Ministry of Economics
Republic of Latvia

ECONOMIC DEVELOPMENT OF LATVIA

REPORT

RIGA

June 2010

Comments, questions or suggestions are welcomed:

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Dear reader,

The experts of the Ministry of Economics have prepared already the 32nd ***Report on the Economic Development of Latvia***. 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 evaluation of the economic situation in Latvia and shows the progress of reforms, as well as offers economic development forecasts.

The global financial crisis has affected the economy of Latvia particularly hard. The gross domestic product during the crisis has decreased by ¼; the unemployment level has increased from 5.3% at the end of 2007 to 19.7% at the end of 2009. Due to the substantial decrease of budget revenues, the general state budget deficit reached 9% of GDP in 2009.

The most critical period for the real sector of the economy was the 1st and the 2nd quarter of 2009, when GDP and employment dropped most rapidly. In the 3rd and the 4th quarter of 2009 the economic recession was still in progress yet significantly slower than in the previous quarters, as well as exports and manufacturing had already shown a slight increase. The estimated GDP has already shown the increase of 0.3% in the 1st quarter of 2010 compared to the previous quarter according to the seasonally adjusted data. Thus, economic recession in Latvia is over.

Currently, we can surely state that Latvia has gone through important macroeconomic adjustments. The economic model, which existed before due to the inflow of foreign capital and the increase of domestic demand does not exist anymore. At the moment, a transition to a sustainable economic model based on exports takes place. The first signs are showing that the situation is really improving in the sectors, which have export opportunities. The exports of goods during the first five months of 2010 exceeded the exports of the same period of the last year by 22%. Latvia's terms of trade have improved – the Latvian export prices have grown more rapidly than the import prices. Compared to the last year, the real effective exchange rate of the lats has decreased. That is advantageous for the Latvian exporters, because their competitiveness is increasing.

Also stabilization of the domestic demand is observed. The confidence indicators are improving in manufacturing, construction and services sectors. A high and continuously increasing current account deficit, which has been characteristic for Latvia over the last years, does not exist anymore – since 2009, the current account balance is positive.

However, it should be noted that the situation in the labour market still is tense, although some positive tendencies can be observed there as well. At the end of March 2010, 194 thousand unemployed were registered at the State Employment Agency. As from April 2010, the situation has begun to improve gradually. The number of registered unemployed people has decreased by 17.4 thousand people from the end of March 2010 until the end of June 2010. Already now, the demand for a qualified labour force is growing, especially in the export-oriented sectors.

Taking into account the economic development tendencies, the government is acting to revive economic growth in the country and to balance the budget expenditures with revenue opportunities. At the same time, the preconditions for successful transition to a higher production level (higher productivity) are created.

The main economic policy priorities of the Ministry of Economics for 2010 are stimulation of the economy and restructuring, support to export activities, development of micro enterprises and promotion of energy independence.

It should be noted that in 2009 and up to the end of 2010 the Ministry of Economics will provide the economy of Latvia with LVL 350 million in the form of state support instruments (LVL 670 million including the attracted private investments). It is the largest state granted support to entrepreneurship over the past 20 years. For instance, in 2008 the Ministry of Economics provided only LVL 20 million.

By attracting the financing of EU structural funds, several state support programmes have been launched or are continued, such as *Development and Introduction of New Products and Technologies into Production, Support to Technology Transfer Contact Points, Support to Business Incubators,* which are aimed at promotion of knowledge based economy, i.e., promotion of knowledge and technology transfer into production to ensure production of higher value added products and establishment of new innovative enterprises.

Priorities for granting state support financing have been changed under my initiative, by focusing on manufacturing and exports. For instance, in 2010 almost LVL 80 million have been granted to export-oriented production development programme *High Value Added Investments*. At the beginning of June, an agreement was achieved with international creditors to increase the co-financing available from the EU funds by LVL 100 million in 2010.

In cooperation with the Ministry of Foreign Affairs, the structure of external economic agencies of Latvia has been optimized and improved. According to a recommendation of the Advisory Committee, new agencies will be opened in Finland, Lithuania, Belarus and Ukraine this year. Moreover, in cooperation with the Ministry of Foreign Affairs and ambassadors, several investment projects will be launched.

By signing the agreement with organizations representing tourism sector, the value added tax for guest accommodation services has been reduced from

21% to 10%. According to the estimations of the tourism associations, it will allow providing approximately 2000 new jobs, as well as will enable at least 5% reduction in price for the provided services.

A lot has been achieved with regard to support for micro enterprises. Today it is possible to establish an enterprise initially investing only 1 lats in equity capital. Also other fees regarding the business start-up have been reduced significantly. An opportunity has been provided to simplify micro enterprise accounting. For small tax payers with the annual turnover of up to LVL 70 thousand, the taxation period regarding the value added tax has been extended and the so-called "cash principle" has been introduced. By introducing patent fees, the individual work performers can work without bureaucratic barriers.

A particular attention is being paid to the development and monitoring the implementation of the annual *Action Plan on Improvement of the Business Environment*, by decreasing the administrative burden on entrepreneurship. It is planned to decrease the registration costs for a new enterprise and to develop an electronic registration system for enterprises. In the result, the future entrepreneurs will not have to visit different institutions – notary, bank, Register of Enterprises and State Revenue Service in order to register an enterprise.

A new draft of the Construction Law has been developed, approved by the government and sent for review to the Saeima. It envisages reducing the number of public and local government institutions involved in coordination of a construction project from 5 to 1, and the maximum period to be spent for the coordination process has been reduced from the current more than 180 days to 60 days. According to the experts' estimation, the gain for the construction sector by eliminating bureaucratic barriers might reach at least LVL 2 million.

In the energy sector, in 2010, the most important work will be to continue the implementation of the launched development projects aimed at promoting energy independence and security of energy supply of Latvia, as well as the integration of energy markets of the Baltic States into the EU single market.

Taking into account the radical changes of the economic development tendencies and the administrative reforms implemented in Latvia, it is necessary to amend the *Energy Development Guidelines for 2007–2016*, by updating the indicative objectives, results, planned sources of the necessary financing and responsible institutions. In 2010, it is planned to announce an international tender to attract an investor, who will be entrusted to construct a 400 MW solid fuel electric power station in Kurzeme.

It should be noted that new *Law on Renewable Energy Resources* is being drafted currently, envisaging to completely change the green energy market functioning principles and to create long-term predictability and stability in this important area. The prices will be set in accordance with the market principles, but not according to the lobby interests. Such procedure will allow giving up the quota system and will ensure the competitiveness of a green energy.

In order to achieve the set goals, we will continue the dialogue with our social partners – entrepreneurs and non-governmental organisations representing them.

The Report will provide you information on the main economic and social indicators, development of the national economy sectors, external economic environment, as well as the economic policy of the government for promotion of growth and jobs, foreign trade policy, utilisation of the EU Structural Funds and the Cohesion Fund, innovation and entrepreneurship policy, as well as other economic reforms.

At the end of the Report, the authors provide recommendations regarding the improvement of the economic policy.

The Cabinet of Ministers has not assessed all the issues addressed in the Report; hence several conclusions on the economic development of the country and proposals for further action reflect purely the opinion of experts of 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 exchange of opinions between the public institutions, various organisations and interest groups, as well as other stakeholders.

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

June 2010

Artis Kampars
Minister of Economics

CONTENTS

ABBREVIATIONS

Abbreviations

CC	Competition Council
CF	Cohesion Fund
CHP	Combined Heat and Power
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
CM	Cabinet of Minister
CPI	Consumer Price Index
CRPC	Consumer Rights Protection Centre
CSB	Central Statistical Bureau
CSMEC	Council of Small and Medium-Sized Enterprises and Crafts
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 May 1, 2004
EU SF	European Union Structural Funds
FDI	Foreign Direct Investment
FIFG	Financial Instrument for Fisheries Guidance
FOB	Price of the good, including value, and transport and insurance costs to the border of exporting country
FTA	Free Trade Agreement
GDP	Gross Domestic Product
HPP	Hydro-Power Plant
IC	interstate commission
ICT	Information and Communication Technologies
IDAL	Investment and Development Agency of Latvia
IMF	International Monetary Fund
IMI	Internal Market Information
JSC	Joint Stock Company
LGA	Latvian Guarantee Agency
LLC	Limited Liability Company
LNAB	Latvian National Accreditation Bureau
LVS	Latvian Standard
MW	megawatt
MWh	megawatt per hour
NEC	National Economy Council of the Ministry of Economics
NGO	Non-Governmental Organisation
NSFD	National Strategic Framework Document
OP	Operational Programme
PJ	petajoule
RSE	Riga Stock Exchange
SEA	State Employment Agency
SJSC	State Joint Stock Company
SLS	State Land Service
SMEs	Small and Medium-Sized Enterprises
SOLVIT	EU Internal Market Problem Solving System (SOLVIT Network)
SPD	Single Programming Document
SRS	State Revenue Service
TDI	Trade defence instruments
TPS	Thermal Power Station
TWh	terawatt per hour
USA	United States of America
VAT	Value Added Tax
WB	World Bank
WTO	World Trade Organisation

Country Abbreviations

AT	Austria	IE	Ireland
BE	Belgium	IT	Italy
BG	Bulgaria	LT	Lithuania
CZ	Czech Republic	LU	Luxemburg
CY	Cyprus	LV	Latvia
DE	Germany	MT	Malta
DK	Denmark	NL	Netherlands
EE	Estonia	PL	Poland
EL	Greece	PT	Portugal
ES	Spain	RO	Romania
EU	EU-27 countries	SE	Sweden
FI	Finland	SI	Slovenia
FR	France	SK	Slovakia
HU	Hungary	UK	United Kingdom

Symbols

–	Magnitude zero / absent	...	Data not available or too uncertain

1. ECONOMIC SITUATION: BRIEF OVERVIEW

The global crisis has hit the economy of Latvia particularly severely. The GDP during the crisis has decreased by ¼ (4th quarter of 2009 compared to the 4th quarter of 2007, which was the last quarter with a positive growth), the unemployment level grew from 5.3% in the 4th quarter of 2007 to 19.7% at the end of 2009. Due to substantial decrease of budget revenues, the general state budget deficit reached 9% of GDP in 2009.

The depth of the crisis in Latvia has been intensified by the marked imbalance of the external sector, which developed during the rapid growth period. Significant increase in private consumption and investments, which exceeded the overall growth of the economy, to a great extent was based on significant inflow of foreign capital. It led to a high current account deficit of the balance of payments and in the result increased vulnerability of the Latvian economy. Due to the impact of the global financial crisis and due to low capital inflow, there was a sharp decrease in private consumption and investments, as well as significant adjustment of the exports-imports balance for goods and services and decline in the output volume was observed.

The most difficult period for the Latvian economy was at the end of 2008, when the financial sector and state budget faced a critical situation and financial help was asked from the international financial organizations. In December 2008, the Saeima adopted *Economic Stabilisation and Growth Revival Programme of Latvia*, which sets forth the key directions to overcome the economic crisis.

The most critical period for the real sector of the economy was the 1st and the 2nd quarter of 2009, when GDP and employment fell most rapidly. In the 3rd and 4th quarter of 2009, the economic recession continued, but at slower pace than in the previous two quarters, as well as exports and industrial output started increasing slightly. In total, the GDP decreased by 18% in 2009.

A rapid economic recession is over in Latvia. According to the GDP estimations, it has increased by 0.3% in the 1st quarter of 2010 compared to the previous quarter according to the seasonally adjusted data.

Table 1.1

Latvia: Key Economic Development Indicators

	2006	2007	2008	2009	2010f
(changes in comparison with the previous year, %)					
Gross domestic product	12.2	10.0	-4.2	-18.0	-3.0
Private consumption	21.2	14.8	-5.2	-24.0	1.0
Public consumption	4.9	3.7	1.5	-9.2	-6.5
Gross fixed capital formation	16.4	7.5	-13.6	-37.3	-30.3
Exports	6.5	10.0	2.0	-15.5	5.0
Imports	19.4	14.7	-11.2	-35.5	5.9
Consumer prices	6.5	10.1	15.4	3.5	-1.6
(% of GDP, unless indicated otherwise)					
General government budget fiscal balance	-0.5	-0.3	-4.1	-9.0	-8.5
General government debt	10.7	9.0	19.5	36.1	55.1
Exports-imports balance	-21.5	-20.2	-13.6	-0.7	-0.8
Changes in the number of employed population (aged 15-74 years)	5.0	2.9	0.5	-12.2	-6.5
Unemployment rate (share of job-seekers in the number of economically active persons aged 15-74 years, %)	6.8	6.0	7.5	16.9	17.0

f – forecasts

The situation has improved due to increase in exports. The volume of exports of Latvian goods and services in the 1st quarter of 2010 exceeded the level of the 1st quarter of 2009 by 4.6%. At the same time, imports decreased by 2.7%. Currently, the exports-imports balance of Latvia has balanced and deficit has remained only at 0.2% of GDP.

Although private consumption in the 1st quarter of 2010 was by 5.8% lower than in the same period of 2009, it should be noted, that it has increased compared to the 4th quarter of 2009 according to the seasonally adjusted data. An increase in retail trade turnover in the first months of 2010 witnesses the improvement of the situation.

The only component of aggregate demand, which continues decreasing this year, is investments. That is due to the cautious crediting policy of the banks, decrease in state and local governments' investments and low capacity load.

According to the breakdown by sectors, an increase in the 1st quarter of 2010 was observed in all goods production sectors. Growth of the key export sectors – manufacturing – should be mentioned. The production volume of manufacturing exceeded in the 1st quarter of 2010 the level of the 1st quarter of 2009 by 6.8%. Wood-processing has achieved particularly encouraging results, where the output in this period has increased by a third exceeding the level of 2007 and 2008. The increase can be observed also in such large and industrially important sectors for Latvia as metal industry and machinery. Also other manufacturing industries are on the path of stabilization. The output of electricity, gas and water supply has grown significantly, which to a great extent was related to the cold winter.

Due to the decrease of investments in the economy, the volume of construction has decreased as well. In the 1st quarter of 2010 compared to the same period of 2009, the volume has decreased by 43.4 percent.

In majority of the services sectors, the volume of output more or less falls behind the level of the 1st quarter of 2009, particularly public services. However, the situation in several services sectors is gradually improving, where, according to the seasonally adjusted data, in comparison with the previous quarter, growth can be observed, for example in trade.

Taking into account positive tendencies (growth of exports, gradual increase of private consumption, improvement of entrepreneurs' confidence, stabilisation of situation in the labour market, as well as increase of producer prices), the Ministry of Economics forecasts, that the GDP will gradually increase in the upcoming quarters. **However, the overall level of GDP will be lower by 3% in 2010 compared to 2009**, because the growth has to revive from a very low level.

Due to the impact of the crisis, the consumer prices decreased gradually. Prices for goods responded the first to the decrease of domestic demand and started falling in the 2nd half of 2008, but prices for services – only in March 2009. From April 2009, when the decline in prices began, until December, the prices decreased on average by 0.5% per month. In the result, in December 2009, the 12-month inflation was negative, i.e., a 1.2% deflation had been observed.

In January and February 2010 compared to the previous month, the decline of prices has stopped. However, as the prices increased faster in the previous year, the 12-month deflation became deeper and in February it reached 4.2%. The consumer prices were by 1.4% lower in June 2010 than a year before. However, the dynamics of prices **since March 2010 do not witness the continuation of deflation**, which has been characteristic in the 2nd half of 2009.

Although private consumption is at the low level, it does not decrease anymore. Thus, it cannot be considered as a factor that can influence decrease of prices. The pressure of supply-side factors on the decrease of prices, which has been characteristic at the beginning of the crisis, when the decrease of prices has been affected by the large amount of production stocks and the willingness of entrepreneurs to get rid of them as soon as possible, is not observed anymore. It could be considered currently, that the stocks adjustment cycle is over and the current production volumes correspond to the low demand level. The further price tendencies from the supply side will be determined by the changes in prices for production factors, which more likely will increase.

The situation in the global financial market has negatively affected the financial sector of Latvia. Due to the rise in prices for monetary resources the crediting volume has decreased. Also, limited availability of finance reduces household consumption and weakens enterprise development chances and increases the necessity to accumulate savings.

At the end of 2008, decrease of deposits attracted from the residents has begun and it has continued also in 2009 reaching the lowest point in the 3rd quarter of 2009. With stabilization of the situation in the financial market, the number of private and corporate deposits went up again, and at the end of the 1st quarter of 2010 compared to the same period of 2009 the growth was by 4.9 percent.

Since November 2008, the volume of loans granted anew to residents per month is lower than the volume of repaid loans, and the volume of loan balance is decreasing. The loans granted to entrepreneurs at the end of the 1st quarter of 2010 compared to the same period of 2009 have decreased by 9.2%, but loans granted to households – by 5 percent.

In 2009, there was a rapid increase in the number of loans with overdue payments, which can be explained by low paying capacity of households and limited savings. However, in December 2009, for the first time since autumn 2008, the number of loans without overdue payments has increased. The total volume of loans with overdue payments in December reached LVL 3.9 billion or 25% of the total loan portfolio of the banks. At the beginning of 2010, a decrease in the number of loans without overdue payments is still continuing. At the end of March 2010, 72.5% of loans were without overdue payments, which were by 15.7% less than in the same period of 2009, when 74.5% of loans were without overdue payments.

The deterioration of the economic situation has significantly affected the fiscal condition of Latvia. The decrease of the budget revenues began at the end of 2008. It forces the government to implement a budget deficit limitation policy that causes additional short-term pressure on decrease of domestic demand and narrowing of the domestic market. In order to cut budget expenditures, optimization of public administration and several sectors has been carried out – reducing the staff in the ministries along with the number of state agencies, hospitals and schools. Moreover, wages in the public sector have been reduced.

The general government budget deficit in Latvia in 2008 was LVL 671.5 or 4.1% of GDP and in 2009 it increased to LVL 1183 million or 9% of GDP.

Due to low economic activity level, budget revenues have not increased also at the beginning of 2010. In the first 5 months of 2010 they were LVL 1939.6 million, which was by 5.3% lower than in January-May 2009, however, budget expenditures were LVL 2094.9 million, which was by 12.2% lower than in the corresponding period of the previous year. In the result, in the first 5 months of 2010 budget deficit comprised LVL 155.3 million (for comparison: budget deficit reached LVL 337.8 million in the respective period of 2009).

In 2010, it is planned that the budget deficit in Latvia will not exceed 8.5% of GDP. In order to ensure conformity of the budget with the decline of economic development and to comply with the agreement of the Latvian government with international partners, decisions regarding significant fiscal consolidation measures were made in preparation of the state budget for 2010. The total budget consolidation in 2010 was carried out in the amount of LVL 507.5 million, i.e., the budget balance improved by 4.3% of GDP.

In the medium term, while moving towards the euro introduction, it is planned to reduce the budget deficit to 6% of GDP in 2011 and 2.9% of GDP in 2012.

Since the end of 2008, when economic recession has reflected in the employment rates, the labour market encountered remarkable changes. Due to the decrease of labour demand, in 2009 the number of the employed in the age group of 15-74 years dropped by 137.4 thousand or 12.2%. It should be noted, that the decrease of employment in 2009 has been affected mostly by the decline of labour demand in construction, where the number of employed dropped by 51 thousand or almost by 40%. The number of employed in manufacturing has decreased as well (by 35.9 thousand or by 21.6%) and trade (by 24.4 thousand or by 11.5%). In the public services sector, the number of employed has gone down by 5.3% (12.3 thousand). However, the number of employed in commercial services has increased in this period (by 1.8 thousand or by 1.3%).

Along with the decrease of employment, the unemployment has grown rapidly as well. In 2009, the unemployment level increased by 9.4 percentage points. According to the data of the State Employment Agency, at the end of 2009, there were 179.2 thousand registered unemployed people, which comprised 16% of the economically active population of Latvia. At the end of March 2010, already 194.2 thousand or 17.3% unemployed people were registered. Since April the situation has been gradually improving and by the end of June the number of registered unemployed people has decreased by 17.4 thousand and the unemployment level has gone down to 15.6 percent.

The recovery of the economy of Latvia in the upcoming years will depend to a great extent on how quickly the global financial system and main trading partner countries of Latvia will recover, how successfully Latvia will be able to compete in the open markets for goods and services.

Economic recovery of Latvia may start in 2011, if financial markets stabilize fully and crediting is restored, which will give positive stimulus for Latvian entrepreneurs and ensure a gradual increase of external demand in the main trading partner countries of Latvia. Therefore in 2011, more rapid development of export-oriented sectors is expected. At the same time, with reviving of domestic demand, it is expected that positive growth tendencies in the sectors oriented towards domestic market will be observed as well. **The Ministry of Economics forecasts, that the GDP will increase by 3% in 2011 compared to 2010.**

Positive tendencies in the labour market (increase of employment) are expected a little bit later than economic growth. Moreover, an increase in the number of employed people will be considerably more moderate than economic growth, because the increase of output to a greater extent will be based on the rise in labour productivity and to a lesser extent on the increase in the number of employed people.

The further development of the economy in the medium term will be determined not only by the recovery of growth in the global economy, but also on the efficiency of economic recovery policy implemented by the Latvian government, which are the key factors for a faster economic recovery of Latvia.

2. DEVELOPMENT OF THE WORLD ECONOMY[1]

The recovery of the world economy has been more rapid than it has been forecasted before, however, regionally development is uneven. It is more rapid in the number of less developed and developing countries. The provision of stimulation policies plays a significant role in the recovery process. Monetary policy has been very expansive based on the provision of unconventional liquidity. The fiscal policy also provided substantial stimulus during the period of deep recession.

The International Monetary Fund (hereinafter – IMF) considers that the USA is the most successful in the recovery process among developed countries, but slightly weaker development is observed in the European countries and Japan. The Asian countries were more successful among the less developed and developing countries. Similarly, a considerable growth has been observed in the South American countries and other fast-growing and developing economies, however, several new EU member states and CIS countries lagged behind.

Table 2.1

GDP Growth
(percentage in comparison with the previous year)

	2008	2009	2010 f	2011 f
World, including:	**3.0**	**-0.6**	**4.2**	**4.3**
USA	0.4	-2.4	3.1	2.6
Japan	-1.2	-5.2	1.9	2.0
EU, including:	0.9	-4.1	1.0	1.8
Euro zone countries	0.6	-4.1	1.0	1.5
CIS	5.5	-6.6	4.0	3.6
China	9.6	8.7	10.0	9.9

Source: "The World Economic Outlook", April 2010, International Monetary Fund; f – forecast

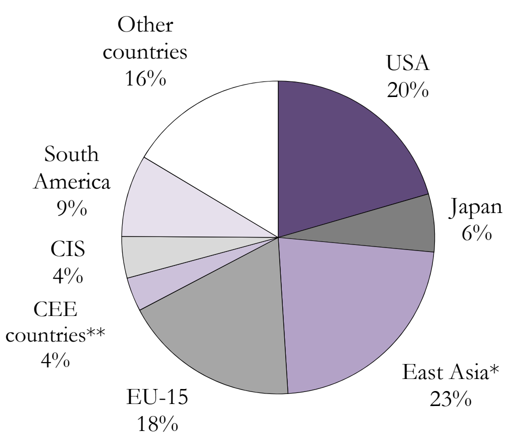
The recovery of the real sector and financial activities is inter-complementary, but the credit availability in several sectors is still limited. Money markets have stabilized, corporate bonds and stock markets start to recover. The growth of crediting in several economies fast-growing and developing countries has started again, but the financial conditions are still stricter than before the crisis.

Consumers and small and medium-sized enterprises have a limited access to the capital market and still face strict loan limitations. The growing public deficits and debts of some developed countries have fostered rapid growth of the state securities rates that impose new risks for the further recovery process.

It is forecasted, that the world economy will increase by about 4.2% in 2010, which should be considered as substantial, taking into account the decrease in 2009. The recovery of activities to a great extent depends on the favourable macroeconomic policies, however, the risk of fiscal vulnerability remains. The IMF suggests maintaining supporting fiscal and monetary policy in the majority of the developed countries in order to promote growth and employment in 2010. However, in a number of the developed countries there is a necessity to implement medium-term strategic planning immediately in order to limit public debt and in the future to reduce it to a sustainable level.

Figure 2.1

Breakdown of the World's GDP by Groups of Countries in 2009
(structure, GDP by purchasing power parity units)



Source: "The World Economic Outlook", April 2010, International Monetary Fund.
* China, Malaysia, Singapore, Thailand, the Philippines
** Central and Eastern European countries - Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Malta, Poland, Romania, Serbia, Montenegro, Slovakia, Slovenia, Turkey

[1] In order to prepare this chapter, the "World Economic Outlook", April 2010 published by the International Monetary Fund and the „European Economy", 2|2010 published by the European Commission has been used.

A considerable growth has started in a number of developing countries, mainly due to the favourable macroeconomic policies that are directed towards the attraction of capital. Taking into account that the IMF assesses the growth in the developed countries as rather weak, the challenge of the developing countries is in a successful acquisition of the growing inflowing capital and promotion of domestic demand by not creating new overheating risks of the economy.

The economic growth has restarted in the **USA,** however the private consumption remains rather weak. Weakening of monetary and fiscal conditions together with other policies in order to support financial sector and housing market has stimulated growth considerably. According to the IMF estimations, the fiscal stimulus in 2009 raised the growth of GDP by approximately 1 percentage point. The real GDP increased by 2.2% (according to the seasonally-adjusted data) in the 3rd quarter of 2009 and by 5.6% in the 4th quarter due to the abovementioned stimulus measures and taking into account substantial reduction of inventories. However, the domestic demand is still weak and lags behind from the pre-crisis level. In the 4th quarter of 2009 the domestic demand increased only by 1.6%. The net exports provided a slight positive contribution to the growth of USA due to the recovery of the world trade and economies of the partner countries.

Further recovery of the US economy will be slower and gradual, especially if the effect of stimulus measures decreases. In 2010, the growth of GDP is estimated by 3%, and that in comparison with the previous IMF estimations is more optimistic. Due to the low households' welfare level, the recovery will be still limited. Slow recovery of financial sector and reduction of indebtedness, as well as comparatively slow growth of activity in the labour market is also expected. The growth in 2011 could slightly decrease – to 2.6% mainly due to the decrease of stimulus policies. It is forecasted that the unemployment rate in 2010 will remain high (9.5%) and in 2011 it will decrease slightly (to about 8%) due to the increase of employment. Inflation in the USA will be moderate – slightly above 2% in 2010 and under 2% in 2011.

Although in a number of **Asian countries** the economic recession in the end of 2008 has been more rapid than forecasted before, still the current recovery is taking place comparatively rapidly. Except for Japan the growth of production volumes in 2009 almost in all Asian countries was bigger than forecasted. The V-shaped economic development points to the decline that was more moderate in comparison with other regions. Also the recovery in Asia is more balanced than in other regions due to the increase of production volumes in the majority of countries that rely on the growth of both, external and domestic demand. Although macroeconomic stimulus in this region was considerable, the domestic demand also made contribution to the growth of several countries in this region. It is forecasted that in the number of Asian countries the recovery will remain comparatively stable also in the future.

Although the growth of GDP in the Asian countries in total is forecasted by 7% annually in 2010-2011, still rather big regional differences exist, that is, economies of the developing countries grow more rapidly than the economies of the developed countries.

Europe is considered as the region, which is most severely hit by the crisis. The recovery of the developed and developing countries differs substantially.

Substantial macroeconomic stimulation has supported the recovery of the developed countries of the region (Germany, France, the United Kingdom), but the domestic demand is still low. Similarly, also export opportunities are limited due to the low external demand. At the same time, high current account deficits and fiscal imbalances hinder the recovery of several small countries (Greece, Ireland, Portugal, Spain), which also negatively affects the development opportunities for other countries of the region.

Also in the new EU member states the development perspectives are different. Further inflow of capital and normalization of foreign trade are forecasted in the countries that have undergone the crisis relatively good (Poland). However, those countries with unbalanced economies in the pre-crisis period (Bulgaria, Latvia and Lithuania) and the countries where high risks of insolvency existed both in private and in public sectors (Hungary, Romania and the Baltic States) are recovering more slowly. Similarly, the recession in the most of the new EU member states has been affected by the rapid decrease of foreign capital inflow, as well as taking into account the decrease of crediting related to the problems in the banking sector, as well as by the drop of construction activity and related crediting.

Although the balancing of the current account is observed in the developing countries, this problem remains topical and hardly solvable in the Euro zone countries due to the limited currency value's adjustment opportunities to improve competitiveness.

