lithuania where there is a clear electricity deficit. This situation has a particular influence on electricity trade in the Baltic States in the summer season.

The project significantly improves the electricity supply security in the interconnection between Estonia and Latvia, as well as energy systems of both countries, by ensuring an efficient power transit corridor between the Baltic and Northern energy systems.

The third Latvian–Estonian interconnection would facilitate also the development of infrastructure of Latvia, Lithuania, and Estonia.

The EU has identified further prevention of isolation of energy systems and energy markets of the Baltic States as one of the priorities.

On July 17, 2009, the protocol of intent ***Baltic Energy Market Interconnection Plan*** (BEMIP) was concluded between the European Commission and a number of Member States including the Republic of Latvia. The Plan is aimed at developing an efficiently functioning energy market, a possibility to implement solidarity mechanisms of the Member States, improving security of electricity supply in the Baltic States, by connecting the energy system of the Baltic State to the rest of the EU, developing an electricity market in the Baltic States and integrating it into the Northern electricity market.

Box 6.9

Electricity and Centralized Heat in Latvia

The volume of **electricity** generation depends on the flow rate in the Daugava River. After closing the Ignalina NPP at the end of 2009, the situation in the electric energy market in the Baltic States has changed. Latvia is no longer the only state in this region with insufficient amount of electric energy generated in its power plants. At the moment, Lithuania is also importing electric energy. Therefore, basically the suppliers from Estonia and Russia compete for supplying electric energy to Latvia.

In 2012, the total supply of electricity was 7859 GWh, which is by 7.1% more than in 2011. JSC "Latvenergo" generated 64.6% of the total electricity supply, it purchased 13.9% from small electricity energy producers and net imports of electric energy constituted 21.5% per cent.

The consumption structure of **centralized heat supply** has remained unchanged over the past years, with central heating comprising 65-70% and hot water supply – 30-35%. Since 2012, 1.2% of the total generated heat energy has been supplied to the industrial sector, 72% – to households, 26.8% – to other consumers. However, the breakdown of heat energy distributed by regions is the following: Riga region – 51.7%, Pieriga region – 11.6%, Vidzeme – 6.1%, Kurzeme – 10.5%, Zemgale – 8.1%, and Latgale – 12 per cent.

In 2012, heat energy for sale was produced in 663 boiler houses and 132 cogeneration plants having generated 7.46 TWh of heat energy for sale.

In 2012, natural gas was the main resource for generating heat energy and electric energy. The share of heat energy produced using natural gas as fuel was 78.4%, woodchips – 14.2%, firewood – 2.2%, heavy fuel oil – 1.1% and other types of fuel – 4.1 per cent.

The BEMIP identifies measures to be implemented for development of an efficient joint Baltic electric energy market and its integration into the electric energy market of the Nordic states. Development of an operating regional market is considered a prerequisite for further integration of the Baltic region into the Nordic electric energy exchange *Nord Pool* region by simultaneously taking over also the *Nord Pool* operating principles. The main measures planned within the BEMIP are related to the internal electricity market (developed cross-border trade, separation of transmission system operators, competitive prices), electricity interconnections and generating powers, and internal gas market and infrastructure.

In order to develop cross-border trade and achieve competitive electricity prices, the BEMIP action plan envisages that the necessary measures are carried out by the countries to ensure that electricity exchange could start operating in the Baltics, including Latvia. *Nord Pool Spot* is the largest European electricity exchange offering day-ahead electricity trade and intraday electricity trade opportunities to its members.

In order to develop cross-border trade and create competition on the market, the Baltic States needed an electricity exchange. Therefore, on June 3, 2013, *Nord Pool Spot* opened the Latvian price area within the electricity exchange. The Latvian price area is related to the Estonian and Lithuanian trade areas, as well as to Russia through the use of Latvian–Russian import and export trade areas.

On January 1, 2012, the Cabinet *Regulations on the Requirements for Public Electricity Network Voltage* came into force stipulating that the overtaken EU standard LVS EN 50160:2010 *Voltage Characteristics of Electricity Supplied by Public Electricity Networks* is mandatorily applicable in Latvia.

Table 6.4

Electricity Supply in Latvia, TWh

	2000	2005	2008	2009	2010	2011	2012
Total electricity supply	**5922**	**7054**	**7794**	**7223**	**7500**	**7340**	**7859**
Gross electricity generation including:	**4136**	**4906**	**5274**	**5569**	**6627**	**6095**	**6168**
from renewable energy resources:	2824	3414	3213	3555	3635	3078	4109
large HPPs *	2794	3263	3038	3391	3445	2823	3627
small HPPs	25	62	71	66	75	64	80
biomass and biogas power stations	-	6	5	4	9	13	65
wind power stations	-	36	40	44	57	107	223
wind power stations	5	47	59	50	49	71	114
from fossil energy resources:	1312	1492	2061	2014	2992	3017	2059
large CHPs **	1163	1278	1524	1476	2402	2425	1409
other CHPs	149	214	537	538	590	592	650
Net electricity imports	**1786**	**2148**	**2520**	**1654**	**873**	**1245**	**1691**

* Daugava cascade – Riga HPP, Ķegums HPP and Pļaviņas HPP
** Riga CHP-1 and Riga CHP-2

Natural gas market

Currently, JSC "Latvijas Gāze", which, according to the *Privatisation Agreement* signed in 1997, has the exclusive rights to carry out transmission, distribution, storage, and trade of natural gas, is the only enterprise operating in the Latvian natural gas market.

In 2012, natural gas consumption was 1508 million m^3 or by 6% lower than in 2011.

The biggest consumers of natural gas in 2011 were CHP and heat supply enterprises of JSC "Latvenergo" – 63.9%, manufacturing – 15%, other consumers – 18.2%. The Riga region uses about 65% of natural gas consumed in Latvia.

The Latvian gas supply system is not connected to the European Union single gas supply system. Latvia receives natural gas only from Russia.

The gas supply business environment in the region and the effective gas supply agreements practically exclude third parties except a regional transmission system operator and access to Inčukalns underground gas storage. The capacity of the gas pipeline Valday-Pskov is not sufficient to ensure gas supply to the Baltic States and to the Northwest region of Russia during winter. Consequently, at the moment, the gas market in Latvia may only be open formally.

The natural gas market at the EU level is regulated by 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.*

Currently, Latvia is a subject to two different exemptions from the requirements of 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 2003/73/EC*) exemption of "the new market" which applies until April 4, 2014 – 10 years after the first commercial natural gas supply under the first long-term contract, and the exemption of "isolated market" which is applied until Latvia constructs an interconnection with any of the EU Member States, except Estonia, Lithuania, and Finland, or the market share of dominant supplier is below 75 per cent.

Currently, the Ministry of Economics is working on implementation of the *Directive 2009/73/EC* in two stages pursuant to the CoM assignment and developing amendments to the *Procedure for Entering into Force of Some Sections of the Energy Law* and the *Energy Law* separating and specifying provisions to be effective as of April 4, 2014 from provisions, the implementation of which may be further suspended.

In order to diversify the natural gas market in Latvia and in the entire Baltic region, it is necessary to ensure an alternative supplier of natural gas in the market. It is possible by:

- constructing an interconnection with any of the EU Member States, except those of the isolated region – Estonia, Lithuania, and Finland (in this case – Poland, by implementing interconnection GIPL of the main gas supply system between Lithuania and Poland);
- implementing a **regional liquefied natural gas (LNG) terminal project**;
- ensuring third party natural gas supplies to the region through the existing main infrastructure.

The LNG terminal has been under discussion for several years, yet the Baltic region countries have not been able to agree on the best location of the terminal, therefore in March 2012, the European Commission launched an independent research, by involving Italian advisors Booz&Co. The research was competed at the end of November 2012 and its conclusions show that the most optimal location for regional LNG terminal, considering the willingness of Finland to participate in the LNG terminal project, would be Estonia or Finland.

Since they have not been able to agree on the location, in May 2013, Estonia and Finland agreed to ask the EC to provide an independent assessment of the best location of the new regional LNG terminal within the Gulf of Finland.

Currently, the EC says that no decision has been made in favour of Finland or Estonia since it is crucial to understand the expectations and scenario of the planned activities of both countries in the first place. The decision-making process is a complex process which involves an assessment of the entire energy infrastructure – both electricity and gas and overall development thereof. It has been agreed that the EC will continue carrying out assessment for a couple of months and try to find the best solution to each country separately and the entire region.

It should be noted that either way the *Inčukalns Underground* Gas Storage Facility (IUGSF) plays an important role in the functioning of the natural gas market of the Baltic region.

In case Estonia and Finland fail to agree on the location of the new LNG terminal by the end of June, 2013, the project might not receive EU financing within this financing stage and the financing will be available again only in 2016.

In order to strengthen the security of natural gas supply in the EU, the *Regulation (EU) No 994/2010 of 20 October 2010 concerning measures to safeguard security of gas supply and repealing Council Directive 2004/67/EC of the European Parliament and of the Council* (*Regulation 994/2010)* was adopted. Among other things, the *Regulation 994/2010* imposes an obligation on the competent authority of the Member States (in case of Latvia – the Ministry of Economics) to develop the *Preventive Action Plan* and the *Emergency Action Plan*.

The *Preventive Action Plan* contains measures to remove or mitigate the risks identified in the risk assessment of the security of natural gas supply in Latvia in the field of both natural gas supply (investments in infrastructure, use of long-term contracts, planning actions in case of an emergency) and the demand (use of interruptible contracts, replacing fuel), preventive measures in relation to the need to improve interconnections between neighbouring member states and possibility to diversify gas channels and supply sources.

The *Emergency Action Plan* contains the measures to be taken to eliminate or mitigate the impact of a gas supply disruption if it cannot be removed by the measures specified in the *Preventive Action Plan*, and the energy suppliers alone can no longer properly respond to gas supply disruptions. The *Preventive Action Plan* of Latvia has been developed, based on the three main crisis levels laid down in the *Regulation 994/2010*:

- Early warning level (early warning);
- Alert level (alert);
- Emergency level (energy crisis).

The *Emergency Action Plan* defines the role and responsibilities of natural gas undertakings and of electricity producers; competent authorities and other structures to which tasks, role and responsibilities have been delegated at each of the crisis levels; procedures and measures to be taken concerning each crisis level, persons responsible for risk management and their roles, measure to be implemented to eliminate an alert level situation and mitigate an emergency level situation, reporting obligations imposed on natural gas undertakings, ensuring access to gas supply in an emergency situation, as well as mechanisms used in cooperation with other Member States.

The *Preventive Action Plan* and the *Emergency Action Plan of Latvia* has been approved by the Decree No 98 of May 23, 2013 of the State Secretary of the Ministry of Economics, and it is available to the public on website of the Ministry of Economics (*http://www.em.gov.lv/em/2nd/?cat=30177*).

Investments in the energy sector

Currently, several infrastructure development projects included in the *BEMIP* are being implemented which will ensure successful integration of the Nordic and Baltic electricity markets.

Within the framework of *Trans-European Energy Network (TEN-E) programme,* the project *Environmental Impact Assessment and Route Investigation of* ***Kurzeme Circle*** is being implemented. The total expenses of the project amount to EUR 0.65 million, deadline – June 2012. The work is carried out in 3 stages: Grobiņa-Ventspils, Ventspils-Tume and Tume-Riga.

On August 6, 2010, the EC adopted a decision to financially support the construction of electric power transmission infrastructure in Latvia by granting co-financing for the project *Kurzeme Circle* within the framework of a single *Nord Baltproject*. EC is planning to invest EUR 131 million in the construction of the Lithuania-Sweden interconnection, furthermore EUR 44 million are granted for improving the network infrastructure in Latvia within the framework of the project *Kurzeme Circle*. The total expenses of the first and second stage of the project *Kurzeme Circle* amount to EUR 88 million, and the deadline is 2014. At the moment, the third stage of the projects is planned to be constructed – 330 kV transmission line Ventspils-Dundaga-Tume-Imanta, the deadline is 2018. This project is expected to attract the European Union co-funding from the new Connecting Europe Facility (CEF) to be established within the European Union budget for 2014-2020. Latvia has submitted 4 projects for entering the list of Common interest projects aimed at preventing the isolation of CEF energy markets within the given financial instrument – *third stage of the project Kurzeme circle* and *Latvian-Estonian third interconnection* to electricity, as well as *Modernization and Extension of Inčukalns underground gas storage (UGS)* and construction of *the Baltic regional liquefied natural gas (LNG) terminal* in the gas sector.

At the moment, the largest project for the development of natural gas infrastructure and improvement of regional supply safety is the ***Increase of Two-Way Gas Flow between Latvia and Lithuania***, within the framework of which a new gas transmission line under the Daugava River is being constructed, 15 drill holes in Inčukalns underground gas storage are being reconstructed, and a new treatment and intelligent piston chamber for pipeline diagnostics is created. By implementing the project, gas supply safety will be improved in both directions and a possibility will be created to supply natural gas from Lithuania to Latvian consumers. The option to supply natural gas from Lithuania will be available in case of insufficient natural gas supply through the gas pipeline from Riga to Bauska during the winter season. The project was completed in 2011 however its deadline had been extended to 2012 for additional works, because the granted financing had not been fully used for the main activities.

After closing the Ignalina nuclear power plant at the end of 2009, the new ***Visagina nuclear power plant project*** is one of the most topical issues in the context of the Baltic energy policy. Latvia supports the *Visagina NPP project* based on the regional solidarity principle, as well as on the economic benefits of the project. However, until some material questions are not answered, it is too soon to decide on involvement of the Latvian energy company "Latvenergo". Besides, after the elections of the Lithuanian Seimas in October 2012 and the referendum on Visagina NPP where the majority of electorate voted against the construction of a nuclear power plant, the future project development is uncertain in the project developer country. It should also be kept in mind that future decisions on the reconstruction of the Narva oil shale thermal power plant blocks in Estonia will have a significant impact on the entire Baltic energy market and the overall energy supply safety in Latvia.

In order to improve heat energy production efficiency, reduce heat energy losses in the transmission and distribution system and to foster replacement of fossil fuel types with renewable fuel, several projects are being implemented within the Cohesion Fund (CF). A total of 58 project applications for the CF's financing in the amount of LVL 34.2 million have been approved until October 25 within the first and the second selection stage of project applications of the activity 3.5.2.1 ***Measures Regarding the Increase of Efficiency of Centralised Heat Supply Systems*** of the supplement to the Operational Programme *Infrastructure and Services*, and among them 15 projects for the CF's financing in the amount of LVL 7.7 million have been finished.

In order to significantly increase the production of electricity and heat energy from renewable resources, diversify primary energy resource supply and increase the coverage of electricity, the activity 3.5.2.2 ***Development of Cogeneration Power Plants Utilising Renewable Energy sources*** of the supplement to the Operational Programme *Infrastructure and Services* is being implemented. Contracts on implementation of 10 projects have been concluded within the selection of project applications for the CF's financing in the amount of LVL 21.4 million.

Renewable energy resources

Latvia, similar to other EU Member States, has committed to achieve the quantitative target set in the *Directive 2009/28/EC* on the promotion of the use of energy renewable resources and amending and subsequently repealing *Directives 2001/77/EC* and *2003/30/EC* and the *National Reform Programme of Latvia for the Implementation of the "Europe 2020" Strategy* – to achieve a 40% share of renewable energy in the gross final energy consumption, as well as a 10% share of renewable energy in the gross final energy consumption in the transport sector. Cost-efficient use of local energy resources and safe energy supply are among the main conditions of national economic independence and energy supply safety. Therefore, it is even more important to improve the efficiency of the existing heat supply systems and use energy resources more efficiently, thus greatly contributing to the reduction of greenhouse gas emissions.

Box 6.10

Renewable Energy in Latvia

In 2012, the electricity production volume reached 6168 GWh, which is by 1.2% more than in 2011. Taking into account Latvia's target under the *Directive 2009/28/EC* and the *National Reform Programme of Latvia for implementation of the EU 2020 strategy* to reach 40% share of renewable energy by 2020, a share of 35.78% was achieved in 2012. 66.6% (4109 GWh) of the total produced gross electricity volume was generated from RE (HPPs, wind, biogas, biomass, etc.). While the total installed capacity for electricity production from RE in 2012 increased by 59 MW, constituting 1701 MW in comparison with 2011. In 2012, the installed capacity of wind turbines was 59MW, as compared to 36MW in 2011, while the installed capacity of biomass and biogas stations was 66MW, as compared to the installed capacity of 30MW in 2011, thus increasing also the volume of produced electricity.

Contribution of electricity produced from renewable energy sources to transport was small in 2012: a total of 1 million tonnes of fuel have been sold and used for own consumption in Latvia in 2011, including pure biofuel or mixture of fossil fuel and biofuel – 24.5 thousand tonnes. In 2012, the final energy consumption consisted of bioethanol – 279 TJ (in 2011 – 318 TJ) and biodiesel fuel – 526 TJ, experiencing a decrease (in 2011 – 617 TJ).

The CoM considered and accepted for information the informative report *Action Plant to Limit the Risk of Rose in the Overall Electricity Price* in the meeting on April 9, 2013. The Report is available on website of the Ministry of Economics: *http://www.em.gov.lv/em/2nd/?cat=30168*. The action plan contains measures to be taken to limit the increase in the mandatory procurement component (MPC).

The action plan envisages a range of solutions to be implemented in 2013 for audit and control of the decisions of the Ministry of Economics on granting the right to sell electricity within the framework of mandatory procurement or receive guaranteed payment for installed capacity projects that have not been implemented yet. The action plan also includes measures for enhanced surveillance of the already implemented projects to ensure that undertakings and power stations in their possession meet all applicable requirements, including the requirements for efficient use of heat energy. The action plan also envisages analysis of costs for energy production depending on the type of energy resources, as well as impact assessment of changes in aid intensity for cogeneration plants on heating tariffs that might result in possible revision of the formula for calculating the mandatory procurement prices, thus reducing the impact on the MPC.

On August 13, 2013, the CoM accepted for information the informative report *Complex Solution to Issues of Electricity Market* that emphasizes the need for a complex solution to the issues of electricity market, providing specific conclusions and proposals. Based on the conclusions and proposals provided in the report, the Ministry of Economics developed several draft laws that were approved by the Saeima in the final reading on November 6, 2013 with an aim to reduce the risk of a rise in the total electricity price to consumers, including the draft law *Subsidized Electricity Tax Law* and related draft laws.

Since the increase in the total electricity price would have a wide influence on economy of Latvia and its further growth, the Ministry of Economics believes that it is necessary to introduce changes in the energy policy as soon as possible to balance the associated policies and make it possible for Latvia to achieve a 40% share of renewable energy in the gross final energy consumption in 2020 and at the same time ensure development of competitive economy and prevent worsening of the quality of life of population.

The CoM considered and accepted for information the informative report *Regarding Situation in the Field of Biofuel Production* in the meeting on April 23, 2013, and entrusted the Ministry of Economic with the task to develop a draft amendments to legislation regarding conformity assessment of fuel and diesel and legislation regarding biofuel quality requirements, conformity assessment, market surveillance and procedure for consumer information in three months with an aim to ensure determining the mandatory 6.5-7% biofuel addition (by volume) to diesel as of April 1, 2014, as well as in cooperation with the Ministry of Transport, the Ministry of Environmental Protection and Regional Development and the Latvian Association of Local and Regional Governments to develop proposals for possibilities to include conditions on granting additional evaluation points in tenders for providing public transport services and state and local government procurements of vehicles in case of offering vehicles that use pure biofuel or fossil fuel and mix of biofuels (biofuel content over 10%) as fuel. Considering the abovementioned, the draft law *Amendments to the Public Procurement Law*, the draft law *Amendments to the Law on Public Transport Services* and the draft law *Amendments to the Law on Procurement of Public Service* providers were announced at the meeting of State Secretaries on October 17, 2013 stipulating that upon organizing a procurement of vehicles, the customer shall consider whether the vehicle functions using high concentration mixtures of biofuel and fossil fuel, pure biofuel or electricity if it is technically possible and economically reasonable to use such a vehicle.

Box 6.10 continued

The CoM committee meeting on November 4, 2013 made a decision to postpone consideration of the issue regarding an increase of the mandatory biofuel addition to fossil diesel to 6.5-7% and entrusted the Ministry of Economics with the task to develop an alternative solution to promote biofuel without envisaging an increase in the mandatory biofuel addition but ensures achievement of the target for renewable energy share in the transport sector and the obligation to use renewable energy, as well as to evaluate alternative and fiscally neutral tax policy solutions to be applied to pure biofuel or fossil fuel and mix of biofuel.

Not only contribution of the existing tools but also the chosen support measures for energy produced from renewable energy resources in the coming years will be crucial until 2020 for Latvia to be able to contribute to preventing climate change and reduce imports of fossil energy resources particularly focusing on the heat supply sector. Therefore, development of economically unfavourable projects should be limited when implementing new support measures for renewable energy.

In order to achieve the set target for the share of renewable energy generated from renewable energy resources in the gross final energy consumption in the transport sector, the consumption of biofuel should be promoted in various sectors, as well as the use of environmentally-friendly private and public means of transport and implement additional measures aimed at development of a public and private electric transport infrastructure, for example, electrification and private electric vehicle charging.

Energy efficiency

The Energy Efficiency Monitoring Report for 2011-2012 shows that in 2011 services and manufacturing sectors have failed to achieve significant energy savings, while the household sector has achieved considerable energy savings (1700 GWh) as the sector is experiencing successful implementation of energy efficiency measures in multi-apartment residential buildings with the support of the EU Structural Funds.

In order to promote energy savings in manufacturing, the CoM approved the *Regulations Regarding Industrial Energy Audit* on March 12, 2013. The regulations establish the procedure for conducting an industrial energy audit, as well as the requirements for energy auditors. The conditions on accreditation of energy auditors come into force on August 1, 2013.

The *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* came into force on December 4, 2012, laying down new challenging requirements for energy efficiency, among them the requirement that all Member States are required to define national indicative energy saving targets for 2020, involve energy distributors and retail energy sales companies in implementing measures to improve energy efficiency of energy end-users, promote development of energy service, ensure that central government purchases only products of high energy efficiency, as well as to decide on establishment of an energy efficiency fund and set mandatory requirements for renovation of buildings in possession and use of the government. A draft law *Amendments to the Public Procurement Law* has been developed. The draft law is aimed at promoting consumption of energy efficient products and services, imposing and obligation in direct administration authorities to purchase only goods and services of high energy efficiency level. In May 2013, Latvia announced the indicative energy saving target to the European Commission – to save 0.67 Mtoe of primary energy consumption by 2020. The requirements of the *Directive 2012/27/EU* have to be transposed into the national law by June 5, 2014. A concept for implementation of certain requirements of the *Directive 2012/27/EU* has been developed.

Energy efficiency of energy-consuming products

EC continues working on improving energy efficiency (eco-design) of energy-consuming products to reduce the negative impact of such products on the environment and achieve higher energy savings over their lifetime.

More than 20 EC regulations on eco-design and energy labelling have been adopted since 2008, setting stricter requirements for energy-consuming products, which are binding also on Latvian producers, importers and distributors. Eco-design and energy labelling regulations apply to such product groups as electric products, lighting, household appliances, heating and cooling equipment, industrial and commercial equipment, etc. (a full list of adopted eco-design regulations is available on the Ministry of Economics website at *http://www.em.gov.lv/em/2nd/?cat=30641*). New eco-design regulations are expected to be adopted for another 27 product groups within the upcoming two years.

6.5. Construction and Housing Policy

The policy for creating a sustainable and competitive construction sector is developed taking into account principles that influence a favourable and competitive business environment by reducing administrative barriers, ensuring effective exchange of construction-related information and increasing productivity of construction service providers. Regulatory framework for building contractors is just as important as access to an adequate infrastructure and support.

On July 9, 2013, the Saeima approved the new ***Construction Law***, which envisages a simplified construction administrative process by excluding multiple interim decisions.

The new *Draft Construction Law* is aimed mainly at significant simplification of the construction process and promotion of its transparency, as well as at facilitation of development of the construction market and of the whole economy. The Draft Law contains the following principles that have to be observed within the construction process:

- The principle of architectonic quality, according to which buildings are planned by balancing the functional, aesthetic, social, cultural heritage, technological and economic aspects of construction, as well as the interests of the customer and the society, by highlighting the individual identity of natural or urban landscape and easily integrating in the cultural environment, thus enriching it and creating quality living-space;
- The principle of engineering quality according to which an engineering solution of a building is safe for using, as well as economically and technologically efficient;
- The principle of openness according to which the construction process is open and the society is informed about the planned construction and the decisions made in relation to it;
- The principle of sustainable construction according to which the construction process creates the quality aspect of the living environment for present and further generations, *inter alia*, by increasing the use of renewable resources and promoting efficient use of other natural resources;
- The principle of accessible environment according to which such environment is created in the construction process that is suitable for people to get around conveniently and use the buildings according to their function.

Recently, a number of amendments have been introduced to the regulatory framework in the construction sector.

The CoM draft regulations *Amendments to the Cabinet Regulations No 112 General Construction Regulations of April 1, 1997* were adopted on June 11, 2013. According to the *Informative Report On Effective Regulation and Procedure for Extending Validity of the Granted Construction Permits and Streamlining the Process*, the draft regulations set the maximum period of construction works – for projects which have received public opinion within the framework of impact assessment of the intended activity on environment or within public discussion concerning the planned construction – 5 years, while for rest of buildings – 8 years.

The draft regulations also envisage a simplified procedure for loggia glazing – by completing a certification card for a simplified renovation and submitting to the building authority, as well as regulations have been complemented specifying that a building design and a construction permit will not be required for demolition of small buildings and placement of individual elements for improvement of territories (lighting fixtures, fences, delimitations, benches, waste-bins, play facilities for children, bicycle stands and similar small architectural forms, pedestrian roads), advertising stands and objects, direction sign posts, if such activities have been coordinated with the building authority. Furthermore, a building design and a construction permit will not be required for advertising stands and objects without electricity connection, if they are lower than 2.5 meters, as well as tourism object and street name sign posts if they are lower than 4 meters and their placement on the land parcel and visual solution have been coordinated with the building authority. Forms of the annexes to the regulations, namely Application – registration card (upon commencement of construction) and a construction permit have been updated, while a new form – request for a construction permit has been created.

Pursuant to Article 13, Paragraph 6 of the *Construction Law* the draft regulations define cases when the commissioning party, upon receipt of the construction permit, shall inform owners of neighbouring land on the construction, as well as cases when an information site board shall be placed on the land. The information procedure shall not be applied if the detail plan of the intended building has been developed along with a design sketch or public discussion regarding the construction has been organized in accordance with Article 12 of the Construction Law. Information site board must be placed on the land with the front facing public areas, i.e. so that it would be clearly visible.

On August 27, 2013, the CoM draft regulations *Procedure for Market Surveillance of Construction Products* was approved with an aim to establish the procedure for market surveillance of construction products, thus ensuring compliance with the requirements of the Regulation (EU) No 305/2011 of the European Parliament and of the Council of 9 March 2011 laying down harmonised conditions for the marketing of construction products and repealing Council *Directive 89/106/EEC* and the *Regulation (EC) No 765/2008* of the European Parliament and of the Council of 9 July 2008 **setting out the requirements for accreditation and market surveillance relating to the marketing of products**. The regulations appoint the market surveillance authority of construction products – the Consumer Rights Protection Centre, as well as determines the rights and obligations of the Centre; defined national standards of construction products in the regulated sphere and procedure for their publishing; establish a procedure for sampling and examination; and establish a procedure for market surveillance of construction products at construction sites.