Table 2.2

Main Macroeconomic Indicators of EU-15 Member States

(%)

	GDP growth				Consumer prices				Current account balance (% of GDP)			
	2008	**2009**	**2010 f**	**2011 f**	**2008**	**2009**	**2010 f**	**2011 f**	**2008**	**2009**	**2010 f**	**2011 f**
EU, total inter alia:	**0.9**	**-4.1**	**1.0**	**1.8**	**3.7**	**0.9**	**1.5**	**1.5**	**-1.1**	**-0.3**	**-0.2**	**-0.1**
Austria	2.0	-3.6	1.3	1.7	3.2	0.4	1.3	1.5	3.5	1.4	1.8	1.7
Belgium	0.8	-3.0	1.2	1.3	4.5	-0.2	1.6	1.5	-2.5	-0.3	-0.5	-0.1
Denmark	-0.9	-5.1	1.2	1.6	3.4	1.3	2.0	2.0	2.2	4.0	3.1	2.6
Finland	1.2	-7.8	1.3	2.2	3.9	1.6	1.1	1.4	3.0	1.4	2.0	1.8
France	0.3	-2.2	1.5	1.8	3.2	0.1	1.2	1.5	-2.3	-1.5	-1.9	-1.8
Germany	1.2	-5.0	1.2	1.7	2.8	0.1	0.9	1.0	6.7	4.8	5.5	5.6
Greece	2.0	-2.0	-2.0	-1.1	4.2	1.4	1.9	1.0	-14.6	-11.2	-9.7	-8.1
Ireland	-3.0	-7.1	-1.5	1.9	3.1	-1.7	-2.0	-0.6	-5.2	-2.9	0.4	-0.1
Italy	-1.3	-5.0	0.8	1.2	3.5	0.8	1.4	1.7	-3.4	-3.4	-2.8	-2.7
Luxemburg	0.0	-4.2	2.1	2.4	3.4	0.8	1.0	1.4	5.3	5.7	11.2	11.6
Netherlands	2.0	-4.0	1.3	1.3	2.2	1.0	1.1	1.3	4.8	5.2	5.0	5.3
Portugal	0.0	-2.7	0.3	0.7	2.7	-0.9	0.8	1.1	-12.1	-10.1	-9.0	-1.,2
Spain	0.9	-3.6	-0.4	0.9	4.1	-0.3	1.2	1.0	-9.6	-5.1	-5.3	-5.1
Sweden	-0.2	-4.4	1.2	2.5	3.3	2.2	2.4	2.1	7.8	6.4	5.4	5.8
United Kingdom	0.5	-4.9	1.3	2.5	3.6	2.2	2.7	1.6	-1.5	-1.3	-1.7	-1.6

Source: "World Economic Outlook", April 2010, International Monetary Fund; f – forecasts

As it has been mentioned above, the **Baltic States** have been hit by the crisis most severely. After the rapid growth in 2001-2007, the GDP of the Baltic States in 2009 decreased more rapidly than in other countries of the region. The domestic demand has declined very rapidly due to considerable external and internal imbalances. Stabilization of the economies of the Baltic States is forecasted in 2010, and growth revival – in 2011. Due to the adjustments of wages and prices, as well as to the state support in the implementation of export programs, the recovery of Estonia takes place quicker.

Table 2.3

Main Macroeconomic Indicators of the New EU Member States

(%)

	GDP growth				Consumer prices				Current account balance (% of GDP)			
	2008	**2009**	**2010 f**	**2011 f**	**2008**	**2009**	**2010 f**	**2011 f**	**2008**	**2009**	**2010 f**	**2011 f**
EU, total inter alia:	**0.9**	**-4.1**	**1.0**	**1.8**	**3.7**	**0.9**	**1.5**	**1.5**	**-1.1**	**-0.3**	**-0.2**	**-0.1**
Bulgaria	6.0	-5.0	0.2	2.0	12.0	2.5	2.2	2.9	-24.2	-9.5	-6.3	-5.8
Cyprus	3.6	-1.7	-0.7	1.9	4.4	0.2	2.7	2.3	-17.7	-9.3	-11.4	-10.9
Czech Republic	2.5	-4.3	1.7	2.6	6.3	1.0	1.6	2.0	-3.1	-1.0	-1.7	-2.4
Estonia	-3.6	-14.1	0.8	3.6	10.4	-0.1	0.8	1.1	-9.4	4.6	4.7	3.9
Hungary	0.6	-6.3	-0.2	3.2	6.1	4.2	4.3	2.5	-7.2	0.4	-0.4	-1.0
Latvia	-4.6	-18.0	-4.0	2.7	15.3	3.3	-3.7	-2.5	-13.0	9.4	7.0	6.3
Lithuania	2.8	-15.0	-1.6	3.2	11.1	4.2	-1.2	-1.1	-11.9	3.8	2.7	2.6
Malta	2.1	-1.9	0.5	1.5	4.7	1.8	2.0	2.1	-5.4	-3.9	-5.1	-5.1
Poland	5.0	1.7	2.7	3.2	4.2	3.5	2.3	2.4	-5.1	-1.6	-2.8	-3.2
Romania	7.4	-7.1	0.8	5.1	7.8	5.6	4.0	3.1	-12.2	-4.4	-5.5	-5.5
Slovakia	6.2	-4.7	4.1	4.5	3.9	0.9	0.8	2.0	-6.5	-3.2	-1.8	-1.9
Slovenia	3.5	-7.3	1.1	2.0	5.7	0.8	1.5	2.3	-6.2	-0.3	-1.5	-1.2

Source: "World Economic Outlook", April 2010, International Monetary Fund; f – forecasts

Taking into consideration the substantial economic recession during the global crisis, the **CIS countries** recover from the recession in a comparatively moderate speed. Similarly to the European countries, the recovery is different among the CIS countries and more successful in Turkmenistan, Uzbekistan and Russia, but less successful in Armenia and Georgia. However, growth in Armenia and Georgia is forecasted in 2010.

The recovery in the CIS countries is determined by a number of factors. Firstly, the growth in the export-oriented countries is fostered by high prices of oil products, gas and metal which support production and employment. Secondly, the normalization of the global trade and capital flow helps the CIS countries to recover. The increase of activity of the real sector in Russia also fosters external demand in the rest of the region. However, such risk factors that can hinder growth in several CIS countries as for instance vulnerability of the financial sector and high independence from foreign capital should be also mentioned.

Similarly to other countries, also in Russia the rapid economic recession in 2009 was determined by the decrease of foreign capital inflow and sharp fall of prices for energy products. Further growth in Russia will depend on the revival of the capital flows, expected stabilization of prices for energy products, as well as on formation of supportive and well-balanced policy. The revival of growth of domestic demand is forecasted.

In 2010 and 2011 the IMF forecasts moderate growth in the CIS countries – by 4% and 3.6%, respectively, but in Russia – by 4% and 3.3%, respectively.

Table 2.4

Main Macroeconomic Indicators of the CIS

(%)

	2008	2009	2010 f	2011 f
GDP growth	5.5	-6.6	4.0	3.6
incl. in Russia	5.6	-7.9	4.0	3.3
Consumer prices	15.6	11.2	7.2	6.1
incl. in Russia	14.1	11.7	7.0	5.7
Current account balance (% of GDP)	4.9	2.6	4.0	3.6
incl. in Russia	6.2	3.9	5.1	4.6

Source: "World Economic Outlook", April 2010, International Monetary Fund; f – forecasts.

The recovery of the global economy takes place more rapidly than it has been forecasted before. However, substantial regional differences still exist – it is slower in developed countries, but more rapid in the majority of less developed and developing countries. The future perspectives should be evaluated cautiously taking into consideration still fragile and uncertain financial systems. A concern exists in several developed countries that public debt levels may increase after the decrease of the impact of macroeconomic stimulus measures, which can negatively affect banking sector.

3. Growth

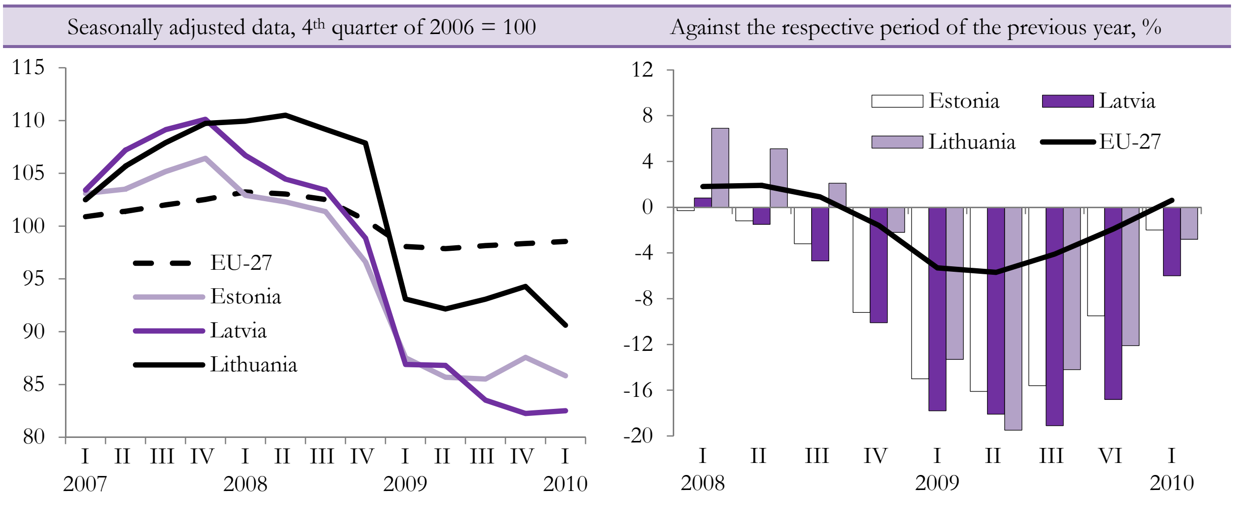
3.1. GDP Dynamics and Aggregate Demand

3.1.1. Development Trends

The global financial crisis has affected the economy of Latvia severely. The GDP during the crisis has decreased by 25% (the 4th quarter of 2009 compared to the 4th quarter of 2007, which was the last quarter with positive growth).

Figure 3.1

GDP Dynamics by Quarters



The most critical period for the real sector of the economy was the 1st and 2nd quarter of 2009, when GDP and employment dropped most rapidly. In the 3rd and 4th quarter of 2009 the economic recession has continued, but at significantly slower pace than before. A slight improvement has been observed in exports and industrial output. In total, the GDP decreased by 18% in 2009.

Table 3.1

GDP of Latvia by Expenditure Items

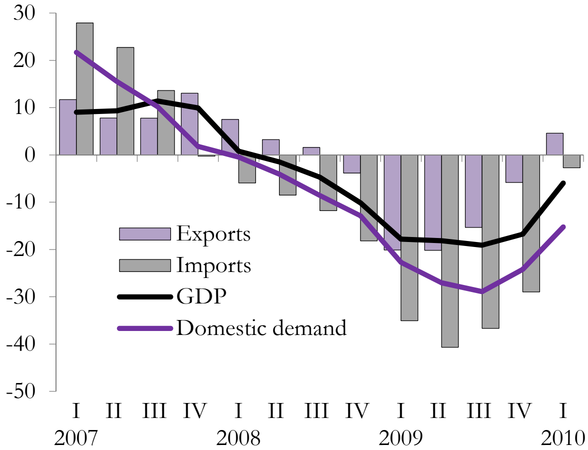
	2009			1st quarter of 2010	
	structure	growth rates	contribution to growth	growth rates	contribution to growth
	%	changes in % compared to the corresponding period of the previous year			
Gross domestic product	100	-18.0	-18.0	-6.0	-6.0
Private consumption	61.6	-24.0	-17.2	-5.8	-4.1
Public consumption	18.7	-9.2	-1.3	-14.0	2.4
Gross fixed capital formation	21.5	-37.3	-12.1	-44.4	-10.6
Inventories	-1.0	–	-2.1	–	7.5
Net exports	-0.7	–	-28.6	–	0.8
– exports	*43.2*	*-15.5*	*-6.9*	*4.6*	*2.2*
– imports	*43.9*	*-35.8*	*21.7*	*-2.7*	*1.4*

In 2009, the decrease of economic activities has been observed in the whole European Union. In total, in 2009, the GDP in the EU went down by 4.2%, including such economies as Germany – by 4.9%, the United Kingdom – by 4.9% and Italy – by 5%. The recession in Lithuania and Estonia was 15% and 14.1%, respectively.

The depth of financial crisis has been intensified by a markedly unbalanced position of the external sector of Latvia, which has developed during the previous years of rapid growth. A considerable growth of private consumption and investment, which was more rapid than the overall economic growth, was largely based on substantial inflow of foreign capital. It has also determined a high current account deficit of the balance of payments and therefore has increased vulnerability of the economy of Latvia. Due to the decrease of financial inflow, a rapid decline of private consumption and investment is observed, along with substantial economic adjustments, which result in improvement of the trade balance of goods and services along with the decline of economic activities upon decreasing domestic demand.

Figure 3.2

Quarterly Changes in GDP and Major Expenditure Items
(percentage change in comparison with the corresponding quarter of the previous year)



The level of domestic demand was by 9% lower in the 1st quarter of 2010 compared to the same period of the previous year, but compared to the 4th quarter of 2009 it has increased by 2.4% according to the seasonally adjusted data.

Along with a significant decline of private consumption and investments, even a faster decrease of imports can be observed. It results in a considerable positive contribution of net exports to the overall changes of GDP.

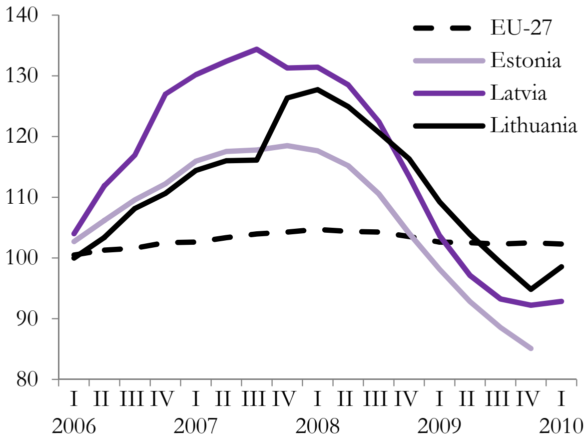
3.1.2. Private and Public Consumption

The decrease of **private consumption** has started already in the 4th quarter of 2007, when it has decreased by 2.3% in comparison with the previous quarter (according to the seasonally adjusted data) and has continued for nine quarters. In 2008, the private consumption was by 5.2% lower than in the previous year. In 2009, a considerable decline in private consumption continued – by 8.6%, 6.3%, 4% and 1.1%, respectively (according to the seasonally adjusted data). In total, the private consumption has decreased by a third in the 4th quarter of 2009 compared to the 4th quarter of 2007, which was faster than the decline of GDP.

A substantial decrease of private consumption in 2008 was largely determined by the decline of household crediting. During the previous rapid growth years the availability of credit resources affected significantly also the possibility to increase the domestic demand, however, when crediting resources started decreasing, the domestic demand went down rapidly.

Figure 3.3

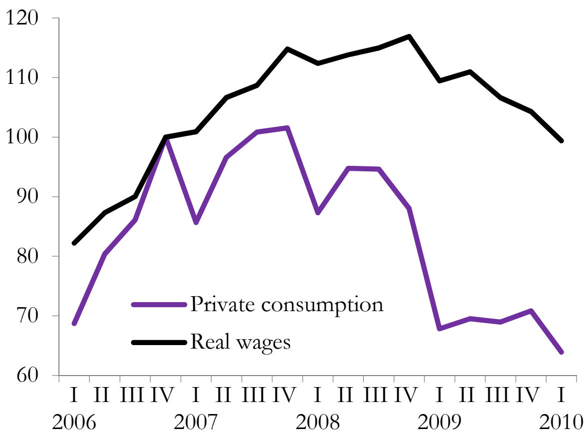
Changes of Private Consumption by Quarters
(seasonally adjusted data, 4th quarter of 2005 = 100)



In 2009, the decrease of private consumption has been more significantly affected by the decrease of real wages and by the increase of unemployment.

Figure 3.4

Dynamics of Real Wages and Private Consumption by Quarters
(4th quarter of 2006 = 100)



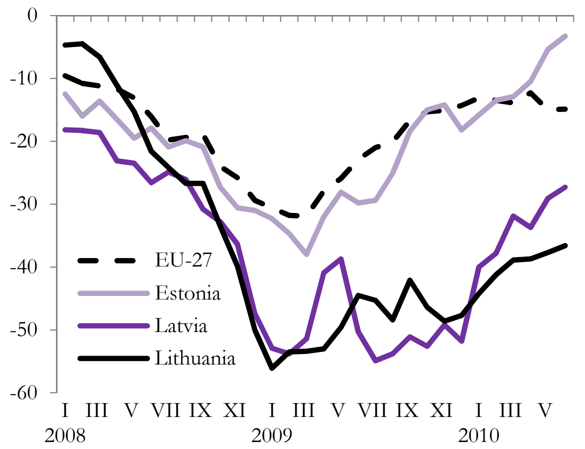
Despite the fact, that private consumption was by 5.8% lower in the 1st quarter of 2010 compared to the respective period of 2009, it should be noted, that it has increased by 0.7% compared to the 4th quarter of 2009 according to the seasonally adjusted data. The increase of retail trade turnover in the first months of 2010 also witnesses the improvement of the situation.

The changes of private consumption in the nearest future will be determined by the situation in the labour market. Taking into account, that adjustments in the labour market have started later and are slower than in the goods markets, the tense situation in the labour market may continue until 2011, when the growth may revive. Thus, the private consumption may remain at a low level at least for two years.

Figure 3.5

Consumer Confidence Indicator*

(seasonally adjusted data)



* Consumer confidence indicator is being calculated as the average balance of responses to the 4 questions regarding financial situation, overall economic situation, assessment of unemployment and savings for the next 12 months.

Public consumption or public services amount to approximately one fifth of the aggregate domestic demand and its value is determined by the volume of the provided public services. During the years of rapid growth, the volume of public services increased at a slower pace than private consumption. In 2008 public consumption continued to grow (by 1.5%) and remained on a high level – 19.6% of GDP. It should be noted that it was 16.6% of GDP in 2006 and 17.4% of GDP in 2007.

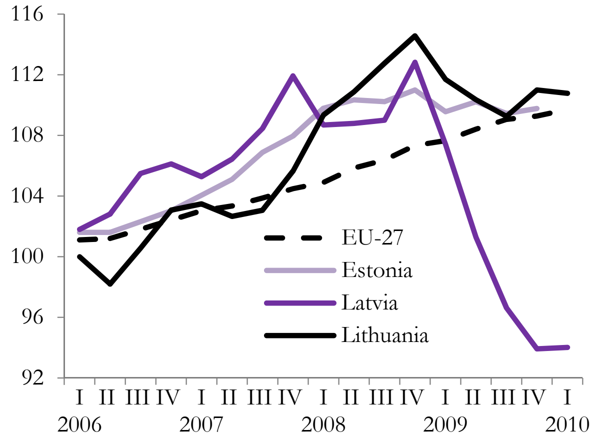
Public consumption started decreasing only in 2009, when the budget consolidation measures were implemented. In 2009, its volume was by 9.2% lower than in 2008 and it was 18.7% of GDP.

Public consumption remained on the level of the previous year in the 1st quarter of 2010, however, it was by 14% lower than a year before.

Figure 3.6

Changes of Public Consumption by Quarters

(seasonally adjusted data, 4th quarter of 2005 = 100)



3.1.3. Investments

Investments in national economy of Latvia decreased very fast over the past two years. Deterioration of the situation in the global financial markets at the end of 2007 and at the beginning of 2008 has diminished the creditworthiness of the bank sphere, which negatively influenced investments.

The amount if investments in national economy of Latvia in 2008 were by 13.6% less than in 2007. Deterioration of the investment environment, low level of domestic and external demand, as well as the level of production capacity load had negative influence on the investment processes in 2009. The investment volumes were one and a half times less than in 2008.

The investment volumes decreased almost twice in total within two years and in 2009 they constituted 21.5% of GDP, which is by one third less than in 2007.

Table 3.2

Gross Capital Formation

	2004-2007 (average annually)	2007	2008	2009	2010 1st quarter
	Actual growth (%)				
GDP	10.4	10.0	-4.2	-18.0	-6.0
Gross Capital Formation	15.4	11.6	-23.6	-47.1	-17.6
– gross fixed capital formation	17.8	7.5	-13.6	-37.3	-44.4
	% of GDP				
Gross Capital Formation	37.6	40.4	31.2	20.4	16.5
– gross fixed capital formation	31.7	33.7	29.3	21.5	11.9
– changes in reserves	6.0	6.7	1.8	-1.0	4.6

Decrease of investment volumes is observed also in other EU member states. Within two years (2008-2009), the investment volumes decreased an average by 12.1% in EU member states and the most significant adjustments were made in 2009. It must be noted that the only country, which has shown positive investment dynamics, is Poland (in 2009, comparing to 2007, investments increased by 8%). The decrease of the investment volumes in the Baltic States has been almost fourfold the EU average.

Latvia's lagging behind has increased significantly by means of the amount of investments per one working person in 2007 in comparison with other EU member states – EUR 6.4 thousand (54% of the EU average), in 2009 – EUR 4.1 thousand (40% of the EU average).

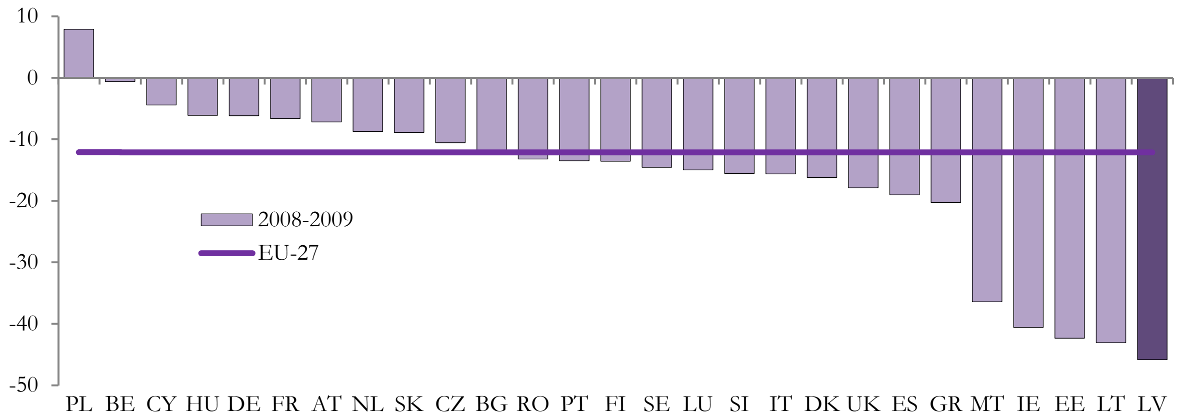
Negative investment dynamics has remained also in 2010. In the 1st quarter of this year, the investment volume decreased by almost half, as compared to the respective period of the previous year, but if comparing to the 4th quarter of the previous year, the investment volumes decreased by 54.7 percent.

It must be noted that the decrease in investments was mostly determined by the corrections made in the investment plans of private sector due to the unfavourable investment climate. The leaders of the Latvian enterprises consider the low demand as the most significant factor limiting the investments. However, the low capacity load (in 2009 in total industry – 56%) witnesses that the potential of the existing manufacturing significantly exceeds the currently employed potential.

Figure 3.7

Changes of Investment Volumes in the EU Member States from 2008 till 2009

(%)



The negative dynamics of private investments were influenced also by decrease of state investment volumes due to the necessity to introduce budget consolidation measures. State investments were reduced accordingly by 15.4% and 30% in 2008 and 2009. As a result, state investments could not reduce the negative consequences of cyclical fluctuations of private investments. In 2009, the state investments formed 18.4% of the total investments in the national economy of Latvia.

Structure of the investment sectors.[1] Though the total investment volumes decreased more in 2008 and 2009 than in the years before the crisis, the changes in breakdown by sectors appear to be very different.

Many sectors have maintained the positive investment dynamics in 2008. In comparison with 2007, investments in agriculture have increased by 23.5%, real estate transactions – by 23.2%, investments in hotel and restaurant business have increased almost twice. Yet, the investment volume in other sectors was less in comparison to 2007. A particularly large decrease of investment volumes was observed in the energy sector – by 28.5%, financial services – by 32.2%, manufacturing – by 23.6% and construction – by 14.7%. Overall, investments in goods manufacturing sector decreased by 18%, but in services sector increased by 6 percent.

With deepening economic crisis, in 2009, the investment activities continued to decrease in all sectors, including the sector of goods manufacturing – by 36.7% and in services sector – by 32.6% in comparison with the previous year. The most significant decrease of investments has occurred in the construction sector (by 72.6%), finances and insurance sector (by 56.8%), and real estate transaction (by 56.1%). According to the provisional data, also the first part of 2010 shows that the investment process has been very weak in all sectors. Investments decreased by almost a half in service sectors and goods manufacturing as compared with the corresponding period of the previous year. However, it must be noted that investments in the communication and information service sectors have increased in 2009, as well as in the 1st quarter of this year correspondingly by 8% and 27.7% as compared with the corresponding period of the previous year.

[1] Investments in breakdown by sectors are presented according to the non-financial investment statistics that do not include all investments in fixed assets.

Table 3.3

Sectoral Dynamics and Structure of Investments

	Growth rates				Structure			
	2004-2007 (average annually)	2008	2009*	2010 1st quarter*	2004-2007 (average annually)	2008	2009*	2010 1st quarter*
Primary sectors	7.6	20.8	-38.5	-57.6	4.4	4.3	4.5	4.9
Manufacturing	17.9	-23.6	-40.4	-18.6	16.2	13.2	14.2	22.4
Electricity, gas, and water supply	13.2	-28.5	-17.5	-68.3	7.8	6.3	15.1	7.3
Construction	26.1	-14.7	-72.6	-81.7	7.2	7.1	1.9	1.3
Trade	5.0	-3.2	-53.8	-50.5	13.2	10.6	8.7	11.6
Transport and communications	3.0	5.7	-17.2	-25.5	13.2	12.2	18.0	23.3
Other commercial services	22.8	10.5	-60.5	-57.9	23.4	29.9	8.3	9.3
Public services	19.5	4.7	-13.9	-57.3	14.7	16.5	29.3	19.9
Total	15.6	-15.6	-34.1	-48.1	100	100	100	100

* estimated using quarterly data

Investments in the manufacturing significantly decreased under the influence of financial crisis. In 2009, they were half as much as in 2007. To a great extent it was determined by the decrease of investments in food industry, wood processing, and in producing of chemical substances and its products. Also at the beginning of this year, the investments in the manufacturing industry continue decreasing. The investment volumes in the 1st quarter of 2010 were by 18.6% smaller than in the respective period of the previous year.

However, investments in sectors like food industry, production of electrical and optical devices and production of vehicles have been decreasing since 2006.

Table 3.4

Dynamics and Structure of Investments in Manufacturing

(%)

	Growth rates				Structure			
	2004-2007 (average annually)	2008	2009*	2010 1st quarter*	2004-2007 (average annually)	2008	2009*	2010 1st quarter*
Food industry	-1.8	-12.3	-59.2	-42.8	21.8	15.7	18.3	15.6
Light industry	-13.3	-34.4	-32.1	-84.3	2.7	1.8	3.7	0.7
Wood processing	18.2	-11.1	-78.4	-96.6	26.4	33.0	7.1	0.3
Paper industry and publishing	20.2	-52.0	-81.7	-47.4	7.2	4.6	1.4	1.0
Chemical industry and related industries	24.3	-53.1	-43.2	-48.3	7.6	5.0	21.1	13.9
Production of other non-metallic mineral products	79.0	-19.6	146.0	31.7	14.4	22.7	39.7	58.0
Production of metals and metal articles	20.5	-22.4	-64.1	10.5	7.1	7.9	4.4	4.7
Production of machinery and equipment	9.0	-36.4	-68.7	-36.4	2.1	2.0	0.8	0.6
Production of electrical and optical equipment	7.1	-2.6	-72.9	9.6	2.5	1.6	0.9	1.4
Production of vehicles	25.0	-26.0	-51.8	49.9	2.3	2.5	1.1	2.0
Other industries	20.9	-72.0	-57.5	-16.8	5.8	3.1	1.7	1.7

* estimated by using quarterly data

However, investment volumes in light industry have been decreasing already since 2003. Investments in light industry in 2008 were almost four times less than in 2003, but in 2009 – decreased by 32%. Such investment dynamics indicate significant decrease of competitiveness of the light industry.

Investments in the wood processing sector have been decreasing since 2008. During the past two years, investments dropped by 81%, but investment volumes in wood processing sector in the 1st quarter of 2010 were at the level of 3% from the investments as compared with the corresponding period of the previous year and it formed only 0.3% of the total investments in the national economy of Latvia.

Since 2004 the positive investment dynamics in sectors of manufacturing of construction materials have been observed. Moreover, during the period of 2006-2007, the annual investment growth rates were more rapid if compared to the two previous years. Investment volumes in the manufacturing of construction materials dropped almost by 20% due to the worsening of situation in the real estate market in 2008, nonetheless, already in 2009 they were almost 2.5 times higher than in 2008. Likewise, the investments in manufacturing of construction materials were by 31.7% higher in the 1st quarter of 2010 than in the respective period of the previous year. These tendencies defined the most significant changes in the investment structure. Investments in manufacturing of construction materials formed almost a half of all investments in national economy of Latvia in 2009 and the 1st quarter of 2010.

In 2010, positive investment tendencies are observed also in metal processing, production of vehicles, and production of electrical and optical devices.

Most likely the investment dynamics will remain negative also in the nearest future, with the gradually decreasing investment decline rates. The investment processes in Latvia, like in other countries affected by the financial crisis, will be largely determined by availability of the financial resources, increase of the overall demand, and implementation of state aid measures for facilitation of business activities.

3.1.4. Exports and Imports

Exports and imports of goods

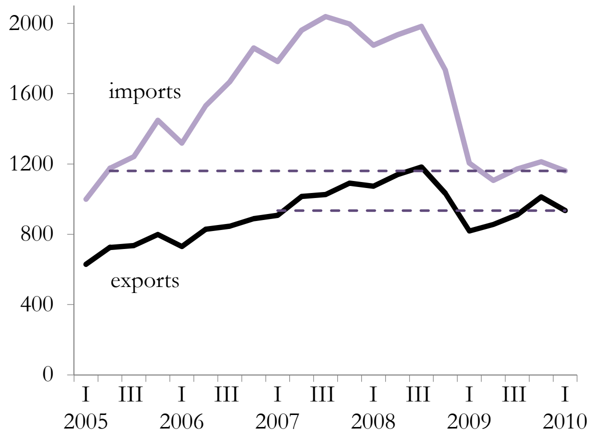
Volumes of Latvian export goods started to decrease rapidly in actual prices at the end of 2008, and it continued till the 3rd quarter of 2009, when the volumes of export dropped to the level of the 3rd quarter of 2006. Volumes of export decreased in total by 19% (in comparable prices by 10%) in 2009 if compared with 2008.

Imports of goods, however, started to decrease in the second half of 2007 as the domestic demand started decreasing. The import decrease was larger than that of export and continued until the 2nd quarter of 2009, reaching the level of the beginning of 2005. Just as export, import also started similarly to grow slowly at the end of 2009. It decreased annually total by 38% in actual prices (in constant prices – by 33%) comparing with 2008.

Due to the fast decrease of import, the volumes of export and import have approximated. As it is shown in Figure 3.8, 2 years ago, export was about a half of the total volume of import, but at the beginning of 2010 it has grown to more than 80 percent.

Figure 3.8

Exports and Imports of Latvian Goods by Quarters
(million LVL)



In 2009, the changes in trading conditions negatively influenced **exports of goods**, and the export prices decreased more rapidly than the import prices. The most significant reduction of an export unit value in 2009 was for wood and timber, and metal and its products. The trading conditions have improved a little in the 1st quarter of 2010.

Exports of goods have decreased almost in all groups of goods in 2009; a particularly fast decrease occurred in the export of metal articles and export of wood and timber products.

An increase of export by 19% was observed in January-April of 2010 if compared to the January-April of 2009. The largest contribution to this increase was due to the increase of wood and timber products, as well as mineral products and agricultural and food products export.

Figure 3.9

Export Dynamics of Latvian Goods by Months
(million LVL)

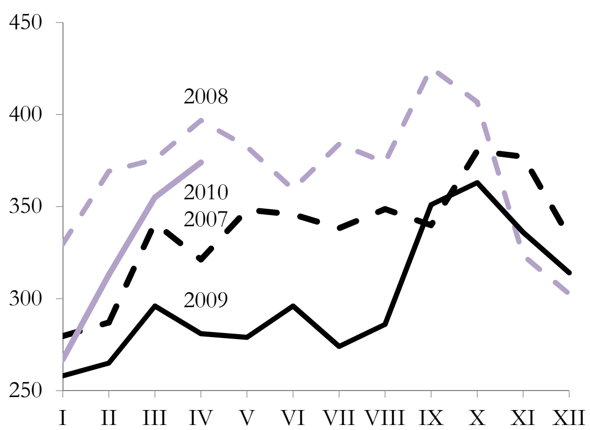


Table 3.5

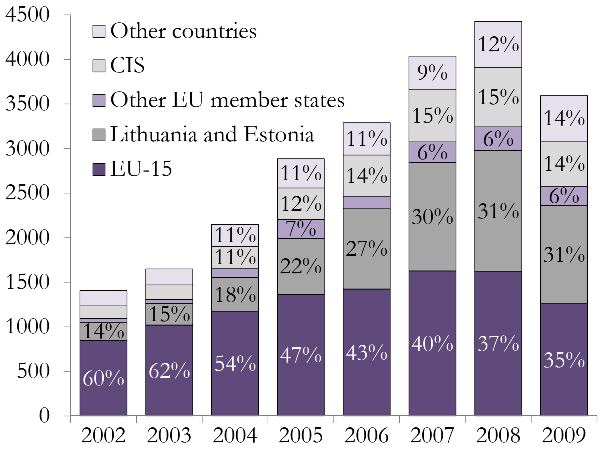
Main Commodity Groups for Export
(%, in current FOB prices)

	2009		January-April, 2010	
	structure	**increase compared to the previous year**	**increase compared to the corresponding period of the previous year**	**contribution in changes of volume**
Total, including:	**100**	**-18.8**	**19.1**	**19.1**
wood and wood products	16.5	-19.0	53.7	8.5
metal and metal articles	12.4	-39.4	12.8	1.7
light industry products	5.7	-24.3	-4.8	-0.3
agriculture and food products	18.6	-10.8	16.2	2.9
products of chemical industry and related industries, plastics	11.4	-17.7	7.1	0.9
machinery products	14.1	-8.2	3.4	0.5
minerals	5.6	8.6	67.1	3.3
vehicles	7.1	-22.2	1.3	0.1
other goods	8.6	-17.0	19.1	1.5

Export to the EU member states decreased by 20% in 2009, but, in January-April of 2010, already increased by 16%. Considering the large proportion of the EU member states in the exports of Latvia, the group of these countries was the main influencing factor on the overall tendencies of Latvian export.

Figure 3.10

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



The largest export increase to the EU member states in the overall export of Latvia was observed for wood and timber products (more than a half of all increase), in January-April of 2010, however, the export of light industry goods decreased slightly.

Export to the CIS member states also decreased significantly in 2009, most substantially – in manufacturing of machinery and in agricultural and food product groups, which formed almost 40% of the total export decrease to the CIS member states. More moderate decrease was observed in export of chemical industry goods. However, export to CIS member states increased by 14% in January-April of 2010, and the main influence to this increase was contributed by agricultural and food products.

In 2009, **the imports of goods** decreased in all groups of goods, the largest whereof – machinery manufacturing and vehicle groups (mainly from the EU member states), however import became stable, in January-April of 2010, and this increase in comparison to January-April of 2009, constitutes 0.1%. The most significant increase is observed in export of chemical industry and metal processing products; but the largest decrease – in import of the group of vehicles.

Imports from the EU member states have grown more rapidly than the overall imports to Latvia, but imports from the CIS member states have decreased slightly.

Figure 3.11

Import Dynamic of Latvian Goods by Months
(million LVL)

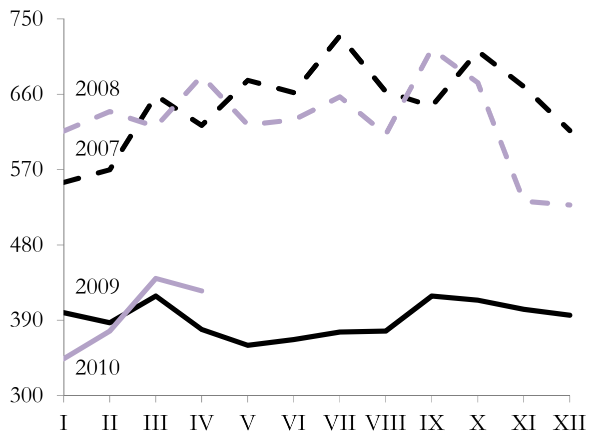


Table 3.6

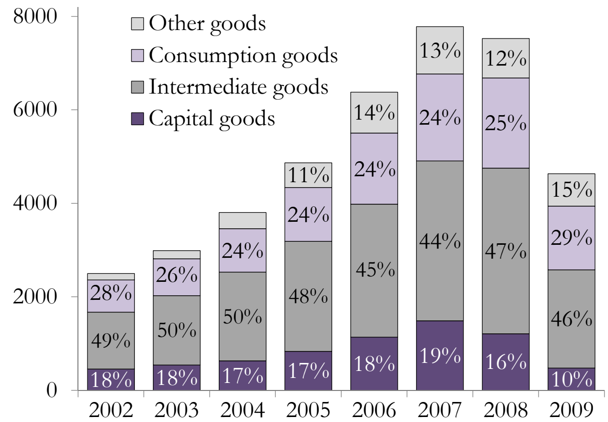
Main Groups of Commodities of Latvian Import
(%, in current CIF prices)

	2009		January-April 2010	
	structure	increase compared to the previous year	increase compared to the corresponding period of the previous year	contribution to volume changes
Total, including:	**100**	**-37.6**	**0.1**	**0.1**
wood and wood products	1.4	-53.1	27.0	0.4
metal and metal articles	8.1	-51.1	16.3	1.3
light industry products	6.3	-25.0	-8.1	-0.5
agriculture and food products	18.2	-17.1	0.2	0.0
products of chemical industry and related industries, plastics	16.9	-27.1	12.9	2.2
machinery products	15.7	-46.2	-2.0	-0.3
minerals	17.2	-30.9	-3.7	-0.7
vehicles	6.5	-62.3	-32.3	-2.4
other goods	9.7	-39.0	1.4	0.1

In 2009, the imports of capital goods decreased considerably, which is related to the decrease of investments. A slight decrease is observed also for the imports of intermediate consumption goods, and the commodities share has grown respectively.

Figure 3.12

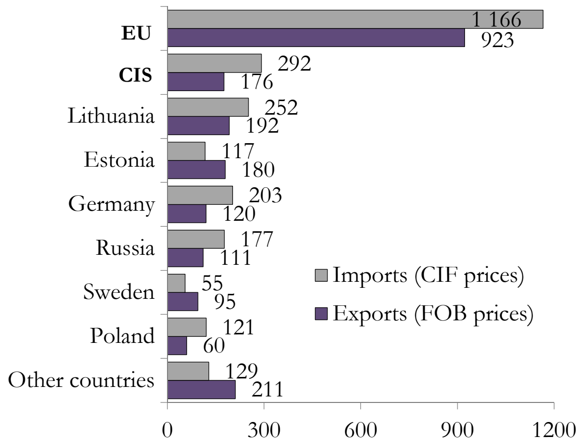
Import by Classification of the Broad Economic Categories
(in connection with the basic sections of national accounts, in current CIF prices, million LVL)



The main **trade partners** of Latvia in January-April 2010 were Lithuania – 15.3%, Russia – 11.1%, Estonia – 10.3%, Germany – 9.9%, Poland – 6.2%, as well as Sweden – 5.2% from the total foreign trade turnover.

Figure 3.13

Foreign Trade Turnover of Latvia* **in January-April 2010**
(million LVL)



* with countries where foreign trade turnover with Latvia is not less than 4%.

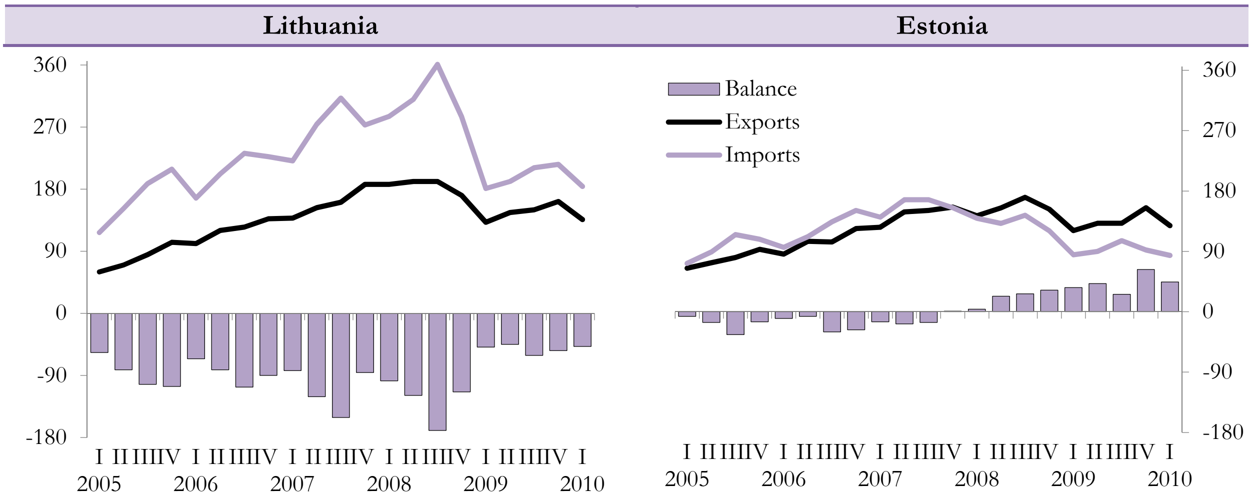
The main foreign trade partner countries of Latvia are **Lithuania** and **Estonia**. Over the last years, the share of these countries in the total share of foreign trade has been continuously increasing. Likewise, during the rapid increase of trade, deterioration of the trade balance with both Baltic States was observed, yet, starting with the 2nd half of 2008, when the total import volumes started to fall, the foreign trade balance with Lithuania and Estonia started to improve (see Figure 3.14).

Foreign trade balance with Estonia is positive as always, but with Lithuania it stays negative. The imports from Lithuania in January-April 2010 exceeded the exports by 31% (in 2009 – by 36%), while the exports to Estonia exceeded imports by 53% (in 2009 – by 38%), although it must be noted that the total trade volume with Estonia is slightly smaller than with Lithuania. The main groups of goods exported to Estonia and Lithuania are agricultural and food products, products of machinery manufacturing, as well as products of the chemical industry. The main groups of goods imported from Lithuania and Estonia are agricultural and food products, mineral products, as well as products of the chemical industry.

Figure 3.14

Foreign Trade Turnover of Latvia with Lithuania and Estonia by Quarters

(million LVL)



Exports and imports of Services

In 2009, about 80% from the negative balance of trade of goods were covered by a positive services balance. With the import of services reducing more rapidly than the export, the services balance has considerably improved (almost by one third).

Slightly more than a half of the services export is made of the revenues from transit transport. Although, in January-March 2010, the revenues from transport decreased, though due to the significant increase of air transport export, this decrease is smaller than the total decrease in the services sector. The revenues from tourists coming to Latvia and export of commercial services have also decreased.

However, in comparison with 2009, the decrease of export of services started to recover, and it is expected that till the end of 2010 it may become stable.

Table 3.7

Export and Import of Services

(%)

	2009				January-March 2010			
	structure		change compared to the previous year		structure		change compared to the corresponding period of the previous year	
	export	import	export	import	export	import	export	import
Services – total	**100**	**100**	**-11.3**	**-27.5**	**100**	**100**	**-9.7**	**-7.7**
including:								
Transport services	50.6	23.1	-11.5	-34.7	53.7	25.8	-6.6	-1.7
– sea transport	17.9	4.9	-4.1	-38.4	18.4	5.2	-17.3	-9.8
– air transport	8.3	8.5	-7.6	-26.1	8.4	9.5	15.3	13.5
– other transport	24.4	9.7	-17.4	-39.0	26.9	11.0	-3.8	-8.4
Travel	18.9	36.4	-5.5	-26.2	15.3	28.0	-14.8	-29.7
Commercial services	29.4	38.7	-13.9	-23.4	30.2	44.7	-11.1	11.1
Other services	1.1	1.7	-18.9	-33.1	0.9	1.5	-39.7	30.6

The export of services to the EU member states, in January-March of 2010 has decreased by a little less than the total export of services (by 3%), transit haulage to the EU member states and revenues from visiting tourists have decreased considerably, but it was compensated by export of commercial services.

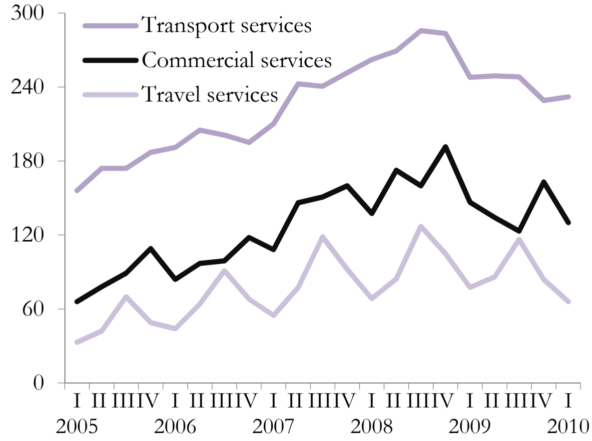
Export of services to the CIS member states, similarly as to the EU member states has decreased slightly (by 6%). Revenues from tourists coming from the CIS member states and export of commercial services have decreased, but it was compensated by significant growth of transit haulage export.

A considerable part of export of services consists of exports to Lithuania and Estonia (approximately 14% and 7%). Export of services to Estonia increased by 14%, and the majority of this growth consists of export of commercial services. Export of services to Lithuania has decreased by 13%, mainly due to the decrease in tourism services.

Figure 3.15

Export of Services by Quarters

(million LVL)



3.2. Contribution of Sectors

3.2.1. Structure of the Economy and Development Tendencies of Sectors

The rapid growth in the previous years, which was fostered mainly by domestic demand, has changed the structure of the economy of Latvia in favour of the services sectors, the growth of which was considerably higher than the development of tradable sectors.

The share of services sectors in the value added increased from almost 72% in 2000 to slightly over 76% in 2009. The share of services sectors continued increasing also during the period of economic recession (in 2008-2009). In 2008, in spite of the economic recession, the output volumes continued growing in some sectors, for example, in transport and communications, public services sectors, as well as in real estate operations. However, in 2009, the decrease of other services sectors, except trade, has been considerably slower than the average of the economy.

Table 3.8

Structure of the Economy

(%)

	By value added		By number of employed	
	2000	**2009**	**2000**	**2009**
Primary sectors	4.7	3.6	14.5	9.0
Manufacturing	13.7	9.9	17.0	13.7
Electricity, gas and water supply	3.6	3.6	1.9	1.3
Construction	6.2	6.6	5.9	7.9
Trade, hotels and restaurants	17.9	16.6	18.8	21.8
Transport and communications	14.1	11.4	8.1	9.1
Other commercial services	23.0	30.9	12.9	17.5
Public services	16.8	17.3	21.0	19.6
Total	**100**	**100**	**100**	**100**

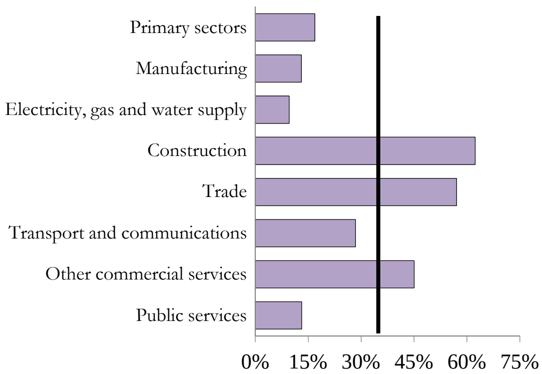
In the period of rapid growth (2004-2007), the GDP increased in total by 36.5% (see Figure 3.16). Three-fourths of the total growth was formed by the growth of construction, trade and commercial services sectors. However, the contribution of manufacturing to growth has been considerably lower – only 5% of the total growth. A very low share of manufacturing in the economy developed in Latvia, thus falling far below the average EU level. The structure of the economy, which developed in the period of rapid growth, could not ensure stable and sustainable growth and, as it had been seen later by the global financial crisis, the unbalanced structure of the economy was particularly dangerous under the circumstances of changing capital flows.

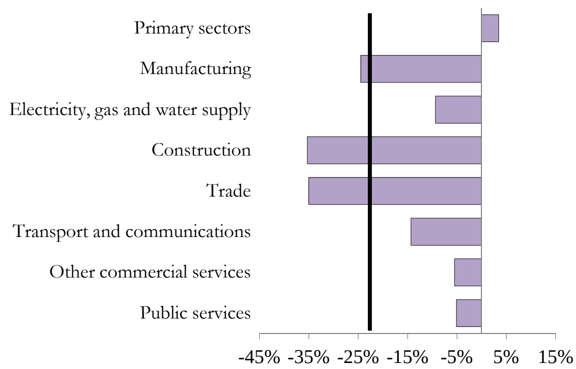
The structure of sectors by the number of employed is a little bit different than by the value added. It is explained by the considerably different productivity level in the economy sectors.

Figure 3.16

Growth of Sectors by the Economic Development Cycles

2004-2007	2007-2009
Growth of GDP by 36.5% in the period	Decrease of GDP by 21.4% in the period





Decrease of both, domestic and external demand affected directly the economic activities of sectors. The output decreases more rapidly in sectors oriented towards domestic demand. The retail trade turnover and construction output decreased significantly in 2009 (by 28% and 33.6%, respectively). These sectors have had the biggest impact on the decline of GDP in 2009. The decrease of trade services reduced GDP by 7.3 percentage points or by more than a third of the total GDP decrease. However, the decline of construction output reduced the total output of the economy by slightly more than 3 percentage points.

Table 3.9

Dynamics of GDP

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

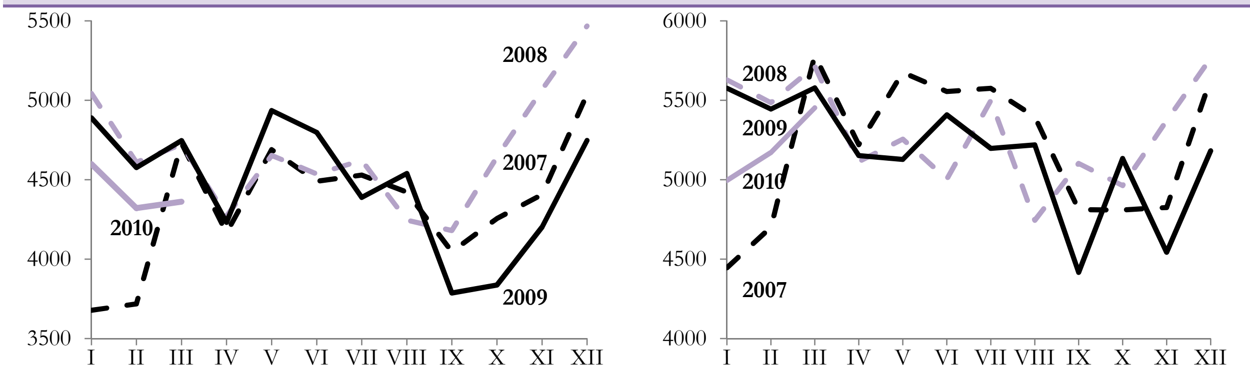
	2008	2009	2009				2010
			I	II	III	IV	I
changes in volumes							
Primary sectors	0.5	3.0	-3.5	3.2	2.3	9.2	5.9
Manufacturing	-6.5	-19.2	-25.9	-23.4	-18.3	-9.0	6.8
Electricity, gas and water supply	-2.4	-7.2	-9.8	-10.4	-14.2	2.3	17.4
Construction	-2.6	-33.6	-27.6	-30.7	-34.2	-39.7	-43.2
Trade, hotels and restaurants	-8.4	-29.0	-26.6	-29.6	-28.9	-31.2	-8.4
Transport and communications	0.5	-14.8	-15.4	-15.0	-18.2	-10.3	2.3
Public services	1.3	-6.3	-3.4	-5.2	-9.8	-6.7	-11.8
Other commercial services	0.0	-5.5	-6.3	-5.4	-3.8	-6.5	-8.3
GDP	**-4.2**	**-18.0**	**-17.8**	**-18.1**	**-19.1**	**-16.8**	**-6.0**
contribution to changes in volumes							
Primary sectors	0.0	0.1	-0.1	0.1	0.1	0.3	0.2
Manufacturing	-1.1	-2.4	-3.4	-3.0	-2.3	-1.1	0.7
Electricity, gas and water supply	-0.1	-0.2	-0.4	-0.2	-0.3	0.1	0.7
Construction	-0.3	-3.2	-2.0	-3.0	-3.7	-3.9	-2.3
Trade, hotels and restaurants	-3.0	-7.4	-7.3	-7.3	-7.7	-7.6	-1.7
Transport and communications	0.1	-2.3	-2.3	-2.5	-3.0	-1.6	0.3
Public services	0.2	-0.9	-0.4	-0.8	-1.2	-1.1	-1.5
Other commercial services	0.0	-1.6	-1.8	-1.5	-1.1	-2.0	-2.3
GDP	**-4.2**	**-18.0**	**-17.8**	**-18.1**	**-19.1**	**-16.8**	**-6.0**

In 2009, the volumes of other commercial services related to domestic demand decreased significantly as well, while the transit transport services, such as railway transport and cargo turnover in ports declined only slightly – by 4.3% and 2.6%, respectively, compared to 2008.

Figure 3.17

Freight Turnover

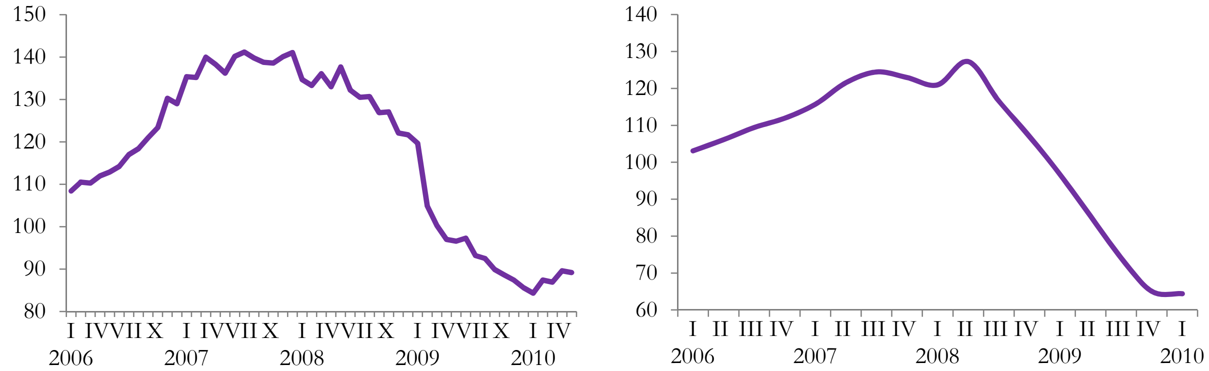
Freight traffic by railway, thousand t	Delivered and received cargo in ports, thousand t



At the end of 2009, the most rapid decrease of output still remained in construction and trade sectors. In the 4th quarter of 2009, the decline was by 38.5% and 31.2% respectively in comparison with the 4th quarter of the previous year. Whereas in tradable sectors the situation gradually improved due to the expanding export opportunities, for example, output of manufacturing in the 4th quarter of 2009 compared to the corresponding period of the previous year decreased only by 9 percent.

Figure 3.18

Retail Trade Turnover (seasonally adjusted data, average monthly turnover in 2005 = 100)	**Construction Volume Index** (4th quarter of 2005 =100)



Due to the improvement of the situation in the global economy and increase of external demand, a tendency is observed, which shows that the output volumes of the so-called tradable sectors in the 1st quarter of 2010 exceed the level of the 1st quarter of the previous year. Manufacturing has increased by 6.8%, transport and communications sector – by 2.3%, primary sectors – by 5.9%, but electricity, gas and water supply sectors – even more than by 17%. The growth of these 4 sectors in total contributed to the overall growth of GDP by 1.8% and according to the seasonally adjusted data the overall growth of GDP was 0.3% compared to the 4th quarter of 2009. However, due to the remaining low output level in such voluminous sectors as trade, financial services and construction, the total GDP level in the 1st quarter of 2010 was by 6% lower than a year before.

Due to stabilization of domestic demand, the situation in retail trade gradually improves. The retail trade turnover according to the seasonally adjusted data in May exceeded the turnover of December 2009 by 5.5%. In spite of the fact, that retail trade turnover is still negative compared to the respective period of the previous year, since the 2nd half of 2009 the decrease rates of retail trade turnover gradually decline. In five months of 2010, the retail trade turnover is by 10.4% lower than in the same period of 2009. In May 2010 compared to May 2009, the retail trade turnover decreased by 7%. In five months of 2010 compared to the same period of 2009, the trade turnover of food products declined by 11%, but the trade turnover of non-food products – by 10.4%. Due to the decrease of investments in the economy, construction volumes declined as well, which in 2009 went down by almost 40%. Construction volumes in constant prices decreased by 1% in the 1st quarter of 2010 compared to the 4th quarter of 2009 according to the seasonally adjusted data. Despite considerable decline of decrease rates, construction volumes are by 43.4% lower in the 1st quarter of 2010 compared to the same period of 2009. House-building and construction of engineering buildings decreased in similar rates during a year.

The role of tradable sectors in the growth will continue to increase along with positive tendencies of exports growth. However, growth stimulus for sectors related to domestic market will also appear, when domestic demand stabilizes.

3.2.2. Manufacturing

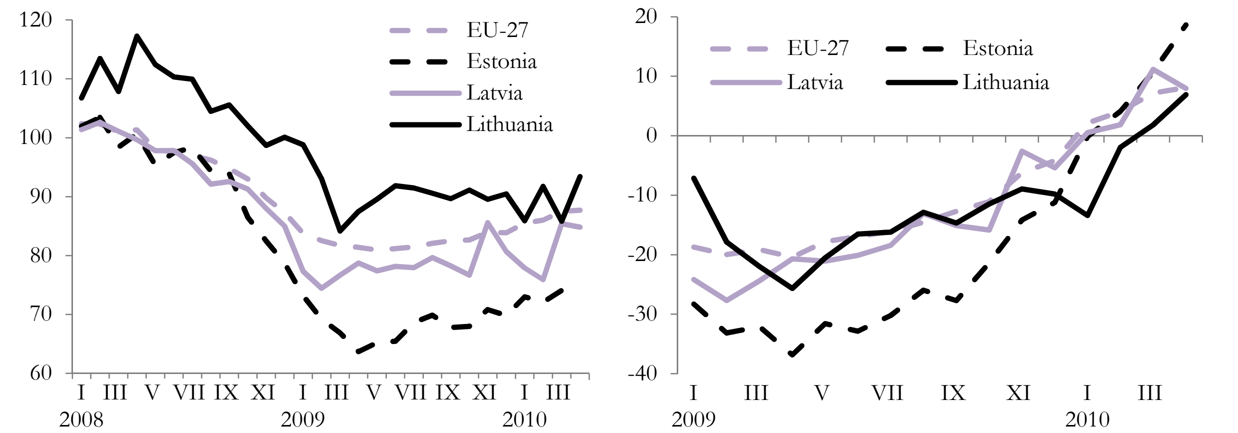
Growth of manufacturing fell considerably behind the average growth rate of the economy during the period of rapid growth and in the result the share of manufacturing in the economy from 2004 until 2008 decreased by almost 3 percentage points, which is considered as a substantial decrease. In 2009, manufacturing comprised only 10% of the total value added.

Figure 3.19

Manufacturing Production Volume Index

seasonally adjusted data, December 2007 = 100

data adjusted by number of working days, in % compared to the corresponding period of the previous year



The situation in manufacturing started deteriorating earlier than the overall in the economy – already in 2007. Initially, it was related to the loss of competitiveness of the sector – significant rise in the labour costs and growth of intermediate consumption costs related with high inflation. Since 2008, the growing impact was related with the decrease of demand (decline of crediting in the domestic market, decrease of the growth rates of the global economy).