On October 29, 2013, the CoM draft *Regulations Regarding European Technical Assessment,* thus establishing a procedure by which Latvia authorizes technical assessment authorities and issues European Technical Assessments of construction products referred to in Article 19, Paragraph 1 of the Construction Products Regulation. The draft regulations specify accreditation, authorization of a technical assessment authority, its activities and supervision, as well as the issue of the European Technical Assessments.

Box 6.11

Data characterising the construction sector

Data of the CSB shows that **in the 3rd quarter of 2013 the construction production volumes in current prices were LVL 400.3 million (EUR 569.6 million).**

In the 3rd quarter of 2013, the construction production volumes according to the seasonally adjusted data in comparable prices have increased by 5.6%, **compared to the 2nd quarter of 2013.** Out of this, the construction of buildings has decreased by 2.2%, while the construction of civil engineering structures has increased by 7.5 per cent.

In the 3rd quarter of 2013, the construction production volumes according to the seasonally adjusted data in comparable prices have increased by 11.6%, compared to the 3rd quarter of 2012. The construction of buildings has decreased by 2.5%, including the construction of medical treatment or health care institution buildings – by 50.9%, educational institutions – by 13.4%, industrial buildings and warehouses – by 7.4%. The increase in construction of residential buildings and administrative building respectively by 82.5% and 78.6% could no compensate the total drop in production volumes in the construction of buildings. The number of civil engineering structures has increased by 20.6%, compared to the 3rd quarter of the previous year, due to a notable rise in the volume of construction of bridges and tunnels by 99.1%, as well as a considerable rise in port construction volumes – 2.3 times.

In the nine months of 2013, compared to the nine months of 2012, the construction production volumes according to the seasonally adjusted data in comparable prices have increased by 8.5%, inter alia, the construction of buildings – by 4.9% and the construction of civil engineering structures – by 11.3 per cent.

In the 3rd quarter of 2013, 677 building permits were granted for the construction, capital repairs, reconstruction and restoration of single-dwelling houses with the total floor space of 140.4 thousand m². That is by 125 building permits more than in the corresponding period of the previous year, while the total floor space has increased by 16.9%. A total of 478 building permits have been granted for the construction of single-dwelling houses with the total floor space of 103.5 thousand m² or by 35.4% larger floor space, or by 145 building permits more.

Moreover, 142 building permits were granted for the construction of industrial production buildings and warehouses with the total floor space of 206.3 thousand m². In comparison with the 3rd quarter of the previous year, 33 building permits more have been granted for floor space that is by 6.5% smaller. A total of 77 building permits were granted for the construction of new industrial buildings and warehouses with the total floor space of 148.8 thousand m² or by 19 building permit more, while the floor space has increased 2.7 times, compared to the 3rd quarter of the previous year.

In the 3rd quarter of 2013, the volume of construction work (in current prices) performed by Latvian builders abroad was LVL 14.4 million (EUR 20.4 million), compared to the 3rd quarter of 2012 (LVL 18.7 million (EUR 26.7 million)), the volume of performed construction works has decreased by LVL 4.3 million (EUR 6.3 million). Yet, in the 3rd quarter of 2013, foreign builders in Latvia have performed construction works in the amount of LVL 2562.5 thousand (EUR 3646.1 thousand), which is by LVL 1042.2 thousand (EUR 1482.9 thousand) less than in the 3rd quarter of 2012 (LVL 3604.7 thousand (EUR 5129.0 thousand)).

In the 3rd quarter of 2013, compared to the 3rd quarter of 2012, the construction costs have increased on average by 1.2%. The costs for maintenance and use of machinery have increased by 2.1%, wages of workers – by 2% and the costs for construction materials – by 0.4 per cent.

By November 30, 2013, a total of 5202 enterprises performing commercial activities in the field of construction of architecture were registered in the Register of Construction Enterprises maintained by the Ministry of Economics, including 1038 construction enterprises in 2013.

As regards the housing policy, the development of the Draft Law on Residential Tenancy continues according to the effective legal framework by balancing the tenant and lessor rights and obligations, improving record-keeping of rental agreements, specifying the rights and obligations of the tenant and his/her family members, as well as observing the principles of free rental market operations.

Since the economic recession, debts of tenants for heating have become a topical issue in multi-apartment buildings. Upon performing an analysis of the reasons of debts, it has been concluded that the main reasons are insufficient or reduced financial resources of residents, lack of a payment discipline, lack of cooperation between the service provider or manager and the debtor (including failure permanently to initiate debt recovery), differing approaches to development of social- support policy-making (including setting apartment benefits) in local governments. In order to address the problem, the Ministry of Economics has developed and the Saeima has adopted in the second reading the draft amendments to the Law on Administration of Residential Houses on July 9, 2013. The draft law has been developed to:

- prescribe the obligation on the manager to control payments of apartment owners for the use of apartment property;
- introduce direct payments for services related to the use of apartment property between the apartment owners and service providers.

On September 26, 2013, the Saeima has approved in the first reading the draft amendments to the *Law on Residential Properties* developed by the Ministry of Economics. The draft law sets forth the conditions of alienation of residential property to encourage payment of debts for administration services and services related to the use of residential property, in case of alienation of residential property, and it specifies the deadline for imposing an obligation on a residential property acquirer to start paying for administration services and services related to the use of residential property if the residential property has been alienated through compulsory auction.

On September 17, 2013, the CoM draft amendments to the Cabinet *Regulations No 1013 of the Cabinet of Ministers of December 9, 2008* P*rocedures by which an Apartment Owner in a Residential Apartment House shall Pay for Services, which are Related to Usage of the Residential Property* were approved. The draft amendments have been developed to prevent a situation where an unreasonably high difference between the reading of the joint meter of the house and the reading of water meter in apartment properties is often calculated in multi-apartment residential buildings. Thus, the draft amendments are intended to specify the procedure for dividing the difference in water consumption, as well as to lay down regulations stipulating that apartment owners make a decision on replacing the water meter installed in individual residential properties and the procedure for its replacement; in case the apartment owners fail to agree within the deadline set in the draft amendments, the building manager will be able to exercise such rights. The draft amendments also envisage changes in the procedure for calculation of the payment for several services related to the use of residential property.

Based on the abovementioned CoM draft amendments, the Ministry of Economics has developed and the CoM has approved draft amendments to the *Regulations No 999 of the Cabinet of Ministers of December 12, 2006 Procedures by which Tenants and Lessors of Residential Space Settle Accounts with Service Providers for Services that are Associated with the Use of a Residential Space* on September 17, 2013 to prevent a situation where tenants of privatized and non-privatized apartments are subjects to different calculation of payment for services related to the use of residential property.

On August 29, 2013, the CoM draft amendments to the *Regulations No 907 of the Cabinet of Ministers of September 28, 2010 Regulations Regarding Inspection, Technical Maintenance and Minimum Requirements of Energy Efficiency for Residential Buildings* were announced at the meeting of State Secretaries. The draft amendments envisage reduced heat energy limit at which the manager of a residential building has an obligation to plan measure to improve energy efficiency, thus promoting heat energy savings.

In order to promote competiveness in the residential building management market and quality management of residential buildings, the *Register of Residential Building Managers* developed in 2012 continues operating in the Ministry of Economics. Currently, 560 managers have been registered in the Register. The main task of this register is to provide the latest information about persons operating or willing to operate in the residential building management market and conformity to the criteria of performing management activities as defined by the *Law on Administration of Residential Houses*. Information from the *Register of Residential Building Manager* regarding services of the manager, territory of the service rendering, qualification and practical experience of the manager or its employees has been published on the website of the Ministry of Economics, as well as the register contains a reference to the rights of the manager to provide management services on the market depending on the obtained professional qualification and practical work experience in management of residential buildings.

On January 9, 2013, the *Law on the Energy Performance of Buildings* came into force, which is supplemented by the updates introduced to the revised *Directive 2010/31/EU* of the European Parliament and of the Council of May 19, 2010 on the energy performance of buildings in addition to the previously effective regulation. According to the delegation defined in the *Law on the Energy Performance of Buildings*, the subordinate regulations to the law in the field of energy performance of buildings were approved in the mid-2013: on June 25, 2013, the CoM approved the Regulations No 348 of the CoM *Methodology for Calculating the Energy Performance of Buildings*, on July 9, 2013 – the CoM regulations No 382 *Regulations Regarding Independent Experts in the Field of Energy Performance of Buildings* and the CoM regulations No 383 *Regulations Regarding Energy Certification of Buildings*.

On June 4, 2013, the CoM considered the informative report *On Financial Solutions to Renovation of Buildings* prepared by the Ministry of Economics. The informative report has been prepared to implement the objectives laid down in the national energy efficiency policy documents and to promote renovation of the building sector, particularly the housing sector in accordance with the requirements for energy performance of buildings. In order to intensify improvement of energy performance of buildings in the programming period 2014-2020, the Ministry of Economics prepared another report in accordance with the task defined in Section 30, Paragraph 2 *The Informative Report On Financial Solutions to Renovation of Buildings* of the protocol decision No 33 of the CoM meeting on June 4, 2013. The report is aimed at evaluating the experience of use of financial resources in the previous period and to prepare relevant proposals for the coming period, as well as to reconsider opportunities to apply the best solutions, including a summary of the best experience of projects implemented within the improvement of energy performance in serial type multi-apartment residential buildings. The report prepared by the Ministry of Economics complement the Informative Report *On Financial Solutions to Renovation of Buildings* approved by the CoM on June 4, 2013. The State Chancellery has sent the report to ministries for information on September 18, 2013.

In 2013, implementation continued for the activity 3.4.4.1 *Improvement of Heat Insulation of Multi-Apartment Residential Buildings* (the activity) of the supplement to the European Regional Fund Operational Programme *Infrastructure and Services*.

Since launching implementation of the activity in April 2009 until December 2, 2013, 1440 project applications have been considered, 303 of which have been completed; contracts on implementation of 596 projects have been concluded with the IDAL. 33 project applications have been approved (to be launched after signing the contract).

Upon analysing the number of submitted projects by regions, it can be concluded that the most active region is Kurzeme with 401 submitted projects, followed by Vidzeme region with 314 project applications. Two regions have maintained medium activity – Zemgale region has submitted 307 project applications, while Riga region – 229 project applications. The lowest number of projects has been submitted from Latgale – 57 project applications. Considering the large number of population and housing, the activity in Riga city with 132 submitted projects is still rather low.

The total funding available within the activity is LVL 62.75 million. Considering the fact that project applications for the entire funding available within the activity have been submitted until the mid-2013, the project applications are no longer accepted since July 31, 2013. A total of LVL 57.98 (92%) have been distributed and reserved. The remaining available amount is LVL 4.77 million (8%) but it cannot be used because of the overcommitment funding in the amount of LVL 15 million granted for implementation of the activity in 2012. The use of its funding is regulated in Section 26, Paragraph 7 of the protocol decision No 25 of the CoM meeting on May 8, 2012. According to this Paragraph, the remaining funding cannot be allocated for the implementation of other EU fund projects if overcommitments have been assumed in any of activities within the priority of the EU fund and non-compliances have been detected or the contract has been terminated within any project of this priority.

The average heat energy savings achieved as a result of implementing the renovations measures range from 30% up to 57%, thus the implementation of the activity results in considerable energy efficiency of multi-apartment residential buildings. Moreover the housing facilities are improved that would not be possible without such support.

The housing renovation process has also significantly influenced establishment of associations of apartment owners and corporate societies of apartment owners because most frequently, when agreeing on launching renovations, residents of the buildings want to deal with building management issues on their own. According to the estimates of the Ministry of Economics, taking into account the total costs of finished projects and of projects to be implemented under concluded contracts, the construction sector has so far received about LVL 138 million from the implementation of this activity.

6.6. Tourism Policy

The tourism policy in Latvia is intended to promote development of local and international tourism, thus improving competitiveness of tourism sector and increasing exports of tourism services.

In 2010, the *Tourism Marketing Strategy of Latvia for 2010-2015* was developed and approved defining the vision of Latvian tourism development and objectives to achieve it, as well as identifying the priority products of the Latvian tourism, basic principles of development and target markets thereof. According to the priorities set in the strategy and by involving experts of the tourism sector, a new image of the Latvian tourism was developed, which is now the uniting idea and a common element for the public and private sector products and marketing development activities.

The objective of the tourism policy is development of sustainable Latvian tourism, boosting competitiveness of tourism services in foreign markets, and the following four sub-objectives have also been defined:

– Boosting the number of overnight travellers;
– Reducing the seasonality effect, by increasing the occupancy of tourism accommodation establishments outside of the busy summer season;
– Ensuring an increase in profitability of tourism services;
– Ensuring an annual increase in exports of tourism services.

Box 6.12

Tourism Development Indicators

According to the data of the UN World Tourism Organization (UNWTO), the number of international tourists in the first half of 2013 has reached 494 million which is by 5% or 25 million travellers higher than in the corresponding period of 2012. Although Asia and Oceania have achieved the best results (+6%) among regions, Europe has also shown stable growth (+5%), which is boosted to a great extent by the increase in the number of travellers in Central and Eastern Europe (+10%), as well as Southern Europe and the Mediterranean countries (+6%).

The tourism sector keeps growing also in Latvia – in the first half of 2013, exports of tourism services reached LVL 187 million which is by LVL 10 million higher than in the same period of 2012.

In the six months of this year, the number of persons served in Latvian hotels and other accommodation establishments has increased by 8.6% (to 772 431). It should be noted that the number of foreign guests served in overnight accommodation establishments has also increased by 11% (473 375 – in the first half of 2012, 526 227 – in the first half of 2013). Russian travellers constituted the largest share – 25%, followed by German tourists (9%) and Lithuanian tourists (8.6%).

Work on the planning document of the medium-term tourism policy *Guidelines on Tourism Development of Latvia for 2014-2020* (announced in the meeting of State Secretaries on September 26, 2013) was commenced in 2013. One of the key tasks of the Guidelines is development of tourism products and boosting competitiveness. Further development of tourism products should be based on seven core values – quality, sustainability (including introduction of environmentally-friendly technology and approaches), individualization, high value added, collaboration, involvement of tourists/gaining experience and cooperation in ensuring competitiveness.

In order to ensure constant involvement of sectoral partners in implementation of the tourism policy, the Advisory Council of the LTDA has been established and continues its activity, composed of authorized representatives from professional and regional tourism associations, the advertising sector, as well as from the Ministry of Foreign Affairs, and the Riga Tourism Development Bureau.

Support measures

In 2013, the key priorities of the LTDA, which is subordinated to the Ministry of Economics, is related to promotion of development of quality tourism infrastructure and single tourism information system, raising awareness about the Latvian tourism image and promotion of Latvia as a tourism destination, conducting marketing research on local and international tourism markets, improvement of tourism service quality, as well as development of local tourism and implementation of international cooperation.

The annual state budget funding for 2011-2013 that is envisaged for promoting tourism development is earmarked as state co-funding for implementation of the Sub-activity 2.3.1.1.2 *Access to International Trade Markets – Strengthening International Competitiveness of Industry Sectors* of the Activity 2.3.1.1 *Access to International Trade Markets* of the supplement to the Operational Programme *Entrepreneurship and Innovations* of the ERDF. Within the framework of the Sub-activity, the following activities are supported:

- organizing national stands at international exhibitions abroad;
- organizing advertising campaigns abroad;
- providing consultancy services to entrepreneurs, local governments, and port administrations about foreign markets, including organizing direct visits, trade missions, and support to participation in exhibitions and searching for cooperation partners.

In 2013, the total amount of funding (state budget funding and the ERDF co-funding, as well as funding for implementation of the project *EDEN VI*) for tourism marketing is LVL 1.5 million.

Improvement of the legal framework

On November 19, 2013, the draft decree of the Ministry of Economics was approved in the CoM meeting with an aim to grant the resort status to the entire administrative territory of the Jūrmala city, except Vārnukrogs, Priedaine and Bražciems territory. The CoM regulations *Procedure for Granting and Annulling the Resort Status* regulates the procedure for granting the resort status and was approved on December 18, 2012, while the Jūrmala city submitted an application for the status in February 2013.

The *By-law of the Latvian Tourism Development Agency* came into force on January 1, 2013 specifying the LTDA status pursuant to the effective *State Administration Structure Law* and the *Law on Public Agencies* by changing the status of a state agency to a public institution.

The *Amendments to 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* came into force on February 8, 2013 for the purpose of introducing the principle of "silence means consent" (according to the *Directive 2006/123/EC* of the European Parliament and of the Council of 12 December 2006 on services in the internal market) to registration of activity of tourism agents and operators in the *Database of Tourism Agents and Tourism Operators (TATO)*.

In order to ensure efficient enforcement of the European Council Directive of *June 13, 1990* on package travel, package holidays and package tours, informing the consumers and other interested people about activities of entrepreneurs engaged in the sector, as well as promoting prevention of fraudulent situations in the sector, in 2010 the Ministry of Economics has developed the *Database of Tourism Agents and Tourism Operators (TATO) (http://tato.em.gov.lv)*. Overall, 587 entrepreneurs were registered in the database by November 20, 2013, 42 of them were registered as tourism operators, 167 – as tourism agents and operators, but 378 – as tourism agents. Every interested person can access the information contained in the database, and the Ministry of Economics urges Latvian travellers to check the conformity of the activity of service providers to the requirements of legislation, in particular the security guarantee of money deposited by tourists.

International cooperation in the field of tourism

In 2013, Latvia continues developing closer cooperation in the field of tourism with other countries, particularly with the 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 on the agenda of foreign visits of intergovernmental commissions and chief state officials.

The *Protocol on Amendments to the Agreement among the Government of the Republic of Latvia, the Government of the Republic of Estonia and the Government of the Republic of Lithuania on Co-operation in the Field of Tourism* was signed in on October 17, 2013 October at the *XII European Tourism Forum*. The protocol acknowledges the achievements of the Baltic States at international level in developing regional cooperation in the field of tourism.

The amendments to the agreement are aimed at promoting integration of the Baltic States in the international tourism industry. One of the core amendments provide for an opportunity to establish joint tourism information offices or appoint joint tourism representatives in the respective and the third countries. The amendments to the agreement also specify and update the cooperation directions of the contracting parties, for example, cooperation in development of the Baltic tourism brand, reducing the administrative burden, applying modern technologies to tourism development, and project development of different international support programmes (like the EU funds).

In October 2013, Latvia has received an invitation to join the OECD Tourism Committee which is a significant step towards promotion of international cooperation. The responsible Latvian tourism institutions will work together with other OECD member states to develop local and international tourism perspectives and to promote the growth of sustainable tourism.

Representation of Latvian interests in the tourism sector at an international level is basically ensured by involvement in the work of the European tourism institutions. Latvia participates in the work of the Tourism Advisory Committee of the European Commission on a regular basis, as well as Latvia is a member of the European Travel Commission, which deals with raising awareness about European, including Latvian, tourism destinations.

6.7. Improvement of Business Environment

An important tool for evaluating the business environment in Latvia is the international survey of the World Bank *Doing Business*, as well as the *Study of Administrative Procedure Impact upon Business Environment* which help to find out the opinion of entrepreneurs about the factors hindering their activity and to prepare a list of tasks within the annual *Action Plan to Improve the Business Environment*.

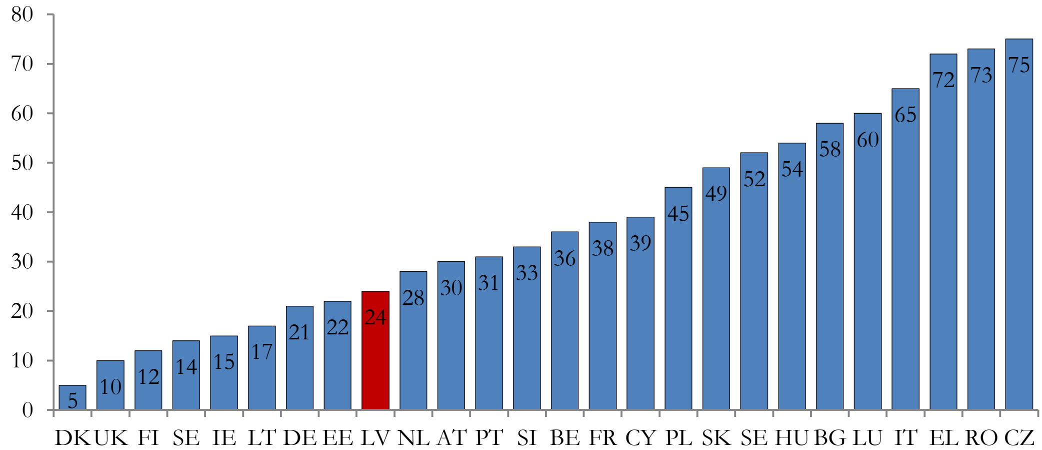
The World Bank research *Doing Business 2014* which covers the reporting period from June 2, 2012 to June 1, 2013 has ranked Latvia 24th among 189 countries. Latvia is ranked 9th among the EU member states in the ease of doing business, letting Denmark, the United Kingdom, Finland, Sweden, Ireland, Lithuania, Germany and Estonia outrival it in the ranking.

It should be noted that Latvia has improved the rating in almost all 10 topics addressed in the *Doing Business* not only this year but also in the past two years. At the same time, Latvia must continue implementing measures to improve business environment to further secure its position as a business and investment friendly country.

Figure 6.7

Rank of Latvia and Other EU Member States in the World Bank's Research *Doing Business* in 2013

(Business environment in general)



Measures to improve the business environment in Latvia have been implemented since 1999 when the Ministry of Economics prepared the first *Action Plan to Improve the Business Environment*. Every year, the plan is updated and approved by the government together with a wide range of organizations representing entrepreneurs which get involved more and more actively.

The objective of the Plan for 2013-2014 (approved by the CoM on April 24, 2013) is "simple and qualitative services in entrepreneurship: more e-services" and it includes 31 measures to be carried out; the following are the most important.

Table 6.5

Rank of Latvia in the World Bank's Research *Doing Business* in 2013-2014

	2013	2014	Changes
Starting a Business	59	57	+2
Dealing with Construction Permits	118	79	+38
Employing Workers	-	-	-
Getting Electricity	89	83	+6
Registering Property	29	33	-4
Getting Credit	3	3	0
Protecting Investors	67	68	-1
Paying Taxes	52	49	+3
Trading Across Borders	23	17	+6
Enforcing Contracts	21	21	0
Closing a Business	46	43	+3

Starting a business – in addition to the possibility for enterprises to submit application for registration in the Commercial Register via the website *www.latvija.lv* introduced late 2012, a range of amendments to the CoM legislation have been made in the first half of 2013, imposing reduced state fees on business start-ups (including electronic registration of companies), for example, the fee for publication of incorporation of a limited liability company with reduced equity has been decreased from LVL 12.60 to LVL 10 (EUR 14.23); the fee for registration transactions in the Register of Enterprises (RE) has been reduced by 10% in case of using the special online form under the supervision of the RE for registration and the customer requests an electronic service. At the same time, simplified requirements have been set for incorporation of companies – as of July 1, 2013 an official of the RE register is entitled to certify signatures for limited liability companies with reduced equity.

In **Construction process** – on July 9, 2013, the Saeima approved the new *Construction Law* to be effective as of February 1, 2014. The Law lays down the fundamental principles of construction, competences of involved parties; it also defines terminology, classification of buildings and requirements to be set for the buildings, as well as specifies the general construction procedure. Subordinate CoM regulations of the *Construction Law* are currently being developed. These regulations are expected to come into force as of February 2014. At the same time, work on introduction and launch of the *Construction Information System* is continued.

Registering property – work on introduction of electronic property registration is continued – the draft laws *Amendments to the Land Register Law*, the *Amendments to the Immovable Property State Cadastre Law* and *Amendments to the Law on Recording of Immovable Property in the Land Register* have been developed in late 2012 and the first reading has been approved by the Saeima on October 10, 2013.

Protecting investor rights – a new e-service *RE Registered Change Notifier* has been developed to give interested persons an opportunity to timely get acquainted with potential changes in registration file of the law subject, and thus giving an opportunity to quickly respond to potential violation of personal right and legal interests. The service is available in trial mode until the end of 2013. During the trial mode the service is free of charge, while it is expected to be a chargeable service as of 2014.

Paying taxes – the CoM *Procedure for Granting Payroll Tax Booklet* was approved on June 4, 2013. According to the procedure, only an electronic form of the payroll tax booklet will be available on the *SRS electronic declaration system* (EDS) as of June 1, 2014. Improvement of the EDS solutions is also continued – as of July 7, 2013, the system allows authentication using identifiers and passwords of a number of Latvian credit institutions via the technical solution of the website *www.latvija.lv*. Thus, users are able to sign in the EDS system using either their EDS identifiers and passwords or *e-Signature* smart card (e-me) and electronic identification (eID) cards, or identifiers and passwords assigned by credit institutions.

Enforcing contracts – an improved regulation of arbitration courts have been developed – on November 12, 2013, the CoM approved the *Draft Law on Arbitration Courts* and amendments to the *Civil Procedure Law*. The amendments to the *Civil Procedure Law* came into force on July 1, 2013 envisaging reduced number of the instances (courts) needed to consider commercial disputes and establishing a special procedure for legal proceedings concerning declaring decisions of members (shareholders) of capital companies null and void (from now on, these matters are considered by the Jelgava court).

The remaining tasks are being implemented within the *Action Plan to Improve the Business Environment for 2013-2014*, as the deadline for completion of those tasks is 2 years. The following priority tasks have to be implemented in the next six months:

- **Starting a business** – as of July 1, 2014 to introduce a possibility to apply employees of new microenterprises for registration in the RE. At the same time, work on electronisation of the documents of enterprises stored in the RE archives;

- in **Construction process** – to develop and approve the subordinate CoM regulations of the *Construction Law* and launch the *Construction Information System* by February 1, 2014;
- **Registering property** – to ensure introduction of electronic property registration in Latvia as soon as possible, adopting the following draft laws by the Saeima: *Amendments to the Land Register Law*, the *Amendments to the Immovable Property State Cadastre Law* and *Amendments to the Law on Recording of Immovable Property in the Land Register*;
- **Employing Workers** – the Saeima must adopt urgent amendments to the *Labour Law*, to strengthen the flexicurity principles;
- **Enforcing contracts** – continue working on improving legal proceedings and making them more efficient. The Ministry of Justice has to submit an informative report to the CoM regarding *The Assessment Results Within the Project "Modernization of Courts in Latvia"* to provide indicative link between the planned works of the Ministry of Justice and the research conclusions (proposals); to promote adoption of the regulation of the arbitration courts by the Saeima, as well as urgent improvement of the procedure for defining *principles for the specialisation of judges* and the procedure for the determination of the case workload;
- **Closing a Business** – to ensure adoption of the amendments to the Insolvency Law by the Saeima as soon as possible – on November 28, 2013, the project is being considered by the Saeima before the 2nd reading.

Representatives of both line ministries and their subordinated institutions and cooperation partners from the LCCI, LDDK and the Foreign Investors Council in Latvia were involved in preparation of the *Action Plan to Improve Business Environment*. Information on the implementation progress of the *Action Plan to Improve Business Environment* is available on the website of the Ministry of Economics: *http://www.em.gov.lv/em/2nd/?cat=30209*.

6.8. Small and Medium-Sized Enterprises

In Latvia, similar to other European countries, small and medium-sized enterprises (SMEs) form a major part of the national economy and play a significant role in GDP building and employment.

In order to foster development of small and medium-sized enterprises and the overall business environment, **support measures to promote micro-enterprise establishment and development** are implemented in Latvia.