In 2009, the domestic demand continued decreasing. Also the rapid decline of external demand left a huge impact on the manufacturing in the 1st half of 2009, which resulted in the overall decline of production volumes by 25% in 2007-2009.

The decrease of output of manufacturing has been observed particularly at the beginning of 2009. Such tendency was typical not only in Latvia, but also in the whole European Union. It was substantially affected by the global financial crisis. Due to the worsening of welfare in the majority of households in the world and due to a high uncertainty, the households and enterprises started cutting down expenses, thus weakening the demand all over the world, especially the demand for consumer and capital goods. The declining demand and decrease in global industrial production were the key factors leading to a large decrease of international trade. In the result, recession in developed countries affected developing countries more rapidly. The decline of global trade at the end of 2008 and at the beginning of 2009 was intensified by the increasing difficulty to access the credit resources.

In the 2nd half of 2009, the revival of growth gradually replaced the decline of economic activities in the biggest developing economies and several developed economies. The increase of external demand provided positive growth stimulus also to Latvian producers – the speed of decline in manufacturing was reducing and the level of manufacturing capacity load was rising in the 2nd half of 2009. Moreover, production volumes in the individual sectors already at the end of 2009 exceeded the level of the respective period of the previous year.

Table 3.10

Structure of Manufacturing in 2009
(%)

	By value added	By number of employed	Share of exports in the sales of sector
Manufacturing – total	**100**	**100**	**54.1**
Food industry	24.2	24.1	23.8
Light industry	5.2	11.2	81.0
Wood processing	18.3	16.8	72.8
Paper industry and publishing	8.6	7.2	45.7
Chemical industry and related industries	9.3	6.0	73.5
Production of other non-metallic mineral products	6.0	3.9	32.5
Production of metals and metal articles	10.3	9.4	72.1
Production of electrical and optical equipment	6.7	4.3	81.6
Production of machinery and equipment	2.3	3.4	86.6
Production of transport vehicles	3.8	6.2	86.5
Other industries	5.3	7.5	48.9

The expansion of export opportunities is the reason for continued increase in the production volume of manufacturing. In April 2010, output of the sector exceeds the output of the corresponding month of 2009 by 10.7%. Since May 2009, when the output of manufacturing has reached the lowest point, a monthly increase of 1% in production volumes of the sector can be observed within a year.

Since the beginning of 2009, competitiveness of manufacturing has been gradually improving mainly due to the decrease of labour costs.

Figure 3.20

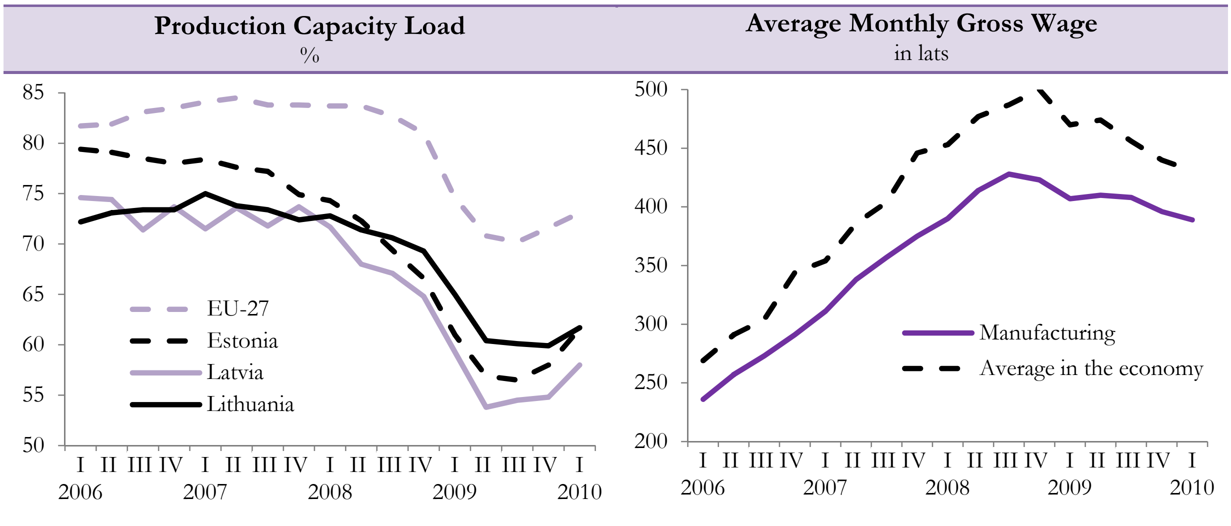


Table 3.11

Changes of Production Volumes in Manufacturing*

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

	2007	2008	2009	2010 I-IV
Manufacturing – total	**0.3**	**-4.7**	**-18.0**	**5.9**
Food industry	1.3	-5.3	-16.5	-6.9
Light industry	0.3	-11.0	-37.6	-5.0
Wood processing	-6.0	-12.1	2.6	39.5
Paper industry and publishing	0.2	-4.2	-15.8	20.5
Chemical industry and related industries	3.1	-2.6	-18.4	-0.5
Production of other non-metallic mineral products	-17.1	-5.6	-34.3	-17.2
Production of metals and metal articles	11.5	1.8	-23.6	6.1
Production of electrical and optical equipment	3.8	4.5	-26.5	-5.5
Production of machinery and equipment	5.0	12.2	-47.6	7.7
Production of transport vehicles	10.7	8.1	-48.8	17.0
Other industries	3.0	-8.0	-18.8	-13.6

* according to NACE Rev.2 classification

The recovery after the crisis is uneven in manufacturing sectors, for example, production volumes in four months of 2010 have increased in wood processing, paper industry and publishing, as well as in production of transport vehicles. Positive tendencies can be observed also in production of metals and metal articles, as well as in production of machinery and equipment. At the same time production volumes are still decreasing in food industry (closely related to domestic demand), production of non-metallic minerals (affected by decline in construction volumes), as well as light industry.

The sales of production of manufacturing in current prices were by 26.3% lower in 2009 than in 2008. The rapid decline of revenues from sales was related not only to the decrease in production volumes, but also to the decrease of producer prices in domestic and foreign markets. In 2009, the average level of producer prices was by 7.5% lower than the level in 2008.

In the four months of 2010, the revenues from sales already exceeded the corresponding period of the previous year by 4.6%. Due to very low domestic demand, the production sales in the domestic market decreased by 10.5% within the abovementioned period. On the contrary, the sales of exported production increased by almost 18%.

In May 2010, the producer prices in manufacturing were by 3.8% higher than in the previous year. Although in May the producer prices of production sold in domestic market within 12 months decreased by 1%, the tendencies of recent months show increase of prices. Producer prices for exported production were by 8.6% higher than in May 2009.

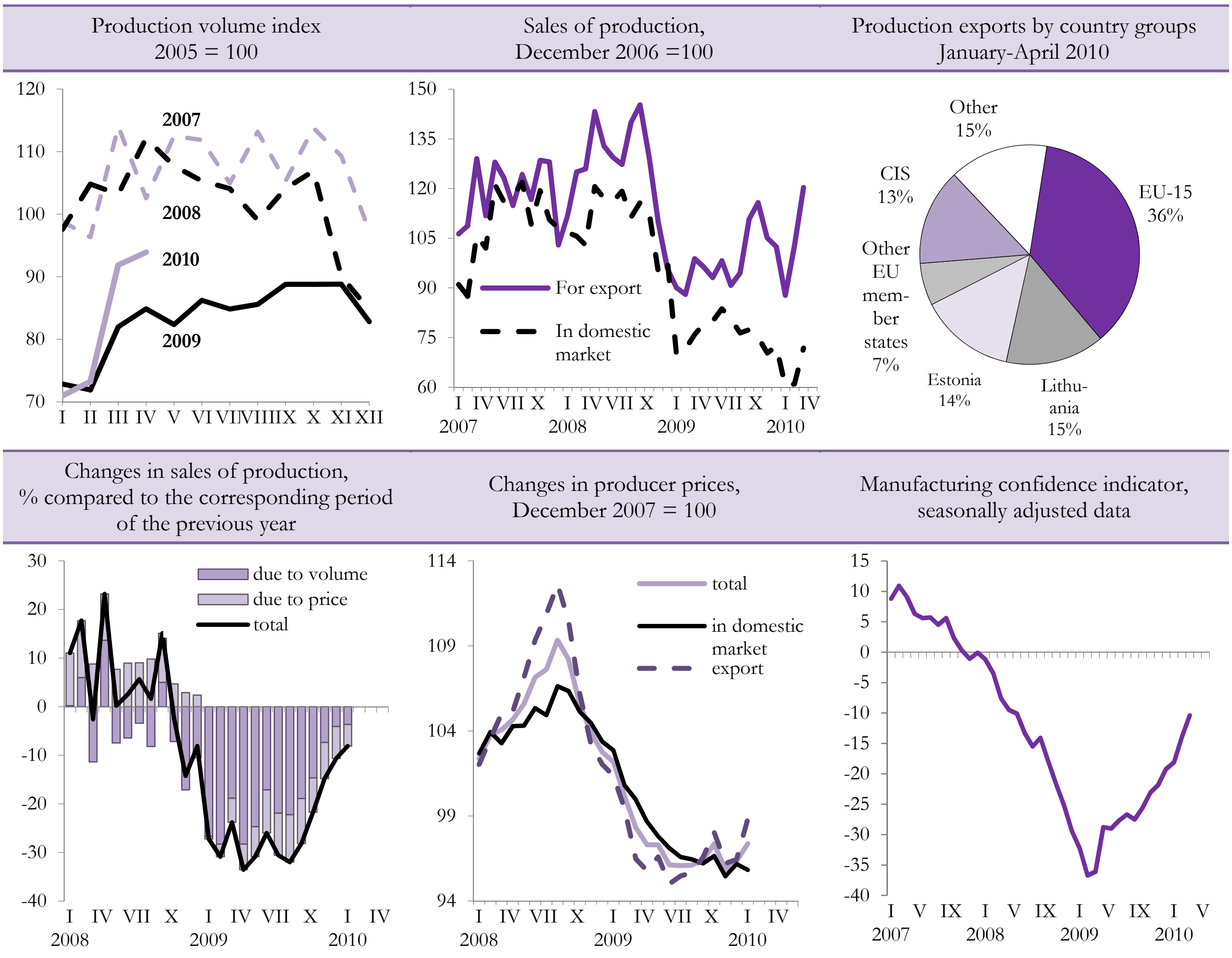
From December 2009 to May 2010, producer prices in manufacturing are increasing on average by 0.9% per month, which should be evaluated as a significant price increase. Furthermore, the price increase in industry in total (mining industry, manufacturing, electricity, gas and water supply) in the period from December 2009 to May 2010 was even higher – by 1.1% per month.

The highest increases of producer prices can be observed in those sectors of manufacturing, which depend on the fluctuations in the world prices, for example, in the metal processing industry producer prices in April 2010 were by 12.3% higher than in December 2009. The tendencies of the world prices for raw materials will have the highest influence on changes in producer prices in Latvia that consequently will influence also the consumer prices.

Due to the decrease of domestic demand and increase of external demand, a considerable increase in the share of exports has been observed. In the four months of 2010, it was 60% of the total sales of production. At the same time, the structure of manufacturing exports did not change significantly over the recent years. A slightly more than 70% of production exports is related to the markets of EU member states, of which slightly more than a half is related to EU-15 member states and almost 30% – to Lithuania and Estonia, whereas 14% of production has been exported to the CIS countries within four months of 2010.

Figure 3.21

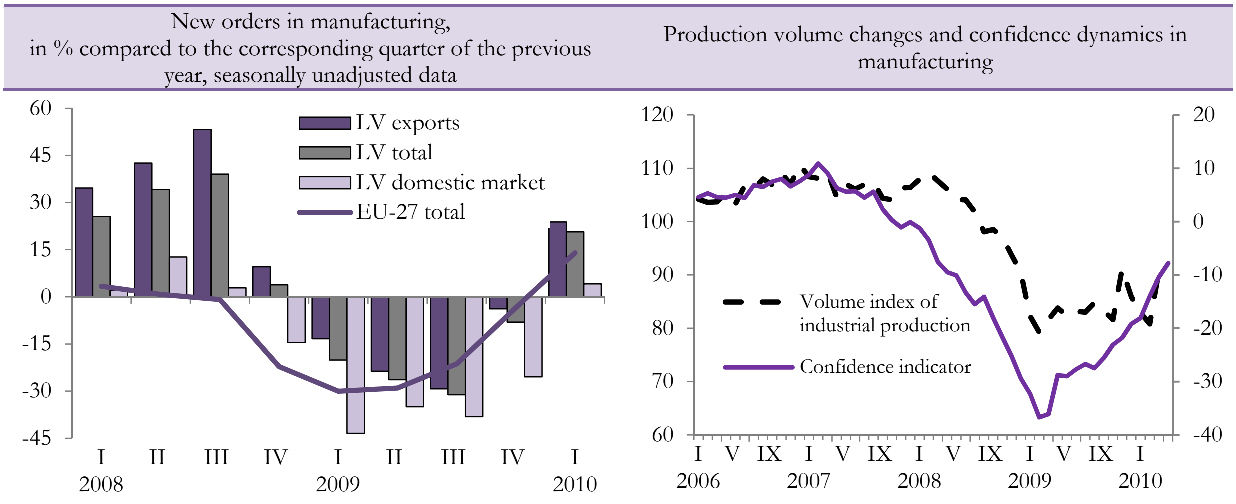
Indicators Characterising Manufacturing Industry



It should be noted, that the volume of new orders in manufacturing is growing relatively steadily and the confidence indicators are improving during the last months. It indicates signs of a stable recovery of the sector. However, there is still a risk that stable growth of manufacturing will be affected by limited access to money resources – for short-term financing, including export credits, as well as for implementation of large-scale investment plans in the medium term.

Figure 3.22

Development Tendencies of Manufacturing*



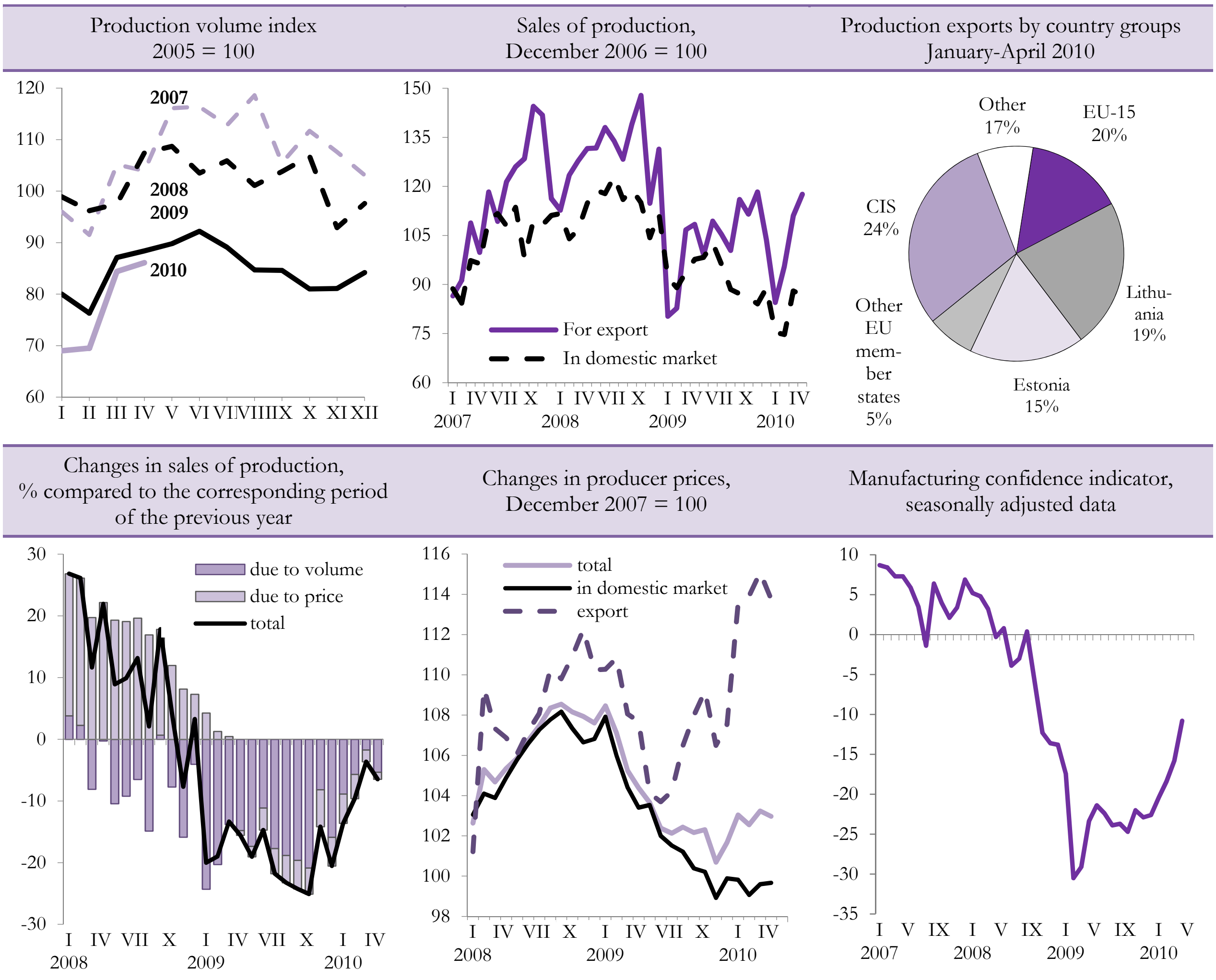
* Data is collected only for those manufacturing sectors, which are working mainly on orders.

The food industry is the largest manufacturing sector both by value added and by the number of employed. In 2009, the food industry formed more than 24% of the value added of manufacturing. In 2009, the output of the sector was by 16.5% lower than in 2008. The decrease of production volume was particularly influenced by the decline of domestic demand. Although the speed of decrease of production volumes is gradually slowing down, the production volumes are by 6.9% below the level of January-April 2009 due to the remaining low level of domestic demand in 4 months of 2010.

The sector exports a slightly over ¼ of production, and the food exports to Lithuania and Estonia comprise 40% of the total exports of the sector. Taking into account that the global financial crisis has substantially affected also our neighbour countries and the demand there has decreased as well, it has influenced the export indicators of food industry. The sales of production increased in export markets only by 8.1% in 4 months of 2010 compared to January-April 2009. In this period, export volumes have increased mainly to the markets of the CIS countries.

Figure 3.23

Indicators Characterising Food Industry



In the same period, the sales of production have decreased in domestic market by more than 12%. The decrease of revenues from sales is determined not only by the decline of sales volumes (by 7.7%), but also by the decrease of producer prices in domestic market. In January-April 2010, producer prices in domestic market were on average by 5.6% lower than in the previous year, whereas producer prices on exported production increase despite the dramatic fluctuations in 2009. In 4 months of 2010, the prices on average were by 4.4% higher than in the corresponding period of the previous year.

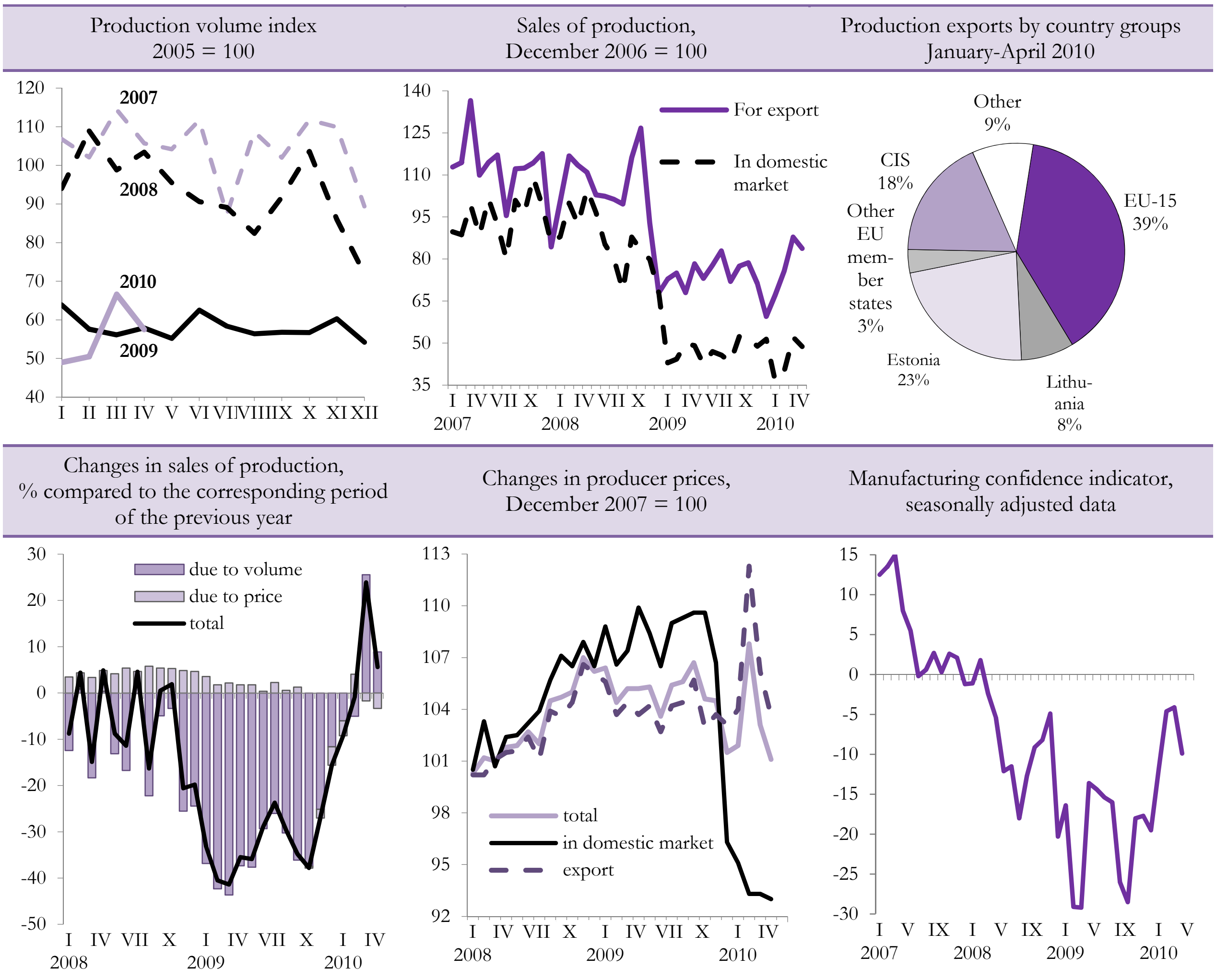
The share of ***light industry*** continued to decrease in terms of the value added of manufacturing in 2009 and amounted to 5.2%. The sector is mainly oriented to foreign markets – over 80% of production is being exported.

As the key markets of light industry are the old EU member states, the industry was significantly influenced by the economic recession in the European Union. In 2009, output of the sector was by 37.8% lower than in 2008. A particularly rapid decline in production volume was observed at the end of 2008 and beginning of 2009. In the second half of 2009, the situation in the sector has stabilized, however, production volumes in 4 months of 2010 are still by 5% lower than in the corresponding period of the previous year.

The sales of the sector in export markets in January-April 2010 exceed the level of 4 months of 2009 by 6.8%. For comparison: in 2009, sales of light industry production decreased by 29%. Similar tendencies can be observed in production sales in domestic market, which decreased by 45% in 2009, but in 4 months of 2010 only by 4.5% in comparison with January-April 2009.

Figure 3.24

Indicators Characterising Light Industry



Regardless of the very low demand in domestic market the producer prices of the light industry basically have remained constant in 2009 and only in December a significant decrease of prices occurred (by 9.7% within a month). Also during further months the producer prices in the domestic market continued to decrease and in April 2010 were by 15.4% lower than a year before.

Slightly different tendencies are characterizing producer prices for exported production. The prices started decreasing already in the mid-2009, but during several months of 2010 even more significant increase of prices could be observed. In the result, producer prices for exported production in 4 months of 2010 were on average by 2.1% higher than in the corresponding period of 2009.

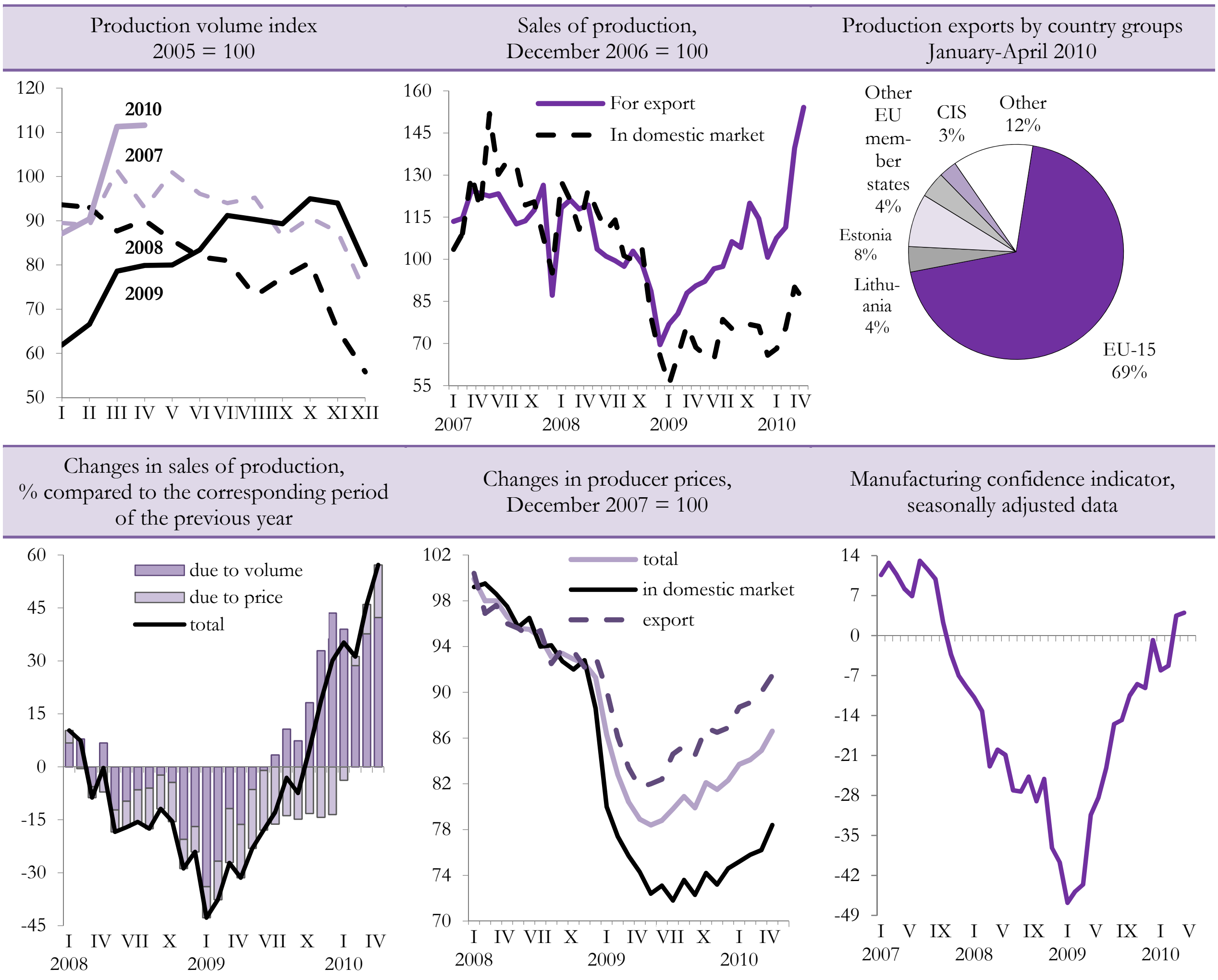
Wood processing is the second largest manufacturing sector and its output in 2009 has increased by 2.6% compared to 2008. After the rapid decline in production volumes at the end of 2008, the situation in the sector has gradually stabilized and the real improvement of the situation has been observed in the middle of the year. From May to December 2009, production volumes of the sector have increased on average by 3% per month. Already at the end of the last year, production volumes of the sector exceeded the level of 2007, which was the year, when decline in the sector started.

The sales of production of the sector were influenced not only by the decline in production volumes, but also by the decrease of producer prices. In the result, in 2009, sales of production of the sector in current prices decreased by 15.4%, including the production sold in the domestic market – by 33.8% and the exported production – by 5.7%.

At the beginning of 2010, positive tendencies are still continuing in the sector. The production volumes are growing rapidly – on average by 3.5% per month, which exceeds the level of the corresponding period of 2009 by almost 40%. In the 4 months of 2010, the sales of the sector have increased both in the domestic market and exports – by 19.9% and 52.5%, respectively.

Figure 3.25

Indicators Characterising Wood Processing



The rapid growth of revenues from sales is determined by the rise in producer prices as well. The decrease in producer prices has been observed both in the domestic and export markets only in the 1st half of 2009, thereafter producer prices have increased gradually. In April 2010, producer prices both in the domestic and export markets have reached basically the level of the beginning of 2009.

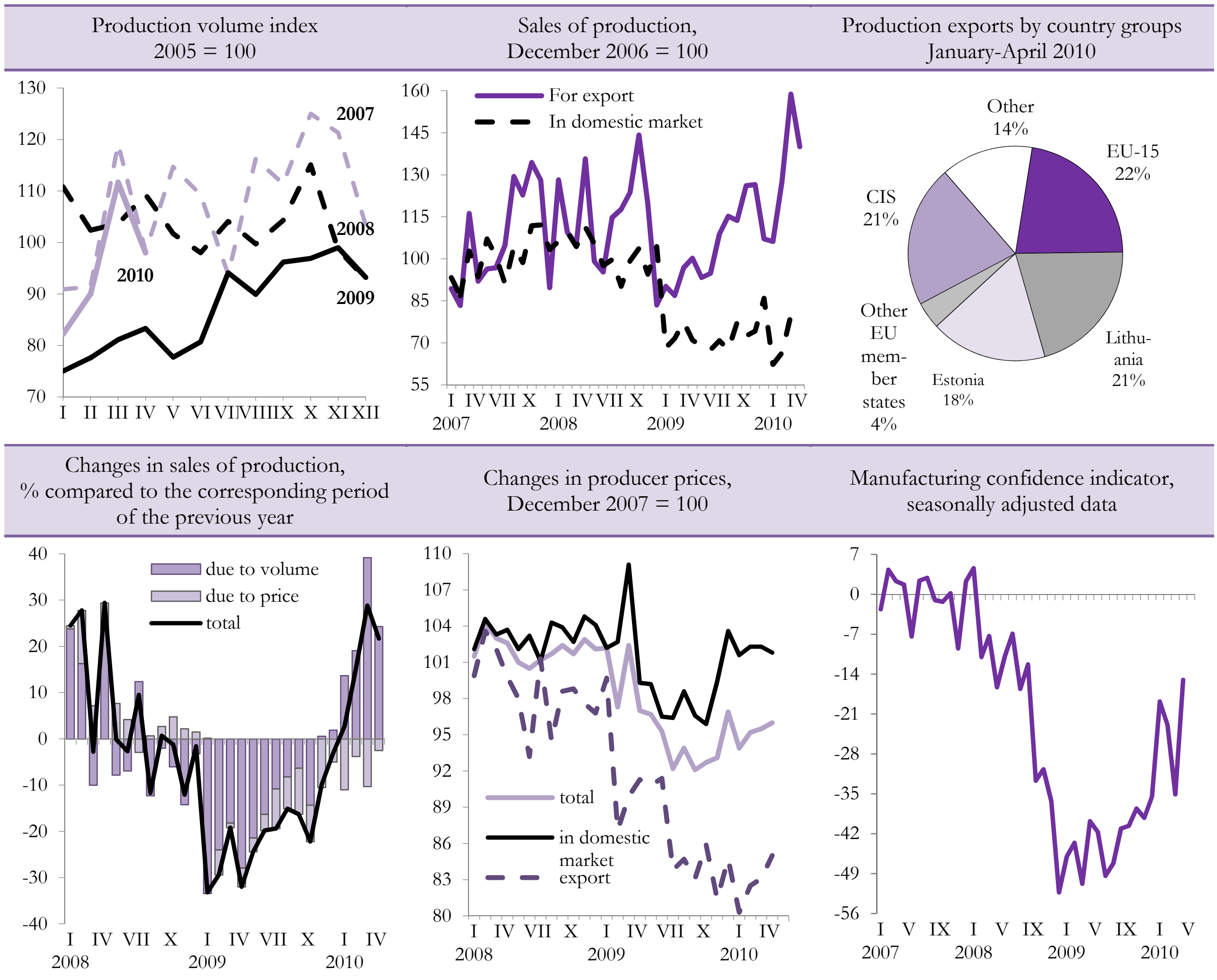
The wood processing sector exports ¾ of production and the main export markets are the old EU member states. The share of the third countries within the export structure compared to 2009 has increased.

Paper industry and publishing sector formed 8.6% of the total value added of manufacturing in 2009. The development of the sector was significantly influenced by the decline in both domestic and external demand due to the global financial crisis. The production volumes decreased most rapidly at the end of 2008 and at the beginning of 2009. Although the situation has been gradually improving starting with the mid-2009, the total annual output has been by 15.8% lower than a year before. In 2009, the output volumes in the publishing sector decreased even faster (by 19.3%), which basically was due to the rapid shrinking of the advertisement market.

As from May 2009 to April 2010, the sector's output is rising on average by over 2% per month. In 4 months of 2010, the sector's output exceeds the level of the corresponding period of the previous year by 20.5%. In total, the paper and publishing sectors have reached the average level of the production volumes of 2008.

Figure 3.26

Indicators Characterising Paper and Publishing Industry



The sector has proved its export capacity and currently it bases its development on an increase of export volumes. In January-April 2010, the volumes of sales in export markets exceeded the level of the first 4 months of 2009 by more than 40%. During the same period, sales in domestic market decreased by slightly over 1%. The share of exports to Lithuania and Estonia at the beginning of 2010 has slightly decreased compared to 2009.

Due to the decrease of demand, a decline of producer prices at the beginning of 2009 has been observed. In the middle of the year, producer prices of the sector increased on production sold in the domestic market, but decreased on exported products at the same time. In April 2010, the level of producer prices on production sold in domestic market is by 2.5% higher than a year before, whereas prices on exported production decreased by 6.9% within a year.

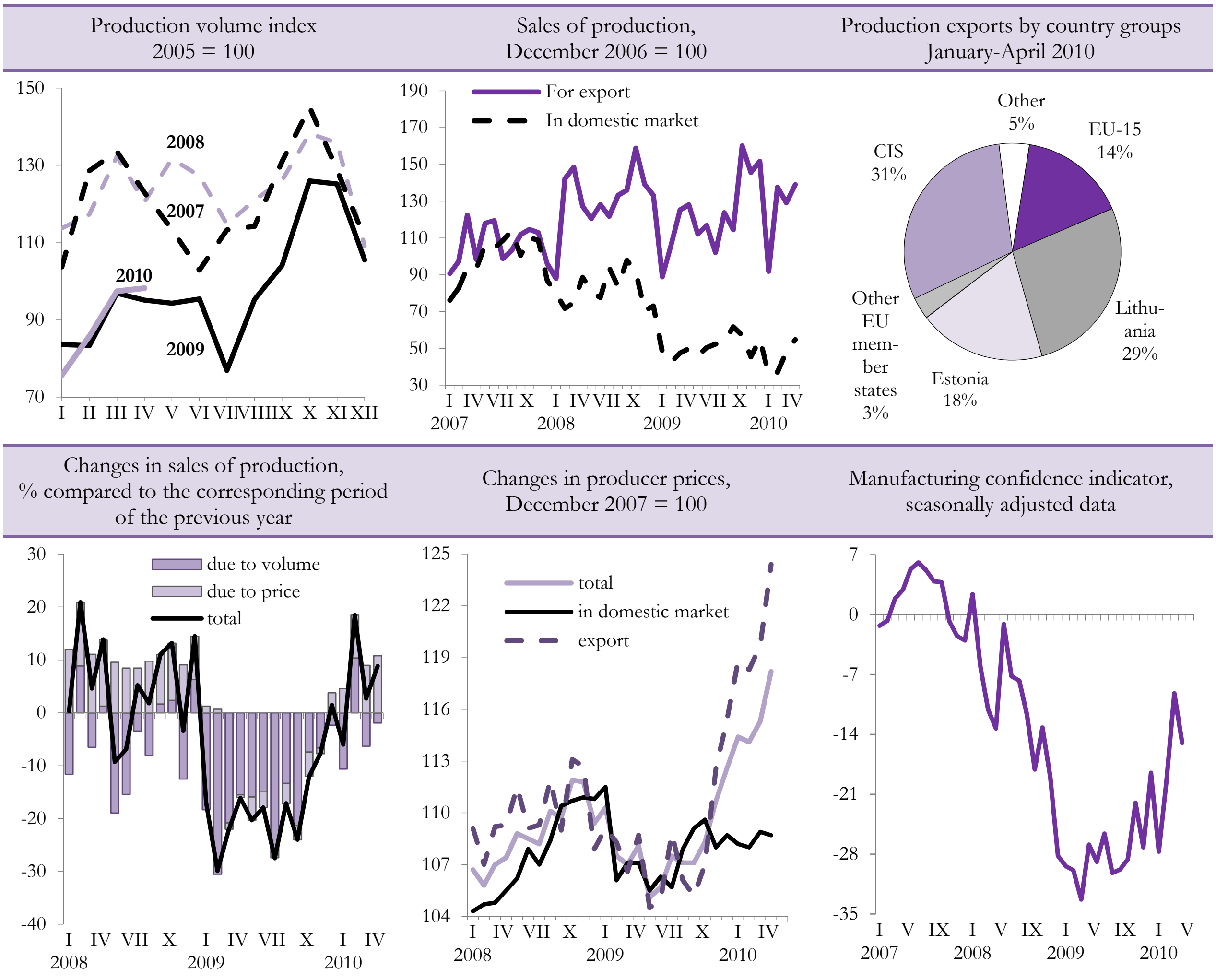
The chemical industry includes production of chemical substances and products, pharmaceutical raw substances and products, as well as rubber and plastic articles. The share of this sector in the total value added of manufacturing in 2009 accounted for 9.3%, and 6% by the number of employed.

In 2009, production volumes of the sector have decreased by 18.4%, however, in a more detailed aggregation, the development tendencies of sectors differed from each other. The production volumes of chemical substances and products decreased by 3.7% last year, the production volumes of pharmaceutical raw substances and products – by 16.4%, but production volumes of rubber and plastic articles – by almost 30 percent.

In January-April 2010, production volumes of the sector were by 0.5% lower than in the corresponding period of the previous year. The production volumes of chemical substances and products were by 33.1% higher and the production volumes of plastic articles were by 3.4% higher than in January-April 2009. At the same time, the production volumes of pharmaceutical sector were by 20 percent.

Figure 3.27

Indicators Characterising Chemical Industry and Related Industries



The main development opportunities of the sector are related to foreign markets. In the 4 months of 2010, the export market sales of production exceed the first 4 months of 2009 by 10.9%. The level of production sold in domestic market decreased by 6.4% in the same period.

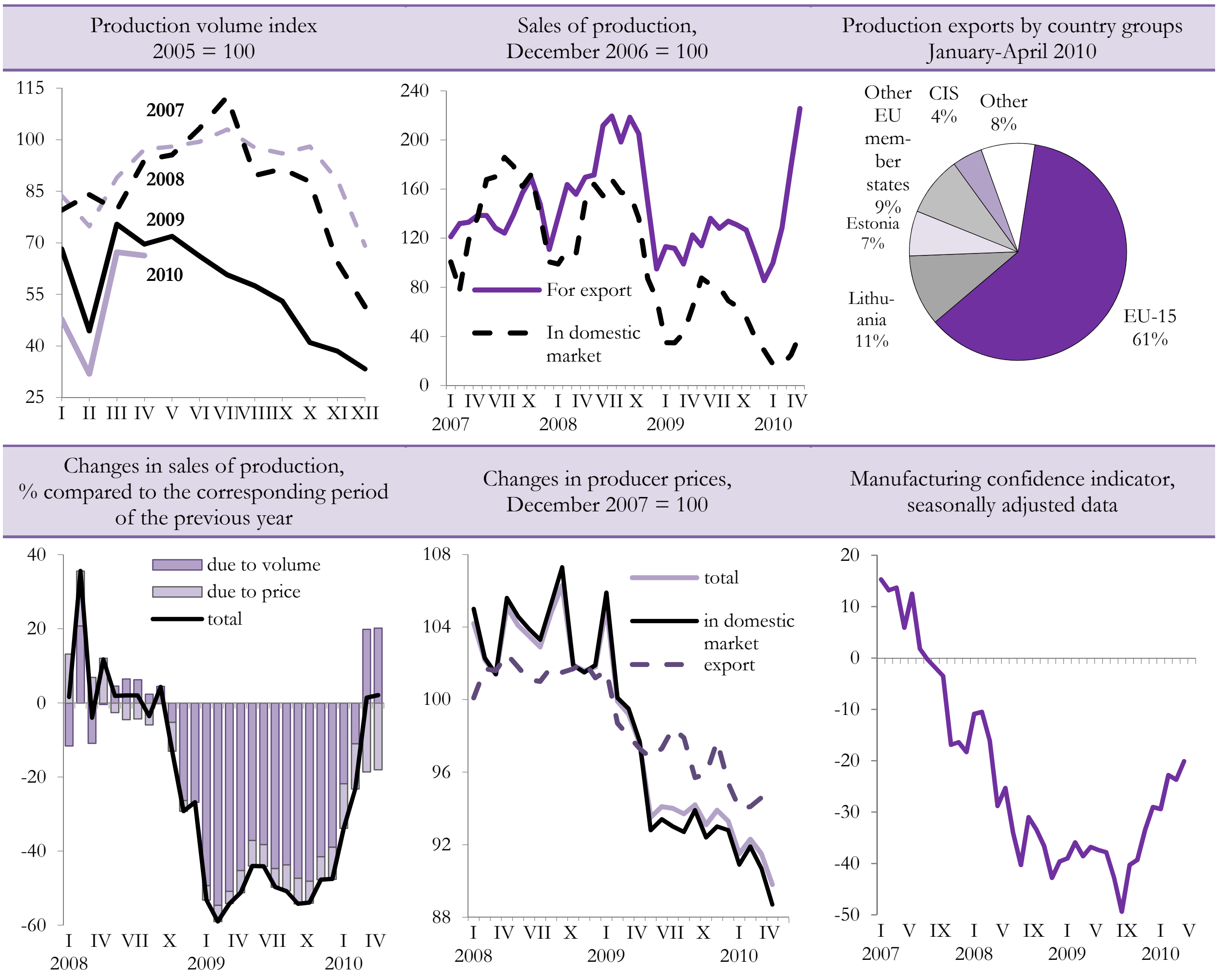
In January-April 2010, the average level of producer prices increased by 6.7% compared to the corresponding period of 2009, which was related to the increase in the average price on production sales in export (by 11.2%), while the prices on production sold in domestic market increased by 0.5 percent.

The decrease of production volumes of ***other non-metallic mineral products*** is influenced by the considerable decline in construction output. At the same time, it should be added that the sector has significantly reoriented itself from the domestic market towards export markets – the share of exports in sector's production sales has increased from almost 25% in 2008 to almost 60% at the beginning of 2010.

The production output has decreased by 34.3% in 2009. In majority of sectors, the most considerable decrease in the speed of decline has been observed at the beginning of 2009. The production output of non-metallic products continued to decrease during almost the whole 2009. In October, the production level reached approximately 40% of the average indicator of 2005. In April 2010 compared to October 2009, the production volumes of the sector have increased by 56% (according to seasonally adjusted data).

Figure 3.28

Indicators Characterising Production of Other Non-Metallic Mineral Products



The relatively rapid growth of the sector was based on expanding export opportunities. In the 4 months of 2010, the production volumes sold in export markets were by 42% higher than in January-April 2009. The main output markets of the sector are EU-15 member states, to which over 60% of total exported production of the sector is being exported.

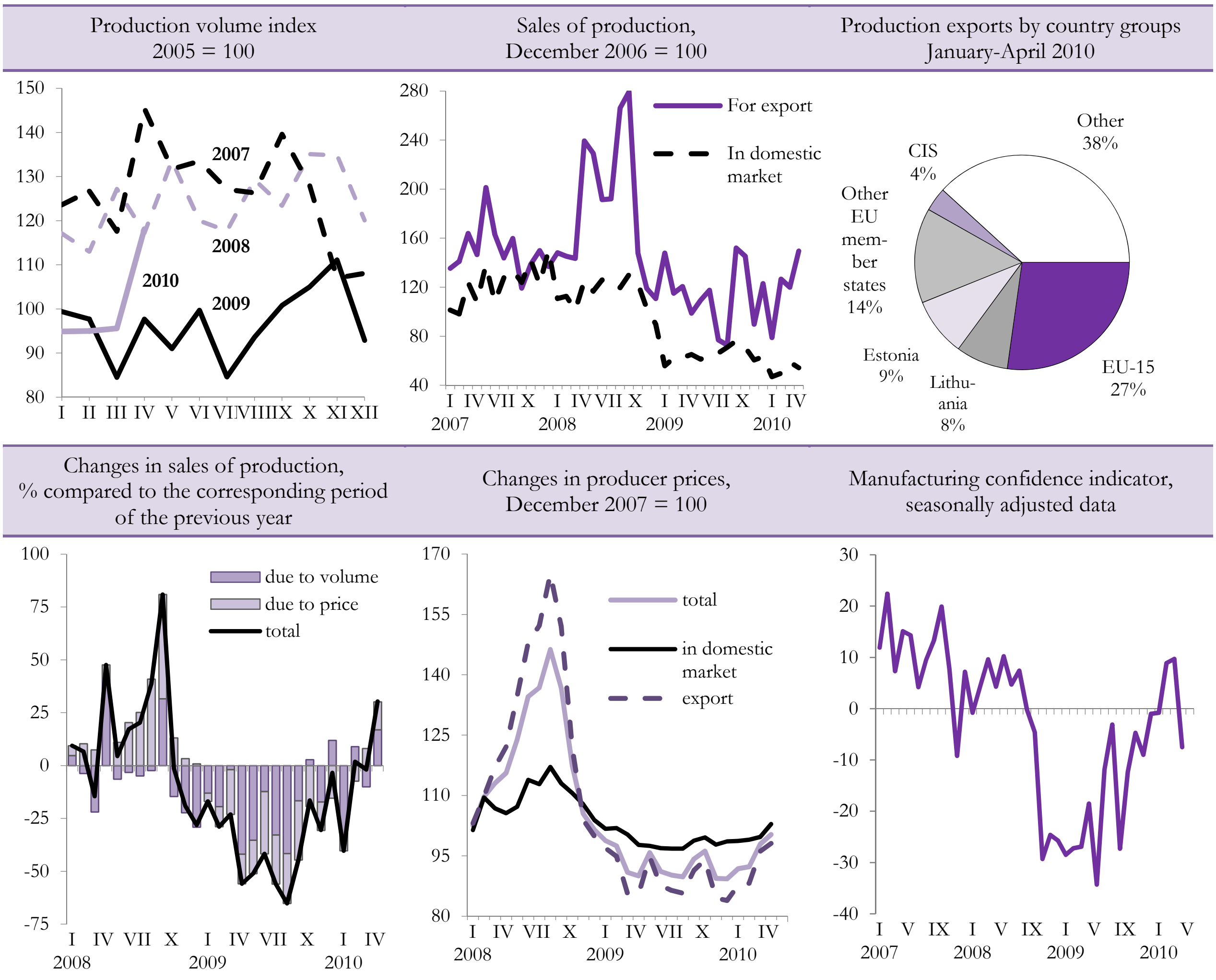
The revenues from sales in the sector are also influenced by a decrease of producer prices. In April 2010, the average producer prices have decreased by 8% within a year, including the price for the production sold in domestic market – by 9.2%, but for the exported production – by 3.4 percent.

In 2009, the sector of ***metals and metal articles*** formed over 10% of the value added of manufacturing and exported almost ¾ of production. Taking into account the large export share of the sector sales, the global economic recession considerably influenced the development of the sector. In 2009, the output of the sector decreased by 23.6% and the sales volumes decreased by approximately 40% both in the domestic market and exports.

The lowest level of the sector output was observed in March 2009. Since that moment until April 2010, the output volumes of the sector increased relatively rapidly – by 2% per month. In the 4 months of 2010, the total output volumes exceeded the volume of January-April 2009 by 6%. However, the sales of production are by 4.9% lower during the same period of time. The sales in the 4 months of 2010 in the domestic market are by 14.7% lower and in export market – by 1.5% lower than in the 4 months of the previous year.

Figure 3.29

Indicators Characterising Production of Metals and Metal Articles



As a result of the global economic crisis and rapidly decreasing demand for metals and metal articles, a considerable decline in producer prices has been observed at the beginning of 2009. From the mid-2008 until the mid-2009, producer prices for exported production declined on average by 5% monthly. However, in the first months of 2010, a slight increase in producer prices on production both sold in domestic market and exported could be observed. In April 2010 compared to December 2009, prices have increased by 4.3% and 16.9%, respectively.

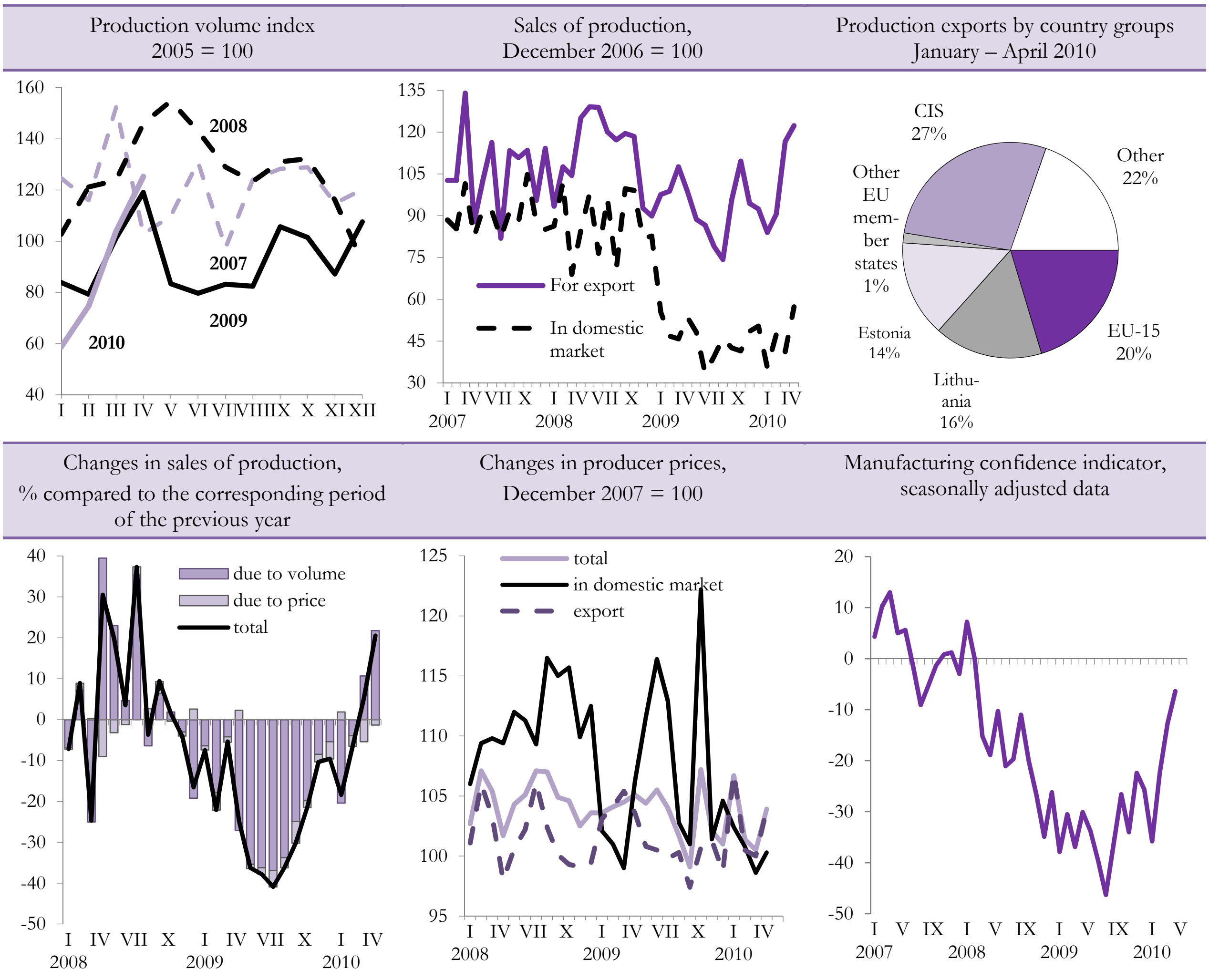
In comparison with the pre-crisis period, the exports share of EU-15 countries has slightly decreased. In the mid-2008, the share of EU-15 member states comprised almost 40%, but in the 4 months of 2010 it is only 27%. At the same time, the share of the third countries' markets has increased.

The share of production of ***electrical and optical equipment*** in the manufacturing since 2000 is slightly increasing. In 2009, due to the rapidly decreasing domestic and external demand, the production volumes of the sector declined by 26.5%. At the same time, revenues from sales decreased slightly slower – by 24.6% because the producer prices of the sector remained the same in the past year in spite of the low demand level.

The most rapid decline of the output of production of electrical and optical equipment could be observed already in the mid-2008, however, at the beginning of 2009, unlike majority of manufacturing sectors, the decline of the production volumes was quite small. In 4 months of 2010, the production volumes still are falling behind the level of January-April 2009 by 5.5%. During the same period, revenues from sales in the sector increased slightly (by 0.3%). The increase was mainly based on the rise of production volumes. In January-April 2010, exports exceeded the level of the corresponding period of the previous year by 2.7%. However, the low level of domestic demand has an impact on decline in sales of production in the domestic market (by almost 10%).

Figure 3.30

Indicators Characterising Production of Electrical and Optical Equipment



Dynamics of sales revenues is closely influenced by changes in producer prices as well. Since December 2009 until April 2010, the producer prices for production sold in domestic market have decreased by 4.1%, and for exported production, they have increased by 5.3 percent.

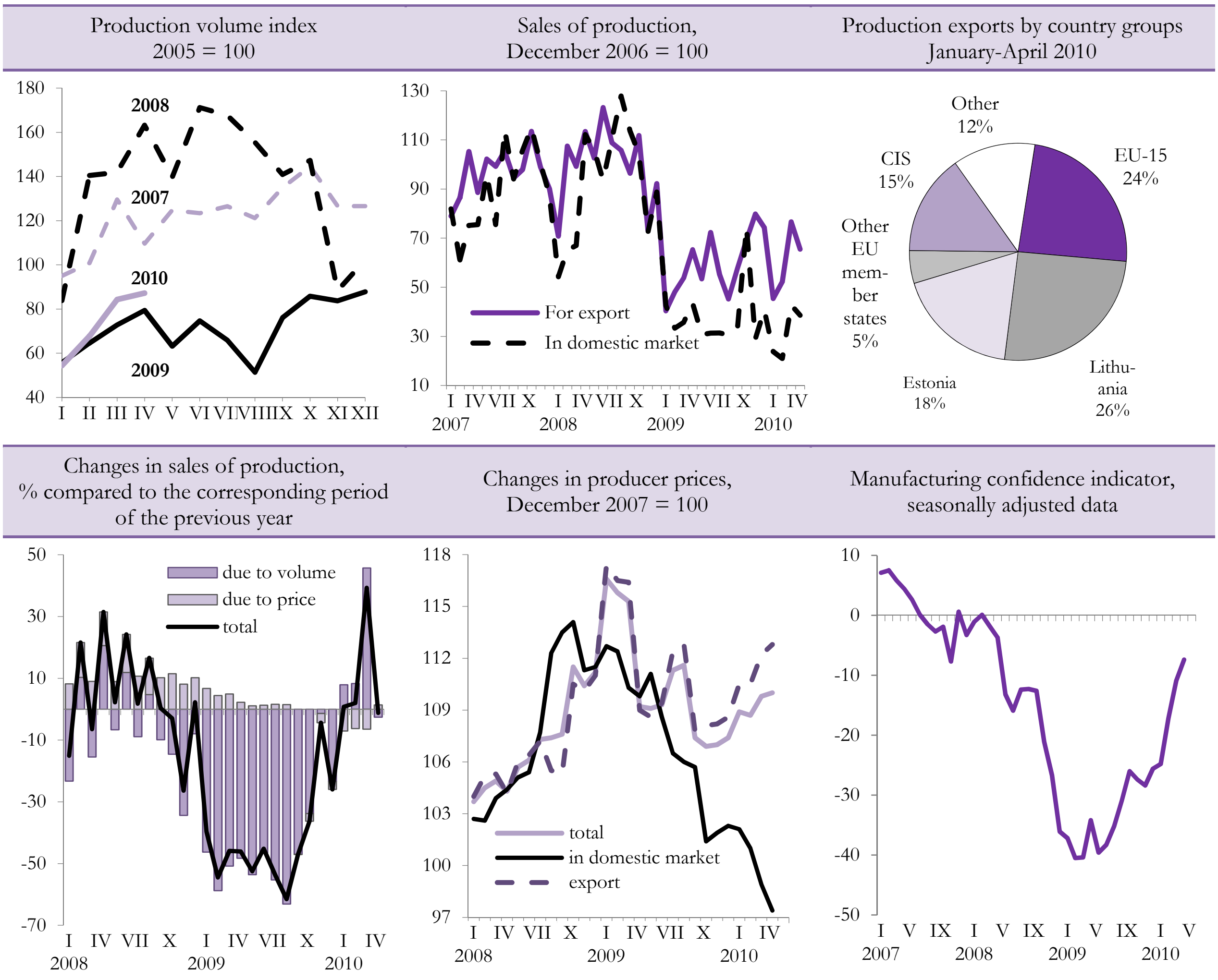
Due to the continuing improvement of the situation in the foreign markets, the share of exports of production of the sector continues increasing as well. In 2007, the sector has exported slightly over 70% of production, but in 4 months of 2010, 83% of production has been exported. There are stable trade partners in the CIS countries and Estonia, however, exports to developed countries, including to the EU-15 member states, increased during the last year.

The production of machinery and equipment sector is mainly the supplier of manufacturing materials and technologies to other sectors, thus, the economic crisis has hit this sector particularly hard, just like elsewhere in Europe. The most rapid decrease in the output volumes occurred during the last months of 2008 and at the beginning of 2009. Moreover, the volumes of both exported production and production sold in the domestic market declined equally rapidly.

The situation in the sector has started slowly stabilizing already in spring 2009 – positive tendencies have been basically related to the slight increase of exported production volumes. However, the overall production level of 2009 was almost by 50% lower than in 2008.