On October 30, 2009, the CoM approved the *Concept of Micro-enterprise Support Measures* with an aim to create the necessary preconditions to encourage unemployed people to start business activity, to create business environment favourable to micro-enterprises, as well as to develop entrepreneurial skills, thus increasing the share of entrepreneurs in the total number of working population. The Concept is being successfully implemented, and the key accomplishments in business improvement are described below.

Box 6.13

The number of small and medium-sized enterprises in Latvia

According to the CSB preliminary data, there were 89 106 economically active individual merchants and commercial companies in Latvia in 2012 (excluding farms, and fish farms and self-employed persons, who perform economic activity), 99.53% of which belonged to the category of SMEs. The breakdown of economically active SMEs in Latvia is the following: micro-enterprises – 84.72%, small enterprises – 12.29%, medium-sized enterprises – 2.52%, large enterprises – 0.47%. An important indicator characterizing economic activity is the number of economically active merchants and commercial companies per 1000 inhabitants. This indicator in Latvia has grown constantly over the last 10 years from 17 in 2001 to 38 in 2012.

However, it is equally important to emphasize the number of performers of individual work (self-employed persons) in 2012 – 47 878 (23 per 1000 inhabitants), as well as the number of farms and fish farms in 2012 – 13 192 thousand (6 per 1000 inhabitants). Taking into account the fact that there is no single methodological practice among the EU Member States for calculating such an indicator characterizing the economic activity as the number of enterprises per 1000 inhabitants, it is difficult to perform an objective comparative analysis of this parameter. The current practice of the responsible EU institutions shows that calculation of the number of enterprises per 1000 inhabitants includes not only individual merchants and commercial companies, but also performers of individual work, farms, and fish farms, etc. Therefore, by applying an analogous practice, in 2011 in Latvia there were 69 performers of economic activity per 1000 inhabitants.

According to the statistics of the *RE*, 18 574 subjects were registered and 4443 subjects were liquidated in the year 2012. Whereas, in the eleven months of 2013, 16 758 subjects were registered and 3871 subjects were excluded from the registers of the RE.

Box 6.13 continued

Definition of SMEs

Definition of SMEs is stipulated in the *Law on Control of Aid for Commercial Activity,* Regulations of the CoM of November 25, 2008, No 964 *Regulations on Declaration Procedures of Commercial Companies According to Small or Medium-sized Commercial Company*, and *Commission Regulation (EC) No 800/2008*:

medium-sized enterprises:

- number of employees: 50–249;
- annual turnover does not exceed EUR 50 million;
- total sum of annual balance is under EUR 43 million;

small enterprises:

- number of employees: 10–49;
- annual turnover does not exceed EUR 10 million;
- total sum of annual balance is under EUR 10 million;

micro enterprises:

- number of employees: 1–9;
- annual turnover does not exceed EUR 2 million;
- total sum of annual balance is under EUR 2 million.

Amendments to the *Commercial Law* of May 2010 significantly reduced the costs required to start a business, envisaging that a **limited liability company** (LLC) **may be founded with reduced equity capital** (from LVL 1). Additionally, the state dues for registration of such a limited liability company were reduced. According to the data of the RE, 55 976 limited liability companies were registered within the time period from May 1, 2010 until December 1, 2013, 67% or 37 423 of them were limited liability companies with reduced equity capital.

Since September 1, 2010, legal and natural persons **can obtain the status of a micro-enterprise taxpayer,** if they meet certain criteria (members are natural entities, turnover does not exceed LVL 70 000 per calendar year, and the number of employees does not exceed 5) and make micro-enterprise tax payments in the amount of 9% (includes all state determined tax payments, except consumer taxes) of turnover or profit from economic activity. Over 28 268 micro-enterprise tax payers were registered at the State Revenue Service from September 1, 2010 until May 1, 2012 (incl., 67% of them are new companies). Micro enterprises employ over 50 000 employees. These micro enterprises are subject to simplified SRS formalities (declarations 4 times a year).

Box 6.14

Activities of the EU in Promoting Entrepreneurship

Small Business Act for Europe

On June 25, 2008, the European Commission approved the review of the *Small Business Act for Europe*, mainly aimed at integrating the use of *Think Small First* principle in the preparation process of political documents, improving the overall political approach to entrepreneurship, particularly promoting development of small and medium-sized enterprises, and helping eliminate obstacles preventing their development. The Act includes proposals for 10 politically binding guidelines and several specific proposals for regulations of normative enactments.

European Entrepreneurship 2020 Action Plan

In order to continue implementing the guidelines laid down in the *Small Business Act for Europe,* on January 9, 2013, the European Commission published the *Entrepreneurship 2020 Action Plan*: *Reigniting the entrepreneurial spirit in Europe,* which includes entrepreneurship activities at European level to bring Europe back to growth and higher levels of employment, emphasising the need to support SMEs and particularly new enterprises. The document sets 3 priority directions of action:

Pillar I – *Entrepreneurial education and training*

The European Commission points out that the entrepreneurial mind-set helps entrepreneurs transform ideas into action and also significantly increases employability. Therefore, the European Commission asks the EU and Member States to focus actively on ensuring entrepreneurial education to students through curricula, thus providing practical knowledge and communication with representatives of entrepreneurs, as well as promoting entrepreneurship orientation in higher education institutions.

Pillar II – *Create an Environment where entrepreneurs can flourish and grow*

The European Commission points out that access to finance and misleading marketing practices constitute one of the most significant constraints on successful growth of SMEs. Therefore, the European Commission asks the EU and Member States to jointly remove barriers to the Single Market, provide comprehensive information to entrepreneurs, thus creating single contact points (incl., information on the use of digital options), provide support and facilitate growth of new enterprises at different stages of their development, minimise the administrative burden and set clearer and simpler requirements arising out of legislations, thereby reducing the tax-related expenses, improve the process of business transfers and insolvency procedures.

Box 6.14 continued

Pillar III – *Role models and reaching out to specific groups*

The European Commission points out that Europe has a limited number of known entrepreneurial success stories and entrepreneurship has not been celebrated as a preferred career path. Therefore, the European Commission asks the EU and Member States to promote entrepreneurial mind-set, by informing the public about entrepreneurial success, particularly paying attention to such population groups as young people, women, disabled persons, and migrants.

European Small- and Medium-Sized Enterprises Week

In order to achieve the objectives of the Act, in 2013 the European Commission organized the annual European scale campaign *European SME week – for small and medium sized enterprises* to provide information (seminars, conferences, discussions etc.) to existing and potential entrepreneurs about activities of the European Union, Member States, and local government institutions in entrepreneurship improvement, promotion and to honour entrepreneurs for contributing to European welfare, creation of jobs, innovations and competitiveness.

Regional and thematic seminars on such issues as marketing strategy, international marketing, consultations and solutions to promote exportability, current support programmes for enterprises, etc. were held in September, October, and November in Latvia within the framework of the *SME week 2013*. A new and important measure was held within the framework of *SME week 2013* – the measure *Small Business Days in Latvia* is aimed at providing practical information to entrepreneurs on how to expand customers' base, to address potential partners and see new business opportunities. The measure *Small Business Days* was organized in 7 Latvian towns and cities: Daugavpils, Rēzekne, Liepāja, Ventspils, Valmiera, Jelgava, and Riga, involving over 300 participants.

Overall, more than 30 informative events for entrepreneurs were organized within the *SME week 2013 in Latvia* involving over 1500 entrepreneurs. Information on the *SME week 2013* is available on website of the Ministry of Economics: *http://em.gov.lv/em/2nd/?cat=30280*.

On November 6, 2013, the Saeima approved amendments to the *Micro-enterprise Tax Law*, introducing changes in the procedure for calculating the micro-enterprise tax rate. According to the amendments, a taxpayer with annual turnover below EUR 7000 (LVL 4920) is a subject to a tax rate of 9%; however, if the annual turnover exceeds the said amount, the tax rate is going to be 11% in 2015, 13% in 2016 and 15% starting from 2017. Such a regulation has been introduced taking into consideration the current situation in relation to disproportionate social guarantees of employees of micro-enterprise tax payers compared to persons working at enterprises that pay taxes within the general tax regimen.

As of January 1, 2010, any natural entity performing economic activity in specific professions or operations may choose to pay the patent fee, which is a complete tax payment for the economic activity of a natural entity in a specific profession (mainly for craft services). Relevant social guarantees are ensured to all payers of the patent fee. A total of 6020 applications for patent fees have been submitted to the State Revenue Service from January 1, 2010 until May 1, 2013. The number of the patent fee payers on average is 350 patent fee payers per month. Typically patent fee payers are persons performing such economic activity as gathering gifts of nature – berries, mushrooms, wild herbs –, photographers, hair stylists, nail care specialists, dressmakers.

Measures to promote business start-ups

In order to foster establishment and development of micro, small, and medium-sized enterprises, IDAL implements the project ***Business Incubators.*** The aim of the activity is to foster establishment and development of new, viable, and competitive enterprises in the regions of Latvia by ensuring the environment and consultancy services necessary for business activity. A **business incubator** is a combination of infrastructure and personnel aimed at aiding new and small enterprises to develop, by supporting them in their early stage of development with infrastructure, day-to-day consultations, and services concerning basic business development issues.

Business incubation services are available in all regions of Latvia, over 20 towns and cities of Latvia. As a result of the activities of 9 business incubators operating in the regions of Latvia and the creative business incubator located in Riga, at total of 571 enterprises have been supported from 2009 to November 1, 2013. 50 of these enterprises were new commercial companies established in 2013. The incubated enterprises have created (maintained) 1267 jobs. Overall, 253 enterprises have left the incubators or have been incubated and started independent business without the support of the business incubator since the launch of the programme in 2009 until the end of 2012. The total available funding within the programme is LVL 20.2 million and the activity is expected to be implemented until October 31, 2014.

A programme providing complex support to business start-ups and new enterprises has been launched since 2009. The programme ***Supporting self-employment and entrepreneurship*** is implemented at the Mortgage and Land Bank of Latvia (see information about the programme and other programmes provide by the bank – in the section below).

Ensuring availability of financing to enterprises

The Mortgage and Land Bank of Latvia (the Mortgage Bank) plays an important role in implementation of support instruments. The Mortgage Bank is a fully state-owned bank and performs the functions characteristic for a development bank.

In 2013, the Mortgage Bank continues implementation of the following support programmes:

– *Support Programme on Improvement of Competitiveness of the Enterprises* co-financed by the ERDF;
– Support programme for *Support for Self-employment and Business Start-ups* co-financed by the ESF;
– *Micro Crediting Programme of Latvia and Switzerland*,
– *SME Growth Loan Programme*;
– *Programme of Agricultural Liquid Assets*;
– *Crediting Programme for Purchasing Agricultural Land*.

Box 6.15

Transformation of the Mortgage Bank into a Development Bank (development financial institution)

In December 2009, the CoM accepted the concept *Transformation of the State Joint Stock Company "The Mortgage and Land Bank of Latvia" into Development Bank*. The aim of the concept was to select the optimal options for transformation of the Mortgage Bank into a development bank, by reducing the number of transactions of a commercial bank and focusing the work of the bank on directions currently crucial to the national economy. The 1st model of the concept was supported envisaging establishment of a development bank on the basis of the Mortgage Bank and gradual discontinuation of commercial bank's functions no later than by December 31, 2013.

In November 2011, the CoM adopted a decision on the sales strategy of the Mortgage Bank's commercial part envisaging the sale of the commercial part in 6 packages, thus selling both assets and liabilities. Contracts of sale of commercial parts in 4 packages of the Mortgage Bank were signed in June 2012. JSC "Swedbank" purchased packages of commercial parts of the Mortgage Bank containing commercial loans of private persons and legal entities, payment and deposit services, while LLC "Swedbanklīzings" purchased LLC "Hipolīzings". "SEB Wealth Management" purchased the management package of the 2nd level pension plans.

In May 2013, the CoM approved the sale of the remaining commercial part packages. A package containing loans granted to real estate developers was sold to JSC "Rietumu Banka". Since private investors proposed inadequate price, i.e. too low a price for the remaining commercial parts, the capital shares of LLC "Hipotēku bankas nekustamo īpašumu aģentūra" were transferred to SJSC "Privatisation Agency".

In November 2012, the data of the commercial customers of the Mortgage Bank were successfully transferred to JSC "Swedbank", thus these customers are now attended by this bank. Overall, the Mortgage Bank has transferred customer deposits or commitments in the amount of LVL 147.7 million to JSC "Swedbank"; moreover JSC "Swedbank" has taken over about 7 thousand loans of the commercial sector in the amount of LVL 86.5 million. Over 70 thousand customer accounts have been transferred from the Mortgage Bank to JSC "Swedbank" within the sale of commercial parts, out of which about 95% are private accounts and 5% – accounts of legal entities.

The transformation of the Mortgage Bank is aimed at establishing a development institution to implement state aid programmes through efficient use of the Mortgage Bank's infrastructure, intellectual and financial potential, by transforming the bank in a way that is advantageous to the state and at the same time ensuring continuity of the implementation of state aid programmes. During the transformation process activities of the Mortgage Bank are focused on important economic directions – financing of small and medium-size enterprises, promotion of new enterprises, development of infrastructure and other national development projects within the framework of CoM approved programmes. In October 2012, the CoM approved the *Informative Report on Establishing a Single Development Financial Institution* (DFI). The DFI is expected to implement state aid programmes in a form of financial instruments that have been implemented so far by the Mortgage Bank, LLC "Latvian Guarantee Agency" (LGA), and SJSC "Rural Development Fund" (RDF), thus ensuring continuous implementation of existing programmes, launching new ones, at the same time being able to fulfil the existing commitments. The DFI is also expected to promote one-stop-shop agency state aid services, ensure more efficient monitoring of invested resources and optimizing costs. In April 2013, the CoM decided to establish the single DFI as a new commercial company operating as a holding company, involving three institutions – the Mortgage Bank, the LGA and the RDF. The Mortgage Bank will be one of the subsidiary companies of this commercial company. The Mortgage Bank is expected to operate without a credit institution licence within the single DFI, accordingly reorganising its activities. The Ministry of Finance will be the shareholder of the new commercial company. A board will be established for management of the institutions composed of representatives from the Ministry of Economics, the Ministry of Environmental Protection and Regional Development and the Ministry of Agriculture.

Currently, the most significant support programme in terms of the amount of loans implemented by the Mortgage Bank is the ***Support Programme for Improvement of Competitiveness of the Enterprises*** approved by the CoM in May 2008. The support within the programme is provided to small, medium-sized, and large enterprises registered in Latvia, which have economically reasonable further activity plans, but cannot receive funding from credit institutions due to increased risks. Within the programme, investment loans (up to LVL 1 million) and current assets loans (up to LVL 500 thousand). In case the loan is expected to exceed LVL 350 thousand, the customer should, prior to receiving the loan at the Mortgage Bank, obtain an approval from their commercial bank if the customer has commitments at the bank. Within the part of the Support Programme for Improvement of Competitiveness of the

Enterprises co-financed by the ERDF, since its launch until the end of November 2013, a total of 106 loans in the amount of LVL 88.8 million have been granted, including loans in the amount of LVL 48.5 million have been issued. Most often projects represent such sectors as wood processing, production of electricity, manufacture of pharmaceutical products and food production.

The programme ***Support for Self-employment and Business Start-ups*** co-funded by the ESF and approved by the CoM in March 2009*,* offers complex support to business start-ups and newly established enterprises, i.e. consultations, trainings, and funding in a form of loans (up to LVL 54 thousand) and interest rate subsidies[1] for starting a business. The support is available for the working-age population including the unemployed who have expressed willingness to start a business or self-employment, as well as new enterprises. For the purposes of this programme, a new enterprise is an enterprise having registered its activity in accordance with the procedure specified in the law not earlier than three years prior to applying for the support within the programme, as well as entrepreneurs having business experience and planning to produce a completely new product or provide a new service on a condition that they establish a new enterprise for this purpose. The amount envisaged in a business plan may not exceed LVL 60 thousand, and at the same time co-financing in the amount of at least 10% of the total amount of the plan must be provided for the projects with the loan amount exceeding LVL 5 thousand for the implementation of the business plan.

The total funding of the programme is LVL 17.5 million, including funding from the ESF and the state budget – LVL 9.9 million, and co-financing of the Mortgage Bank in the amount of LVL 7.5 million. Within the total funding of the programme LVL 15.4 million is envisaged for loans and interest subsidies, while LVL 2.01 million – for consultations and administrative costs. The practical implementation of the programme was launched in August 2009. Since then, cooperation agreements with 3577 interested entrepreneurs have been concluded, 2091 clients have submitted business plans, including 1124 start-up projects have been supported for the total loan amount of LVL 12.9 million.

Since January 2010, within the scope of the programme, training is available throughout the territory of Latvia for those programme participants whose theoretical and practical knowledge is insufficient to carry out commercial activity and to prepare a business plan. Training according to the modular approach is available in such modules as basics of business activity (small business organization), management basics, legal regulation of entrepreneurship, finance management of the enterprise, accounting and taxes of economic activity, and basics of marketing. Until now, 1780 programme participants have been trained.

In September 2009, the CoM adopted regulations *On Loans for Promotion of Development of Small (Micro), and Medium-Sized Enterprises and Agricultural Service Cooperatives*. In accordance with these regulations, in February 2010, the Mortgage Bank launched implementation of the ***SME Growth Loan Programme***. The programme is aimed at improving access for economic activity operators registered in Latvia to financing, thus promoting development of the national economy. The maximum amount for investment loans for one economic activity operator is LVL 300 thousand, farmers – LVL 2 million; the maximum loan amount for liquid assets is LVL 200 thousand. Besides, according to the conditions of the programme, the maximum amount of a loan within this programme per one micro-entrepreneur operating in service industry may not exceed LVL 30 thousand. By the end of November 2013, 882 loans in the amount of LVL 41.5 million have been granted, including loans for LVL 35.5 million that have already been issued within the framework of the programme.

In May 2010, the Mortgage Bank launched the ***Programme of Liquid Assets Loans for Producers of Agricultural Produce.*** Producers of agricultural produce, as well as groups of fruit and vegetable producers may receive liquid assets loans from LVL 5 thousand up to LVL 700 thousand with a term of up to 2 years, while the maximum loan for agricultural service cooperatives can reach LVL 2 million. Guarantees of the RDF may be attracted for these loans. Until now, 925 loans in the amount of LVL 29.7 million, including loans in the amount of LVL 29.1 million have been granted within the framework of the programme.

In September 2011, the CoM approved the ***Micro Crediting Programme of Latvia and Switzerland.*** The programme is aimed at improving the possibility of micro-enterprises to receive financial support for business start-ups or development. The programme is implemented within the framework of the cooperation programme between Latvia and Switzerland, and the total funding of the programme is LVL 5.1 million[2],

[1] Interest rate subsidy is granted to all beneficiaries of start-up loans in the amount of either 80% or 70% of the total interest amount. Beneficiaries of financial support (enterprises up to one year) themselves must cover just 20% of the total interest amount, while companies from 1-3 years are granted subsidies on the amount of 70% of interest payments.

[2] Within the framework of the programme, the Loan Fund has been established for providing financial support – micro-loans and grants; the Fund is administered by Switzerland to an extent of 80% and the Mortgage Bank – to an extent of 20%. Yet, management costs of the programme are funded by Switzerland to an extent of 80% and the state budget – to an extent of 20 per cent.

including LVL 4.6 million that are earmarked for micro-loans for investments and liquid assets of up to LVL 10 thousand, as well as LVL 436 thousand – for grants to repay the loans[1]. The programme will run until June 2015. So far, micro-loans have been granted to 843 micro-enterprises in the amount of LVL 4.9 million including granted micro-loans in the amount of LVL 4.6 million. Moreover, in case of 639 loans grants in the amount of LVL 436 thousand have been granted as well.

In May 2012, the CoM approved the regulations of the ***Crediting Programme for Purchasing Agricultural Land***. Up to LVL 300 thousand are available for purchasing agricultural land within the programme for the purpose of producing agricultural products and purchasing buildings on the land if the cadastral value of buildings does not exceed 30% of the cadastral values of land. The total budget of the programme is LVL 10 million and loans within the programme are going to be granted by the end of June 2014. According to the Cabinet regulations, the Mortgage Bank deals with accepting, assessing the applications and issuing and administering the loans within the programme, while the decision on granting the loan is adopted by the RDF based on the bank's recommendations. Practical implementation of the programme was launched in July 2012, and 209 loans in the amount of LVL 6.8 million have been granted so far.

LLC "Latvian Guarantee Agency" (LGA) is a state-owned capital company aiming to promote access to funding for enterprises registered in Latvia. Currently, LGA offers six financial instruments to improve competitiveness:

Direct instruments for enterprises:

– loan guarantees aimed at helping enterprises to attract credit resources in cases when their collateral is insufficient to receive credit resources;
– export loan guarantees aimed at supporting exporters covering political and commercial risks related to export transactions;
– mezzanine loans aimed at providing long-term funding to Latvian enterprises in addition to the granted bank loans to cover all investment project costs in material and non-material assets;

Indirect instruments for enterprises (through other institutions):

– seed capital investments aimed at providing financing for pre-investigation, assessment and development of a product or a business idea concept. This instrument is implemented by Imprimatur Capital within the Holding Fund administered by the LGA;
– start-up capital investments aimed at providing financing for development and first marketing of entrepreneurs' products. This instrument is implemented by Imprimatur Capital within the Holding Fund administered by the LGA;
– venture capital investments aimed at providing financing for development and first marketing of products, growth and expanding activities of entrepreneurs by increasing production capacity, developing sales markets and products or attracting additional working capital. This instrument is implemented by BaltCap within the Holding Fund administered by the LGA;
– commercial loans. This instrument is implemented by SEB banka and Swedbank within the Holding Fund administered by the LGA. The programme was completed on September 26, 2012, because it started overlapping lending activities of private commercial banks.

A number of other instruments are being developed.

On March 10, 2009, the CoM adopted Regulations on ***activity 2.2.1.3 "Guarantees for Improvement of Enterprise Competitiveness" of the Supplement to the Operational Programme "Entrepreneurship and Innovation"***. The goal of the regulations is to provide the enterprises with access to funding for development of commercial activities and for implementation of the EU funds projects by ensuring guarantees in situations when the collateral at the disposal of the enterprise is not sufficient to attract sufficient credit resources, and the banks evaluate the enterprise as too risky, as well as to facilitate competitiveness of Latvian enterprises, to promote absorption of new markets and secure positions in the existing ones.

In April 2009, the LGA launched implementation of the activity ***Guarantees for improving enterprise competitiveness***. At the moment, the ERDF financing available within the activity is LVL 11.2 million.

The LGA issues guarantees for such financial services as loans for investments, liquid asset loans, financial leasing, local factoring, as well as bank guarantees (tender, advance payment, payment, execution or time guarantee). The guarantees cover up

[1] The amount of the grant in Riga, its local governments and major cities is LVL 500, while the amount of the grant in the rest of Latvia is LVL 750. The amount of grants defined in the programme was granted in August 2013, and therefore new grants are no longer granted, but issue of previously allocated grants is continued.

to 80% of the principal amount of the financial service but not exceeding EUR 1.5 million per one enterprise.

Guarantees issued within the framework of the ***Loan Guarantee Programme*** since launching the activity until October 31, 2013:

- The number of issued guarantees – 367 guarantees to 251 enterprises;
- the amount of issued guarantees – LVL 86.3 million;
- the amount of guaranteed loans – LVL 194.8 million.

Within the framework of the Loan Guarantee programme until October 31, 2013, the most guarantees have been provided to enterprises operating in the following sectors: manufacturing – 53%, construction – 18%, electricity, gas supply, heat supply and air conditioning – 6%. In terms of number, most of the issued guarantees are guarantees for liquid assets – 36%, investment guarantees - 29% and financial leasing guarantees – 25 per cent.

In May 2009, the CoM adopted regulations *On Short-term Export Credit* establishing coverage and beneficiaries of ***short-term export credit guarantees,*** as well as the procedure for granting guarantees and the procedure under which the guarantor covers the loss. The LGA export credit guarantee covers up to 90% of the amount of deferred payment but not exceeding EUR 1 million or an equivalent amount in another currency. The deadline of the deferred payment may not exceed 2 years.

Within the framework of the **Export Credit Guarantee Programme** since launching the activity until October 31, 2013:

- the number of applications – 242 applications from 63 enterprises;
- the number of issued guarantees – 127 guarantees to 33 enterprises;
- the amount of guaranteed loans – LVL 8.6 million.

Most of the companies (94%) that have concluded contracts represent the manufacturing sector (for example, manufacture of communication equipment, manufacture of electrical household appliances, manufacture of veneer sheets and wood-based panels, manufacture of soap and detergents, cleaning and polishing products, manufacture of food products, etc.). In terms of countries, most of the guarantees have been granted to markets in the CIS countries – Russia (34%) and Belarus (24%), as well as countries like Kazakhstan (17%), Ukraine (6%), Kyrgyzstan (2%), etc.

In August 2011, the CoM approved the *Regulations Regarding Mezzanine Loans for Improving Competitiveness of Economic Operators*, setting the requirements for granting the support in a form of **mezzanine loans** for improving competitiveness of economic operators. The maximum amount of a mezzanine loan is LVL 700 thousand. The amount of a loan does not exceed 40% of the total costs of an investment project. The total amount of the loans is LVL 13.1.

By October 31, 2013, a total of 5 mezzanine loans in the amount of LVL 1256.1 thousand have been granted and 9 applications for mezzanine loans have been submitted. The purpose of the mezzanine loan is to issue long-term loans to Latvian merchants in addition to loans issued by banks to cover investment costs of the project, which are associated with the set-up of a new merchant, the expansion of an existing merchant, increasing the diversity of production with new products or significant changes in the production process.

In January 2012, the activity 2.2.1.1 *Holding fund for the investment in guarantee, high-risk loans, and venture capital funds and other financial instruments* was taken over from the European Investment Fund.

Within the framework of the **Holding fund loan instruments**, until October 31, 2013, a total of 32 loan agreements for LVL 10.1 million have been concluded, while within the framework of venture capital instruments, a total of 31 different stage venture capital investments in the amount of LVL 10.2 million have been made.

The additional funding in the amount of EUR 1.8 allocated on May 10, 2013 has been successfully absorbed by the Imprimatur Capital seed capital fund for the purpose of financing early stage investments up to EUR 50 thousand, particularly focusing on supporting those who complete the acceleration programme. By the end of October, the additional funding has ensured investments in the amount of EUR 0.2 million in four enterprises.

On August 6, 2013, three new venture capital funds were established and are operating in accordance with the new venture capital state support programme the ***Growth Capital Funds*** approved by the CoM on May 29, 2012. These funds – *Expansion Capital Fund*, *FlyCap Investment Fund I* and *ZGI-3* – will continue providing access for Latvian small and medium-sized enterprises to venture capital financing for business start-up and development, as well as improve competiveness and growth of enterprises. The Growth capital funds will improve and expand the venture capital sector in Latvia by complementing the range of other venture capital fund opportunities implemented by the LGA. The Growth capital funds allow receiving venture capital if an enterprise has insufficient own resources and the expected investment risk is too high to attract the required amount of financing from credit institutions.

The growth capital funds will invest in micro-, small, and medium-sized enterprises operating in Latvia. An enterprise will be able to receive investments of up to LVL 1 million to provide financing for pre-investigation, assessment and development of a product or a business idea concept, development of products, growth and expanding the activity by increasing production capacity, developing sales markets and products. The growth capital funds will invest in enterprises with high growth potential. The growth capital funds will be funded by financing available within the sub-activity *Holding fund for the investment in guarantee, high-risk loans, and venture capital funds and other financial instruments* of the European Union structural funds. The total amount of investments of the growth capital funds in Latvian enterprises is expected to reach EUR 40 million (about LVL 28 million).