Figure 3.31

Indicators Characterising Production of Machinery and Equipment



Although in 4 months of 2010 the sector sales volumes exceed the level of the corresponding period of 2009 by over 10%, they considerably fall behind the average indicator of 2008. Like majority of the sectors, also development of production of machinery and equipment is closely related to the changes in external demand. In January-April 2010, sales of production in exports are by slightly more than 15% higher than in the first 4 months of the previous year, and the volumes of production sold in domestic market in the same period are by 20% lower. The sector is exporting almost 90% of production. The main export markets remain in the EU member states. Moreover, more than 40% of exports are sold in Lithuania and Estonia. A relatively big part of exports of the sector is associated with the markets of the CIS and other countries.

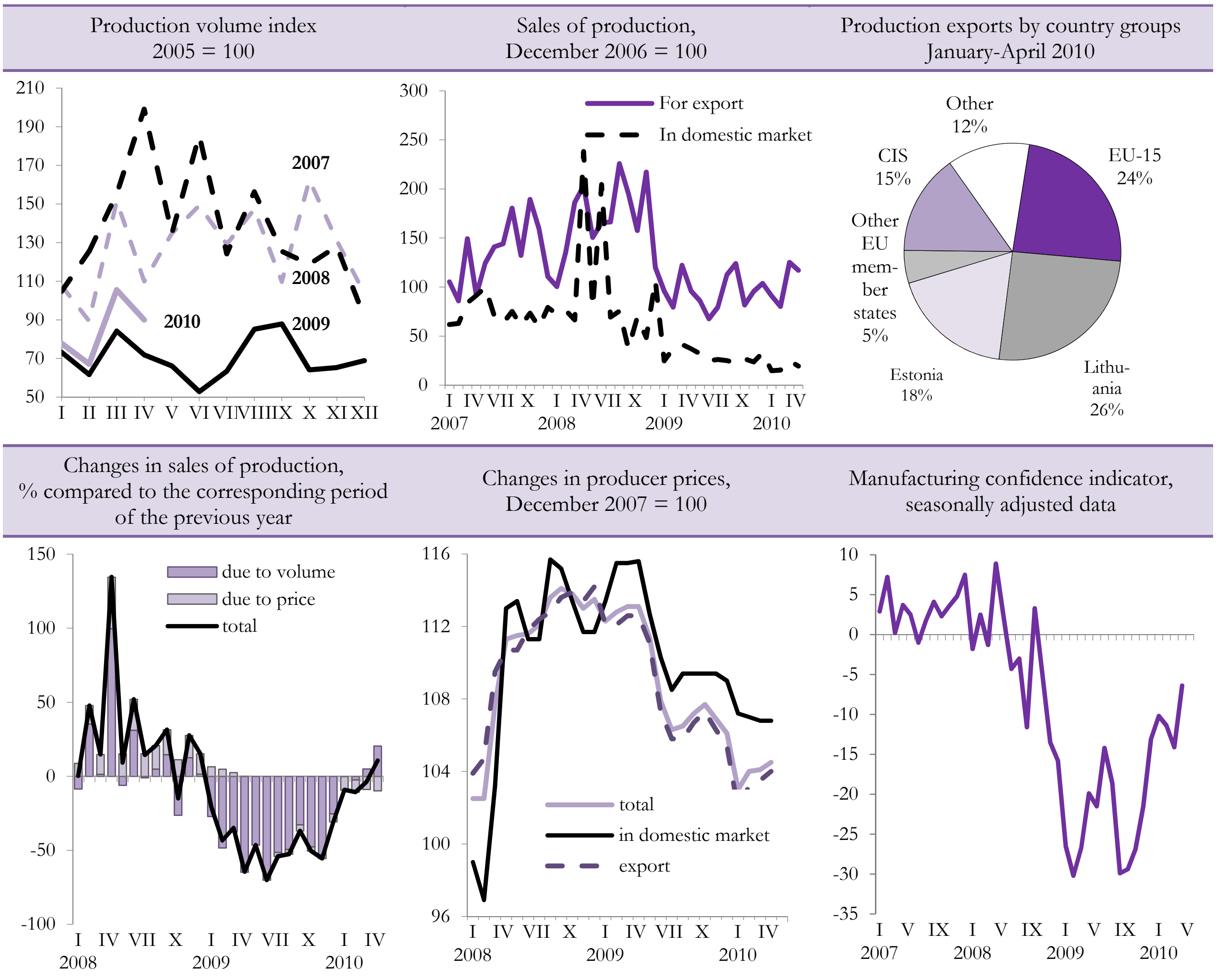
A decline of both, external and domestic demand affected the producer prices, which have increased by more than 3% in 2009. In the first months of 2010, when the demand in the global markets was rising, the producer prices for exported production increased as well. In April 2010, producer prices are by 3.8% higher than in December 2009. However, the producer prices for production sold in domestic market are still decreasing. As of April 2010, the prices have decreased by more than 11% within a year.

Production of transport vehicles sector is a relatively small manufacturing sector, which is characterized by marked fluctuations of production volumes. As almost 90% of production is being exported, the global financial crisis followed by the decrease in the demand quite considerably influenced indicators of the sector. In 2009, production volumes were by 48.8% lower than in 2008.

Like the majority of the manufacturing sectors, also production of transport vehicles sector faced the most rapid decline in the production sold in the domestic market (by almost 70% in 2009). Also in 4 months of 2010, the sales volumes in domestic market continue to decrease and are by 50% below the level of the corresponding period of the previous year. However, production volumes sold in export markets have increased at the beginning of 2010 (by 5% compared to the first 4 months of 2009). The main export markets are the old EU member states, where 40% of all exported production is sold. Important trade partners are also in Lithuania and Estonia, where 14% and 17% of all sector exports is being sold, respectively.

Figure 3.32

Indicators Characterising Production of Transport Vehicles



Changes of producer prices for the products sold in both the domestic and foreign markets are rather similar. Despite the decline in demand, the decrease of prices is relatively small. In April 2010, producer prices for exported production and production sold in the domestic market have decreased by 7.6% on average within a year.

The production of transport vehicles sector is basically oriented towards orders, therefore it should be concluded that the production volumes of the sector in the 1st half of 2010 will remain at a low level, because new orders in both domestic and foreign markets do not exceed the level of the 1st quarter of 2009.

3.2.3. Energy Sector

Both the imported (coal, wood, petroleum products, natural gas, electricity) and local energy resources (end-of-life tyres, household waste for fuel, peat, firewood, straw, biogas, bioethanol, biodiesel) are used in Latvia to supply fuel, electricity and heat to sectors of economy, commercial consumers and residents. A part of electricity is generated by Latvian HPPs and CHPs, biogas from waste deposit areas and wind power stations, whereas the other part is imported. Mainly the imported fuels (natural gas and petroleum) and local fuels (firewood) are used in heat generation.

In 2009, energy resource production and recycled products in Latvia formed 88 PJ. The import of energy resources was 161.2 PJ out of which 58.6 PJ was import of biogas.

Total consumption of primary energy resources in Latvia in 2009 were 183.6 PJ and self-sufficiency in total consumption of primary energy resources was 35.8%. Firewood of total consumption 28.6% was one of the widely used local energy resources in total consumption of primary energy sources, electricity generated by Latvian HPPs and wind power stations in the total energy consumption was 6.9 percent.

Table 3.12

Consumption of Primary Energy Resources in Latvia, PJ

	2003	2004	2005	2006	2007	2008	2009
Total consumption*	**184.3**	**188.4**	**191.9**	**199.0**	**204.6**	**196.5**	**183.8**
including:							
coal and wood	2.8	2.8	3.3	3.6	4.4	4.4	3.5
peat	0.9	0.1	0.1	0.1	0.1	0.1	0.0
petroleum products	59.3	61.0	61.9	67.5	73.3	69.3	57.0
natural gas	56.4	55.8	56.9	58.9	56.9	55.8	51.4
firewood	46.7	49.2	49.2	49.6	48.5	45.8	52.6
electricity	17.8	18.9	19.9	18.9	20.8	20.5	18.6
other energy resources **	0.5	0.6	0.6	0.6	0.6	0.7	0.7

* all energy resources have been calculated based on the lowest heating value;
** end-of-life tyres, household waste for fuel, straw, biogas, bioethanol, biodiesel

The volume of ***electricity*** generation depends on the flow in the Daugava River. Also, electricity imports from Russia, Estonia, and Lithuania play a rather substantial role in electricity supply.

Table 3.13

Electricity Supply in Latvia, TWh

	2003	2004	2005	2006	2007	2008	2009
Total electricity supply	**6.6**	**6.8**	**7.1**	**7.4**	**7.8**	**7.8**	**7.2**
Electricity generation including:	**4.0**	**4.7**	**4.9**	**4.9**	**4.8**	**5.3**	**5.6**
HPPs *	2.2	3.0	3.3	2.7	2.7	3.0	3.4
CHPs**	1.4	1.2	1.3	1.7	1.5	1.5	1.5
Other CHPs	0.3	0.3	0.3	0.4	0.5	0.6	0.5
Small HPPs	0.1	0.1	0.1	0.0	0.1	0.1	0.1
wind generators	0.0	0.0	0.0	0.0	0.1	0.1	0.0
Net electricity import	**2.6**	**2.1**	**2.1**	**2.5**	**3.0**	**2.5**	**1.7**

Source: AS "Latvenergo", the Ministry of Economics, CSB
* Daugava cascade and Aiviekste HPP (HPP of AS "Latvenergo")
** CHP of AS "Latvenergo"

In 2009 AS "Latvenergo" generated 67% of the total energy supply, 10% was purchased from small producers of electricity, 23% were formed by the net electricity import. Total electricity supply has reduced by 8% in comparison with previous year.

The consumption structure of the ***centralised heat supply*** has not changed in the recent years, with central heating comprising 65-70% and hot water supply accounting for 30-35%. Of the total amount of heat sold, 1.4% was sold to the industrial sector, 73.7% to households, and 24.9% to other consumers. However, distribution of heat sold to the regions is the following: Riga – 51.7%, Pieriga region – 11.5%, Vidzeme region – 6.2%, Kurzeme region – 10.2%, Zemgale region – 7.8%, and Latgale region – 12.6 percent.

Heat for selling is produced in 678 boiler houses and 56 cogeneration stations, which in 2009 produced 7.31 TWh of heat energy.

In 2009 natural gas was mainly used to produce heat. The proportion of the produced heat using natural gas as fuel was 76.8%, however using woodchips – 12.5%, wood – 3.6%, heavy fuel oil – 3%, and other types of fuel – 4 percent.

The largest consumers of ***natural gas*** are CHPs of "Latvenergo" and heat supply enterprises (62.5%), industry (17.3%), and other consumers (~20%). The region of Riga accounts for about 70% of the total natural gas consumption in Latvia.

3.3. Forecasts

The Ministry of Economics has developed medium-term economic development forecasts for the period until 2016.

The economic development scenario has been developed in relation with the future economic development opportunities, which are largely determined by the response of the global economy to the financial crisis and by the possibilities of overcoming it and of reviving growth, as well as by the efficiency of economic recovery policy implemented by Latvia.

The global economic recovery is more rapid than forecasted before, however, there are substantial regional differences – it is slower in developed countries and faster in newly industrialized countries and developing countries. The future development perspectives should be assessed cautiously, taking into account still fragile and unstable financial systems. Due to the decrease of the impact of macroeconomic stimulation policies, the majority of developed countries face doubts that public debt levels may increase, which will negatively affect banking sector. The main political priority in the global economy is still related to the recovery of the financial system, taking into account also the subordinate impact of the real sector's recession. The financial problems of the public sector and the necessity to decrease the excessive budget deficit to ensure sustainability of public finances in the majority of the EU member states may negatively affect further development of the EU.

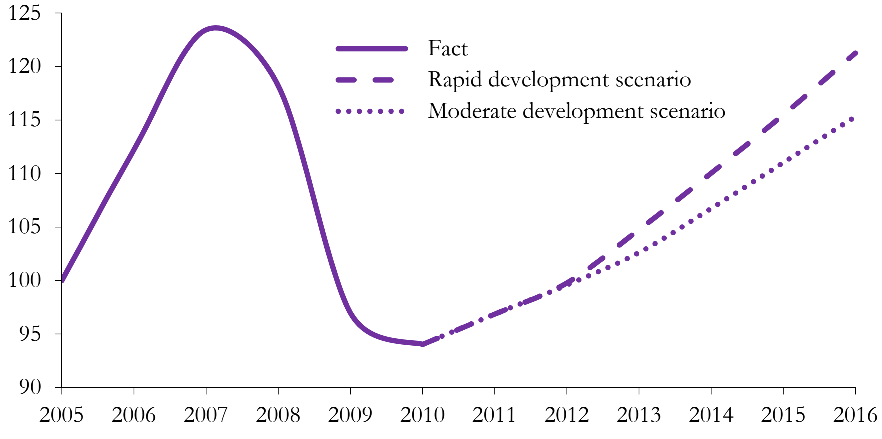
Economic development in 2010-2011

The results of the 1st quarter of 2010 already indicate positive tendencies – the GDP in comparison with the 4th quarter of 2009 has increased (by 0.3% according to seasonally adjusted data), and the private consumption has increased by 0.7%. However, both GDP and private consumption lag behind considerably from the level of the 1st quarter of the previous year (by 6% and 5.8%, respectively). The exports of Latvian goods and services in the 1st quarter of 2010 already exceed the level of the 1st quarter of 2009 by 4.6 percent.

In 2010, one should not count still on a substantial increase of external demand, however the domestic demand will not grow due to the low level of investments. Decrease of investments in the private sector will be mainly affected by the still limited access to financial resources, as well as by the awaiting behaviour of entrepreneurs regarding future perspectives. Decrease of investments will be partly compensated by the policy implemented by the government for the improvement of availability of financial resources. Therefore, the total volume of GDP in 2010 may still lag behind from the level of 2009 by 3 percent.

Figure 3.33

Forecast of Latvian GDP
(%, 2005 = 100)



In the upcoming years, the net exports will continue to improve, i.e., the exports-imports deficit will decrease. Growing external demand will stimulate an increase of export volume. It should be noted that imports of intermediate consumption goods will grow due to expansion of export opportunities when the growth of manufacturing industry will rise again. However, the remaining relatively low level of domestic demand will not cause extra pressure on import increase.

The economic growth in Latvia may start in 2011 with the assumption that the global financial markets will stabilize and crediting will revive. It will positively affect Latvian enterprises and will ensure the increase of external demand in the Latvian export markets for goods and services. Thus, more rapid development of export-oriented sectors is expected in 2011. At the same time, due to revival of domestic demand, it is expected that positive growth tendencies will be observed also in the sectors, which are oriented towards domestic market. The Ministry of Economics forecasts the growth of GDP by 3% in 2011 compared to 2010.

Table 3.14

Forecast of Latvian GDP by Expenditure Items

	2010	2011	2012-2016*
	growth rates, % over the previous year		
Gross domestic product	**-3.0**	**3.0**	**4.6 / 3.6**
Private consumption	1.0	3.3	5.2 / 3.9
Public consumption	-6.5	-1.0	1.8 / 1.4
Gross fixed capital formation	-30.3	2.5	6.4 / 4.0
Exports	5.0	6.0	7.3 / 6.3
Imports	5.9	2.2	8.9 / 6.9
	structure, %		
Gross domestic product	**100**	**100**	**100****
Private consumption	65.1	65.0	67.9 / 66.9
Public consumption	17.3	16.3	13.3 / 13.7
Gross fixed capital formation	15.3	15.1	17.0 / 15.9
Changes in inventories	3.0	2.4	6.4 / 5.3
Exports	49.6	51.3	58.4 / 58.5
Imports	-50.4	-50.0	-63.0 / -60.3
Exports-imports balance	-0.8	1.3	-4.6 / -1.8

* numerator – rapid development scenario, denominator – moderate development scenario
** structure in 2016

Looking at the breakdown by sectors, the decline of GDP in 2010 will be determined by the narrowing of construction sector. Also in trade and several commercial services sectors the output will be below the level of 2009. The decrease of the public budget will directly affect the public services sector (public administration, health care and education). However, the increase of external demand in the foreign markets will bring positive growth stimulus for the export-oriented sectors, mainly to the manufacturing, as well as to the transport and communications sector.

Development perspectives in 2012-2016

Economic development tendencies of Latvia in the medium term will be closely related to the recovery of the global economy. If financial markets stabilize, then it will positively influence both Latvian entrepreneurs and foster increase of economic activities, as well as demand for our goods and services in the export markets, especially the EU.

In the medium-term, the main growth stimulus of Latvia should be related to the expansion of export opportunities. Therefore, a particular role in ensuring growth is played by the main export-oriented sectors – competitiveness of manufacturing in both international and domestic markets.

The competitiveness of Latvian manufacturing is based mainly on relatively cheap labour and low total costs. Due to the rise of labour costs and prices in 2006 and 2007, these advantages to a great extent had been lost. The current crisis conditions with low demand and strict budget limits when wages in the public sector are considerably reduced cause high pressure on the overall level of wages and prices, which partly improve the competitiveness of Latvian producers. However, it should be taken into consideration that under circumstances of free movement of workers it will be not possible to maintain competitiveness of the Latvian economy with such methods, therefore a corresponding productivity increase and increased complexity of export products will play a critical role, allowing to compete in the international markets much more successfully.

Table 3.15

Forecast of Latvian GDP by Sectors
(real growth, % in comparison with the previous year)

	2010	2011	2012-2016 (average annually)*
Gross domestic product	**-3.0**	**3.0**	**4.6 / 3.6**
Primary sectors	1.0	4.3	3.9 / 3.4
Manufacturing	5.0	5.0	5.6 / 5.0
Electricity, gas and water supply	9.4	0.4	2.1 / 1.6
Construction	-29.1	4.5	4.6 / 2.8
Trade, hotels and restaurants	-0.3	3.3	4.4 / 2.7
Transport and communications	2.5	4.4	6.3 / 5.4
Other commercial services	-4.0	2.1	4.8 / 3.7
Public services	-9.2	1.3	2.0 / 1.6

* numerator – rapid development scenario, denominator – moderate development scenario

According to the rapid growth scenario, in order to ensure the average growth of 4.6% in 2012-2016, the production volumes of manufacturing should increase by at least 5.6% annually. Moreover, the rapid growth scenario foresees improvement of foreign services balance of Latvia mainly due to the transport services.

It is forecasted, that in the medium-term growth will be not as rapid as it has been observed in 2005-2007, since its driving force will be not the large financial inflows that have stimulated domestic demand and fostered mainly the development of services and activities in the real estate sector. The main driver of growth will be expanding export opportunities.

The main risk for further growth is an inefficiently implemented structural policy for improving competitiveness of the economy in the conditions of limited access to financial resources, including the state budget.

4. Macroeconomic Stability

4.1. Public Finances

4.1.1. Fiscal Policy and Public Debt

As it is shown in Table 4.1, deterioration of the economic situation has had a significant impact on the fiscal position of Latvia. The general sector budget deficit[1] in Latvia was LVL 671.5 million or 4.1% of the gross domestic product in 2008 and in 2009 it had increased by LVL 1183 million or 9% of the gross domestic product.

Table 4.1

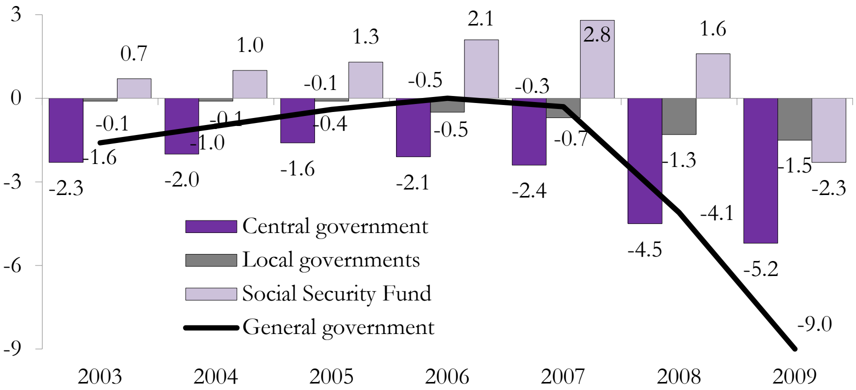
General Government Budget

	2003	2004	2005	2006	2007	2008	2009
Revenues (million LVL)	2120.2	2583.2	3184.1	4208.0	5236.7	5605.9	4499.9
(% of GDP)	33.2	34.7	35.1	37.7	35.4	34.6	34.4
Expenditures (million LVL)	2223.6	2659.6	3220.8	4261.2	5283.1	6277.5	5682.9
(% of GDP)	34.8	35.8	35.6	38.1	35.7	38.8	43,4
Balance (million LVL)	-103.5	-76.5	-36.7	-53.1	-46.5	-671.5	-1183.0
(% of GDP)	-1.6	-1.0	-0.4	-0.5	-0.3	-4.1	-9.0

In 2009 the general government budget deficit was determined by the deficit in the central government budget and local governments budget as well as in the Social Security Fund (see Figure 4.1). The social insurance budget has run at a surplus in the previous years, though in 2009 the deficit has appeared in it.

Figure 4.1

General Government Budget Balance by Sub-Sectors
(% of GDP)

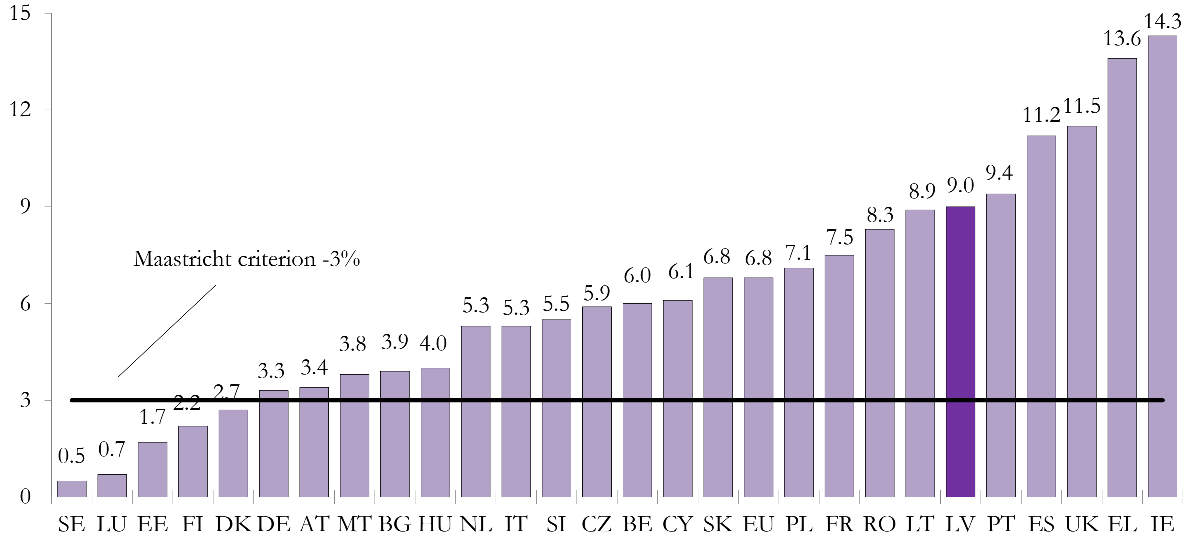


Similarly, the average level of the budget deficit in the EU Member States continued to grow in 2009. As it can be seen from the Figure 4.2, in all 27 EU Member States the budget deficit was registered in 2009. The average level of the budget deficit in the EU Member States was 6.8% of GDP in 2009 (2.3% of GDP in 2008, 0.8% of GDP in 2007). The budget position has deteriorated in 25 EU Member States in 2009. It only improved in Estonia and Malta. In 2009, the highest general government budget deficit as a percentage of GDP was observed in Ireland, Greece, United Kingdom, and Spain. In these countries the budget deficit exceeded 10% of GDP.

According to the forecasts of the European Commission in the spring of 2010, the budget situation in the EU Member States in 2010 will continue to deteriorate slightly, however it is forecasted that beginning with the 2011 the situation will gradually improve. In 2010, the average budget deficit of the EU Member States is forecasted to be in the amount of 7.2% of GDP, while in 2011 – 6.5% of GDP. In 2010 and 2011, the largest budget deficits exceeding 10% of GDP are to be expected in Ireland and United Kingdom, but slightly less, approximately 9% of GDP – in Greece and Spain.

Figure 4.2

General Government Budget Deficit in EU Member States in 2009
(% of GDP)



In 2010, it is planned that in Latvia the general government financial deficit will not exceed 8.5% of GDP. In order to ensure compliance with the state budget and decline of economic development and to observe the agreement between the government of Latvia and the international partners, in preparation of the state budget decisions about significant measures of fiscal consolidation were made.

The budget of 2010 consolidation in general was made in the amount of LVL 507.5 million, i.e., budgetary balance was improved by 4.3% of GDP. Within the fiscal consolidation the budget revenue was increased by LVL 262.9 million including:

- personal income tax revenues – LVL 154 million;
- real estate tax revenues – LVL 30.2 million;
- excise tax revenues – LVL 12.1 million;
- car and motorcycle tax revenues – LVL 0.1 million;
- social security contributions revenues – LVL 36.7 million;
- revenues from annual vehicle duties – LVL 18.9 million;
- revenues from performing payments on state capital (dividends) – LVL 11 million.

Also, expenses were reduced by LVL 244.6 million including:

- expenditures of the state budget – LVL 200.3 million;
- expenditures of local governments budget– LVL 44.2 million.

In the medium term, moving towards the aim – introduction of the euro –, it is planned to reduce the general government budgetary balance in 2011 by 6% of GDP and in 2012 – by 2.9% of GDP.

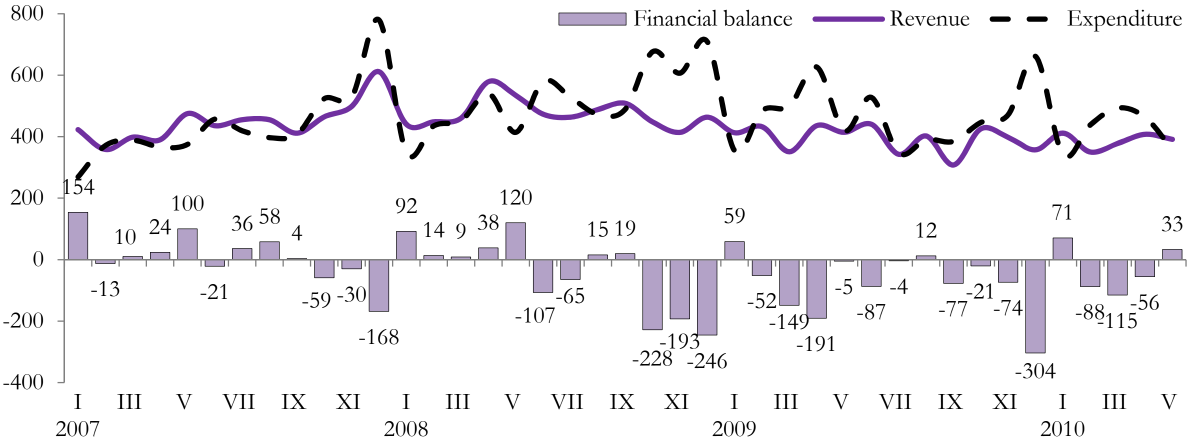
In order to create a basis for sustainable economic development and to ensure fiscal responsibility consistently, it is foreseen to develop a *Draft Law on Fiscal Discipline*, which would set the budget deficit level corresponding to the forecast changes of GDP and macroeconomic indicators, state budget expenditure fluctuation range and the ceiling of maximum growth of these changes, thus ensuring anti-cyclic activity of fiscal policy, as well as will provide the area of responsibility of the government, the Cabinet of Ministers, other institutions, and local governments, to ensure compliance with the fiscal discipline on all levels of state administration.

In 2009, **the revenue of the state consolidated budget** amounted to LVL 4734.7 million, which is by 17.3% less than in 2008, and which mainly was determined by the decrease of tax revenues in the general state budget by LVL 766.5 million. At the same time, expenditure in 2009 amounted to LVL 5626.8 million, which is by 10.2% less than in 2008. The deficit of the total government consolidated budget in 2009 reached LVL 892.1 million (see Figure 4.3).

In the 5 months of 2010, the total expenditures of the state consolidated combined budget were LVL 2094.9 million, which is by 12.2% less than in the respective time of last year. For comparison, in the five months of 2009, the total expenses of the state consolidated combined budget for 8.9% exceeded the level of the respective period of time in 2008. In the same time period of last year, the financial deficit of consolidated combined budget was LVL 337.8 million, while in the 5 months of 2010 it was only LVL 155.3 million.

Figure 4.3

Total Government Consolidated Budget
(million LVL)

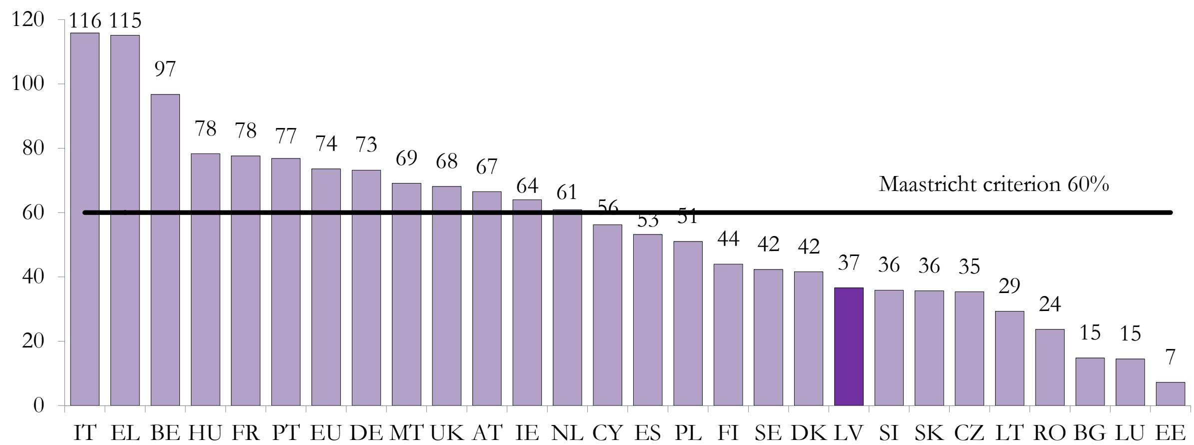


The level of the general government debt[1] in Latvia is one of the lowest in the EU (see Figure 4.4).

In 2009, the EU average level of the general government debt was 73.6% of GDP (61.6% of GDP in 2008, 58.7% of GDP in 2007). The general government debt exceeded the Maastricht criterion that is 60% of GDP in 12 EU Member States in 2009. In 2009, the highest general government debt in percentage of GDP was observed in Italy, Greece, and Belgium, while the lowest general government debt in percentage of GDP was registered in Estonia, Luxembourg, Bulgaria, and Romania.

Figure 4.4

General government debt in EU Member States in 2009
(% of GDP)



The general government debt in Latvia has gradually increased until 2007 – from LVL 933.9 million at the end of 2003, until LVL 1329.8 million at the end of 2007, it has even decreased in percentage of GDP from 14.6% to 9%. However, it increased very rapidly in 2008 to ensure national funding commitments and reached LVL 3181.4 million or 19.7% of GDP at the end of 2008, but at the end of 2009 – LVL 4783.4 million or 36.6% of GDP (see Figure 4.5). The debt level is mainly influenced by the debt of the central government.

At the end of 2008, on the basis of the *Economic Stabilization and Growth Revival Programme of Latvia,* the International Monetary Fund, European Commission, World Bank, European Bank for Reconstruction and Development and several EU Member States have agreed on providing financial support to Latvia in the amount of EUR 7.5 billion. The allocated financing will be available from 2008 until 2011 and will determine the increase of the central government debt in the following years.

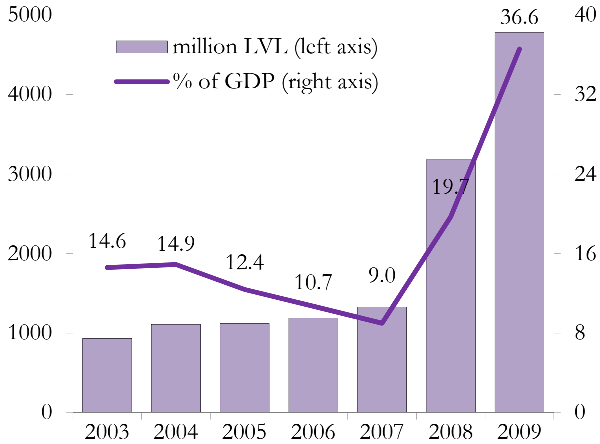
Within the framework of International Financial Assistance, by the end of 2009, funds in amount of LVL 2293 million were received, from which LVL 1320 million were uptaken for covering general financing necessity and for implementation of the measures for financial sector stabilization. Surplus of the received assistance funds in the amount of LVL 973 million in accordance with an agreement with the creditors was reserved in the accounts of the State

[1] Accordingly to methodology of the European system of accounts (ESA 95)

Treasury in the Bank of Latvia for the needs of state budget performance and financing of the liabilities of state debt (LVL 517 million), as well as possible stabilization measures of financial sector (LVL 456 million).

Figure 4.5

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



In order to ensure compliance with the criterion specified in Maastricht Treaty on the general government debt in the middle term, opportunities to manage following debt restructuring measures will be considered:

– to reduce the incurred indebtedness using marked International Financial Assistance resources if they will not be used in full;
– regarding further uptaking of the International Financial Assistance programme in the amount of EUR 7.5 billion granted to Latvia the opportunities to agree with international creditors on transactions structure that envisage the rights to use resources but at the same time do not make the immediate increase of committed funding.

Taking into consideration the present forecasts and possible debt restructuring measures, it is expected that the debt level of the general government in the middle term will not exceed the criterion of debt specified in the Maastricht Treaty that is 60% of GDP.

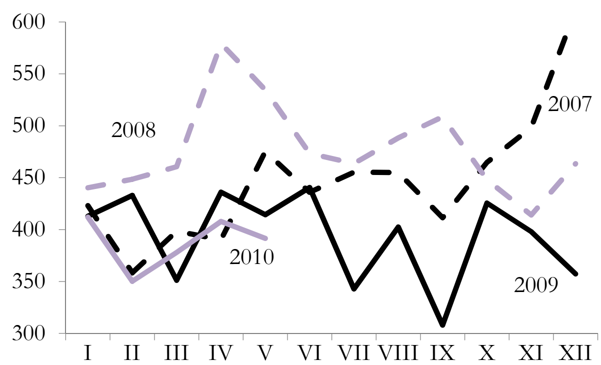
4.1.2. Budget Revenues

Decrease of economic activities and internal demand negatively influence budget revenues that started to reduce at the end of 2008. The total revenue of general government consolidated budget in 2009 was LVL 4734.7 million, which was by 17.3% less than in 2008. It was mainly determined by the decrease of tax revenues.

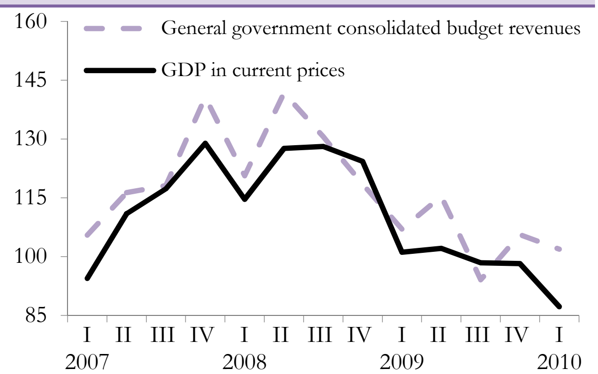
Collected taxes in 2009 formed almost 75% of all budget revenues. Despite the increase of the special tax rates in 2009 the total tax revenue decreased by 25.8% and it reached LVL 3515 million. The tax revenue decrease was affected by reduction of economic activities – decrease in household revenue, decline of retail turnover, increase of unemployment, etc.

Figure 4.6

General Government Consolidated Budget Revenue by Months*
(million LVL)



GDP in Current prices and General Government Consolidated Budget Revenues by Quarters
(2006 4th quarter = 100)



* according to official data of monthly reports of the State Treasury

Due to the low level of economic activities, also at the beginning of 2010 the general government consolidated budget revenues did not increase. In the five months of 2010, it was LVL 1939.6 million, which is by 5.3% less than from January till May, 2009. Similarly, the share of tax levy in the total revenues continue to decrease. Tax revenues in the first five months of 2010 were LVL 1391.5 million. It is by 9.7% less than in the respective period of the previous year and constitutes 71.7% of the general government consolidated budget revenues.

Table 4.2

Budget revenues*
(% of GDP)

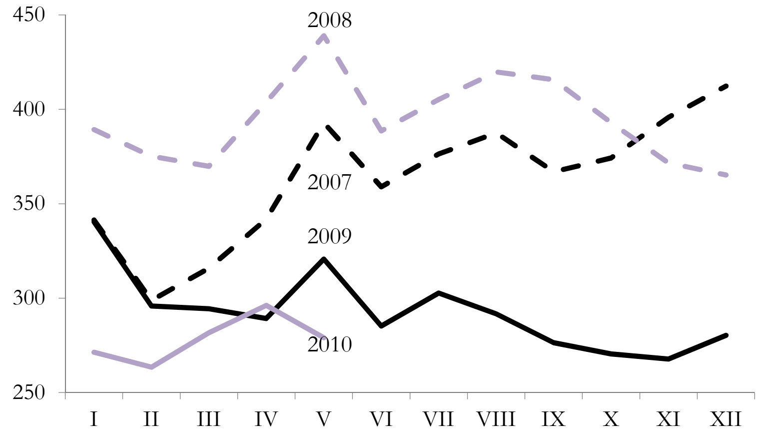
	2007	2008	2009	1st quarter of 2009
General government consolidated budget revenues	**36.2**	**35.4**	**36.2**	**40.0**
I Tax revenues	**29.5**	**29.3**	**26.9**	**28.6**
1. Indirect taxes	*11.4*	*10.4*	*10.1*	*10.7*
– value added tax	8.1	6.9	6.1	6.9
– excise tax	3.0	3.3	3.9	3.7
– customs duties	0.2	0.2	0.1	0.1
2. Income taxes and property taxes	9.2	9.9	7.6	8.7
– corporate income tax	2.7	3.1	1.5	1.3
– personal income tax	6.0	6.4	5.6	6.7
– real estate tax	0.5	0.4	0.6	0.7
3. Social insurance contributions	*8.6*	*8.7*	*8.9*	*8.9*
4. Other taxes	*0.4*	*0.3*	*0.2*	*0.2*
II Non-tax revenues	**6.7**	**6.1**	**9.3**	**11.4**

* according to the official data of the State Treasury

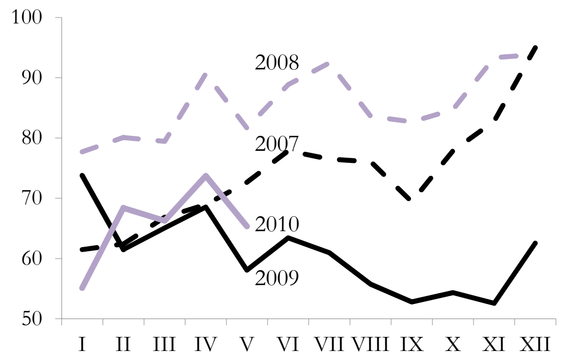
More than ¾ of the total tax revenues consist of three taxes – mandatory state social insurance contributions, personal income tax, and value added tax.

Figure 4.7

Tax Revenues by Months*
(million LVL)



Personal Income Tax



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

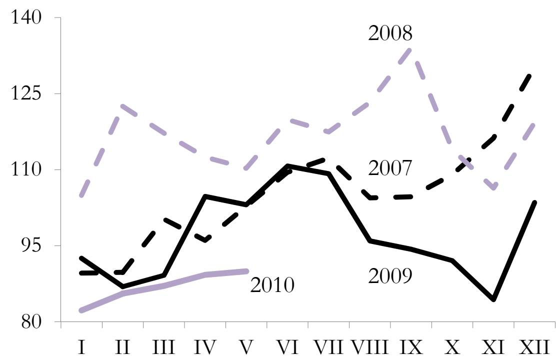
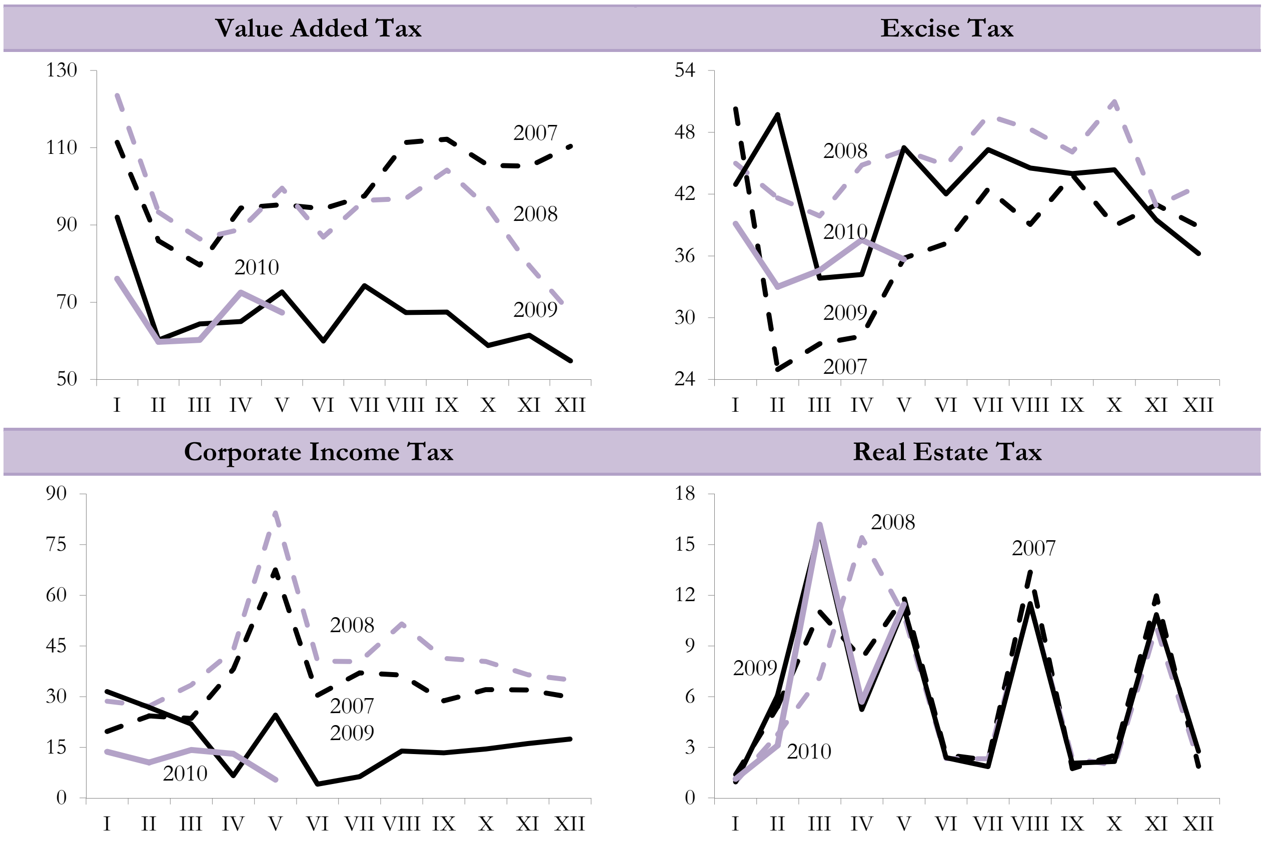


Figure 4.7 continued



* according to official data of monthly reports of the State Treasury

Almost 54% of all the tax revenues in 2009 were made of **employment tax**. Reduction of unemployment, reduced work pay, as well as a growing share of hidden economy mainly determined the decrease of the employment tax levy. In 2009, revenues from personal income tax reduced by 29.1%, while reduction of the mandatory state social insurance contributions in comparison with the previous year were more moderate (by 16.8%). The more rapid decrease in revenues from personal income tax was caused by the amendments of the tax law introduced at the beginning of the year 2009, when the tax rate was reduced from 25% to 23 percent.

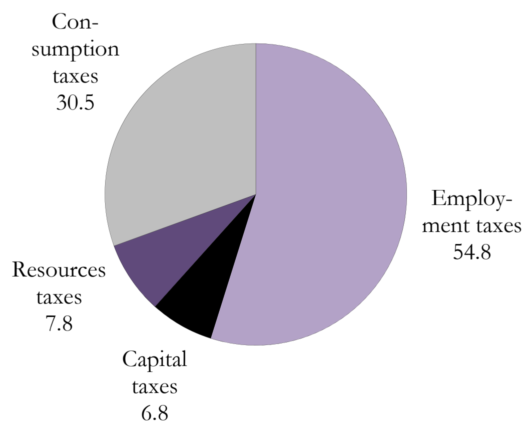
In the first months of 2010 the share of the employment tax in the total tax revenue continues to grow. As of January 1, 2010, new amendments to the *Law on Personal Income Tax* came into force. The general rate of the tax was increased from 23% to 26%, the basis of the personal income tax was expanded including all profits from capital – dividends and interest income will be subject to a 10% rate, but the capital increase – 15%. Personal income tax is also imposed for using employer's passenger car for private needs; the income tax for self-employed persons is raised subjecting them to the general rate of personal income tax and other changes will take place. Expansion of the personal income tax base and increase of the tax rate have partially compensated for the low economic activity in the labour market – in the 5 months of 2010, the tax revenues were LVL 328.9 million, which means that they have been basically maintained at the level of the respective period of the previous year (growth by 0.6%).

However, the revenues from mandatory state social security contributions from January till May, 2010, were LVL 434.2 million. That is by LVL 42.3 million or 8.9% less that in the five months of 2009.

Figure 4.8

General Government Consolidated Budget Tax Revenues by Tax Groups in the five months of 2010

(%)



The share of **consumption tax** in the tax structure has reduced from 33.7% in 2007 to 30.5% in the five months of 2010. Within the years of fast growth, the revenues from the consumption taxes substantially increased. It was promoted by growing internal demand and high inflation. As from the end of 2008, due to the decrease of internal demand and consumer price pressure the consumption tax levy started to decrease.

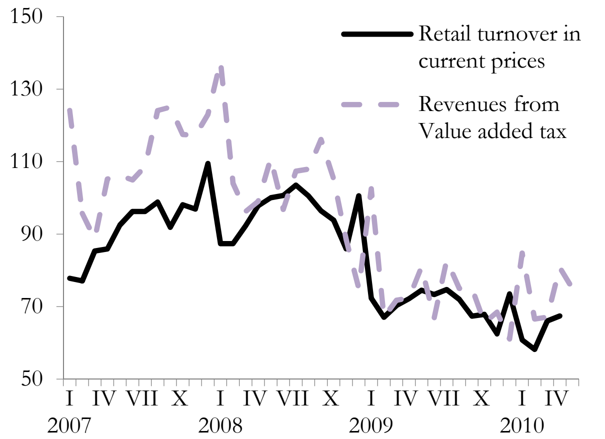
In 2009, the revenue of the value added tax amounted to LVL 798.4 million, which is by 28.5% less than in 2008. On January 1, 2009, the standard rate of the tax was increased from 18% to 21%. Yet, this increase of the tax rate did not compensate for the drop of the total retail turnover.

The share of the excise tax revenues in 2009 dropped by 14.6%, despite the increase of excise tax rates, especially for tobacco products. The increase of the excise tax rates for almost all the excise goods implemented at the beginning of the year 2009 and the global economic recession has caused a rapid decrease in the volumes of sales of excise goods, which accordingly decreased also the revenues from the excise tax.

Figure 4.9

Retail Turnover in Current Prices and Revenues from Value Added Tax

(December 2006 = 100)



From January 1, 2010, changes in the *Law on Value Added Tax* came into force. The norms of the new law are aimed to develop business environment and promote competitiveness of small enterprises. These amendments simplify or abolish statutory requirements (for example, regarding presentation of value added tax invoices and submitting the annual value added tax declaration), thus reducing the administrative burden for entrepreneurs.

In the five months of 2010, the value added tax revenues were LVL 336 million, which is by 5.2% less than in the period from January till May, 2009. VAT revenues are interlinked with the changes in the amount of retail turnover. If compared with the respective period of 2009, the retail turnover in the five months of 2010, in the real prices has decreased by 9.7 percent.

During the same period, the revenues from excise duty consumption share were LVL 74.8 million. That is by 20.9% less than from January till May, 2009. The decrease in revenues from excise duty was affected by the decline of alcohol and cigarette sales amount, which is indicative of expansion of illegal market.

The share of **the capital tax** in the total tax revenues gradually increased till 2008 (12.1%). In 2009, along with reducing economic activities and increasing number of insolvent companies, corporate income tax revenues have dropped sharply, namely, by LVL 197.2 million or by 60.8% less than in 2008.

A decrease of the capital tax revenues is observed also in the first months of 2010. From January till May, corporate income tax revenues were LVL 57 million. That is by 48.8% less than in the respective months of 2009. A decrease in revenues from corporate income tax mainly is affected by the sector of financial services that incurs serious losses (the decrease constitutes approximately a half of the total decline of the revenue from corporate income tax).

It must be noted with regards to the corporate income tax that starting with 2010, the norm of representation expenses that can be deducted from the taxable income is reduced (from 60% to 40%); for the purposes of corporate income tax calculation, the share of costs not associated with economic activity and maintenance of the social infrastructure objects, which is not included in the expenditures, has increased 1.5 times; the taxpayer's option to decide whether to pay reduced advanced payments if the amount of profit has been decreased.

It must be mentioned that the economic recession to a lesser extent has affected the revenues from real estate tax. In 2009, it was LVL 73.1 million in 2009 (by 3.3% more than in 2008). As from January 1, 2010, the real estate tax rate is raised for land and buildings used for commercial activity to 1.5%, the minimum payment is fixed at LVL 5 for each taxable object, uncultivated lands are subject to the increased rate of 3%, the real estate tax must also be paid for engineering-technological buildings. Starting with 2010, the real estate tax base is expanded – the residential houses with cadastral value below LVL 40 000 are subject to 0.1% of the cadastral value, with cadastral value of LVL 40 001-75 000 – 0.2%, with cadastral value above LVL 75 000 – 0.3%.

In the five months of 2010, the tax revenues from real estate tax were LVL 37.6 million. It is by 4.7% less than in the respective period of the previous year. Taking into consideration that since January tax base is expanded and the tax rate is raised, the decrease in tax revenues is explained by deterioration of population's paying capacity and by the debt increase in real estate.

Changes in the group of **resources tax** are mainly related to the excise tax on oil products, because natural resources tax forms almost 3% of revenues of this group. In comparison with the previous years, in 2009 the share of the resource tax group grew and was 8.3% of the total tax revenues. In 2009, the excise tax on oil products was collected in the amount of LVL

284.1 million, which exceeded the collection of the year 2008 by 0.3%. This was mostly related to the increase of the excise tax rate on oil products. The natural resources tax revenues in the previous year reduced by almost 23 percent due to the substantial decrease of economic activities.

From January till May, 2010, the excise tax revenues on oil products were LVL 105.2 million. It is by 6.6% less than in the five months of the previous year. The decline of the tax revenues is related to the decrease of oil product consumption corresponding to current economic situation in the country.

4.1.3. Budget Expenditures

The declining budget revenues forced the government to implement a policy for reduction of the budget deficit which in the short-term creates additional pressure on the diminishing internal demand. As it has already been mentioned, the total revenues of the state consolidated combined budget decreased by 10.2% in 2009 and the decrease was slower than the reducing budget revenues.

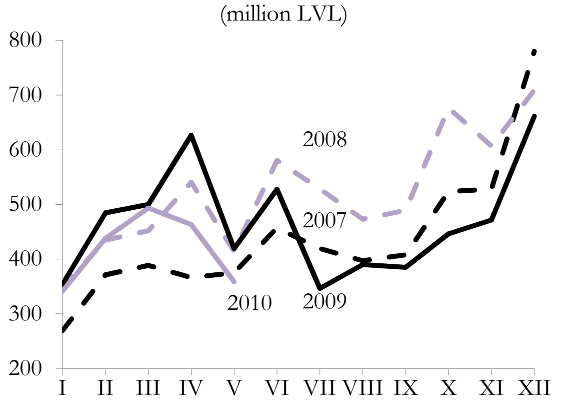
Taking into consideration the objective set by the government – the budget deficit cannot exceed 8.5% of GDP in 2010 – the expenditures of the government were substantially restricted when developing the draft budget law of 2010.

In the five months of 2010, the total expenditures of the state consolidated combined budget were LVL 2094.9 million, which is by 12.6% less than in the respective period of the previous year. For comparison – in the five months of 2009, the total expenditures of the state consolidated combined budget exceeded the level of the respective period in 2008 by 8.9%.

Figure 4.10

General Government Consolidated Budget Expenditures by Months*

(million LVL)



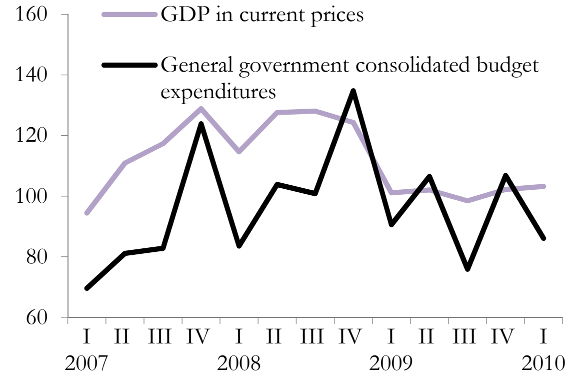
* according to official monthly report data of the State Treasury

Although the budget expenditures decreased in 2009, the expenditures for subsidies and grants continued to increase. If compared with 2008, these expenditures grew by 6.5% and reached LVL 2857.7 million. The increase is mainly related to the growing number of unemployed and paid unemployment benefit, dismissal benefit payments of the employees fired from the public sector, as well as other social benefits. Expenditures for subsidies and grants form almost a half of all expenditures of the state consolidated combined budget.

Figure 4.11

GDP in current Prices and General Government Consolidated Budget Expenditures by Quarters

(2006 4th quarter = 100)



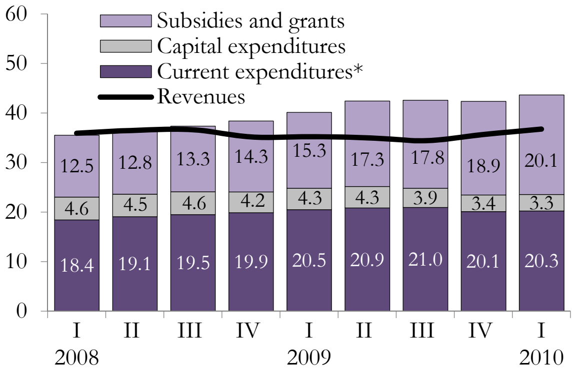
In 2009, the capital investment expenditures were reduced very considerably. They constituted LVL 507.4 million, which was by 34.6% less than in 2008. The high share in expenditures remained for current expenditures (47.5%), which reduced by 18.3% in 2009. In order to reduce the expenditures of the general government consolidated budget, optimization of the state administration and particular branches was performed – reduction of the number of employees of the ministries, as well as reduction of the number of state agencies and hospitals.

Taking into consideration the great reduction of expenditures, in the five months of 2010, expenditures for subsidies and grants have reduced by 9.8% if compared to the period from January till May in 2009. At the same time, the capital investments expenditures (for 34.9%) and the current expenditures (for 18.3%) have reduced more rapidly.

Figure 4.12

General Government Consolidated Budget Revenue and Expenditures

(% of GDP)



* including payments for borrowings and loans as well as payments to the EU

In 2009, in proportion with the expenditures in the functional categories, the expenditures increased for social security (by 14.6% if compared to 2008) and environmental protection (by 11.1%). In 2009, essential reduction of expenditures was observed in other groups, for instance, security and maintenance of territories of the local governments (by more than 40%), public order and safety, economic activities, as well as recreation, culture, and religion (by more than 20%).

From January till May, 2010, the biggest share was for social security (more than 35% of all expenditures), followed by expenditures for education, economic activity, and general government services. If compared to the first five months of 2009, the expenditures from January till May, 2010 for military defence, economic activity, recreation, culture and religion, as well as for education have reduced for almost ¼.

Table 4.3

Expenditures of the General Government Consolidated Budget by Functions*

(percentage)

	2008		2009		2010 1st quarter	
	structure	of GDP	structure	of GDP	structure	of GDP
Expenditures – total	**100**	**38.6**	**100**	**42.9**	**100**	**44.6**
General public services	13.6	5.3	14.8	6.3	16.8	7.5
Defence	3.5	1.3	2.4	1.0	1.8	0.8
Public order and safety	5.0	1.9	4.5	1.9	4.2	1.9
Economic affairs	18.1	7.0	15.7	6.7	16.3	7.3
Environmental protection	2.4	0.9	2.2	0.9	0.8	0.3
Housing and community amenities	3.6	1.4	2.1	0.9	1.8	0.8
Health	8.1	3.1	7.5	3.2	6.4	2.9
Recreation, culture, and religion	4.0	1.5	3.4	1.5	2.6	1.1
Education	20.2	7.8	19.6	8.4	14.9	6.7
Social security	21.5	8.3	27.9	12.0	34.4	15.4

* according to the official data of the State Treasury

In order to reach the aim – budget deficit less than 3% of GDP in 2012 –, during the upcoming years, the government will be forced to continue reducing the budget expenditures.

The public demand is made up of public consumption or public services, the value of which is determined by the volume of the provided public services and public investment, namely capital investments using the budget resources.

Table 4.4

Public demand

(%)

	% of GDP			Changes over the previous year		
	2007	2008	2009	2007	2008	2009
Public Demand	**23.1**	**24.6**	**22.6**	**10.0**	**-2.8**	**-15.3**
Public consumption	17.4	19.8	18.7	3.7	2.6	-10.1
– central government	9.5	10.9	10.0	1.4	3.1	-12.2
– local governments	7.9	8.9	8.6	6.6	2.1	-7.7
Gross fixed capital formation	5.7	4.8	4.0	27.8	-15.4	-29.8
– central government	2.8	1.8	1.4	-3.7	-38.2	-33.1
– local governments	2.8	3.1	2.6	91.3	7.7	-27.9

* with the social security fund

In 2008, the public demand decreased slightly slower than GDP. The reduced demand was mainly determined by a reduction of expenditures by almost 40% of gross fixed capital formation of the central government if compared to 2007. At the same time, the expenditures of local governments for investments increased by 7.7% in 2008.

Also in 2009, the social demand decreased at a slower rate than GDP. If compared to 2008, public consumption in the previous year decreased by slightly more than 10%. Similarly, the expenditures for state investments (almost by 30%) continue the rapid decrease. It must be noted that the central government reduces expenditures more rapidly for the total fixed capital development, but the reduction rate of expenditures of local governments are more moderate.

Overall, social demand reduced by 15.3% in 2009.

4.2 Prices

4.2.1 Consumer Prices

After the accession of Latvia to the EU, the country experienced high inflation that reached 18% in the mid- 2008 (12-month inflation).

Decrease of inflation began at the end of 2008, when the domestic demand went down and consumer prices started to decline. At the beginning of 2009, the rise of administratively regulated prices and increase in the rate of value added tax and excise tax slowed down the process. Prices for goods responded first to the decline of domestic demand and started to go down in the 2nd half of 2008, but prices of services – only in March 2009.