Box 6.16

Growth Capital Funds

Expansion Capital Fund is focused on enterprises at growth stage that have already completed the product development stage and need financing to start commercial manufacturing, apply more aggressive marketing and sell products. The fund prefers export-oriented enterprises and enterprises with high growth potential. The team of the fund is highly experienced in wood processing, metal processing, manufacture of machinery and equipment, chemical industry, transport, food, IT services, waste recycling, publishing, health care and packaging sectors.

In addition to financing enterprises at development stage, the **FlyCap Investment Fund I** plans to invest 20-30% of funds resources in new enterprises that have already developed a business model and have verified viability of a product, by attracting first customers. The priority sectors are manufacturing, IT, health care and business services.

ZGI-3 plans to diversify its portfolio by investing about 10% of fund's resources in enterprises at seed capital stage, 20% in start-up capital stage, while remaining resources – in the growth capital stage.

On September 26, 2012, a contract on establishment of the ***Baltic Innovation Fund*** (BIF) was signed between the Baltic States and the European Union. The available BIF funding might amount up to EUR 200 million, out of which EUR 100 million are expected to be public resources, while remaining EUR 100 million are planned to be attracted from private investors. The LGA is the contracting party from Latvia. The BIF will make it easier for Baltic micro-, small, and medium-sized enterprises wishing to expand activities in the Baltic region and internationally to access funds, by attracting venture capital investments for one enterprise up to EUR 15 million, thus creating new jobs and promoting knowledge-based economy in the Baltic States. The BIF also promotes development of the venture capital sector and attractiveness of markets in the Baltic States to investors. Latvia will provide the co-financing in the amount of EUR 20 million necessary for establishment of the BIF from the resources available to the LGA. By the end of October 2013, three funds have been selected within the framework of the BIF. Currently, these funds – *BaltCap Private Equity Fund II*, *BPM Mezzanine Fund* un *Livonia Partners Fund* deal with attracting private investors to be able to start investing in enterprises as of 2014.

The LGA plans to implement also **a micro-loan fund** with the estimated budget in the amount of EUR 5 million. The tender regulations were prepared by the end of October 2013.

6.9. Innovation and New Technologies

The total financing for research and development (R&D) in Latvia in 2012 was 0.66% of GDP or LVL 102.2 million (in 2011 – 0.7% or LVL 99.4 million). Investments of private sector (enterprises) in 2012 were 23.7% of the total investments in R&D or 0.16% of GDP (in 2011 – 0.18% of GDP). Although public sector and higher institutions financing in actual figures has increased in 2012, constituting LVL 26.4 million (in 2011 – LVL 24 million), it has remained unchanged in the total GDP – 0.17%. The amount of foreign, including the EU structural funds investments in research and development activities has increased in 2012, reaching LVL 51.5 million (in 2011 – LVL 50.7 million), the amount-to-GDP-ratio constituted 0.33% in 2012, as compared to 0.35% in 2011.

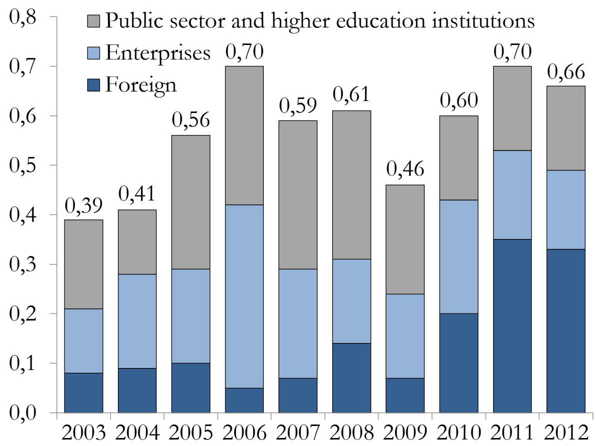
In Latvia, investments in R&D development are still considerably behind the objective set in the *National Reform Programme of Latvia for the implementation of the EU 2020 strategy* envisaging that the total investments in research and development increase to 1% of GDP in Latvia by 2015 (in 2020 – 1.5% of GDP).

The *Eurostat* data for the time period from 2008-to 2010 show that about 29.9% of the enterprises in Latvia were innovative (within the survey period from 2006-to 2008 – 24.3%), while in the EU countries this indicator was on average 52.9%. At the same time, turnover of innovative enterprises of the total turnover of enterprises in 2010 constituted 54.5% (CSB data), indicating a higher demand for products or services of innovative enterprises, thus providing competitive advantages to innovative enterprises.

Figure 6.8

Funding for research and development

(% of GDP)



The share of products of high technologies in total exports is rather small. In 2012, this indicator was 12.4% (in 2011 – 12.8%). The share of products of medium-high technologies in the total exports constituted 19.9% in 2012 (in 2011 – 20.4%); however, the total share of export of high and medium-high technology products was 32.3% of the total export structure in 2012 (in 2011 – 33.2%).

In 2013, the draft *Guidelines on Science, Technological Development and Innovations for 2014-2020* are still being developed. The Guidelines are expected to identify the key challenges to scientific activity, define objectives of the government policy, the main principles and priorities for development of science, technology and innovation. The Guidelines include also the *Smart Specialization Strategy* of Latvia, which is a precondition for investments of the EU funds in research and innovation planning for 2014-2020. The *Smart Specialization Strategy* will identify the areas on which the limited resources should be focused to achieve the required critical mass, accomplish significant results and develop competitive advantages (see Box 6.17), and also to identify the innovation system problems (see Figure 6.9).

Box 6.17

Guidelines on National Research, Technology Development and Innovation for 2014-2020

Guidelines on National Research, Technological Development and Innovation for 2014-2020 is a medium-term policy planning document that lays down the objectives and priorities of national research, technological development and innovation policy for the time period until 2020. The key objective of the research, technological development and innovation policy is building the capacity of knowledge base and innovations and coordination of the innovation system in Latvia. As regards the national development planning system, the guidelines are a part of the *Smart Specialisation Strategy*, and therefore they have been developed based on the *Smart Specialisation Strategy of Latvia*. Yet, *the Informative Report on the Development of the Smart Specialisation Strategy* outlines the content of the *Smart Specialisation Strategy* and its link with the growth of national economy. The *Smart Specialisation Strategy* envisages development of the vision, finding competitive advantages, selecting strategic priorities and a policy aimed at maximum unlocking the knowledge-based potential of regions, thus ensuring the growth of national economy. The aim of the policy is building innovation capacity and establishing an innovation system to promote and support technological progress in national economy. In order to develop a justification for the *Smart Specialisation Strategy,* the Ministry of Education and Science has analysed export potential of national economy industries and assessed knowledge capacity of Latvia. As a result, the *Smart Specialisation Strategy* lays down three directions of transformation of national economy, defined seven priorities and identifies five smart specialisation areas.

The *Smart Specialisation Strategy* lays down the following directions of transformation of national economy:

– Change of manufacturing and exports structure in traditional industries of national economy.
– Future growth industries that currently have or might have high value added products and services.
– Industries having significant horizontal impact and contribution to transformation of national economy.

Growth priorities:

– Efficient use of primary products for manufacture of high value added products, development of new materials and technologies as well as diversification of use thereof. Broader use of non-technological innovations and the potential of creative industry of Latvia in manufacture of high value added products and services of national economy industries.
– Establishment of an innovation system aimed at supporting development of new products and technologies within the current industrial and cross-sectoral framework, as well as new industries with high growth potential that are based on the key enabling technologies, ensure efficient identification system of new products/ services and are able to find and support the development of new products within the current industrial and cross-sectoral framework, as well as develop new industries with high growth potential.
– Improvement of energy efficiency including development of new materials, streamlining production processes, introduction of latest technological innovation, use of alternative energy resources and other solutions.
– Development of a modern and up-to-date ICT system in private sector and public sector.
– Modern education system to meet the requirements of future labour market and to promote the transformation of national economy and the development of competences, entrepreneurial ability and creativity necessary for the implementation of the SSS priorities at all levels of education.

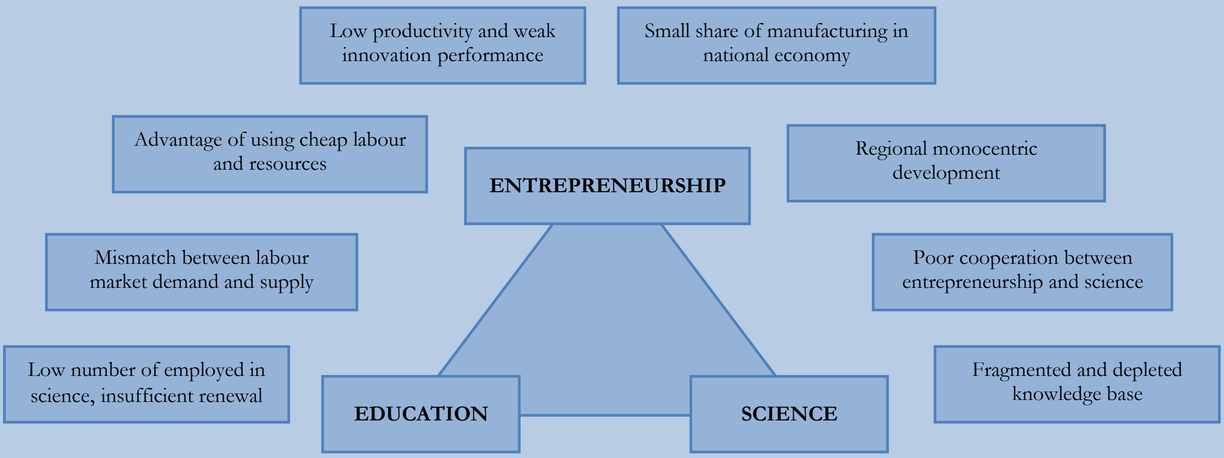
Box 6.17 continued

– Well-developed knowledge base (fundamental science and scientific infrastructure) and human capital in those areas of knowledge where Latvia has comparative advantages and which play an important role in the transformation process of national economy: knowledge areas related to the smart specialisation areas: (1) knowledge-based bio-economy, (2) bio-medicine, medical technologies, bio-pharmacy and bio-technologies, (3) intelligent materials, technologies and engineering systems, (4) smart energy and (5) ICT, as well as key enabling technologies identified by the EC (nanotechnologies, microelectronics and nano-electronics, photonics, progressive materials and production technology, bio-technology).
– Identification and specialisation of current resources of territories, outlining the perspective opportunities and directions of economic development, including the key and perspective business areas in local government territories.

Specialisation areas:
– Knowledge-based bio-economy.
– Bio-medicine, medical technologies, bio-pharmacy and bio-technologies.
– Intelligent materials, technologies and engineering systems.
– Smart energy.
– Information and communication technologies.

Figure 6.9

Identified Issues of Latvian Innovation System



The key innovation activities were implemented, according to the main directions for improving Latvian innovation system set in the *National Reform Programme of Latvia for the implementation of the EU 2020 strategy* follow:
– developing scientific activity potential;
– establishing a long-term platform for cooperation between enterprises and scientists;
– supporting development of innovative enterprises.

In 2013, implementation of several measures were continued to develop **scientific activity potential** with aim to increase the number of employed in science and research, establish competitive scientific institutions with state-of-the-art materially-technical provision (by consolidating state scientific institutions and strengthening their infrastructure).

In 2013, the Ministry of Education and Science continued to support 5 *State Research Programmes* for cross-sectoral scientific research commissioned by the state within five priority scientific directions approved by the CoM. Implementation of the existing state research programmes will be completed in 2013. Furthermore, financing in the amount of LVL 4 million has been earmarked for implementation of the programmes in 2013.

In 2013, implementation of the EU Structural Funds activity *Development of Science Infrastructure* was continued. The total public financing of the activity is LVL 103.7 million and it is implemented in two selection stages. Since the late 2011, 9 projects are being implemented within the first selection stage, thereby modernising and properly equipping 9 research centres of national importance for the total co-financing of the EU Structural Funds in the amount of LVL 56.3 million thus covering 27 public scientific institutions. In 2012, 11 projects of enterprises have been approved for the total co-financing of the EU Structural Funds in the amount of 46.3 million within the second selection stage. Projects involve development of a research infrastructure in the private sector and research service rendering to the private sector. A total of LVL 41.57 million has been paid for the purpose of improving scientific infrastructure since the launch of the projects until December 1, 2013.

In 2013, implementation of the EU Structural Funds activity *Support to Research and Development* was continued, providing support for implementation of practical research projects in the state priority science directions. Overall, decisions on approval of 122 projects for total EU funds financing in the amount of LVL 37.8 million have been adopted in the activity. In 2013, implementation of 113 projects was continued for the total EU funds financing in the amount of LVL 32.2 million. Implementation of 7 projects has been completed in previous years, while two contracts on implementation of project have been terminated in 2013. By December 1, 2013, 408 internationally recognized publications have been issued and 44 international patents have been applied within the projects.

Fostering long-term cooperation between enterprises and scientists involves measures aimed at creating better environment for commercialization of research results. The main activities in this area in 2013 have been implemented within the state support programmes *Competence Centres* and *Technology Transfer Contact Points*.

Within the programme *Competence Centres* support is provided for cooperation between scientists and enterprises in conducting of large-scale industrial research and development of new products and technologies. Competence centres are established in six sectors important to the national economy of Latvia and they are as follows: pharmacy and chemical industry, information and communication technologies, forestry sector, manufacturing of electric and optical equipment, environment, bioenergetics and biotechnology, as well as transport and engineering). The programme will be implemented until 2015 for the total public funding in the amount of LVL 37.4 million and additional co-funding in the amount of LVL 22 million is expected to be attracted from the private sector. A total of 72 enterprises and 17 scientific institutions are involved in the competence centres, while over 300 researchers are involved in the conduct of researches.

The activity of eight *Technology Transfer Contact Points* was still supported in 2012. *Technology transfer contact points* are structural units established by higher education institutions supporting and promoting the activity of knowledge and technology transfer, for example, identifying the results of commercially accomplished researches gained by higher education institutions and its institutes, gathering information on demand of entrepreneurs regarding research results, as well as bearing responsibility on maintenance of external relations and provision of information about research activities and experience of organizations, as well as providing services of industrial property rights protection. The total EU structural funds financing available for the programme until 2013 constitutes LVL 1.7 million. As a result of activity of *Technology transfer contact points*, in the time period from 2008 to December 1, 2013, commercialization offers *of* 360 research projects have been prepared, 242 patent applications (including 24 international patent applications) have been submitted, as well as 271 agreements on cooperation of enterprises and researchers were signed on carrying out commissioned researches, providing scientific services, and sale of industrial property or the right to use it. The activities implemented within the *Technology transfer contact points* have attracted financing from private sector in the amount of LVL 1.4 million.

Implementation of the *Cluster Programme* co-funded by the EU funds was continued in 2013 to promote collaboration between mutually unrelated enterprises, research, educational and other institutions, to improve competiveness of sectors and enterprises, export volumes, promote innovation and new products. The programme supports 11 cluster projects which involve at least 300 enterprises, 22 educational and research institutions, as well as several non-governmental organisations and local governments. The total public financing until 2015 is LVL 3.4 million. Maximum LVL 300 thousand is granted to one cluster. The *Cluster Programme* funded by the EU structural funds consequently originates from the cluster support activities funded from state budget resources and implemented by the Ministry of Economics in 2009-2011.

In 2013, IDAL and Ministry of Economics continued work in the high level working group of the flagship programme *Transnational Leading Programme for Innovations, Clusters and SME Networks in the Baltic Sea Region (BSR Stars)* established within the *EU Baltic Sea Strategy*. BSR Stars is aimed at strengthening competitiveness and economic growth by fostering transnational linkages between specialized research and innovation nodes, leading to strategic innovation alliances – clusters and SME networks. Since 2011, the following results have been achieved within the BSR Stars:

- the *StarDust project* has been implemented (2011–2013), comprising 5 international cluster pilot projects in the field of telecommunications (pilot project: *Mobile Vikings*, Latvian partner – Latvian IT cluster), water treatment technologies (pilot project: *Clean Water*), design of comfortable living for elderly people (pilot project: *Comfort in Living*; Latvian partner – Art Academy of Latvia), involving elderly people in social activities (pilot project: *Active for Life*), water transport (pilot project: *MarChain*,

Latvian partner – Latvian Logistics Association);
- joint call for innovation projects of *BONUS & BSR Stars* has been developed and implemented, as well as *BSR Innovation Express* Call – both activities are aimed at improving access to finance and supporting new or further developing existing cross-border innovation projects;
- development of innovation platform/network has been ensured to give students an opportunity to create demo concepts of new products or services according to the needs and orders of enterprises *(DEMOLA)*.

In 2013, **development of innovative enterprises was still supported** by implementing measures launched in the previous years and working on development of new programmes to support investments in development and introduction of new products in production, as well as support investments in development of new production plants and boost "green" technologies.

In 2013, IDAL continued providing financing to implementation of projects approved within the 1st selection stage of project application of the programme *Development of New Products and Technologies* and the 1st and 2nd selection stage of project application of the programme *Introduction of New Products and Technologies into Production* aimed at developing and introducing new or significantly improved products, technologies or technological processes in production. At the same time, IDAL continues supporting the programme *Development of New Products and Technologies – Support for Securing Industrial Property Rights*. Within all of the three programmes, 203 contracts for the total EU structural funds financing in the amount of LVL 34.4 million have been concluded, and 182 projects for the total amount of LVL 26.7 million have been completed by December 1, 2013. The approved projects are expected to attract co-funding in the amount of LVL 61.6 million from the private sector.

On September 2, 2013, IDAL started accepting project applications for the 3rd selection stage of the state aid programme *High Added Valued Investments* for the total available financing in the amount of LVL 40 million. At the same time, on October 22, 2013, the CoM approved the proposal of the Ministry of Economics to earmark additional funds in the amount of LVL 24 million for implementation of the 4th selection stage of the programme, thus allowing supporting a wider range of enterprises. The CoM also made a decision to increase the aid intensity for one project from 35% to 45%, as well as agreed to increase the maximum amount to be paid to one project up to LVL 900 thousand. At least 72 projects are expected to be supported within the 3rd and 4th stage of the programme, while the total amount of investments is likely to constitute at least LVL 144 million. In 2013, implementation of projects approved within the 2nd selection stage of project applications for the total available EU Structural Funds financing in the amount of LVL 25.6 million was continued. 14 project applications of enterprises have been approved for the requested amount of LVL 25.6 million. At the same time, implementation of 21 projects was continued in 2013 for the total financing of LVL 44.2 million approved within the first selection stage. On December 1, 2013, 15 projects for the total financing of LVL 31.7 million have been completed within both stages of the programme. The programme aims to increase the potential of Latvian production enterprises to invest in knowledge or technology-based projects, including attraction of foreign investments to high added value sectors, by supporting the purchase of production equipment, construction or modernization of production plants with an aim of promoting new jobs.

Implementation of the programme *Development Programme of New Products and Technologies of Micro-, Small and Medium-Sized Enterprises* co-funded by the EU structural funds is continued in 2013. Project applications for the programme are accepted since late 2012. The programme is targeted at promoting activities aimed at developing innovations, new products or technologies and strengthening technology transfer competiveness of micro-, small- and medium-sized enterprises. The programme provides support for outsourcing researches, protection of industrial property rights, and certification of a new product or technology. The total EU structural funds financing available within the programme is LVL 2 million. The financing per one beneficiary is LVL 10 thousand with maximum aid intensity – 60%. The programme is expected to support at least 200 micro, small- and medium-sized enterprises, by attracting co-financing in the amount of LVL 1.2 million from the private sector. By December 1, 2013, a total of 28 projects have been submitted within the programme, out of which 9 project applications have been approved for the financing in the amount of LVL 81.9 thousand.

In the second half of 2013, Latvia has been preparing for practical implementation of the programme *"Green" Industry Innovation* under the Norwegian Financial Mechanism. The programme is aimed at increasing competiveness of "green" enterprises by promoting environmentally friendly solutions in various sectors and developing green innovations and "green" business. A Technology Incubator is planned to be established within the framework of the programme as a cooperation platform for developing new innovative and technology-based ideas, products and technologies, including cooperation between scientific institutions and early-stage innovative enterprises. The programme also envisages an open call for project applications aimed at providing support to enterprises for purchasing equipment that help reducing waste and emissions and promote introducing environmentally friendly solutions in production process. Total financing of the programme is LVL 8.8 million, out of which LVL 7.9 million is co-financing from the Norwegian financial instrument and LVL 0.9 million – public financing from Latvia. The planned activities of the programme are expected to be launched in early 2014.

For the purpose of educating the society and raising public awareness of innovation and entrepreneurship, as well as encouraging people to start a business and focus on development and application of innovative solutions, IDAL continued implementing the EU structural funds programme *Measures to Encourage Innovations and Business Start-ups* in 2013. In 2013, informative and educational measures have been implemented within the programme, for instance, series of practical seminars for authors of innovative business ideas and seminars on commercialization of technologies, a mentoring programme for new entrepreneurs and training course *Become an Entrepreneur in 5 days*. The innovative business idea competition *Idea Cup 2013,* networking seminars, a business TV show *Firmas noslēpums (Trade Secret)* for new entrepreneurs has also been organised in 2013, as well as Latvian innovation portal *www.innovativelatvia.lv* has been maintained. In 2013, Latvia has been preparing for implementation of several new activities, for example, to develop in Latvia the concept of open innovation model *DEMOLA* created in Finland. *DEMOLA* is a collaboration platform for students and entrepreneurs which gives students an opportunity to create demo concepts of new products or services according to the needs and orders of enterprises (in cooperation with teachers, researchers, etc.). At the same time, a new activity is expected to be implemented with an aim to promote start-up of new and innovative enterprises in their early stage, by providing the necessary consultations and knowledge to authors of business ideas and business developers on preparation and implementation of projects, including providing support in attracting external financial sources. Total EU structural funds financing available within the motivation programme for implementation of all activities until 2014 constitutes LVL 2.1 million.

At the end of 2013, the Saeima approved amendments to the Law on Corporate Income Tax envisaging improvement of corporate income tax incentive as of July 1, 2014 to promote investments of the private sector in research and development, providing a possibility to write off certain research and development costs in the year that such costs were incurred by applying a value-increasing factor of 3.

6.10. Information Society

The information society is a social development phase based on free mutual information exchange, developing a knowledge-based economy. Information society consists of the technological base (infrastructure, software), a range of information services available to the society, and of the level of individual skills and knowledge.

As a result of development of information and telecommunication technologies[1] (ICT), information and knowledge are more increasingly used in work and labour relations, education and everyday life (see Box 6.18).

On October 1, 2013, the CoM approved the *Guidelines on Information Society Development for 2014-2020* which analyse the achievements over the past seven years and define the priorities until 2020.

Some of the key policy results achieved: the high number of regular internet users, relatively high share of households with broadband internet connection, the high number of employees using computer and internet on a daily basis, as well as a relatively high share of population using distance-learning services. As regards the results not yet achieved, the main ones are the share of the ICT sector in GDP that has not been achieved, the low number of people purchasing over the Internet and the low turnover of companies from online sale.

The guidelines set the following objectives for the new planning period:

- to increase efficiency of public administration (by streamlining processes);
- to improve business environment (by improving e-commerce results);
- To improve the e-skills of people (by improving the average skills level and reducing the share of non-internet users);
- to improve access to internet (by increasing the number of households having access to internet);
- to ensure easy access to services in the electronic environment (by increasing the share of people and companies using internet for

cooperation with public and local government authorities, as well as medical treatment institutions);
- to increase investments in research and innovations (by increasing investment volumes and the share of innovative businesses).

In preparation for the new multiannual budget period (2014-2020) draft concepts and guidelines have been developed, for example, the *Concept of Development of Internet Websites of State Direct Administration and Central Public Administration Institutions, the Guidelines on Cyber Security Strategy of Latvia for 2014-2018, the Guidelines on Protection and Maintenance of Intellectual Property Rights for 2014-2018, etc.,* as well as draft informative reports, for example, *Informative Report Regarding Broader Use of Personal Identification Cards, the Informative Report Regarding Cross-border Interoperability of Electronic Signature and Electronic Identification, etc.*

Box 6.18

The role of the ICT sector

According to the CSB data, in 2012, the share of the ICT sector in GDP constituted 3.7%. In 2012, 3947 companies operated in the ICT sector in Latvia, employing more than 20.7 thousand persons, the companies' turnover reached LVL 1.9 billion, staff costs – LVL 218 million. The value added to the ICT production reached LVL 32 million, provision of the ICT services – LVL 431 million. The foreign trade balance of the ICT was negative: LVL -92.8 million, because imports amounting to LVL 517.4 million exceeded exports with LVL 424.6 million. It should be noted that in 2011 imports of ICT products increased by 10.7% while exports – by 19.3% in comparison with 2010.

According to the data of the CSB survey *Computer and Internet Usage in Households,* 72% of all households had computers and an internet connection in 2013 (households with at least one person in the age group of 16-74 years). The best situation with accessibility to computers and internet was observed for households in the Pieriga region (computers – 78%, internet – 75%), and in the Riga region (computers – 76%, internet – 76%) while in other regions, the situation was not as good – in the Zemgale region (computers – 68%, internet – 69%), Vidzeme region (computers – 68%, internet – 68%), and Kurzeme region (computers – 68%, internet – 68%) and Latgale region (computers – 65%, internet – 65%). 71% of inhabitants in the age group of 16-74 years used a computer and internet on a regular basis (at least once a week). 70% of all households had a broadband internet connection.

In 2013, 97% of all companies having 10 and more employees had computers, 94% of such companies had internet connection, and 56% of enterprises had their own website. In 2012, 93% of companies having 10 and more employees used internet for cooperation with the public and local government institutions. In 2013, 41% of all employees of enterprises used a computer connected to the internet.

At the beginning of the academic year 2012/2013, general education schools used 33.6 thousand computers in the learning process, which is about 1 computer per 6 students. 563 or 67.7% out of 831 schools with an internet connection had their own homepage on internet.

The EU structural funds financing and the financing from the state and local government budgets in the amount of LVL 104.7 million has been used for the development of electronic government and information society until 2014.

Yet, the EU structural funds financing in the amount of LVL 135.5 million is expected to be used within the next multiannual budget period (2014-2020).

Within the implementation of the measures under the Cohesion policy priority direction *Access to ICT, e-government and services* it is expected to provide support to promote balanced development of the entire territory of Latvia through construction or improvement of an electronic communication infrastructure, at the same time developing economic activity-friendly environment based on available information, reuse of public sector information, integrated ICT solutions of public sector and private sector and integration of Latvia into the European single digital market, as well as improvement of the general quality of life of people, contributing to the access to services, increasing the social productivity, reducing the administrative burden and improving mobility.

The NGOs of sectors also actively participate in building information society. The Latvian Information and Communications Technology Association (LIKTA) have developed the *ICT Sector Priority Charter.* The charter is aimed at defining clear and measurable tasks for the development of information society in Latvia for the next 5 years setting 6 key directions: a society educated in the field of ICT and equipped with the e-environment infrastructure, up-to-date e-government, ICTs-based competitive business environment, active welfare (e-health, lifelong learning) and easily accessible cultural heritage. The charter was signed on June 13, 2012. The charter was signed by several ministries, the NGOs of the sector, employers' organizations, leading higher education institutions, enterprises of the sector and other organizations.

The LIKTA should also be commended for its contribution to the euro introduction process, by adapting information systems of public institutions and enterprises.

Along with Latvia's accession to the EU, the EU initiatives related to development of the information society have become binding to Latvia.

A new aim has been set in the European Commission's communication *A Digital Agenda for Europe* adopted on August 26, 2010 (see Box 6.19) – in relation to the *Europe 2020 Strategy* to gain economic and social benefit from the digital single market based on fast and ultra-fast internet.

Box 6.19

Action Plan for the *Digital Agenda for Europe*

The *Digital Agenda for Europe* sets seven priority measures (action areas): a vibrant digital single market, improving interoperability of ICT-based tools and services, building trust and security of users, fast and ultra-fast internet access, research and innovation, enhancing digital literacy, skills and inclusion, ICT-enabled benefits for EU society, like, climate changes, health care and ageing population. The programme areas include 101 measures, among them 31 legislative initiatives and 23 measures to be implemented in the EU Member States.

The Action Plan emphasizes the following areas as particularly supported:

– *Fast and ultra-fast internet access*. In order to ensure equal access to electronic communication services all across Latvia: national implementation plan for broadband network must be developed and implemented, relevant laws and regulations must be adopted to facilitate investments in broadband networks, fully absorb the EU structural funds and the Rural Development fund financing (see Sub-chapter "Broadband internet") and implement a European radio spectrum policy programme;
– *Enhancing digital literacy, skills, and inclusion*. In order to promote development of information society by giving Latvian population an opportunity to obtain e-skills according to their education and professional activity level: to implement long-term policy for e-skills and use of digital tools and properly encourage SME's and disadvantaged groups; to implement telecommunication regulation and the provisions of the Audiovisual Media Services (AMS) Directive regarding disability; to integrate e-learning in the national policy for the modernisation of education and training;
– *Trust and security*. In order to build public trust in use of internet: to join and use the European scale *Network of Computer Emergency Response Teams*(*CERT network*); carry out large scale attack simulation and test mitigation strategies; implement hotlines for reporting offensive or harmful online content, organise awareness raising campaigns on online safety for children.

The Action Plan includes measures also in the rest of action areas. The action area *Digital single market*: implement the key Directives supporting the digital single market, including the Services Directive, Unfair Commercial Practices Directive and the Telecoms Framework, as well as adapt laws on e-invoicing. The action area *Interoperability and standards*: Apply the European Interoperability Framework (including the geospatial information) and implement commitments on interoperability and standards in the Malmö and Granada Declarations. The action area *Research and innovations*: by 2020 double annual total public spending on ICT by attracting equal private funding, and engage in large-scale pilots to test and develop innovative and interoperable solutions in areas of public interest. The action area *ICT-enabled benefits for EU society*: implement smart meters and agree on their additional functionalities, include specifications for total lifetime costs for all public procurement of lighting installations; improve interoperability of e-government; ensure conformity of single contact point of the Services Directive; agree on a common list of key cross-border public services; meet the requirements of the European Rail Traffic Management System.

In order to assess the results achieved from June 2012 to May 2013 within the *Digital Agenda for Europe (*along with the "to-do" list updated in late 2012), the European Commission has prepared the third progress report *Digital Agenda Scoreboard*. It analyses the progress of 132 policy measures and 13 targets. Overall, measures are being implemented successfully. 70 measures have already been implemented, 54 are being implemented according to the time schedule, while 8 measures are at the risk of delay. All in all, the EU has made a good progress with respect to the increase in the number of regular internet users. Internet users have purchased and used e-government services online more. The amendments to the legislation have allowed reducing considerably the prices for mobile phone roaming. Basic broadband coverage in the EU is nearly 100%, although fixed communication lines are not available everywhere. *LED lighting* is expanding swiftly. Thus, it was concluded that the targets might be achieved in all areas by 2020.

The progress report assesses the progress of the EU Member States. Latvia has made a significant progress both in broadband penetration (at least 30 Mbit/s) and ultra-fast broadband penetration (at least 100 Mbit/s), exceeding the average EU levels. However, broadband internet is mainly concentrated in cities. Also fixed communication line coverage in Latvia is one of the lowest in the EU. The report also highlights the rapid progress in buying online cross-border that previously was at very low level, and the rapid increase in the share of population using internet in communication with public administration authorities that previously was low. The report also emphasises the high use of internet outside work and home in Latvia (one of the highest in the EU), and at the same time the low share of enterprises providing their staff with portable devices for accessing the internet (one of the lowest in the EU).

On December 18, 2012, the EC assessed the progress of *Digital Agenda for Europe* and prepared an urgent 'to-do' list in digital area for the next 2 years, particularly emphasizing the role of broadband internet in fostering economic growth in Europe (see Box 6.20).

The *Memorandum of Cooperation on Establishment of the "E-skills partnership" in Latvia* was signed during the *E-skills week* in 2013 (from March 18 to 24). It was signed by the public sector, representatives of ICT sector and the NGOs in response to the European Union initiative *The Grand Coalition for digital jobs creation*.

Box 6.20

Communication of the European Commission *"Digital 'to-do' list: new digital priorities for 2013-2014*

On December 18, 2012, the EC defined an urgent 'to-do' list in digital area setting 7 main priorities for 2013-2014:
- Create a new and stable broadband regulatory environment;
- New public digital service infrastructures through Connecting Europe Facility;
- Launch Grand Coalition on Digital Skills and Jobs;
- Propose EU cyber-security strategy and Directive;
- Update EU's Copyright Framework;
- Accelerate cloud computing through public sector resources;
- Launch a new electronics industrial strategy.

Electronic services

An internet website *www.latvija.lv* has been developed as a single access point for the services of the state and local governments in Latvia. In order to improve its visual presentation, the portal was complemented with important sections "Life Events" and "Returning to Latvia".

Information on e-procurement and development of e-services is available on the website of the State Regional Development Agency (*www.vraa.gov.lv*), while the information on e-government and the policy of information society is available on the website of the Ministry of Environmental Protection and Regional Development (*www.varam.gov.lv*).

According to the data of the State Regional Development Agency, in 2012, the public and local government institutions have purchased goods in the *Electronic Procurement System* for about LVL 18.3 million (in 2011 – LVL 13.4 million), thus achieving direct and indirect savings in the amount of about LVL 4.1 million at the expense of reduced prices and administrative costs). The majority were procurements of computer technologies, medicaments, printing equipment and office supplies.

According to *Eurostat* data 17% of Latvian enterprises (except the financial sector) with 10 and more employees in 2013, used internet to offer goods and services on the Latvian Electronic Procurement System (average in the EU – 13%) and 6% in other EU countries (average in the EU – 2%).

On April 2, 2012, issue of electronic identification cards (eID) was launched. A total of 332 592 electronic identification cards have been issued as of November 1, 2013. The card is also used as the carrier of a secure e-signature (it includes 120 free of charge timestamps for signing documents with a secure electronic signature). In late 2013, the number of electronically signed documents reached 5 million (in 2013 – 1.8 million).

On September 23, 2013, the CoM committee approved the draft concept of the Ministry of Transport on online election system; however, the financing for the development and introduction of feasibility study of the system is expected to be available no later than in 2015.

Broadband internet

According to the *Eurostat* data, the number of broadband internet access lines in Latvia in January 2013 reached 23.1 (the EU average – 28.8) per 100 inhabitants (a broadband internet access line is a line where the data transfer rate is higher or equal to 144 kbit/s). In late 2012, already 98% of all internet connections ensured broadband internet speed. Besides, 43.4% of all broadband connections had speed above 30 Mbit/s (average in the EU – 14.8%) and 20% even had speed above 100 Mbit/s (average in the EU – 3.4%).

According to the data published on the internet speed measurement website *speedtest.net* of the internet research company "Ookla Net Metrics", at the end of December 2013, Latvia with the download speed of 34 Mbit/s is ranked 13th and upload speed of 24.5 Mbit/s is ranked 11th among 188 countries.

On November 9, 2011, the EC pursuant to the EU state support conditions approved the support scheme for LVL 71.5 million aimed at providing ultrafast broadband internet network all over Latvia.

The first stage of the project *Development of Next-Generation Electronic Communication Networks in Rural Regions* is expected to be implemented within the period from October 2012 until August 2015 using the ERDF financing in the amount of LVL 16.2 million and private financing in the amount of LVL 2.4 million. The project will be implemented by the SJSC "Latvia State Radio and Television Centre", establishing 165 internet access points and installing optical cable lines of 1900 km in length, thus providing a quality internet connection with a speed from 30 to 100 Mbit/s to the citizens and enterprises and eliminating the gap between urban and rural areas. Yet, construction of new access points and installation of optical cables are planned to be continued within the second stage of the project. The second stage is expected to be finished by 2018. The expected funding is LVL 55.3 million (including the EU structural funds).

In order to identify development directions of next-generation electronic communication networks, on December 7, 2012, the Cabinet of Minister approved the draft solutions proposed in the *Concept for Next-Generation Broadband Electronic Communication*

Network Development for 2013-2020 that envisage further development of grids, new optical internet access points in rural municipalities (281 territorial unit), attracting new electronic communication companies to network development, state aid programmes for establishing local loops ("last mile" connections) and other measures.

In order to promote private investments in 4G network development, CIT allowances will be granted to the biggest investors. On May 21, 2013, the Cabinet of Ministers approved granting the CIT allowance to LLC "Latvijas Mobilais Telefons" for the implementation of the investment project "Development of Next Generation Mobile Communication Network in Less Densely Populated Territories", as well as on November 26, 2013 it approved granting this CIT allowance to LLC "Bite Latvija" for the implementation of the investment project "BITE 4G network development outside the biggest cities of Latvia".

On June 18, 2013, the CoM approved the amendments to the legislation that envisage an opportunity to locate access points to electronic communication optical networks free of charge at private persons' property within the framework of the state support programme project *Next Generation Networks in Rural Territories*. Such a decision makes it possible not to raise the price for internet access services, thus ensuring the same prices in rural territories as in cities and towns.

Combating computer piracy

According to the data of the international software copyright protection organisation "Business Software Alliance" (BSA), the level of computer piracy in Latvia in 2011 reached 54%. The losses to the Latvian economy caused by piracy have constituted LVL 16 million (EUR 23 million).

The BSA campaigns "Secret Buyer" conducted on a regular basis revealed that the share of honest sellers of computer software was tended to increase. In 2011, 52% of software sellers had positive attitude towards the use of pirated software, while in 2013 – 32%. Over this period, the number of Latvian sellers offering pirated software dropped from 29% to 5%.

E-commerce

According to the *Eurostat* data, 32% of Latvian population in 2013 have ordered goods or services online (the EU average – 47%), while 15% of the Latvian population ordered goods or services online from other EU countries (the EU average – 12%).

In 2013, 22% of all enterprises (except the financial sector) with 10 and more employees had purchased goods or services over the internet or other computer networks (the EU average – 37%). However, 10% of all enterprises (except the financial sector) with 10 and more employees had sold goods or services over the internet or other computer networks in 2013 (the EU average – 17%). The turnover of e-commerce constituted 8% of the total turnover of these enterprises (the EU average – 14%).

6.11. Competition Policy

The Competition Council (CC) is responsible for implementation of the competition policy in Latvia ensuring protection of competition by promoting reduction of administrative obstacles, liberalisation of markets and enterprise activities under conditions of strong competition, to ensure that consumers can choose various high quality goods and services. In order to raise the overall public awareness about the positive impact of fair competition on public welfare, to enable the society to identify violations of competition rights and to become intolerant with respect to such violations, the CC carries out public information measures and other measures promoting competition.

The work of the CC is performed in compliance with the *Competition Law*, other regulatory acts, and the operational plan of the institution covering such significant activity directions as:

– protection of competition;
– promotion of competition.

Protection of competition

Protection of competition comprises activities directed against the following violations of the *Competition Law*: prohibited agreements and abuse of a dominant position. The CC also controls mergers of enterprises.

The priority of the CC is identification and prevention of the most severe breaches of the *Competition Law* – prohibited agreements and dominant position abuse.

The *Competition Law* defines several areas, where an agreement between market participants is prohibited, because its purpose or consequences hinder, restrict, or distort the competition, including participation or non-participation in competitions or auctions or regarding the provisions for such actions (inactions). The CC initiated an investigation of a possible breach of this particular norm against more than 300 energy construction procurements (see Box 6.21).

Box 6.21

<u>The CC fines 26 energy construction companies for participation in a cartel</u>

On June 17, 2013, the CC made a decision to fine 26 companies dealing with energy construction for distortion of competition and rising prices altogether in more than 300 procurements. A fine for the total amount of LVL 2 million was imposed on the companies.

A prohibited agreement resulted in distortion of competition in a total of 316 procurements organized by JSC "Latvenergo" and JSC "Sadales tīkls", three procurements of SJSC "Latvijas Dzelzceļš", two procurements of LLC "LatRosTrans" and a procurement organized by CBF LLC "Binders". These commissioning parties purchased construction works of electrical installations and infrastructure (for example, installation, repair and modernization of power lines). The works were mainly performed in Latgale and Vidzeme and the procurement amounts ranged from several thousands to 150 thousand lats.

The energy construction companies fined had concerted their participation in the given procurements from 2006 until initiation of the infringement case by the CC, thus eliminating competition and taking away the possibility for clients to get lower prices adequate for the market situation. A prohibited cartel agreement was implemented according to the following scheme – an applicant who had previously agreed to win the procurement either sent ready estimates to competitors or instructed them on the exact number they should bid or sent its own estimates and asked competitors to increase their bid.

Considering the duration of the infringement and the severe damage to particular commissioning parties and their clients, the CC has imposed significant fines on the companies involved in the infringement. The fines are calculated as a percentage of undertakings' net turnover of the previous financial year, taking into account the duration and severity of the infringement. Thus higher fines were imposed on those companies which had participated in more cartelized procurements. In terms of percentage the CC has applied the highest fines since its inception.

The commissioning party *JSC Sadales tīkls/JSC Latvenergo* had an important role in this infringement – both companies clearly ignored irrational similarities in proposals of the applicants. Representatives *JSC Sadales tīkls/JSC Latvenergo* also had close contacts with certain applicants of the procurements. Yet, the requirements of *JSC Sadales tīkls/JSC Latvenergo* for certain number of applicants contributed to the motivation to imitate competition.

Initial information on the alleged infringement the CC received from the Corruption Prevention and Combating Bureau (CPCB). This institution had also initiated a criminal investigation against officials of *JSC Latvenergo* and *JSC Sadales tīkls*. During the case investigation the CC found that even more construction companies had participated in the cartel than it could be seen from the CPCB's data.

The *Competition Law* stipulates that any market participant in a dominant position is prohibited to abuse it in any way within the territory of Latvia. Abuse of the dominant position may be also a direct or indirect imposition or application of unfair purchase or sales price or other unfair trade conditions. The CC detected a breach of this particular norm in the activities of *JSC Latvijas Gāze* (see Box 6.22).

Box 6.22

<u>The CC commands *JSC Latvijas Gāze* to change its debt recovery practice</u>

On October 1, 2013, the CC made a decision identifying that *JSC Latvijas Gāze* has abused its dominant position by refusing to sign natural gas supply contracts with new users before they had paid previous users' debts. *JSC Latvijas Gāze* has been ordered to halt its unfair practice, and subjected to a fine of LVL 1.6 million.

Although *JSC Latvijas Gāze* may appeal the CC decision to court, violations that were uncovered by the CC must be eliminated immediately after the company receives the final decision of CC.

Natural gas consumers – households and companies – that have suffered due to the unfair practice of *JSC Latvijas Gāze* can turn to the company with a claim to compensate money they paid to cover other consumers' debts. If *JSC Latvijas Gāze* refuses to compensate the losses, the affected consumers have the right to turn to a court of law.

During investigation of the case, the CC was reported more than 500 episodes where *JSC Latvijas Gāze* refused to sign natural gas supply contracts with new users until they had paid other users' debts. After having analysed the reports, the CC identified the following types of violations:

– *JSC Latvijas Gāze* demanded new owners to pay debts owed by previous owners or tenants;
– new owners were asked to pay the debt of a company-tenant that used premises for economic activities;
– new tenants were asked to cover the debt of a previous tenant (not current tenant) or a tenant of previous owner;
– *JSC Latvijas Gāze* asked a company that uses premises for economic activities to cover the debt of previous owner or other company that has rented premises from the previous or current owner.

In its decision the CC explains than in case *JSC Latvijas Gāze* is unable to make debtors pay their debts for gas, new consumers of the company not only have to pay the debt but also cover its recovery cost. Such practice of *JSC Latvijas Gāze* also increases the volume of such debts, because clients have no motivation to pay for the service knowing that the new owner will be held liable for these debts. *JSC Latvijas Gāze* itself is not actually motivated to timely engage in debt recovery to prevent the debt from growing. Such practice of *JSC Latvijas Gāze* is possible largely because there is no competition in this market. New users have no possibility to choose another service provider, which would supply gas without imposing debt commitments pertaining to other persons.

Box 6.22 continued

At the same time the CC in its decision defines exclusions when *JSC Latvijas Gāze* has the right not to sign a contract with a new user until the debt pertaining to another person is paid:

– a manager, tenant or lessee wants to sign the contract, and the existing owner has a debt for natural gas supply – these potential users may easily find other premises, while the owner has a motivation to pay the debt, otherwise it will be difficult for him/her to lease the premises. The same condition is applied if the debt is made by the previous tenant of the current owner;
– *JSC Latvijas Gāze* has refused to sign the contract with an owner or a manager because the tenant has a debt. Such a procedure is established by the *Regulations Regarding Supply of Natural Gas* imposing a responsibility on the owner to make sure that a tenant pays for the consumed natural gas before the deadline specified in the contract;
– in order to prevent debtors from changing owners of premises maliciously to avoid paying their debts, the CC has no objections to practices of *JSC Latvijas Gāze* not to sign gas supply contracts with new tenants who live in the same household as the owner (for example, they have the same declared address). *JSC Latvijas Gāze* also has the right not to sign contracts with a company that rents premises and is considered to share the same market as the owner of the property being rented (for example, the two companies have the same owner).

Considering the large amount of natural gas consumers, there may be also other exceptions. However, *JSC Latvijas Gāze* itself should further assess each individual case. Since the company has a dominant position in the market, it has a duty not to abuse the market power.

The CC emphasizes that its decision shall not be interpreted as a reason for *JSC Latvijas Gāze* to increase tariffs. The current tariff calculation methods do not allow such practice of *JSC Latvijas Gāze*. Besides, the complaints reviewed by the CC show *JSC Latvijas Gāze* attempts to recover old debts from new tenants apply to 5% of total volume of *JSC Latvijas Gāze* debts.

The CC carries out merger control of market participants, if the total turnover of the merging participants in the preceding financial year has been at least LVL 25 million or if their total market share in the particular market exceeds 40%. The *Competition Law* stipulates that before the merger, these market participants have to submit a notification about the planned operation to the Competition Council.

The CC has the right to prohibit a merger by a decision if that merger creates or strengthens a dominant position. A merger may be prohibited also if the merger substantially reduces competition in any particular market. If the planned merger causes no significant impact, the CC adopts a permitting decision on the merger. Yet, in order to prevent negative consequences regarding competition in the market, the CC may permit the merger by imposing binding conditions on merger participants. Such CC permit on conditions was granted to *UAB Malinvest* and *JSC Rīgas Dzirnavnieks* (see 6.23).

Box 6.23

<u>The CC imposes conditions on millers' transaction</u>

On July 29, 2013, the CC made a decision to permit the Lithuanian company *UAB Malinvest* to purchase shares of *JSC Rīgas Dzirnavnieks*, thus acquiring decisive influence over the company. So far, the largest shareholder of *JSC Rīgas Dzirnavnieks* was Sweden Company *LANTMANNEN CEREALIA*. In order to prevent any damage to competition, merger participants have to observe conditions of the CC regarding production and sale of flour in Latvia.

According to the CC decision, after the merger *UAB Malinvest* and *JSC Rīgas Dzirnavnieks* and their associated companies (for example, *UAB Malsena Plius* – one of the largest and most advanced grain processing companies in Lithuania) have to sign a long-term contract, at least for six months, on delivery of flour whenever Latvian customers request such a contract.

The CC decision also imposes an obligation on *JSC Rīgas Dzirnavnieks* to deliver wheat flour to industrial customers in Latvia for five years after the merger and to ensure the same assortment and quality as now. While the necessary assortment and volume of rye flour should be delivered at least for three years after the merger as far as possible in terms of financial situation and production capacity.

The abovementioned binding conditions are aimed at preventing risks caused by a merger of mutually competing companies, and in particular, to maintain the activity of *JSC Rīgas Dzirnavnieks* as an industrial supplier of wheat and rye flour which is important for Latvian producers of bread and pastry products.

JSC Rīgas Dzirnavnieks produces and sells all types of wheat and rye flour, flour mixes, flakes and other grain products to bakeries and confectionaries, as well as products in small packages to end users. The company closed year 2012 with losses.

Up to the merger two effective competitors – *JSC Rīgas Dzirnavnieks* and *JSC Dobeles Dzirnavnieks* – operated in the market of wheat flour for industrial customers in Latvia, but *UAB Malsena Plius* could be considered as a potential competitor. Yet, the rye flour, in its turn, is sold also by other larger producers, for example, *JSC Jelgavas dzirnavas*, where modernization has been recently implemented and which has the ability to significantly increase sales of rye flour.

Competition promotion

This direction of activities includes market supervision and research, as well as development of the competition culture in the society. The task of the CC is to focus on gathering and analysing comprehensive information on the competition situation in various markets, promotion of competition in markets with no competition or insufficient competition, improvement of public awareness about the positive impact of competition on public welfare.

By obtaining information on specific markets within the framework of market supervision, the CC analyses the competition situation, and if necessary, develops and submits proposals for improvement of the competition situation to responsible authorities, as well as checks the supervised markets for violations of the *Competition Law*.

One of such supervisions was carried out in the free trade market of electricity. Within the framework thereof, the CC concluded that companies buying electricity on the free market at the moment have a possibility to easily change suppliers. Moreover, the existing suppliers can successfully compete with prices and contract provisions, and therefore competition on the electricity trade market may intensify. However, an essential condition for competition after the expected market opening to supply electricity to households in the future is to set a reasonable deadline for market opening in order to give potential market participants a possibility to plan their operation on this market.

In order to observe the activities related to introduction of the euro, the CC is carrying out a broader control of pricing practices on the markets. The CC also cooperates with the Ministry of Economics and the CRPC to make sure that companies compete with each other on the main consumer markets without entering into prohibited agreements that causes artificial increase in prices. Currently, as a part of the supervision of introduction of the euro, the CC supervises also price changes on several major consumer goods and services markets. The CC in its work also uses the data of price monitoring conducted by the Ministry of Economics, assessing weekly price fluctuations of certain food and non-food product groups, analysing relations within a retail trade chain and among competing retail trade companies in various Latvian towns and cities.

In order to make application of the Competition Law more efficient and easier for entrepreneurs, amendments to the said law have been forwarded for public discussion. These amendments contain improvements to prevent shortcomings identified so far. Preparation of the amendments is based on the EU Court opinions and practice of other EU Member States. The amendments increase the opportunity for enterprises to get exempted from the fine, to explain the CC their opinion and receive a compensation for the losses caused by distortion of competition. The procedure for merger control has also been made efficient, as well as the possibility for the CC to force companies to pay the fines and fulfil the obligations imposed on them has been strengthened. And the CC now has an opportunity to focus its resources on investigation of the most severe violations.

6.12. Export Promotion and Foreign Investment Attraction Policy

In order to achieve the "economic breakthrough" of Latvia referred to in the *National Development Plan* and to successfully implement the objectives set in the Guidelines on National Industrial Policy, the Cabinet of Ministers approved the ***Guidelines for Export Promotion of Latvian Goods and Services and Attraction of Foreign Investment in 2013-2019*** in the meeting on May 28, 2013. Successful implementation thereof depends directly on implementation of the Guidelines on National Industrial Policy which outlines the directions of the necessary structural reforms.

Improvement of competitiveness of Latvian enterprises, targeted measures to attract foreign direct investments and support to enterprises for accessing foreign markets are the key strategic objectives defined in the guidelines that will ensure favourable environment for investments in Latvia and promote its international recognition and facilitate entry of Latvian enterprises in foreign markets.

The guidelines define the key aims, principles, and main directions of action of export promotion and foreign direct investment (FDI) attraction policy for the next seven years. Successful implementation of the guidelines requires a single and dynamic cooperation model for all parties involving public and local government authorities and the private sector and scientific institutions alike.

Particular measures in these directions of action are implemented pursuant to the *Action Plan for Export Promotion of Latvian Goods and Services and Attraction of Foreign Investment for 2013-2019,* which is added to the guidelines document.

Attraction of Foreign Direct Investments

The FDI attraction policy is aimed at improving competitiveness of Latvia as investment-friendly environment, based on the aspects important for investors: macroeconomic indicators of the country, business environment – simple bureaucratic procedures and a stable tax policy, access to properly qualified labour, market potential, access to the necessary infrastructure, offered support instruments and incentives. It is important to attract foreign investments to industries that ensure changes in the structure of national economy in favour of foreign demand-oriented[1] industries, particularly medium-high and high technology industries[2].

FDI play an important role in the promotion of further economic growth in Latvia both through acquisition of industrial and management skills and creation of new jobs, thus giving an opportunity to apply new technologies and preconditions to technology transfer, promoting integration of the country in international trade and involvement of enterprises in industrial sales chains.

Foreign investment attraction should be primarily aimed at geographically close neighbouring countries where Latvia is recognised and no extra resources are required for informative measures, economically stable and developed countries with growth potential and needs of sectors of national economy that meets the perspective cooperation possibilities of Latvia, as well as countries that ensure largest global investment outflows – USA, France, Germany, the United Kingdom of Great Britain and Northern Ireland, Japan, China, Russia, and India.

In order to compete successfully in the foreign investment attraction market and to improve the progress of local and foreign investment projects of national importance, since 2010, IDAL has been **implementing** the investment attraction **methodology *Polaris*** envisaging unified and coordinated activity of ministries, municipalities, infrastructural companies, and public institutions in implementing strategically important domestic and foreign investment projects, as well as involvement of the private sector, universities, and research institutions.

The Coordination Council for Large and Strategically Important Investment Projects established in 2010 ensures coordinated interagency cooperation for successful implementation of investment projects; the Council is composed of the Ministers of Economics, Transport, Finance, Foreign Affairs, Environment, Agriculture, Regional Development and Local Governments, Education and Science, as well as the involved representatives from state and municipal institutions, infrastructural companies, non-governmental organizations, and other experts.

The Council meetings deal with issues of investment attraction strategy and activities to be carried out; identify problematic issues that hinder the progress of investment projects, for example, improvement of electricity connection and its quality in industrial areas, as well as instructions to solve such issues have been assigned to the responsible institutions thus ensuring successful implementation of investments projects.

In order to concentrate available resources in a more targeted way and to increase the return on them in the FDI attraction, they contain the key principles for further action:

- An expanded and active FDI attraction methodology – *POLARIS process*, according to which all further activities related to investment attraction are carried out;
- Investment attraction marketing activities.

Taking into account the limited resources, activities for FDI attraction in 2013–2015 are planned to focus on few target countries (the Nordic countries, Germany, the United Kingdom) and certain target sectors – metal processing and engineering industry, wood industry and information technologies, including establishment of shared service centres.

With the present tax incentives to promote investments and develop a business-friendly environment in Latvia, on March 13, 2013, the Cabinet of Ministers approved the Regulations Regarding Sub-activity *1.3.1.1.6 **"Support to create jobs"** of the Supplement to the Operational Programme "Human Resources and Employment"* aimed at increasing the number of well-paid jobs and growth of added value and export. All of the six project submitted within the activity have been supported for the total amount of LVL 17.17 million, out of which LVL 4.54 million is the EU structural funds financing. At least 863 new jobs are expected to be created. Four of the supported projects involve combined office administrative services; one of the project applications has been submitted by a plastic packaging manufacturer, while another one – by a car manufacturer.

[1] Foreign demand-oriented industries – agriculture, mining and quarrying, manufacturing, transport and storage, information and communication services

[2] Medium-high and high technology industries – manufacture of pharmaceutical products, computers, electronic and optical products, air and spacecraft and related machinery and medical instruments, and manufacture of chemicals and chemical products, weapons and ammunition, electrical equipment, machinery and work equipment, motor vehicles, ships and boats, railway and other transport (except aircraft) and repair and installation of machinery and equipment (NACE Rev. 2. 20, 25.4, 27, 28, 29, 30 (except 30.3), 33)

In order to promote development of manufacturing companies, on May 21, 2013, the Cabinet of Ministers approved the *Regulations Regarding Sub-activity 2.3.2.2.2 "**Support for Investments in Construction or Reconstruction of Industrial premises**" of the supplement to the Operational Programme "Entrepreneurship and Innovations""* which is a new support programme co-financed by the EU structural funds for construction or reconstruction of industrial premises. The activity is aimed at establishment or expansion of new enterprises, by developing industrial premises in regions. Construction, renovation or reconstruction of one or several buildings is supported within the project for the purpose of creating industrial building. The total financing available within the activity is LVL 12.6 million. The maximum support financing for one project is LVL 1 million. The maximum acceptable support intensity is 50%. According to the provisions of the activity, the project applicant has to lease the commissioned building to at least three mutually unrelated micro, small- or medium-sized manufacturing enterprises, which will create at least 50 new jobs. These enterprises must not be related to the project applicant. Currently, 9 projects have been applied for the support for the total requested support amount of nearly LVL 8 million. In this activity, projects are expected to be implemented in Daugavpils, Jelgava, Jūrmala, Liepāja, Rēzekne, Valmiera and Ventspils or near these cities. Project evaluation is expected to be completed by the end of 2013.

In order to promote large investment attraction to Latvia, the amendments to the *Law On Corporate Income Tax* came into force on January 1, 2011 envisaging reintroduction of **the corporate income tax rebate** for initial long-term investments **made within the scope of eligible investment projects** that ensure the commencement of a new activity profile or modernisation or expansion of the current activity, which includes manufacture of new products, changes in the current activity, transferring from the manufacture of one type of products to the manufacture of another type of products or from the provision of one type of services to the provision of another type of services, or essential changes in general activity processes. As of January 1, 2014 the minimum amount of initial long-term investments giving the right to apply for the corporate income tax rebate is EUR 10 million.

The abovementioned tax rebate is classified as state support and valid until December 31, 2020. It is applied to industries with high export potential or significant contribution to increase in value added and exports pursuant to the national medium-term priorities defined in 2009.

According to Section 17^2 of the *Law On Corporate Income Tax,* a taxpayer has the right to apply a tax rebate to initial long-term investments made within the scope of a supported investment project in the amount of 25% of the total initial amount of long-term investments up to LVL 50 million and in the amount of 15% of the total initial amount of long-term investments for the part, which exceeds LVL 50 million.

By December 1, 2013, the CoM has supported 13 eligible investment projects for the total investment amount of LVL 124.8 million (EUR 177.6 million, which might reduce the future corporate income tax payable to the government budget by LVL 28.8 million (EUR 41 million).

Additional information about attracted foreign direct investments is available in Section 4.3.3.

Export support instruments

Latvian exporters are offered a wide range of direct export support services, covering consultations on export-related issues, including foreign markets, specific trade requirements and search for business partners. Furthermore, export skills and informative seminars about external markets are organized and identification and fostering of export and investment projects is carried out.

In the nine months of 2013, the IDAL has supported participation of 34 Latvian entrepreneurs in 17 international exhibitions arranged national stands of Latvian enterprises in 16 international industry (construction, IT, food, textile, etc.) exhibitions abroad, thus involving a total of 94 enterprises. In this period, the IDAL has organized 24 trade missions, involving 386 entrepreneurs, to USA, Azerbaijan, Denmark, Italy, Japan, Kazakhstan, Russia, China, Great Britain, Lithuania, Moldova, the Netherlands, Finland, Turkmenistan, Ukraine, Germany, and Sweden, and 34 individual visits of Latvian entrepreneurs to Denmark, France, Japan, Lithuania, Ukraine, Germany and other countries, provided 374 initial consultations on foreign markets and search for business partners to Latvian entrepreneurs, as well as concluded 254 cooperation agreements.

In 2013, activity of Foreign Economic Representative Offices of Latvia was ensured in Belarus, Denmark, France, Japan, Russia, China, Great Britain, Lithuania, the Netherlands, Poland, Ukraine, Germany, and Sweden. The representations provide support to Latvian companies in developing and keeping business contacts, implementing external marketing measures, and provide information about requirements of particular foreign markets.

Services of the Foreign Economic Representative Offices of Latvia and IDAL are provided to the entrepreneurs according to the one-stop agency principle, thus the representations arrange individual business visits of entrepreneurs, provide support for participation of enterprises in international exhibitions abroad, processes export requests and projects, and ensure processing of consultation requests and information requests in the field of foreign investment attraction.

Activity 2.3.1.1 ***Access to International Trade Markets – external marketing*** is implemented within the framework of the measure *Entrepreneurship Support Activities of the Operational Programme of the EU Structural Funds for 2007-2013 Entrepreneurship and Innovations*. Within the framework thereof, merchants are offered extensive support in implementation of international marketing measures – participation in exhibitions, business matchmaking, trade missions, organizing seminars and conferences.

In 2013, the Council for Coordination of Foreign Economic Policy continued the work on ensuring coordinated cooperation between public institutions and entrepreneurs in developing and implementing successful foreign policy to improve competiveness of the Latvian economy and strengthen exportability. The schedule of visits abroad of public officials for 2013 involving Latvian entrepreneurs was presented at the beginning of the year and updated on a regular basis. The schedule makes it possible for entrepreneurs to duly plan participation in business delegations, while organizers of the visits have a possibility to timely identify interests of entrepreneurs.

In 2013, the design contest for Latvian exposition at the exhibition *World Expo 2015* to be held from May 1 until October 31, 2015 in Milan was organized to find the best and most original solutions for architecture of the Latvian pavilion and content of Latvian exposition. After evaluating 10 proposals, the judges decided not to award the first place but continue negotiations with two runner-ups to take the final decision on the winner during the negotiations.

The IDAL in cooperation with the Ministry of Economics organized the contest *Export and innovation awards* for the ninth year in a row. The contest is aimed at appreciating and honouring the most successful Latvian entrepreneurs for producing both new and exportable products and providing high quality local products to the domestic market, implementing innovations and developing industrial design. Winners of the contest *Export and innovation awards 2013* are listed in Box 6.24.

Box 6.24

Export and innovation awards 2013

The IDAL in cooperation with the Ministry of Economics has organized the contest *Export and innovation awards* for the ninth year in a row, evaluating the most successful enterprises and their products in the following categories:

- Best exporter in large/medium partnership group;
- Best exporter in small partnership group
- Innovative product;
- Industrial design;
- Import substitute product;

The winner of category *Leading exporter* is found by evaluating the largest Latvian exporter based on data and contribution to sustainable growth.

119 applications were submitted for participation in the award *Export and Innovation Award 2013*.

The winners of the *Export and Innovation Award 2013*:

- category *Best exporter in large/medium partnership group*:
  1. LLC "VALPRO";
  2. JSC "RĪGAS ELEKTROMAŠĪNBŪVES RŪPNĪCA";
  3. LLC "V.O.V.A.";
- category *Best exporter in small partnership group*:
  1. LLC "KNOWLEDGEPRICE.COM";
  2. LLC "LATLAFT";
  3. LLC "DIGITĀLĀS EKONOMIKAS ATTĪSTĪBAS CENTRS";
- category *Innovative product*:
  1. LLC "PERUZA" Small Fish High-Speed Nobbing machine;
  2. LLC "ISTABAI" Remote control tool for home heating;
  3. LLC "HUGLOCK" universal furniture – connection system "HugLock";
- category *Industrial design*:
  1. LLC "MAFFAM FREEFORM" hanging basalt fibre chair "MANU Nest";
  2. LLC "MGS FACTORY" wooden run bike "DIP DAP" and its packaging;
  3. JSC "RĪGAS PIENA KOMBINĀTS" ice cream "Nu Fruit";
- category *Import substitute product*:
  1. LLC "PAPĪRFABRIKA "LĪGATNE"" Recycled White Drawing, Watercolour and Office Paper;
  2. LLC "UNITED OILS" Motor Oil and Technical Fluid Product Line "MAGNA";
  3. LLC "NP FOODS" Gutta drink "ColaDeLuxe".

Winner of the title *Leading exporter 2013* is JSC "UPB".

In order to promote the increase of the total export volume of enterprises (especially to countries with a high risk degree) and expand the export markets (the CIS region, rapidly growing economies, etc.), as well as to secure positions in the existing export markets, short-term export credit guarantees are available and described in more detail in Section 6.8 of the Report.

6.13. Consumer Rights Protection and Market Surveillance

The Consumer Rights Protection Centre (CRPC) is the main institution ensuring coordination in the field of supervision of laws and regulations regarding the protection of consumer rights, and it works to guarantee the protection of consumer rights and interests. In order to ensure implementation of functions of the institution, the CRPC implements activities for the supervision of consumer rights observation (both in the field of protection of consumers' economic interests and supervision of compliance with consumer rights in draft contracts and contracts concluded by consumers and producers, sellers, or service providers), considers consumers' complaints, provides information and consultations to consumers and entrepreneurs, implements supervision measures of unfair commercial practice, e-commerce, and advertisements, supervision measures of safety and conformity of goods and services, carries out national metrological supervision, supervision of dangerous equipment and investigation of dangerous equipment accidents.

Box 6.25

Performance of the CRPC in the nine months of 2013

In the nine months of 2013, the CRPC has provided 26 197 **consultations** to consumers and legal entities. The number of rendered consultations has decreased by 1% compared to the corresponding period a year ago. When requesting a consultation, consumers most often have been interested in issues related to their rights if they have purchased a product or received a service of poor quality. Most of questions are related to footwear, mobile phones, electric appliances, distance contract services, electronic communication services, rent and public utilities services and aviation. Consumers have been interested also in issues beyond the competence of the CRPC or issues on which the CRPC have no right to make a binding decision, jut provide consultations, for instance, quality of electronic communications, payments of insurance compensation, as well as public utilities and food products.

In the nine months of 2013, the CRPC has received 1648 consumer **complaints**. Most often consumers have filed complaints concerning goods and services incompliant with contract provisions. A large number of complaints have been about commercial practice, advertising and e-commerce, as well as failure to observe the principle of legal equality of contracting parties. Out of all received complaints, the majority concerned footwear quality, followed by electronic goods and mobile phones. In the field of services, the majority of complaints concerned aviation, rent/public utilities services, as well as electronic communication services.

Box 6.26

Euro introduction measures

In 2013, the legal framework has been improved to ensure a transition to euro as of January 1, 2014, as well as to keep prices for goods and services stable. The Ministry of Economics is implementing several important measures:

– Monitoring prices for goods and services in the framework of which prices for most popular goods and services are observed in more than 400 points of sale or service provision locations in the largest cities and towns of Latvia. Since October 1, information on the monitoring results is published four times in a month. According to the price monitoring results of the ten months of this year, in 86% of cases the prices for goods and services have not been changed, in 7.1% of cases the prices have been increased, while in 6.7% of cases – decreased. Price fluctuations mainly rely on seasonality, as well as the rise in world prices for raw materials and other resources like fuel and energy resources. Monitoring results show that the price level for goods and services is stable and current fluctuations depend on processes that have no connection with introduction of the euro. Price monitoring is expected to be implemented also in 2014;
– Initiative Fair Euro Introducer has been implemented with an aim to protect consumer interests, by asking entrepreneurs to provide accurate and correct recalculation of prices, as well as price displaying before and after introduction of the euro. By the end of November 2013, over 1200 merchants have joined the initiative and the recognition sign of the initiative has been placed in more than 10 thousand points of sale or service provision places.

Participation of a lecturer in regional seminars has also been ensured to inform people about changes in the procedure for using cash registers, reprogramming of cash registers (cash register instructions), reflecting the total amount of transactions in invoices, bills of lading and other documents confirming transactions, the dual circulation period of the lats and the euro, changes in the field of accounting and tax payments, the procedure for displaying prices; to explain practical examples of price tags, exceptions of the procedure for displaying prices during the dual *display period* of *prices, control measures, as well as to provide information on the business initiative Fair Euro Introducer*.

Box 6.26 continued

As regards the dual *display period* of *prices –prices for goods and services must be displayed in lats and euro in the period from October 1, 2013 to June 30, 2014* – price control will be ensured to supervise compliance with the requirements in points of sale or service provision locations. Supervision is carried out by the CRPC. The mandatory requirements to display prices in both currencies have been imposed to protect consumer rights and to help consumers to make an information-based and economically justified decision.

Within the protection of consumers' rights the CRPC in 2013 has identified such priority areas as protection of collective interests of consumers in the field of consumer crediting, vehicle rental services, collective online shopping, waste management, driving school services, supervision of commercial practice of food supplements, supervision of security guarantees and contract provisions offered by complex tourism service providers to consumers, supervision of commercial practice applied outside regular point of sales or place of service provision, supervision of commercial practice related to online plane ticket pricing, assessment of commercial practice in the field of price comparison websites. In the nine months of 2013, implementation of 9 surveillance projects has been launched or carried out (see Box 6.25).

In the nine months of 2013, the CRPC has adopted 13 binding decisions regarding violations of collective interests of consumers within the supervision of commercial practice. The key issue in the nine months of 2013 was consumer crediting, particularly in the field of fast loans. Taking into account the issues and trends identified in the field of consumer crediting, the CRPC developed guidelines *Assessment of Consumers' Ability to Repay a Loan to Creditors that Do Not Conform to the Status of a Credit Institution* to prevent misinterpretation of the CRPC regulations regarding assessment of paying ability. In order to prevent unfair commercial practice in the field of consumer crediting advertising, the *Guidelines on Fair Commercial Practice in the Field of Consumer Crediting* has been developed.

Considering the large number of requested consultations and growing consumer complaints, the CRPC in 2012 launched a surveillance project of commercial practice and contract provisions when signing contracts with consumers and applied commercial practices in the field of collective online shopping. The project was continued until July 2013. Within the project implementation the CRPC carried out inspections of 31 collective shopping websites offering consumers to buy e-coupons for purchasing different products and services. As a result of the inspections of websites the CRPC has detected nonconformities in all websites, including unfair (non-compliant with professional diligence, misleading) commercial practices, advertising noncompliant with legislation and unfair/unclear contract provisions. After having evaluated the information obtained, the CRPC found it would be *useful to develop Guidelines on Fair Commercial Practice in the Field of Collective Online Shopping*. In order to raise consumer awareness, the CRPC has developed consumer tips for purchasing goods and services on collective shopping websites/coupon websites based on collected information, including an analysis of consumer complaints and market trends. These tips have been published on the CRPC homepage.

The European Consumer Centre (ECC Latvia) continues providing support and information to consumers in case of unsuccessful **EU cross-border purchases**. ECC Latvia is a member of the *European Consumer Centres Network* (ECC-NET) operating within the framework of the Consumer Rights Protection Centre with the support of the European Commission. In the nine months of 2013, the ECC Latvia has provided 357 consultations to consumers concerning cross-border issues in the EU and reviewed 162 complaints on cross-border issues in the EU. An important measure implemented by the ECC Latvia is the campaign *Know and Travel* implemented at the Riga International Airport in cooperation with the CRPC within the European Passenger Rights Day. The campaign involved a survey on air passengers' awareness of their rights when travelling in the EU and other activities. The ECC Latvia also participated in the campaign organized by the European Commission to raise public awareness of passenger rights in the EU, in the framework of which a survey on passenger rights in the EU and other informative activities were carried out at the Riga International Coach Terminal.

In 2013, the CRPC in the field of **market surveillance** has identified such priority directions as safety and conformity improvement of products in such areas as construction materials, electric goods, machinery, personal protective equipment, toys, children's bunk beds, louvers, bijouterie, sky lanterns, as well as supervision of skiing slopes, playgrounds and inflatable attraction places. Moreover, a price surveillance project was launched. In relation to the fact that Latvia is going to join the eurozone as of January 1, 2014, and the dual *display period* of *prices* from October 1, 2013 to June 30, 2014, the CRPC has developed a price surveillance project for the dual *display period* of *prices*, and involved the Food and Veterinary Service (FVS), the SRS and the CC in the price control as well. A participation agreement with the Latvian National association for Consumer Interest Protection has been concluded on conduct of controls in regions (see Box 6.27). The CRPC is involved in activities to raise awareness of enterprises and consumers during introduction process of the euro. The CRPC has also prepared the *Guidelines on the Procedure for Indication of Prices for Goods and Services in the Dual Display Period of Prices*. In August 2013, the CRPC commenced informative control with an aim to inform enterprises, to draw attention to requirements expected to come into force in near future and to check display of prices in object where dual price display has already been applied. In the nine months of 2013, a total of 633 informative controls have been conducted and over 250 consultations provided via e-mail or phone.

Box 6.27

Improvement of the Legal Framework

In order to ensure reasonable costs of consumer crediting services (interests and other payments), to promote assessment of consumers' ability to pay, to ensure application of reasonable late payment interest and fair procedure for discharge of payments under the contract, the Ministry of Economics prepared amendments to the *Consumer Rights Protection Law* in the first half of 2013. The above-mentioned draft law was considered by the CoM on November 12, 2013 and it is currently forwarded to Saeima for consideration. The draft law envisages a prohibition to conclude consumer crediting contracts from 11 p.m. to 7 a.m., imposing a maximum annual interest rate limit in the amount of 100% (except loans below EUR 100), as well as a possibility to repay the loan in instalments once a month in proportion to the validity period of the contract and the amount of principal amount at least, to restrict increase in late payment interest and prohibit to use bills of exchange as means of payment.

In order to promote consumer rights protection and provide an opportunity to consumers to exercise and protect their legal rights, using independent, fast, efficient and fair out-of-court dispute resolution, the Ministry of Economics has prepared draft laws *Law on Out-of-court Resolution for Consumer Disputes* and *Amendments to the Consumer Rights Protection Law* and submitted them for inter-institutional coordination on November 14, 2013. These laws envisage introduction of the requirements of the *Directive 2013/11 of* the European Parliament and of the Council on Alternative Dispute Resolution (ADR) for consumers and *the Regulation 524/2013* of the European Parliament and of the Council on Online Dispute Resolution (ODR) for consumers into Latvian legislation. The draft law *On Out-of-court Resolution for Consumer Disputes* applies to out-of-court dispute resolution providers offering or defining solution to the dispute (i.e. adopt a binding or non-binding decision), as well as to persons responsible for bringing the parties together to help them find a solution (for example, mediators). The draft law lays down principles for activities of out-of-court dispute resolution entities and the principles for dispute resolution, including the principle of competence, independency, transparency and fairness, as well as the procedure for supervision and cooperation of out-of-court dispute resolution entities. According to the draft law, out-of-court dispute resolution entities have a duty to consider the dispute within 90 days. According to the draft law *Amendments to the Consumer Rights Protection Law,* consumers are entitled to turn to the Committee for Consumer Dispute Resolution according to the procedure for out-of-court dispute resolution. The committee is an independent collegial decision-making authority that deals with dispute resolution between consumer and manufacturer, trader or service provider based on an application of consumer. The committee will be composed of representatives from consumer rights protection organizations and non-governmental organizations of enterprises specialised in the area of the particular. The committee is planned to be based at the Consumer Rights Protection Centre, while the list of its chairperson and members will be approved by the Minister of Economics. The draft law is expected to come into force as of January 1, 2015, while the new procedure for out-of-court resolution of consumer disputes is expected to be applied as of July 1, 2015.

In order to transpose the Directive 2011/83/EU of the European Parliament and of the Council of October 25, 2011 on the protection of consumers in respect of distance contracts and contracts negotiated away from business premises, the Ministry of Economics has developed draft regulations of the CoM Regulations Regarding Distance Contracts and Regulations Regarding Contracts Negotiated Away from Business Premises that have been announced at the State Secretaries' meeting on 31 October, 2013. Both projects specify requirements for providing information to consumers in case of conclusion of a distance contracts negotiated away from business premises, as well as clearly lay down the rights and obligations of the parties when consumer exercises the right of refusal, i.e. withdraws from the contract within 14 days. After adoption of the draft regulations, the requirements thereof are expected to be applied as of June 13, 2014.

In summer of 2013, discussions regarding the proposal for the *Directive of the European Parliament and of the Council on consumer credit agreements relating to immovable property* were closed, and the draft directive was submitted to the European Parliament for approval. The Draft Directive envisages setting requirements for advertising mortgage crediting services, information to be provided prior to signing the contract, verifying consumer's creditworthiness, calculation of the annual interest rate, early clearing of the credit, access to databases for assessing the creditworthiness, as well as a surveillance mechanism of credit intermediaries and creditors, and requirements for competence of the given service providers.

On July 9, 2013, the EC approved the proposal for a *Directive of the European Parliament and of the Council on package travel and assisted travel arrangements.* The Draft Directive envisages modernisation of the effective Directive *90/314/EEK* of the European Parliament and the Council of 13 June 1990 on package travel, package holidays and package tours. The aim of the Draft Directive is not only create equal conditions for operators, eliminated legal obstacles to cross-border trade and reduce the compliance costs for companies but also to achieve high level of consumer protection and reduce the detriment for consumers by specifying what combinations of travel services are protected in accordance with the EU package travel provisions and replacing unclear and outdated provisions. Currently, text of the draft directive is being discussed at the working group of the EU Council of Ministers.

Box 6.27 continued

On February 13, 2013, the EC proposed a new package of laws regarding market surveillance of products and product safety, including the *Proposal for a regulation of the European Parliament and of the Council on market surveillance of products* and the *Proposal for a regulation of the European Parliament and of the Council on Consumer product safety*. The draft laws envisage replacing current regulation to improve the safety of consumer products circulating in the Single Market and to step-up market surveillance concerning all non-food products. According to the regulation of consumer product safety, consumer products must be safe. The regulation also imposes certain obligations of economic operators, as well as lays down provisions on development of standards to support safety requirements. The draft regulation of new market surveillance envisages coordinated application of market surveillance requirements in different EU Member States, thus ensuring better protection of consumers and other users, as well as reduce administrative burden on economic operators and regulate information exchange between market surveillance authorities.

In the field of **state metrological supervision**, the CRPC has assessed conformity of measurement equipment to the normative requirements at the place of use in 75 manufacturing, trading, and service rendering enterprises in the nine months of 2013. A total of 1109 units of measurement equipment have been subjected to metrological monitoring. Considering the significant amount of perfumery and cosmetic products imported to Latvia (including from Russia and other former EU countries, as well as Turkey and India) and the growing number of local producers over the past few years, a metrological supervision project of pre-packed goods has been launched in the field of perfumery and cosmetic products in 2013, carrying out priority control of goods labelled with the "e-mark". A total of 31 inspections have been carried out within the project.

6.14. Quality Assurance

6.14.1. Quality Structural Policy

The main task of public authorities in the field of product and service conformity assurance is to promote adequate application of and compliance with laws and regulations in the regulated and non-regulated sphere, as well as to improve the base of the laws and regulations in accordance with the European Union requirements, taking into account the needs of the national market and economy, hence ensuring compliance of products and services, and fostering better competitiveness of entrepreneurs and reduction of obstacles to international trade.

The quality assurance infrastructure system in Latvia is regulated by the *Law on Conformity Assessment*, *the Standardization Law*, and *the Law on Uniformity of Measurements*, as well as other related normative acts.

The main directions of the policy are as follows:

- maintenance and improvement of the conformity assessment infrastructure (including testing and calibration laboratories, inspection and certification institutions, environmental verifiers) in line with the needs of the Latvian national economy, in order to protect consumers and the environment from low-quality products and services and to promote an increase of merchants' competitiveness and trustworthiness of Latvian production, as well as of services provided by Latvian merchants;
- improvement of the respective informative and consultative base;
- ensuring participation of national institutions of accreditation, standardization, and metrology in international organizations, by maintaining their international recognition and compliance of the Latvian quality assurance system with international requirements;
- maintenance and international comparison of the national base of metrology standards in order to ensure the necessary traceability of measurements and to protect the society from inaccurately performed measurements;
- promoting introduction of quality management, environmental quality and other voluntary management systems in enterprises in order to ensure manufacturing of high-quality products, service rendering, and competitiveness of Latvian merchants in international markets;
- promoting efficient market surveillance, in order to provide equal conditions to all market participants, and protecting consumers from potential unfair competition of merchants.

The offices Standardization Bureau, Latvian National Accreditation Bureau, and Metrology Bureau forming the Limited Liability Company with share capital "Centre of Standardization, Accreditation and Metrology" under the supervision of the Ministry of Economics, carry out the functions and tasks of national standardization, accreditation, and metrology institutions.

6.14.2. Accreditation, Standardization, Metrology

Since July 1, 2009, the Limited Liability Company "Centre of Standardization, Accreditation and Metrology" has been carrying out the tasks in the field of standardization, accreditation, and metrology as stipulated in the *Standardization Law*, *Law on Conformity Assessment*, *Law on Uniformity of Measurements*, as well as in other related laws.

Standardization

The Standardization Bureau (LVS) of LLC "Standardization, Accreditation, and Metrology Centre" in capacity of the national standardization organization, in compliance with the *Standardization Law*, manages and coordinates activities of Latvian merchants and organizations in the field of standardization.

The main functions of LVS are to set up a fund of Latvian standards and to issue Latvian standards in cooperation with international and European organizations of standardization.

Since 2004, LVS is a full-fledged member of the European Committee for Standardization (CEN) and of the European Committee for Electrotechnical Standardization (CENELEC). LVS is also a corresponding member of the International Organization for Standardization (ISO) and an associate member of the International Electrotechnical Commission (IEC).

In accordance with the approved plans, the priority directions of the LVS activity is distribution of standardization information, updating and maintaining the totality of Latvian standards, improvement of the electronic sales system of standards and cooperation with international, European, and national standardization organizations.

Until November 1, 2013, over 38 000 standardization documents have been registered in the LVS, including 32 000 European standards adapted to the status of a Latvian standard. In the four months of 2013, 1242 European standards have been adapted, 30 mandatory applicable standards and 11 Eurocodes have been translated into Latvian. Standardization information services have been provided to 2687 legal and physical persons.

The automatic electronic information notification system introduced by LVS has provided a free of charge service *Monthly Report on the Standards Registered in Latvian Standard Status and Cancelled Latvian Standards* to 548 regular customers in fields of their interest.

In 2013, a new Standardization technical committee LVS/STK 52 "Beauty Salon Services" has been established.

Within the framework of the contract signed with the official journal of RL *Latvian Herald (Latvijas Vēstnesis)* on exchange of information, the section "Standards Regarding Legislation" of the LVS website has been updated in 2013 by adding 19 CoM regulations containing direct or indirect references to standards, as well as 14 lists of applicable standards, in total 4270 standards.

Latvia has submitted an application for organizing the European Standardization Summit 2015 during the Latvian Presidency of the Council of the European Union.

In September 2013, a project in cooperation with the ISO was launched regarding participation of Latvia in the work of 5 international technical committees as a full member.

In 2013, development of a new information system was begun to provide additional services to customers, to give them an opportunity to comment on draft standards electronically, to improve the development, maintenance and security of the LVS database, as well as to ensure better traceability and transparency of standardization processes. These changes in the database will provide users with access to broader information on standards, as well as give an opportunity to follow the work of other committees. It should be noted that the European standardization organizations are gradually changing their information technologies, and thus imposing new obligations on the LVS to be able to ensure information exchange and security thereof.

Accreditation

The Latvian National Accreditation Bureau (LNAB), which is a structural unit of LLC "Standardization, Accreditation, and Metrology Centre", ensures the operation of the national accreditation system. Pursuant to the *Regulation (EC) No 765/2008 of the European Parliament and of the Council*, LNAB acts in capacity of the national accreditation institution and in this capacity it is announced (notified) to the European Commission.

The increase in the number of accredited institutions observed over the recent years proves the importance and stability of the accreditation process in the sphere of conformity assessment. An increasing number of new institutions want to prove their competence by gaining accreditation. Many of the institutions are expanding their field of activities. At the moment, the status of accreditation is maintained for 238 accredited institutions. Accreditations have been awarded to two laboratories in the Russian Federation, while accreditation is maintained for one laboratory in Kazakhstan and one laboratory in Azerbaijan, as well as certification institution of persons in Ukraine. The conformity of one laboratory is maintained in compliance with the *Principles of Good*

Laboratory Practice. One institution has been accredited according to the requirements EU *Regulation No. 600/2012* and LVS EN ISO 14065:2013 *Greenhouse gases – Requirements for greenhouse gas validation and verification bodies for use in accreditation or other forms of recognition*. Information on the accredited institutions is available on the LNAB website *www.latak.lv*.

LNAB has approved conformity of the accreditation system to the *Multilateral Recognition Agreement (MLA) of the European Cooperation for Accreditation (EA)* in six spheres of accreditation. In order to continuously conform to these requirements and harmonize accreditation procedures, employees of LNAB participate in several committees – EA Inspection and Certification Committee, EA Laboratory Committee and working groups, meetings of the Multilateral Recognition Agreement Committee and General Assemblies.

In the framework of international cooperation, LNAB also collaborates with accreditation institutions of Belarus, Ukraine, and Uzbekistan. Cooperation with the accreditation institution of Georgia is continued by assisting in fulfilment of the European and international requirements.

LNAB has also fostered participation of national laboratories in international inter-laboratory comparative testing programmes and has organized examinations of skills. Furthermore, training seminars are organised for conformity evaluation institutions and LNAB involved experts.

Metrology

Obligations in the area of metrology under international agreements are implemented in Latvia by the national metrology institution – SAMC Metrology Bureau (LATMB).

By signing the *Mutual Recognition Arrangement* of the *International Committee for Weights and Measures* (CIPM MRA), Latvia committed to maintain an internationally recognized metrology system, and therefore calibration certificates of the LATMB are internationally recognized. Signature of the memorandum of the European Association of National Metrology Institutes imposes an obligation on Latvia to provide national metrology laboratories with national measurement standards that meet the requirements of the EURAMET guidelines.

According to the law on *Law On Uniformity of Measurements,* the main tasks of the LATMB are the following:

– to maintain a base of standards of physical quantity measurement units;
– to assess conformity of measurement equipment, approve types and maintain a register of national measurement equipment;
– to calibrate reference standards;
– to organize inter-laboratory comparisons and participate in them;
– to represent Latvia in international metrology organizations and cooperate with metrology institutions of other countries.

The LATMB maintains eleven measurement standards (including mass, length, angular, electric, etc.) in accordance with the international requirements. In 2013, nine national measurement standards have been calibrated in foreign national metrology institutions. In the eleven months of 2013, the LATMB has calibrated 38 reference standards at LLC "National Metrology Centre of Latvia" (LNMC), as well as assessed and approved 22 measurement equipment types.

Additional funding has been granted for calibration of national measurement standards in 2014. The LATMB as an internationally recognized national metrology institution with the main task to maintain national measurement standards under the international mutual recognition arrangement will be entitled to certify conformity of the national metrology system of international metrology institutions to the requirements of the EU.

The lack of own laboratories and equipment to control parameters of national standards is compensated by the use of LNMC equipment which is also outdated and used to provide the LNMC chargeable services, and therefore significantly hinders and often makes it impossible to assess stability, repeatability drift of a standard or reproduced measurement unit with the required accuracy.

As of 2014, the LATMB plans to actively represent Latvia in technical committees and working groups of international organizations EURAMET, WELMEC and OIML to participate in development of issues and proposals included in the agenda, as well as to present the national opinion.

6.15. Privatization

The goal of privatization is, by changing the owner of a property owned by the state or local government, to create a favourable environment for private capital operation in the interests of economic development of Latvia and to narrow commercial activity performed by the state and local governments.

As the goal of mass privatization in Latvia has been basically achieved, the *Law on the Completion of Privatization of State and Local Government Property and Use of Privatization Certificates (Law on the Completion of Privatization)* came into force on September 1, 2005, prescribing the procedure of completing the privatization process and land reform and ensuring completion of the use of privatization certificates (see Box 6.28).

Box 6.28

<u>Law on the Completion of Privatization of State and Local Government Property and Use of Privatization Certificates</u>

The *Law on the Completion of Privatization* stipulates:

– the deadline of August 31, 2006, by which every legal or natural person may propose to bring any state or local government property to privatization;
– the procedure, by which a privatization proposal submitted by a person is reviewed and a decision on bringing a state or local government property to privatization is adopted;
– that privatization may be denied and the state or local government property remains in its possession, if the property is necessary for performing public administration functions or commercial activity of the state or local government;
– that the Cabinet of Ministers or a local government had to adopt decisions on bringing a state or local government property to privatization by December 30, 2010;
– that decisions on bringing the state or local government property involved in a dispute regarding property rights to privatization shall be adopted in four months from coming into force of a court decision or a notarial act;
– that the state joint stock companies "Latvenergo", "Latvijas pasts", "International airport "Riga"", "Latvijas dzelzceļš", "Latvijas gaisa satiksme" and "Latvijas valsts meži" are not subject to privatization or alienation;
– the deadlines for the persons willing to buy out land allocated for permanent use have to submit an application on buying land property (November 30, 2007), as well as by which a land boundary plan or confirmation of the land redemption payment made with privatization certificates before concluding the land redemption contract has to be submitted to the State Land Service (September 1, 2008), as well as for the application for a decision on the allocation of the property for payment has to be submitted (August 31, 2011) and that the land purchase agreement has to be concluded by December 30, 2011;
– that privatization certificates do not have an expiry term, but may be only used within the framework of the privatization process;
– the procedure for completion of the issuance of privatization certificates. The final deadline by which applications for granting of privatization certificates could be submitted was December 28, 2007.

In order to ensure successful and open progress of privatization completion processes, the Cabinet of Ministers has set the procedure on how the institutions implementing privatization and land reform have to set up publicly available registers of privatization proposals and land property buy-outs.

<u>Privatization of state property and land</u>

Privatization of state property and land is carried out and privatization proposals are summed up by the state joint stock company "Privatization Agency" under the *Law on Privatization of State and Local Government Property.*

A decision to bring a state property object, including capital shares and vacant land to privatization is made by the Cabinet of Ministers, while a decision to bring a building land, on which there are buildings owned by another person, to privatization is taken by the Privatization Agency. The decision is made on the basis of a privatization proposal submitted by any natural or legal person.

From September 1, 2005, when the *Law on the Completion of Privatization* came into force, until October 31, 2013, 636 proposals for privatization of real estate, 57 proposals for privatization of state capital shares, and 4419 proposals for privatization or continuation of privatization of land have been registered in the Register of Privatization Proposals of the Privatization Agency. After August 31, 2006, those privatization proposals were registered in the Register of Privatization Proposals, which were submitted by mistake to other state and local government institutions up to that date and later were transferred to the Latvian Privatization Agency according to its competence.

The Cabinet of Ministers has not yet considered 5 proposals for privatization of state property objects, out of which two proposals for privatization have not been considered due to litigation pending regarding ownership rights. Three proposals for privatization have not been considered because their consideration is hindered by legal issues.

The Privatization Agency has received proposals for privatization of 79 state property objects with issues regarding ownership rights. The Privatization

Agency is authorized to address a court or a notary on behalf of the state in order to take all the necessary steps to recognize it as a property without an owner or an heir. The Privatization Agency has not addressed the court regarding 12 property objects because the privatization proposals for these objects have been sent to the relevant local governments or the privatization of those objects has been rejected. The Privatization Agency has addressed the court regarding 67 property objects to establish a legal fact and recognise the abovementioned objects as a property without an owner or an heir that belongs to the state. Out of these, 52 legal proceedings have been closed and court has ruled on satisfying the application of the Privatization Agency and establishing the legal fact that the property is a property without an owner and thus belongs to the state. In 13 cases, the application of the Privatization Agency has been left unadjudicated based on Section 258 of the *Civil Procedure Law* because a dispute regarding the rights has arisen in a matter to be adjudicated in accordance with special adjudication procedures and such a dispute is required to be adjudicated in court in accordance with procedures regarding actions. In 2 cases, legal proceedings are still pending. After passing a court ruling on recognizing the property as a property without an owner or an heir, the CoM is drafting decrees on bringing the property object to privatization or a justified rejection to bring it for privatization. The CoM has already made decisions on bringing 4 property objects to privatization.

A natural or legal person eligible to acquire movable or immovable property in Latvia can be the subject of privatization of state-owned property (real estate, capital shares, land). Payments for the property objects have to be made in lats (LVL) and/or privatization certificates.

From April 17, 1994 until October 31, 2013, the privatization provisions in the statutory procedure have been approved for 2529 state property objects (excluding land). 94 companies have been transformed into public joint stock companies, thus emitting 439.14 million shares into public circulation. During this period, income obtained from privatization of state-owned property objects (excluding land and sale of shares and alienation of capital shares emerged as a result of capitalization of debts) amounted to LVL 1.669 billion, of which LVL 402.81 million was in cash and LVL 1.267 billion in nominal values was for privatization certificates. New owners took over obligations of privatized state companies (enterprises) for the value of more than LVL 187.95 million. The amount of the specified investments was LVL 146.35 million, while the amount of investments actually made reached LVL 267.54 million.

The Privatization Agency has been carrying out privatization of state-owned land since 1997. By October 31, 2013, 5177 state land lots were privatized (purchase agreements signed). The total sales price for the privatized state land constitutes LVL 202.55 million, of which LVL 99.66 million was in cash and LVL 102.89 million in property compensation certificates. On October 31, 2013, income from privatization of these land lots amounted to LVL 195.13 million, of which LVL 96.26 million was in cash and LVL 98.87 million – in property compensation certificates.

Privatization of local government property objects and land

A decision concerning privatization of local government real estate is made by the municipality – city (regional) council. The decision is made on the basis of a privatization proposal submitted by any natural or legal person.

A natural or legal person eligible to acquire local government property in Latvia within the process of privatization can be the subject of privatization of local government property (real estate, a deemed part of the real estate, capital company, capital shares, land). Payments for local government property objects have to be made in lats (LVL) and/or privatization certificates.

Privatization of local government property in the municipality area is ensured by the property privatization commission of the respective municipality (city, region).

Compliance of privatization projects, regulations, and announcements approved by a municipality council with the provisions of the *Law on Privatization of State and Local Government Property* and the *Law on the Completion of Privatization* is ensured by the Ministry of Economics.

From February 17, 1994 until October 31, 2013, the Ministry of Economics has reviewed and accepted for information 3330 privatization projects for the total estimated price of LVL 161.02 million (*inter alia* payments in certificates for the nominal value of LVL 59.142 million).

From January 1, 1997 until October 31, 2013, the Ministry of Economics has reviewed and accepted privatization provisions in respect to 1678 building land lots and vacant local government land lots (separate announcements of privatization of building land lots as from September 1, 2005) for the total value of land in the amount of LVL 26.47 million (of which LVL 13.3 million must be paid in property compensation certificates).

Section 41(2) of the *Law on Privatization of State and Local Government Property Objects* imposes an obligation that the council of municipality submits a decision on approval of privatization project of local government property object, and the approved privatization project to the Ministry of Economics. The submission of a decision on approval of provisions (announcement) regarding privatization of a building land lot or a vacant land to the Ministry of Economics is voluntary and is not imposed by the law.

Privatization certificates

A privatization certificate is a state-allocated dematerialized security that can be used only once as the means of payment for a state or local government property to be privatized.

Privatization certificates are issued and used according to the *Law on Privatization Certificates*. By October 31, 2013, 112.38 million privatization certificates have been issued to 2.4 million people. Out of which 103.58 million privatization certificates are granted for the time they have lived in Latvia and 794.7 thousand privatization certificates are granted to 41.4 thousand politically repressed persons. 8.01 million property compensation certificates out of all granted privatization certificates have been issued to 117.2 thousand former owners or their heirs, including 691.7 thousand certificates for property alienated for the state needs at the privatized specialized state agricultural enterprises, 4896.4 thousand for land in rural areas, 970 thousand for house ownership, 814.7 thousand for urban land, 461 thousand for companies and other property units, 89.8 thousand for property taken away from politically repressed persons and 85.6 thousand for property alienated illegally.

As from December 1, 2007, in accordance with the Section 27 of the *Law on Completion of Privatization*, 58.2 thousand persons have lost their rights to transfer 1.64 million privatization certificates to their accounts.

According to the *Law on Privatization of Land in Rural Areas*, 11 076 decisions on payment of cash compensations for former land ownership in rural areas have been made by October 31, 2013. Compensations for the total amount of LVL 17.45 million have been paid to 8411 persons, thus cancelling 0.62 million property compensation certificates.

As part of cancelling 165.71 thousand privatization certificates for political repressions, compensations for the total amount of LVL 4.64 million have been paid to 26.2 thousand politically repressed persons by October 31, 2013. According to Section 28 of *Law on Completion of Privatization*, 3.5 thousand politically repressed persons have lost the right to cancel 16.13 thousand privatization certificates.

By October 31, 2013, 107.19 million privatization certificates or 95.4% of the total number of issued certificates have been used for privatization of state and local government property (see Table 6.5). From April 1, 2008 until October 31, 2013, instead of 533.47 thousand property compensation certificates 670.21 thousand privatization certificates have been used.

Table 6.6

Use of Privatization Certificates

(by October 31, 2013)

Type of property	Amount	Number of privatization certificates	including the number of property compensation certificates
		million	thousands
Residential buildings	446 thousand apartment privatization units	38.0	589.8
Enterprises and other properties	no exact data	7.3	109.6
Capital shares (stocks)	no exact data	44.5	954.0
including:			
in public offering	128.7 million shares	37.1	858.0
Land	317.1 thousand land lots	17.4	5164.2
Total:		**107.2**	**6817.6**
% of total certificates issued		95.4%	85.1%

In October 2013, holders of privatization certificates could use services of 7 licensed intermediary capital companies for transactions in the market of privatization certificates. The total amount of monthly transactions with privatization certificates (buying from natural persons and selling) performed by intermediary capital companies until October 31, 2013, ranged from 2.44 thousand privatization certificates in January to 69.68 thousand privatization certificates in July and from 0.19 thousand property compensation certificates in October to 1.72 thousand property compensation certificates in April.

According to Paragraph 2 of *Regulations Regarding the Use of Privatization Certificates* approved by the Cabinet of Ministers on October 16, 2007, privatization certificate accounts open and service JSC "Latvijas Krājbanka" and State Joint Stock Company "Mortgage and Land Bank of Latvia", as well as other crediting institutions, which are entitled to accept money deposits by natural persons and which have harmonised their internal rules with Commission for Licensing Mediation Companies of Privatization Certificates. On November 1, 2013, 2.407 million privatization certificates or 2.1% of the total number of granted privatization certificates, including 0.107 million property compensation certificates were held on the accounts of 379.7 thousand natural persons.

On November 1, 2013, 0.291 million privatization certificates or 0.3% of the total number of granted certificates, including 0.006 million property compensation certificates were held on the accounts of privatization compensations of legal persons.

On November 21, 2011, the Financial and Capital Market Commission adopted a decision on terminating all financial services provided by the JSC "Latvijas Krājbanka". On December 13, 2011, the Riga Regional Court announced the bankruptcy procedure of JSC "Latvijas Krājbanka" based on the application of the Financial and Capital Market Commission. Moreover, the bankruptcy procedure of the insolvent JSC "Latvijas Krājbanka" was initiated by the decision of Riga Regional Court of May 8, 2012.

According to Subparagraph 31.9 of the *Regulations Regarding the Use of Privatization Certificates*, the bank servicing the privatization certificate account of a customer has a duty to: in case the bank loses the status of a credit institution or the right to accept cash deposits of natural persons, or decides to stop handling privatization certificate accounts, it must immediately stop the opening of new accounts, continuing handling accounts until their transfer to another bank, and conclude an agreement with another bank on the transfer of privatization certificate accounts by coordinating the procedure for the transfer of accounts with the Commission for Licensing Mediation Companies of Privatization Certificates. Pursuant to Paragraph 2 of the *Regulations Regarding the Use of Privatization Certificates*, the Mortgage Bank is the only credit institution entitled to open and handle privatization certificate accounts at the moment, while JSC "Latvijas Krājbanka" in liquidation continues handling the existing accounts.

Currently, JSC "Latvijas Krājbanka" in liquidation is subject to an obligation imposed by the law to stop opening of new privatization certificate accounts and to continue handling the existing accounts until conclusion of an agreement with another bank on the transfer of privatization certificate accounts.

According to the amendments to the *Regulations Regarding the Use of Privatization Certificates* effective as of January 1, 2013, a simplified procedure has been established for individual transfer of privatization certificated accounts from one credit institution to another.

On November 7, 2013, the Saeima in the 3rd reading approved the amendments to the *Law on Privatization Certificates* to be effective as of January 1, 2014. According to the amendments to the law, public administration shall deal with handling privatization certificate accounts which includes opening and maintenance of certificate accounts, the transfer of certificates in the privatization certificate account and other services related to servicing of certificate accounts and circulation of certificates. The amendments envisage that the CoM shall appoint a public administration institution or delegate a private person to deal with handling of privatization certificate accounts. And therefore, draft regulations of the CoM are being prepared regarding the delegation of the public administration task – servicing of privatization certificate accounts – to the Mortgage Bank which is going to take over servicing of privatization certificate accounts from the JSC "Latvijas Krājbanka" in liquidation by May 31, 2014 pursuant to the amendments to the *Law on Privatization Certificates*.

<u>Privatization process of residential buildings</u>

On October 31, 2013, 349 residential buildings and 1511 state apartment properties were in the possession and under management of the Latvian Privatization Agency, out of which 913 state apartment properties are situated in residential buildings in possession of the Latvian Privatization Agency and 598 state apartments are situated in residential buildings that are handed over to the management of apartment owners.

Privatization process of state residential houses

Privatization of 13 state residential houses has been commenced according to the decision of the board of the Privatization Agency within time period from June 1, 2013 until October 31, 2013.

Privatization announcements have been sent to 121 tenants of state apartments to be privatized and to tenants of non-residential premises, notification of conclusion of purchase contracts have been sent to owners of property objects handed over in possession until privatization and invitations to conclude agreement on acquisition of land, as well as 51 purchase contracts of state apartment properties have been signed according to the procedure specified in the *Law on Privatization of State and Local Government Residential Houses* within time period from June 1, 2013 until October 31, 2013.

Management process of residential buildings and apartments

A total of 16 residential buildings have been handed over to owners of apartment properties in possession within time period from June 1, 2013 until October 31, 2013.

17 state apartment properties have been handed over to the possession of local governments of cities, towns and counties within the period from June 1, 2013 until October 31, 2013.

Land reform

The main goal of the land reform is to rearrange the legal, social, and economic relations of land use and ownership from command economy to market economy.

The state land reform process includes allocation of vacant land and land pertaining to the state for permanent use, restoration of ownership rights, and redemption (purchase) of the land allocated for permanent use, as well as privatization (alienation) of land owned by the state or local government. Redemption (purchase) of land allocated for permanent use and restoration of ownership rights to land allocated for permanent use and land for completion of the land reform are carried out with regard to the rural and urban land reform being implemented in the country.

In cities and rural regions, allocation of land for the use and land for payment has been completed. According to the *Law on Completion of Privatization* land redemption (purchase) agreement for the allocated urban or rural land had to be concluded with the Mortgage Bank by December 30, 2011.

Overall, during the land reform until December 30, 2011, the Mortgage Bank concluded 174 231 agreements on 181 945 land units of more than 1.2 million hectares.

Section 16(1) of the *Law On Completion of Land Reform in Rural Areas* envisaged that the former land owners or their heirs, as well as former land owners who until July 21, 1940 commenced the purchase (concluded an accessory contract) of real property left in Latvia by German emigrants from the "General Agricultural Bank" or the "State Land Bank", as well as the heirs of such persons to whom the ownership rights to immovable property have not been restored or the property compensation certificates thereof have not been granted, would have an opportunity to claim land units of equal value allocated for completion of the land reform by a decision of the local government until December 30, 2009.

If the former land owners or their heirs wanted to restore their ownership rights to land, according to the *Law on the Completion of Land Reform in Rural Areas* they had to submit a proposal to the Central Land Commission (CLC) by December 28, 2007, but documents confirming ownership and hereditary rights had to be submitted by September 1, 2008.

Regulations of the Cabinet of Ministers of December 20, 2008 *Procedure on Reviewing Requests Submitted to the Central Land Commission* prescribe the procedure according to which former land owners or their heirs must restore land ownership rights to land planned for completion of land reform.

Before starting the process of restoring land ownership rights, the State Land Service (SLS) in cooperation with the local governments examines whether:

– ownership rights to the claimed land have not been already recognized or restored to the submitter of proposal or to another person;
– property compensation certificates have not been received;
– the proposal on restoration of ownership rights has been submitted in the corresponding local government by June 20, 1991;
– the documents confirming ownership and hereditary rights to the claimed land have been submitted by June 1, 1996;
– the land has been allocated for permanent use or rights to permanent use have been terminated and a land lease agreement for this land has been concluded with the local government.

After performing the said examination, the CLC decided on the priority group for reviewing applicants' claims.

The former owners or their heirs who had submitted a claim for restoring ownership rights and documents confirming ownership or hereditary rights by June 20, 1991, but have not received the land or property compensation certificates, as well as former land owners who by July 21, 1940 had started to redeem the real estate left in Latvia by German emigrants from the General Agriculture Bank or State Land Bank, are considered as the first priority claimers regardless of the claim submission date.

The status of the second priority claimers corresponds to those former owners or their heirs, who had submitted a claim for restoring ownership rights by June 20, 1991, as well as had submitted documents confirming ownership and hereditary rights by July 1, 1996.

The status of the third priority claimers corresponds to those applicants, who had submitted the claim after June 20, 1991, or documents confirming ownership or hereditary rights after July 1, 1996.

The CLC has recognized claims for ownership rights to land of 12 982.64 hectares allocated for completion of land reform submitted by 1066 persons.

14% of all claimers for land allocated for completion of the land reform are the first priority claimers, 3% – the second priority claimers, but the third priority claimers constitute the largest number of claimers for land allocated for completion of the land reform, i.e. 83 per cent.

In order to ensure restoration of ownership to land allocated for completion of the land reform, local government and regional level commissions for completion of land reform have been established in the SLS regional branches, as well as a state level commission for the completion of land reform has been established in the central structure of the SLS. The commissions established by the SLS organize sending a land unit list to the applicants and summarizing the land units selected by the applicants. A representative of the particular local government, authorized to sign the allocation schemes of land distribution allocated for completion of the land reform and land boundary schemes intended for restoring ownership rights, must participate in the work of these commissions.

After the auction, the SLS commission for completion of the land reform sends the auction minutes and a land boundary scheme signed by the claimer to CLC for preparing a statement and sending it to the claimers for continuing the processing of ownership rights.

The process for the restoration of ownership rights to the first priority claimers was commenced in 2010. Since August 2010, the state level commission for completion of the land reform established by the State Land Service has examined claims of 91 first priority claimers.

Examination of claims of the first priority claimers in commissions for the completion of land reform of local government and regional level, as well as in state level was completed at the end of March 2011.

After receiving the CLC statement on restoration of ownership rights, the claimers of all priorities carry out a cadastral survey of land units. After the cadastral survey, the CLC makes decisions on restoration of ownership rights, and the claimer thereby obtains the rights to register the property in the Land Register.

In April 2011, the preparation of lists of land units planned for completion of the land reform and sending thereof to the second and third priority claimers for selecting the respective land units was launched at the local government or regional level. Those claimers having insufficient area for compensating the inheritable land at regional level were offered an opportunity to select land units at state the level within the territory of Latvia.

A total of 35 claims of the second priority claimers for the selection of land planned within the land reform have been examined, the majority of former properties of the second priority claimers were located in the territory of former Ludza district, Valka district, Cēsis district, Preiļi district, and Balvi district. Land boundary schemes were selected and signed for a total of 37 land units for an area of 155.5 ha. 30% of the second priority claimers refused to choose land units. Examination of claims of the second priority claimers at local government, regional and state level was completed in November 2011.

A total of 693 claims of the third priority claimers for selection of land planned within the land reform have been examined as well. 37 third priority claimers refused to choose the land allocated for restoration of ownership rights.

In some areas of Latvia, there was insufficient land planned for the land reform for the third priority claimers, and therefore 188 third priority claimers were granted the rights to select land in all rural territory of Latvia. The CLC granted 204 third priority claimers the rights to select land in all territory of Latvia for restoration of ownership rights to the claimed land of 2716.78 hectares. The state level commission for the completion of land reform of the State Land Service started working in late July 2012.

According to Section 16(3) of the *Law on Completion of Land Reform in Rural Areas*, the CLC was entrusted with the decision-making (recognition) on restoration of ownership rights to the land allocated for completion of land reform until December 30, 2013.

By November 2013, the state level commission for the completion of the land reform of the State Land Service had examined applications of the third priority claimers for restoration of ownership rights to 844 selected land units. 132 third priority claimers were allocated the entire land claimed for restoration of ownership. A total of 543 land boundary schemes of land units have been signed.

52 third priority claimers still have not acquired the land claimed for restoration of ownership because some of them has to deal with inheritance-related formalities, some of the claimers fail to attend the Committee meetings for various reasons, some of them refused the land units during the meetings of prior to auction since they were unaware of land-use options and of the actual condition of the selected land units.

In order to corroborate ownership rights in the Land Register, the claimers have to carry out a cadastral survey of the land unit and obtain a decision of a relevant institution on the restoration of the ownership rights. Based on the aforementioned, the CLC, the SRS and local governments of cities and towns continue decision-making regarding restoration of the ownership rights of former land owners or their heirs, as well as allocation of land in possession for payment in case the cadastral survey of land has revealed that the total area of the land unit of the concerned person exceeds the area of land to which ownership right has been restored.

According to Section 6 of the *Law on Completion of Land Reform in Cities,* the relevant local government shall prepare and submit a notification regarding the completion of land reform and a report on execution of the relevant works specified in regulatory enactments regulating the land reform to the State Land Service by November 30, 2014. As regards rural areas, Section 4(4) of the *Law on Completion of Land Reform in Rural Areas* stipulates that the report shall be prepared and submitted to the SLS by November 30, 2014. By November 2013, preparation of reports and announcements has already been commenced in 4 towns: Olaine, Līgatne, Saldus and Limbaži.

6.16. Reform for Management of Commercial Activities of Public Persons and Capital Shares

Latvia fully or partially owns a large number of capital companies having a major impact on the national economy. State-owned capital companies have considerable assets and some of these companies are the leading employers in the country. Thus, the state must constantly monitor the performance of state-owned capital companies to promote responsible, efficient, and performance-oriented management of capital companies, as well as to increase the value of capital companies in the future. Some local government capital companies play an important role in providing certain services within a particular administrative territory.

Currently, the state holds 100% shares in 69 capital companies; it has the decisive influence over 6 capital companies and holds less than 50% shares in 69 companies. The state holds shares directly in a total of 144 companies.

There are 323 capital companies in the Republic of Latvia, in which a local government is the sole member (local government capital companies), 39 capital companies are under decisive influence of local governments, while local governments hold 50% or less shares in 243 companies. Four local governments have no holdings in capital companies.

Box 6.29

Commercial Activity of Public Persons

Involvement of public persons in commercial activity causes a risk of market distortion. Therefore, it is acceptable for a public person to perform commercial activity only in exceptional cases where there is a particular reason for performing commercial activity. The main economically justified reason for state participation in capital companies is prevention of market failures and thus raising social welfare. All the limitations of commercial activity under the *State Administration Structure Law* are set for a legitimate purpose, i.e. a public person shall be an equal partner to a private business without distorting competition only in case it is necessary for implementing security functions and the national policy in a public area of life. Yet, they often are interpreted much broader thus resulting in commercial activities of the state and local governments in sectors that formally comply with Section 88 of the *State Administration Structure Law*, though actually contradict the purpose of the given norm to limit state commercial activities.

Management of state capital shares

Latvia applies the decentralised model for state capital shares management which is implemented by the holder of capital shares – a line ministry or any other institution. Analysis of the practice of state capital shares management in Latvia resulted in identifying the following key issues:

- the holder of state capital shares plays several simultaneous roles (the role of a customer, owner and sectoral policymaker in one person);
- low return on equity;
- no clear definition of financial and non-financial objectives and no analysis and evaluation of the performance of capital companies with respect to the objectives;
- no single and transparent state capital shares management;
- insufficiently professional state capital shares management (including involvement of professionals);
- no single management system that would promote improvement of the business environment;
- the regulation of state capital shares management is fragmented and incomplete;
- political decision-making in day-to-day management.

The Cabinet of Ministers considered and approved the *Concept for Commercial Activity of Public Persons* and the *Concept for Management of State Capital Shares* developed by the Ministry of Economics in line with the principle laid down in the OECD *Guidelines on Corporate Governance of State Owned Enterprises* in the meeting of May 15, 2012.

For the purpose of implementing the solutions proposed in the concepts and approved by the Cabinet of Ministers, the Ministry of Economics has developed a package of draft laws, including the draft law *On Management of Capital Companies and Capital Shares of Public Persons* based on the effective *Law on Capital Shares and Capital Companies of the State and Local Governments*, as well as amendments to the *State Administration Structure Law* envisaging changes in conditions giving the right to public persons to establish a capital company or acquire interest in an existing capital company. The draft laws have been approved in the Cabinet meeting on May 28, 2013 and submitted to the Saeima for consideration. The Saeima has approved the 1st reading of these draft laws.

The reform of management of capital shares owned by public persons is aimed at increasing return on capital and introducing the principles of good corporate governance in the management of capital companies, as well as revise conditions for commercial activity of public persons. Implementation of the management reforms of capital shares will ensure a higher return on capital (higher dividends), the public will have access to information about management of state-owned capital shares and capital companies, achievement of defines financial and non-financial objectives.

The reform of commercial activity of public persons envisages the following:

– changes in the conditions for commercial activity of public persons, i.e. stipulating that a public person may acquire interest in a capital company in order to eliminate a market failure or if the capital company deals with property management, bearing strategic importance for further development of state or local government administrative territory or for state security. Moreover, a public person may acquire interest in an existing capital company if the market failure cannot be eliminated efficiently in another administrative way or by providing support, and such involvement of a public person is a reasonable way to improve social welfare;
– overall strategic objectives should be defined for a public person to be pursued by involvement in a capital company; these objectives should arise out of legislation and policy planning documents. Social non-financial medium-term objectives should be derived from the overall strategic objectives defined for the public person and included in the medium-term strategy for activities of the capital company;
– imposing an obligation on a public person to reassess shareholding in capital companies and its conformity to the principles of commercial activity of public persons at least once in five years and specifying the overall strategic objectives as necessary. Reassessment of state shareholding in a capital company should be coordinated by the State Capital Shares Management Bureau;
– a capital company of a public person should be transformed into an institution (public agency) in case of establishing that the status of the capital company is not an appropriate model to achieve the objectives for a public person shareholding in the capital company.

The reform of the management of state capital shares envisages the following:

– the reform applies to the management of all capital companies (capital shares) owned by public persons;
– to implement a partially centralised model for state capital shares management. This model involves establishment of a centralized management institution – the State Capital Shares Management Bureau. In a partially centralised model, state capital shares management is shared by: (a) a line ministry responsible for the growth of the sector and sector-specific issues (for example, developing legislation, policy planning documents, sectoral policy objectives, proposals for the draft government budget), as well as defining specific, non-financial objectives of capital companies; (b) the State Capital Shares Management Bureau responsible for monitoring financial performance and introduction and implementation of corporate governance principles;
– the State Capital Shares Management Bureau should be established as a direct administration institution subordinated to the Cabinet of Ministers under the supervision of the Prime Minister. The State Capital Shares Management Bureau should be financed from the government budget. The State Capital Shares Management Bureau shall have the following competence: (1) to develop guidelines on efficient management of capital companies and capital shares; (2) to provide a conclusion to holders of state capital shares (if the State Capital Shares Management Bureau is not the holder of capital shares) regarding coherence between the financial objectives laid down in the medium-term strategy for activities of the capital company and the non-financial objectives laid down in the medium-term strategy for activities of the capital company and the share payable as dividends; (3) to consult the Cabinet, the holders of public person capital shares and capital companies on

the aspect of implementation of corporate governance; (4) to ensure preparation of an annual public report on state owned capital companies and capital shares; (5) to assess the financial objectives and performance achieved by capital companies; (6) to assess and provide an opinion on the need for acquisition, maintenance, termination of the public person shareholding, as well as on the need for acquisition or termination of decisive influence of the state according to the law; (7) to develop and maintain a database of candidates of the council and the board members; (8) to develop draft laws and regulations and policy planning documents according to its competence and submit them to the Cabinet for approval; (9) to perform functions of the holder of capital shares in those capital companies where State Capital Shares Management Bureau has been appointed as the holder of capital shares; (10) to implement alienation and privatisation of state capital shares;

– to impose an obligation on capital companies to develop a medium-term strategy for activities, and establish a procedure for coordination of the strategy. the State Capital Shares Management Bureau is expected to get involved in assessment of the medium-term strategy for activities of a capital company by providing a conclusion;
– to lay down conditions for assessment of performance of capital companies coordinated by the State Capital Shares Management Bureau (the Guidelines on Good Corporate Governance, common framework for achievement of financial objectives). The holder of capital shares shall assess the abovementioned, make a decision on further action to increase the return on assets and the value;
– to lay down requirements for ensuring transparency of information – a possibility to access information on the objectives, performance, latest financial results, management structure of capital companies and other information;
– the State Capital Shares Management Bureau shall prepare the annual public report on state owned capital companies and capital shares in the previous year and submit it to the Cabinet and the Saeima for information by July 30 of the current year;
– to establish a council in the largest capital companies of a public person and public private capital companies - a capital company may establish a council only in case the company in the current financial year has achieved all of the following criteria: (1) net turnover above LVL 15 million (EUR 21 million); (2) total amount of the balance above LVL 3 million (EUR 4 million); (3) the average number of employees exceeds 50;
– motivating remuneration – a system for the board and the council members where remuneration shall be linked with the performance as well. Remuneration conditions shall be revised and updated once a year;
– to establish a new procedure for appointing the board and the council members. The board and the council members should be appointed using the database, based on the criteria for professionalism and competence (education, experience, expertise in the sector, finance, management, motivation methods, etc.). The State Capital Shares Management Bureau develops the database of candidates of the council and the board members, maintains and updates it on a regular basis. An appointment commission composed of representatives nominated by the State Capital Shares Management Bureau and the holder of state capital shares or the council (if any such council has been established), as well as independent experts and representatives nominated by the relevant line ministry, as necessary, assesses the candidates from the data base and puts forward to the holder of state capital shares or the council of the capital company. At the same time, if the state capital company is important for implementation of a certain sectoral policy, the line ministry appoints at least a half of the number of council members under the Articles of Association to the holder of state capital shares. Representatives nominated by the ministries must meet the required qualification criteria for entering a person in the database of candidates of the council and the board members. The holder of state capital shares or the council are entitled to reject, based on justified reasoning, the candidates nominated by the appointment commission or the line ministry. In such case, another selection process shall be organised to select the necessary candidate;
– to introduce a flexible dividend policy to increase the value of capital companies according to the objectives of each capital company, including subsidiary companies of state-owned capital companies to differentiate the long-term applicable dividend policy.

The draft laws developed within the framework of the reform of commercial activity and capital shares management of public persons are expected to be adopted in the first half of 2014, while the State Capital Shares Management Bureau might be established in 2014.

6.17. National Economy Council

The National Economy Council (NEC) of the Ministry of Economics is an advisory institution established by NEC founder organizations – the Ministry of Economics, Latvian Chamber of Commerce and Industry, Latvian Association of Local and Regional Governments, Free Trade Union Confederation of Latvia, and Employers' Confederation of Latvia, and it takes part in the process of solving issues related to business policy and acts in compliance with Subparagraph 6.11 and 7.2 of Regulations No 271 *Regulations of the Ministry of Economics* of the Cabinet of Ministers of March 23, 2010, *Agreement on Cooperation in the National Economy Council* concluded on February 17, 1999, and NEC Bylaws No 1-7-33 of August 29, 2013.

In order to represent the interests of sectors professionally, as well as to improve cooperation between the Ministry of Economics and other state institutions, NEC invites sectoral associations, representing entrepreneurs of the respective sector and their interests, as well as independent experts – economists, representatives of education and science – to participate.

The objective of NEC activity is to promote development and implementation of favourable business environment policy in Latvia, as well as to promote introduction of principles of sustainable development of national economy and to encourage the process of sustainable development of the state and participation of the society in it, to identify circumstances hindering entrepreneurship, and to perform all the necessary activities to eliminate them, to participate in the drafting of laws and regulations and policy programming documents that promote commercial activity, and to promote innovations and external trade.

Box 6.30

<u>NEC Personnel and Work Organization</u>

Based on a decision of the Managing Committee, NEC personnel are approved by the Minister for Economics.

The Minister for Economics represents the NEC opinion on behalf of the NEC in the Coordination Council for *Large and Strategically Important Investment* Projects and the Coordination Council for Foreign Economic Policy, as well as other cross-industry forums.

The NEC Managing Committee is a consulting and coordinating institution that takes part in settlement of issues related to business policy and is responsible for assessment and approval of issues of the agenda of NEC meetings and action plan of NEC, as well as for ensuring and improving efficiency of the NEC activity.

The Minister for Economics approves the personnel of the Managing Committee. The Managing Committee is composed of the Minister for Economics and representatives of the four NEC founders, who are simultaneously the NEC members:

- 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 Managing Committee is entitled to involve representatives in reviewing issues included on the meeting agenda within their competence (for example, the Foreign Investors' Council in Latvia, the Latvian Academy of Sciences, the *Cooperation Council of Agriculture Organisations, relevant state institutions and public organisations).*

NEC consists of 29 NEC experts designated by NEC Managing Committee, including the Minister for Economic, the NEC chairperson and representatives from business organisations, public structures and other organisations.

Representatives from the Foreign Investors' Council in Latvia, Riga Technical University, the association "Latvian Market Association", the Latvian Academy of Sciences and the Latvian Chamber of Crafts participate in the NEC meetings in observer status.

The NEC founders in the meetings of NEC Managing Committee make decisions on changes or additions to the composition of NEC.

NEC is managed by the Chairman elected by the members of the NEC Managing Committee from among its members in a rotation sequence for a term of office of one year.

NEC meetings are held on average once in a month.

The work of NEC is ensured by the Secretariat of the National Economy Council, activity of which is ensured by the Ministry of Economics. The NEC Managing Committee makes the recommending decisions of NEC between NEC meetings.

Box 6.30 continued

In order to improve the cooperation model of the Ministry of Economics and the non-governmental sector and to enhance advisory mechanism, on April 28, 2012, the NEC Managing Committee made a decision on improvement of the NEC structure, by establishing six sub-committees whose tasks and mission are to combine advisory councils established by a decree of the Ministry of Economics, to promote dialogue between the Ministry of Economics, the minister, other ministries and non-governmental organizations regarding important criteria for policy development of business-friendly environment in Latvia, as well as ensure implementation of principles for development of sustainable national economy and to promote a sustainable development process of the country and public involvement in this process.

The NEC Managing Committee evaluated and developed such a model to make it possible for the NEC to discuss important and subordinate matters regarding comprehensive economic policy and review these matters through industry committees that directly or indirectly cooperate with the non-governmental sector.

The NEC structure consists of six committees:

– Domestic Market Committee;
– Competitiveness Committee;
– Energy Committee;
– Construction and Housing Policy Committee;
– Tourism Committee;
– Micro-, Small- and Medium-sized Enterprise Committee.

NEC reviews and monitors settlement of issues, draft normative documents, national economy development concepts, the state budget, and other documents important for the development of Latvian economy. NEC prepares proposals and adopts recommending decisions on these issues. NEC carries out a dialogue between the entrepreneurs and the Ministry of Economics, as well as with other state institutions and public organizations.

The decisions adopted by NEC are of recommending nature.

NEC cooperates with the Cabinet of Ministers, ministries, and other state institutions to achieve that the proposals suggested by NEC necessary for improving the business environment are included in the laws and regulations prepared by the responsible institutions.

On May 21, 2009, NEC, the Ministry of Economics, and the Ministry of Finance signed a cooperation memorandum on *Growth, Competitiveness, and Employment*. The cooperation memorandum is aimed at cooperation and harmonized action of NEC, the Ministry of Economics, and the Ministry of Finance to promote economic growth, employment, and competitiveness of Latvia, as well as active participation in development and implementation of sustainable strategy of Latvia.

In order to represent professionally the interests of economic sectors in an efficient dialogue with the Ministry of Economics, the NEC and other business organisations and state institutions, the Ministry of Economics has set up a model for cooperation with the national economy sectors.

Box 6.31

NEC on Priorities of Economic Policy

NEC believes that Latvia should continue the work on development of a stable macroeconomic environment and the growth of national economy in general. In order to promote competition, Latvia must form a balanced budget, competition control must be intensified, and competition development must be promoted in all sectors of national economy in the interests of the society, by timely identifying the risk sectors where violations of the competition law are possible, by limiting administrative and other barriers to the competition.

NEC still considers taxation policy and administration, labour force education, macroeconomic stability, and non-predictability of amendments to the legislation to be the most problematic spheres.

Normative acts must be assessed already during their drafting process, in order to identify and prevent possible violations of the competition law, technical barriers to trade, and discriminating conditions within the sector of free movement of goods and services and business law. The state support and procurement monitoring must be improved, thus achieving a high transparency level for projects with state support.

Establishment of an efficient and competitive sectoral structure must be facilitated, research and development and innovations must be promoted, especially within the private sector, measures must be developed and implemented facilitating co-operation of education, research, and national economy sectors by ensuring transfer of knowledge and technologies. Faster absorption of Structural Funds and new export markets and consolidation in the existing ones must be promoted. The export promotion institutional base, as well as raising its capacity, development of Foreign Economic Representative Offices, accessibility of financial instruments, and support to enterprises in export marketing must be provided.

The NEC reviews proposals for improvement of legislation submitted by the institutions-associations representing the entrepreneurs. Sectoral associations evaluate and give an opinion on the draft legislation. The Ministry of Economics in its turn informs the drafters of the laws and regulations about proposals for improving legislation submitted to the NEC and carries out other measures to implement programmes for development of national economy and improvement of business environment approved within the framework of the government declaration.

At the moment, 15 sectoral associations are represented in NEC (chemistry and pharmaceutics, finance, transport-transit, logistics, power engineering, information and communication technologies, IT cluster, trade, electrical engineering, electronics, light industry, wood industry, engineering industry and metal working, construction, tourism, hotels and restaurants, food, publishing, education, and science).

By signing the memorandum of understanding, the parties agreed to unite their resources for the development of programming documents, take measures for the implementation of the programmes for the improvement of economic development and business environment adopted within the framework of the declaration by the government, and that sectoral associations will assess and give an opinion on draft legislation elaborated by the ministries.

In 2013, 10 National Economy Council meetings have been held, in which the following main issues have been considered:

– economic breakthrough: *Draft Guidelines on National Industrial Policy for 2013-2020*;
– economic breakthrough: *Draft Guidelines on Regional Policy until 2020* prepared by the Ministry of Environmental Protection and Regional Development;
– economic breakthrough: *Latvian Energy Long-Term Strategy 2030 – Competitive* Energy *for Society*;
– *Tax Policy Strategy for 2014-2016*;
– Further limitation and reduction of costs of the mandatory procurement component;
– *Action Plan of Combating Shadow Economy* and its status;
– Time schedule for development of the *Smart Specialization Strategy* and defining priority research directions thereof;
– Medium-term and long-term labour market forecasts.
– Medium-term government budget planning and link of the budget for 2014 with the *National Development Plan*;
– *Judicial Reform*: what has been done and further steps;
– regarding the status of preparation process for the *programming period 2014-2020 in the field of the EU funds;*
– regarding the NEC proposals *to promote preparation of qualified employees in natural science-related industries, imposing a mandatory examination in physics and chemistry on graduates of comprehensive schools;*
– higher education issues in terms of economic growth;
– regarding temporary residence permits;
– *Reports on Progress of Construction Regulation;*
– Practical assessment of *the tax policy for 2014-2016*.

7. Recommendations

Currently, the main competitive advantage of Latvia is cheap labour – labour costs in Latvia are considerably lower than in the old EU countries. The cheap labour and the relatively high profitability do not provide incentives to change the business model and create other competitive advantages. Yet, it will be impossible to sustain the advantage of cheap labour under circumstances of free labour mobility, and therefore incentives for new competitive advantages should be created.

Sustainable development of national economy of Latvia needs promotion of structural changes in the economy in favour of production of goods and services with a higher value added, including by increasing the role of manufacturing, modernizing manufacturing and services and export sophistication. It is an essential precondition for convergence of national economy of Latvia with the developed EU countries and improvement of welfare of people, which can be achieved by boosting innovation-based economic competitiveness of Latvia.

A crucial precondition for sustainable economic growth is strengthening the innovation system in Latvia. At the moment, the low innovation level indicates significant shortcomings of the current innovation system. The identified shortcomings are linked to each individual subject of the innovation system and their mutual interaction.

The main challenges to the innovation system requiring active state action are the following:

- The current business model is insufficiently aimed at innovation;
- The poor cooperation between the business sector and science;
- The current education system fails to ensure a match of labour demand and supply;
- Insufficient scientific and research capacity, technology development and innovation.

At the same time, in order to ensure stable economic growth in the medium-term, it is equally important to continue implementing the measures to improve business environment, especially those related to institutions framework (legislations, tax policy, and support institutions) and improvement of infrastructure. It is also crucial to maintain stable macroeconomic environment. Fair business environment should be promoted to prevent restriction of competition in the market by both entrepreneurs and public persons.

In order to prepare for and adapt to the significant structural changes, the labour market requires proactive reforms. The social assistance system must be improved and reformed to make it more efficient and at the same time ensure better protection of the poor. Latvia has to focus on organizing and encouraging motivation to work.

Taking into account the abovementioned, in our opinion, the immediate tasks of the economic policy are as follows:

- **for developing a knowledge-intensive economy:**
  - to facilitate cooperation between scientists and entrepreneurs by supporting competence centres in order to promote cooperation between the research and manufacturing sectors for implementing industrial research, new products, and technologies, as well as to support technology transfer contact points for purposeful development of the necessary research competence at universities and research institutions and to promote introduction of research results in production;
  - to support development of new products and technologies by encouraging entrepreneurs to implement industrial research by introducing new products, services and technologies in production;
  - to support more actively the development of science potential by concentrating it in areas where Latvia has comparative advantages;

- **for promoting export:**
  - to continue ensuring access to export credit guarantees in order to increase access to the markets with a higher risk degree and to promote export of Latvian goods and services;
  - to continue supporting the participation of entrepreneurs and their unions in international exhibitions and trade missions, in order to foster absorption of new markets;
  - to develop and expand the network of Latvian foreign economic representation offices thus providing the Latvian entrepreneurs with a range of state export support services broadly and easily accessible in export markets;
  - to ensure representation of Latvian external economic interests in the framework of a multilateral, bilateral and regional trading policy to improve contractual conditions of international trade;

- to continue addressing protective measures by eliminating trade barriers faced by Latvian entrepreneurs both in the EU internal and foreign export markets, thus fostering access to world markets and exportability of Latvian entrepreneurs;

- **for ensuring access to workers and improving the supply:**
- to timely identify mismatch between the labour supply and demand according to the development trends of the labour market by providing information to education policy makers; to improve cooperation between various institutions in implementing pre-emptive changes in the labour market;
- to improve the life-long learning system to prevent the current mismatch in the labour market and reduce the risks of structural unemployment;
- to increase attractiveness and quality of vocational education by matching it to the labour market demands;
- to pay particular attention to the youth who are neither studying nor working aimed at returning them back to the education system for obtaining qualification and practice;
- to encourage active involvement of employers in improving the quality of education – establishing practice places, participation in development and improvement of education programmes, as well as development and implementation of active labour market policy measures;
- to develop interdisciplinary education/study programmes focusing on developing business competence; to increase the role of hard sciences and natural sciences in basic and secondary education;
- to develop 1st stage professional higher education (college) studies;
- to review the legal framework of employment relations, by enhancing flexibility opportunities between the employer and the employee;
- to promote a match between training and the labour market demands by improving (changing) the current planning system of labour training, revising the current methodology for short-term forecasting of the labour market and the procedure for defining training directions to take into account the medium-term forecast of the labour market, as well as the medium-term and long-term development objectives of national economy;

- **for improving business environment and ensuring competitiveness:**
  - to develop excellent business environment. To ensure the introduction of electronic registration of real property in the field of real property registration in Latvia. To develop new *Annual Accounts Law* in the field of taxes and accounting. To continue the work on improving and streamlining legal proceedings through introduction of an electronic document exchange system in courts and the principle of specialization of judges. To introduce an opportunity to apply employees of new micro-enterprises for registration in the Register of Enterprises;
  - to develop a procedure for application of the CIT allowance to investments of enterprises in research and development, and to define guidelines for identification of research and development activities, the requirements for research and development project documentation, cost accounting, the conditions for application of the CIT allowance, as well as the institutional framework for evaluation of research and development projects;
  - to develop a mechanism for establishment of industrial areas to ensure coordinated and result-based development of industrial areas in regions to foster entrepreneurship and to attract new local and foreign investments;
  - to restructure the tax system, by making it more socially fair and business-friendly. It must be achieved that the tax burden on entrepreneurship and employment is reduced;
  - to reduce shadow economy by supporting fair and honest entrepreneurs and providing favourable conditions for a transition to official economy; to continue transforming the SRS into an institution helping the entrepreneurs;
  - to revise participation of a public person in business activities and implement a reform of capital shares management and business activities of public persons;
  - to promote development of e-government and e-services. To reduce the risks of implementing projects of information systems and e-services by strengthening the administrative capacity and competence of customers and monitoring project implementation. Functionality of the e-signature must be expanded, accessibility to e-services must be provided and the usage of electronic procurements must be facilitated;
  - to ensure introduction of the one-stop agency principle with regard to availability of the state and local government services. To introduce a one-stop agency principle in registration of real

property data, thus ensuring data exchange between the National Real Estate Cadastre Information System and the State Unified Computerised Land Register;
  - to develop an up-to-date legal framework of the construction process and new construction standards, including adaptation of the Eurocode standards into the system of laws governing the construction sector, thus creating pre-conditions for development of a sustainable and competitive construction sector;
  - to improve mutual coordination of data and terms for entering data in state registers and other information systems and to ensure maximally complete and quick update of information stored in the registers in order to prevent discrepancy of information between the registers and the actual situation, as well as to avoid repeated requests of information from respondents;
  - to prioritise cases and actively address the most severe violations of the *Competition Law* – prohibited agreements and abuse of the dominant position. As regards the abovementioned violations, particularly identification of cartels, preventive measures are of big importance by performing inspections in the priority markets and implementation of leniency program;
  - to improve the regulation of merger report consideration to ensure quality public service. It is particularly important to foster coordination of the regulation with neighbouring countries to reduce the amount of information to be provided, promote awareness of market participants and develop explanatory guidelines, thus ensuring faster consideration of reports;
  - to implement measures to promote free and fair competition within the regulatory framework of the sectors (including the legislation drafting process), thus reducing the risks to competition caused by actions of public persons;

- **for ensuring access to finance:**
  - to provide access to finance at all business development stages, particularly, at the business start-up stage;
  - to continue issuing loan guarantees. It is necessary to provide enterprises with a possibility to access credit resources for commercial activities in case of insufficient security for attracting the necessary amount of credit resources;
  - to develop venture capital instruments for stimulating investments in development and expanding activities of enterprises. Financing of venture capital funds requires private investor resources;

- **for improving energy efficiency:**
  - to make energy efficiency a cross-industry policy objective, by including it not only in industry and service policy areas, for example, energy, construction, industrial, domestic market, etc., but also in natural resources, including renewable energy resources, agricultural manufacturing and processing policy areas (agricultural policy, forestry policy, fisheries policy), environmental, regional transport, and communication policy areas, as well as emphasize it in international relations, education and training;
  - to promote and support energy efficiency in multi-apartment buildings, public buildings, industrial buildings by developing a sustainable financing model (a rotating fund) for improvement of energy efficiency;
  - to revise the minimum requirements for energy efficiency of buildings, considering the most optimal costs, contributing to the lowest costs during the estimated lifetime;
  - to improve the criteria and define the objectives regarding construction of low or nearly zero energy consumption buildings;
  - to promote public awareness of various methods and practices for improving energy efficiency of buildings, to promote application of good practice of energy efficiency of buildings to public sector buildings;
  - to strengthen support for research, development and implementation of new energy efficient technologies, thus providing a possibility for dynamic development of energy efficiency solutions, as well as innovations and new jobs;
  - to identify the best energy economy scheme for Latvia imposing an obligation on energy traders to save energy in the end-consumption sectors under the *Energy Efficiency Directive 2012/27/EU*;

- **for ensuring efficient, safe, and sustainable energy supply:**
  - to continue Latvian and Northern electricity market integration and increase market liquidity and objective, transparent electricity pricing, as well as development of regulatory framework of the market;
  - to complete risk assessment for possible liberalization scenarios of the natural gas market of Latvia;

- to ensure implementation of energy infrastructure development projects and energy market integration measures within the *Baltic Energy Market Interconnection Plan*, as well as to achieve including the infrastructure projects important for Latvia in the list of projects of general importance;
- to develop proposals for reducing the risks of increasing electricity prices by evaluating the current support;
- to develop an economically reasonable and flexible policy for the use of renewable energy resources in producing energy.

A consistently implemented structural policy will promote revival of the Latvian economy, which will form the basis for increasing the standard of living of the population. Successful development and economic growth of Latvia will depend not only on the work of public institutions, but also on personal initiative of any person anywhere in Latvia under the conditions of mutual public understanding and dialogue.