Since April 2009, at the time when the decline started until December the prices on average decreased by 0.5% annually. As a result, in December 2009 the 12-month inflation was negative, i.e., 1.2% deflation.

Figure 4.13

Consumer Price Changes

(12-month inflation, %)

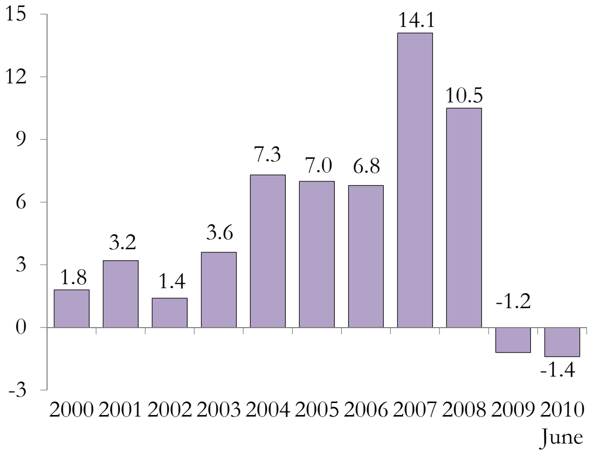


Table 4.5

Consumer Price Changes by Months

(%)

Year	Month	Compared to the previous month	Compared to the respective month of the previous year	Average during the year
2009	January	2.2	9.8	14.9
	February	1.1	9.6	14.3
	March	0.2	8.2	13.5
	April	-0.4	6.2	12.5
	May	-0.5	4.7	11.4
	June	-0.5	3.4	10.2
	July	-0.6	2.5	9.1
	August	-1.0	1.8	7.9
	September	-0.2	0.5	6.7
	October	-0.2	-0.9	5.5
	November	-0.7	-1.2	4.5
	December	-0.5	-1.2	3.5
2010	January	0.2	-3.1	2.5
	February	0.0	-4.2	1.3
	March	0.5	-3.9	0.3
	April	0.9	-2.7	-0.4
	May	-0.1	-2.3	-1.0
	June	0.4	-1.4	-1.4

Prices in January and February 2010 compared to the previous month did not decrease. However, as the prices in these months of the previous year increased faster, the 12-month deflation increased reaching 4.2% in February.

From March 2010, the dynamics of price changes do not indicate continuation of deflation. Private consumption is not decreasing anymore and is not considered as a factor that could substantially determine further decrease of prices. The greatest impact on the average level of prices in 2010 could be caused by external factors related to changes in prices for food and fuel. Therefore, price increase could be expected in autumn after the seasonal price decrease during the summer months. The overall annual changes of prices could be close to zero.

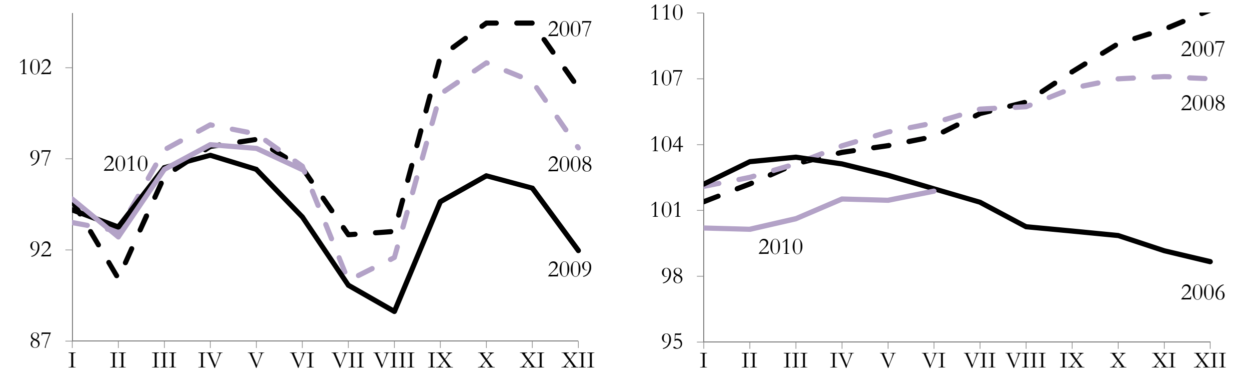
In June 2010, the consumer price level has grown by 1.8% compared to December 2009. The highest impact on price increase is contributed by such consumption groups as home – by 6.6%, transport – by 5% and food – by 3.9%. The prices increased also for alcohol and tobacco – by 1.7%. Furthermore, price decrease was observed in such consumption groups as clothes and footwear, household appliances, health, communications, recreation and culture, education, as well as hotels and restaurants.

Figure 4.14

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

Figure 4.14 continued

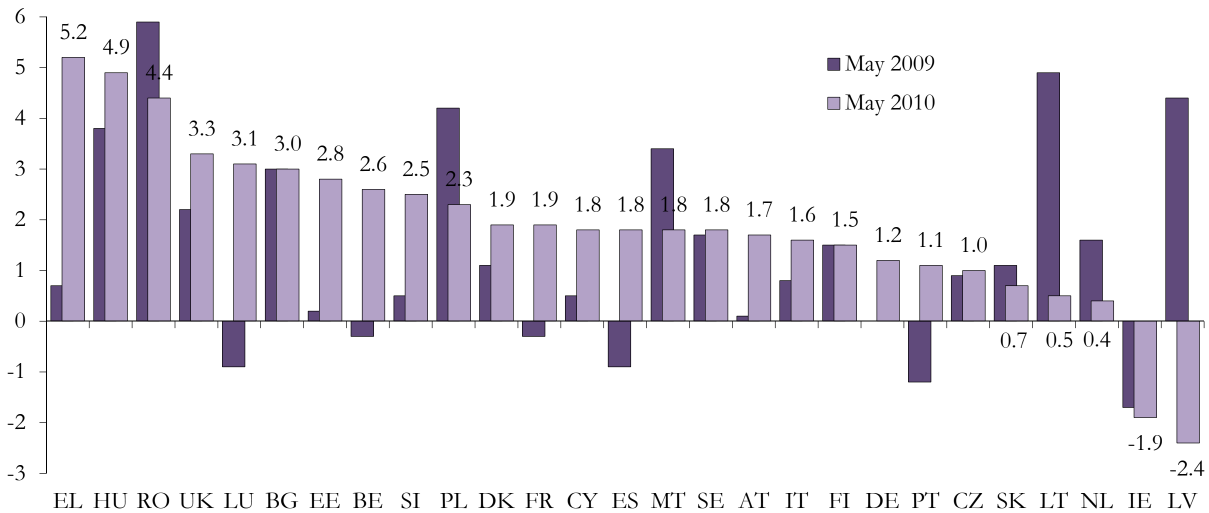
Clothes and footwear	Other groups of commodities and services



The lowest level of inflation in the European Union in general was reached in the mid-2009. Since then, consumer price inflation started to increase. A depreciation of the currency exchange rate of the Euro against the US Dollar, as well as increase of prices for energy resources and raw materials had a significant impact on inflation.

Figure 4.15

Changes of the Harmonised Consumer Price Index in the EU Member States in May 2009 and May 2010
(12-month inflation, %)



Source: *Eurostat*

The price level in the European Union in May 2010 compared to May 2009 has increased on average, but the price level in Romania, Poland, Malta, Slovakia, Lithuania, the Netherlands, Ireland and Latvia has decreased.

The highest inflation level in May 2010 was observed in Greece, Hungary and Romania (5.2%, 4.9% and 4.4%, respectively). Deflation has been observed in two EU member states – Latvia and Ireland (2.4% and 1.9%, respectively).

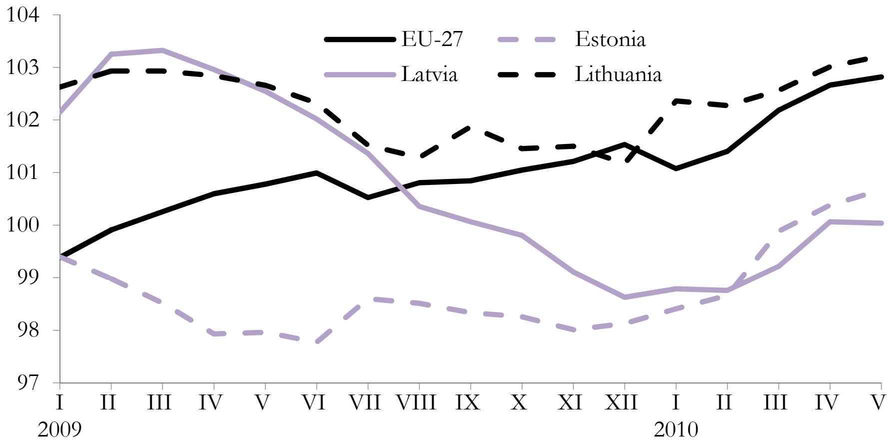
Deflation in Estonia started earlier than in Latvia. Decrease of prices in Estonia had been observed already at the beginning of 2009.

The consumer prices in May 2010 compared to December 2009 increased in all Baltic States.

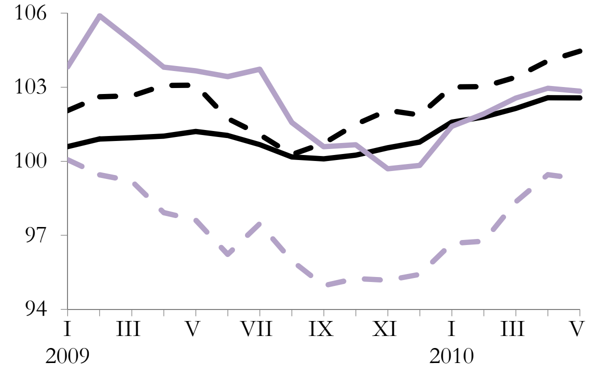
Within the five months of 2010, the food prices in the EU as well as in the Baltic States have increased. The highest increase of prices in the food product group was observed in Estonia – by 4.1%, in Latvia the prices increased by 3% and in Lithuania – by 2.5%. During the year (compared to May 2009), consumer prices for food products in Estonia and Lithuania increased by 1.7% and by 1.3%, respectively, but in Latvia the prices have decreased – by 0.8 percent.

Figure 4.16

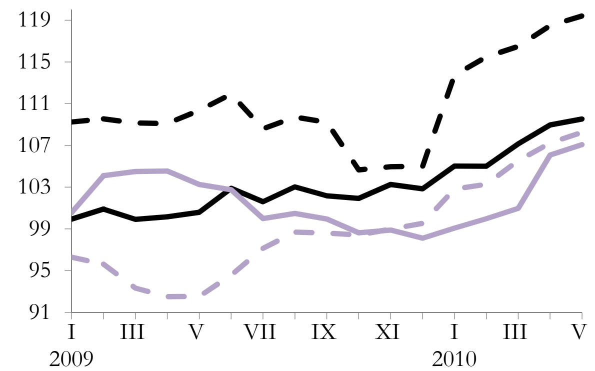
Harmonised Consumer Price Index by Months in 2009
(December 2008 = 100)



Food products
(including alcohol and tobacco)



Energy



The energy price level within five months of 2010 has also increased in all Baltic States. Consumer prices for energy in May 2010 compared to December 2009 increased most rapidly in Lithuania – by 13.7%, as well as in Latvia and Estonia – by 9.1% and 8.8%, respectively. Consumer prices for energy within a year compared to May 2009 increased in Estonia and Lithuania by 17% and 8.2%, respectively, but in Latvia – by 3.7 percent.

4.2.2 Producer and Foreign Trade Prices

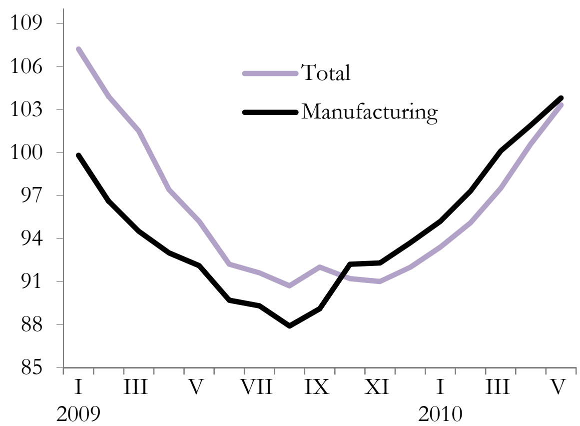
The decrease of **producer prices** started before the decrease of consumer prices. Besides, the decrease of prices affected both domestically sold and exported products.

In 2009, the price decrease of domestically sold products was related mainly to the rapid decrease of domestic consumption, while the price decrease of exported products was related to the price decrease in the global market of the main export products of Latvia – timber and food products. Producer prices started to grow at the end of 2009.

The producer prices increased by 3.3% during a year (May 2010 compared to May 2009). Prices of production sold in domestic market decreased by 0.6%, but prices of exported production increased by 9.4%. The biggest influence on the overall level of producer prices was due to the changes in the prices for electricity, gas supply, heat supply and air conditioning, as well as production of metal, wood and timber.

Figure 4.17

Producer Price Changes
(12-month inflation, %)



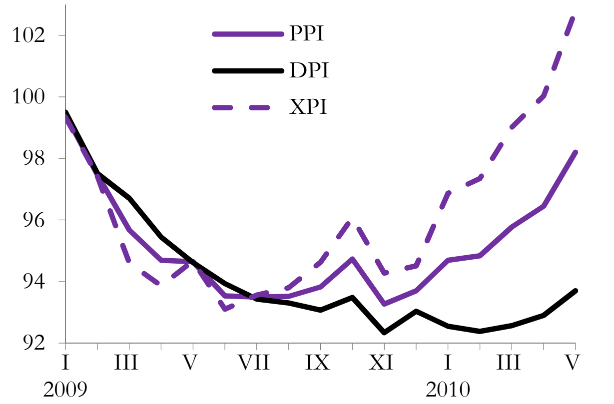
Tendencies of the past months show an increase in the producer prices for the production sold not only in export markets, but also in domestic markets. The overall monthly increase of producer prices in manufacturing comprised 0.9% from December 2009 until May 2010.

The highest increase of producer prices is observed in the manufacturing sectors, which depend on the price fluctuations in the world. For example, producer prices in the metal processing industry in April 2010 where by 12.3% higher than in December 2009.

Figure 4.18

Producer Price Changes in Manufacturing

(December 2008 = 100)

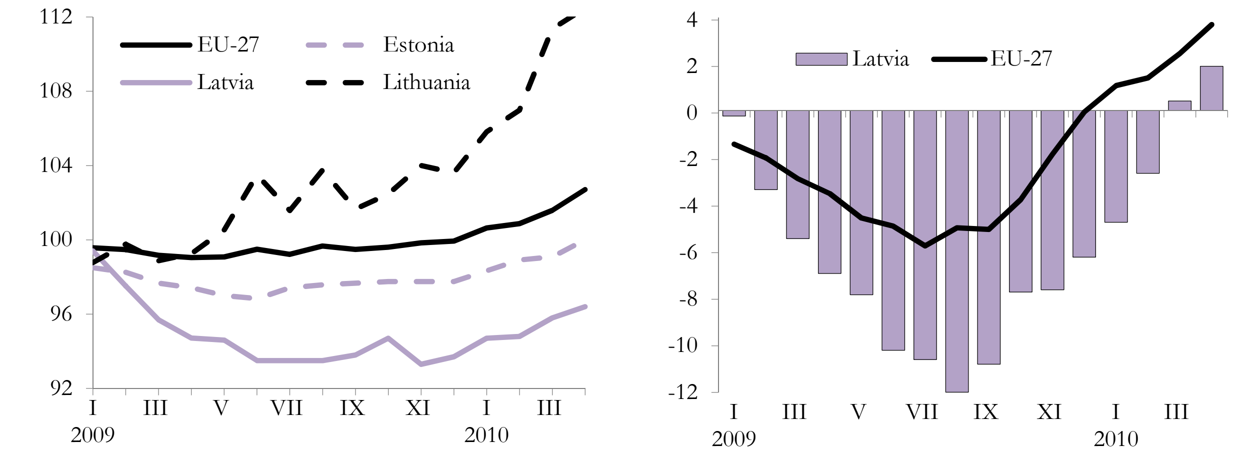


PPI – producer price index
DPI – producer price index for products sold in the domestic market
XPI – producer price index for exported products

Figure 4.19

Producer Price Index by Months in Manufacturing

December 2006 = 100	Changes over the corresponding period of the previous year,%



The producer prices in manufacturing in the European Union in general and in the Baltic States continued to grow at the end of 2009 and at the beginning of 2010. The fastest increase is also observed in Lithuania in the first months of 2010.

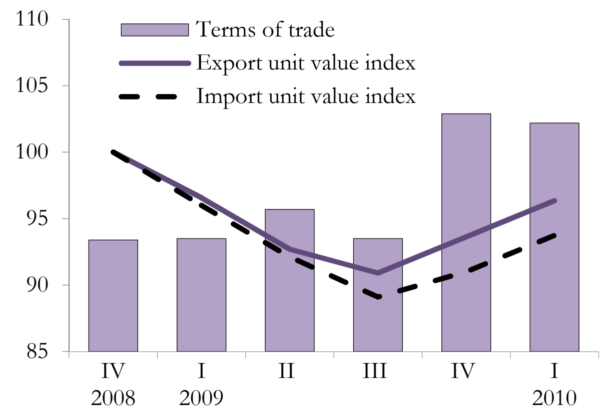
The terms of trade in Latvia deteriorated until the 3rd quarter of 2009. Since the 4th quarter of 2009, the terms of trade started to improve in general. The export prices in the 1st quarter of 2010 compared to the 1st quarter of 2009 have decreased by 0.2%, but the import prices – by 2.4 percent.

The export prices have grown more than the import prices for chemical products and related industries, as well as for basic metals and basic metal products. The export and import prices increased in production of mechanisms and mechanical appliances, as well as electrical equipments.

Figure 4.20

Export and Import Unit Value Indices and Terms of Trade Index

(export and import unit value index in the Q4/2008 = 100; terms of trade index in% over the respective quarter of the previous year)



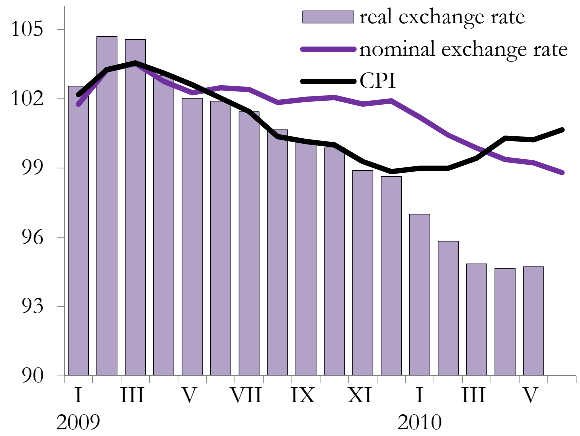
Since 2009, the real effective exchange rate of the Latvian lats has decreased rapidly, which means that the competitiveness of Latvian enterprises has improved.

Previously, the decrease of the real effective exchange rate of the lats has been determined by the decrease of consumer price index, but at the moment, decrease of the real effective exchange rate of the lats is determined by the decrease of the nominal effective exchange rate of the lats (see also Chapter 4.4.1.).

Figure 4.21

Effective Exchange Rate of the Lats*

(December 2008 = 100)



* Effective exchange rate of the lats has been calculated in relation with 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

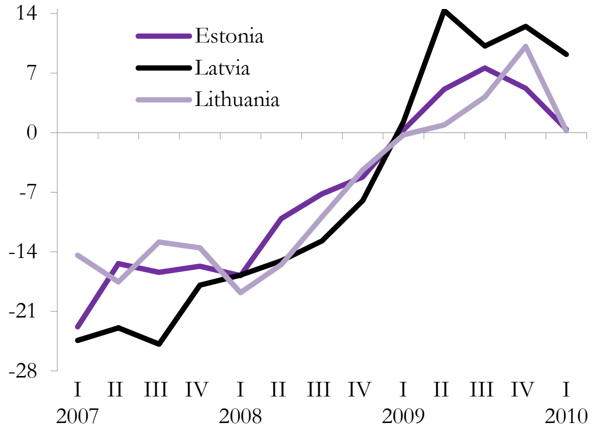
High and continuously growing current account deficit that was typical in Latvia for several years has started to decrease since the second half of 2007, and starting from 2009 the current account balance has already been positive.

In 2009, the positive balance of the current account in Latvia has reached 9.6% of GDP (1.3% in the 1st quarter, 14.3% in the 2nd quarter, 10.2% in the 3rd quarter and 12.5% in the 4th quarter). Also in the 1st quarter of 2010, the current account balance was positive – 9.2% of GDP. Changes in the current account are related mainly to the improved foreign trade and income balance items.

Figure 4.22

Current Account Balance in the Baltic States

(% of GDP)



Source: *Eurostat*

Similarly to Latvia, substantial adjustments to the balance of payments of the current account are taking place also in our neighbouring countries.

In Estonia, the current account surplus in 2009 reached 4.6% of GDP compared to the 9.4% deficit a year before. However in Lithuania, the positive balance of the current account was 3.8% of GDP in 2009 (deficit in 2008 – 11.7% of GDP).

A foreign trade deficit of Latvia in 2009 compared to the previous year has decreased and was 6.5% of GDP. The decrease of the negative foreign trade balance in the 1st quarter of 2009 was determined by the faster decrease of imports than in exports, but in the 3rd and 4th quarter – by faster growth of exports than increase of imports. In the 1st quarter of 2010 compared to the respective period of the previous year, the exports of goods increased by 16.6%, but imports declined by 2.7%, resulting in the decrease of the foreign trade deficit by 4.2 percentage points and reached 6.4% of GDP. It should be noted that since the beginning of 2008, the negative trade balance has decreased almost three times.

Contrary to the balance of goods, the adjustment of the balance of services is moderate. In 2009, the surplus of the balance of services reached 6.3% of GDP, which exceeded the level of 2008 by 2.2 percentage points. The improvement of the balance of services was determined by the rapid decline of imports in the 1st quarter of 2009, however, the decline of exports was almost ten times slower – by 2.2%. Since the 2nd quarter of 2009, the dynamics of both imports and exports is stable. In the 1st quarter of 2010, the services exports were by 9.7% lower and the services imports by 7.7% lower than a year ago.

Since the 2nd quarter of 2009, the positive balance of services fully covers the negative trade balance of goods, and the balance of goods and services is positive.

Substantial changes are observed also in the income balance of the current account, which has been positive since the 4th quarter of 2008. In 2009, the income balance comprised 6.5% and in the 1st quarter of 2010 – 5.2% of GDP. The rise of the positive balance of the income balance is mainly related to the reinvested profits, indicating to the high losses of foreign investors. The current transfer balance of the current account is positive with a slight tendency of growth.

Substantial adjustments of the current account determined changes in the capital flow. In 2008, the capital inflow decreased rapidly, but in 2009 its outflow had been already observed. Due to the impact of the global financial crisis, when the capital inflow went down, there was a significant decrease of the domestic demand, which resulted in substantial adjustments of the economy.

Figure 4.23

Current Account Deficit, Investments and Savings
(% of GDP)

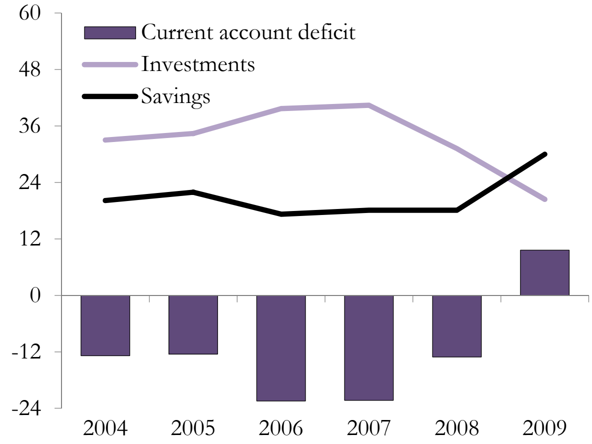


Table 4.6

Balance of Payments of Latvia
(% of GDP)

	2006	2007	2008	2009	1st quarter of 2009	1st quarter of 2010
A. Current account	**-22.5**	**-22.3**	**-13.1**	**9.6**	**1.3**	**9.2**
Trade balance	-25.6	-23.9	-17.7	-6.6	-10.5	-6.4
exports	30.7	28.5	28.3	27.7	24.8	33.6
imports	-56.3	-52.4	-46.0	-34.3	-35.4	-39.9
Balance of services	3.3	3.5	4.0	6.3	6.4	6.5
Net revenues	-2.7	-3.3	-1.6	6.5	3.6	5.2
Current transfers, net	2.4	1.3	2.2	3.4	1.8	3.9
B. Capital account	**1.2**	**1.9**	**1.5**	**2.4**	**3.0**	**3.4**
C. Financial account*	**30.5**	**24.6**	**11.4**	**-7.8**	**-14.1**	**0.0**
Direct investment	7.5	6.8	3.0	0.4	0.6	-4.7
abroad	-0.9	-1.3	-0.7	0.1	0.1	-1.2
in Latvia	8.3	8.1	3.7	0.3	0.5	-3.5
Portfolio investment**	0.2	-1.6	0.8	3.2	6.3	-1.0
assets	-1.3	-1.0	1.8	4.1	8.3	2.1
liabilities	1.5	-0.5	-1.0	-0.9	-1.9	-3.1
Other investments	22.6	19.3	7.6	-11.3	-21.1	5.6
assets	-9.7	-21.7	-1.4	-5.5	9.2	11.0
liabilities	32.2	40.1	8.9	-5.8	-30.3	-5.4
D. Net errors and omissions	**0.6**	**-0.8**	**-1.8**	**0.8**	**-0.1**	**3.2**
E. Reserve assets	**-9.9**	**-3.4**	**2.0**	**-5.0**	**10.0**	**-15.8**

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

The rapid inflow of foreign capital until 2007 positively affected investments on the one hand, but on the other hand it became a substantial factor for decreasing the level of savings – the investment level increased from 33% to 40.4%, but the level of savings decreased from 20.2% to 18.1% compared to 2004, providing less than a half of domestic investment financing.

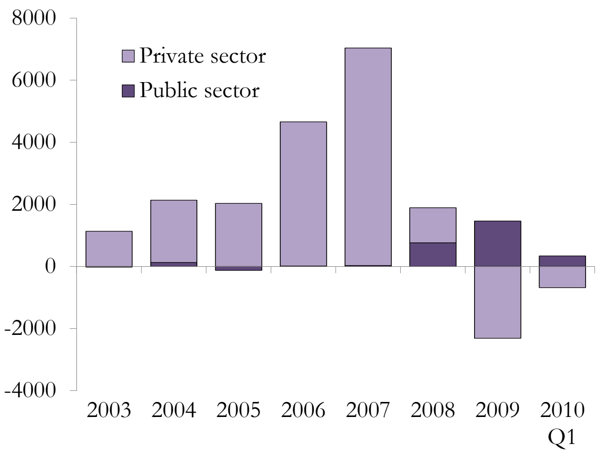
As the conditions in the global financial markets deteriorated, the situation changed sharply. A high debt burden, decrease of economic activities and income, as well as uncertainty about the future development fostered savings of households. Along with the increase in the level of savings, the investments are decreasing rapidly. In 2009, the share of investments in GDP was 20.4% or almost two times less than in 2008. However, the level of savings in 2009 was 30% of GDP.

4.3.2. Financial Flows

The inflow of foreign capital started increasing in Latvia at the beginning of transition, which was fostered by liberalization of financial flows. There are no limitations with regard to conversion of the national currency in Latvia. Foreign companies may freely withdraw their investments and profits after paying taxes. Also all residents of Latvia are free to use the financial services of any foreign company. There are no restrictions for operations with securities.

Figure 4.24

Inflow of Foreign Investment 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 has increased by almost 3.5 times. In 2008, the inflow intensity of foreign investments was much slower, which was mainly determined by the unfavourable conditions in the global financial markets. The volumes of private foreign capital inflow in 2008 in comparison with 2007 were almost seven times lower. However, since the 4th quarter of 2008, the outflow of private foreign capital is observed. In 2009, the outflow of private foreign capital was almost 2 times higher than the inflow in 2008. In the 1st quarter of 2010, the capital outflow continued although in smaller amounts. The negative effect of private capital outflow on the financial account was slightly decreased by the long-term loans of the public sector.

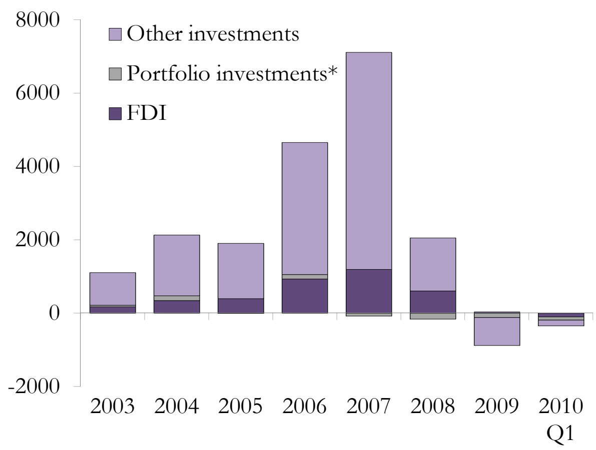
With the change of the dynamics and direction of foreign capital flow, its structure also changes.

During the period of 2005-2007, the foreign direct investments (FDI) 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 decreased by almost a half and reached 30% of the negative balance of the current account. In 2009, the incoming FDI flows exceeded the level of the previous year only by 6%. However, in the 1st quarter of 2010, the FDI flows were negative (3.5% of GDP). The fluctuations of the incoming FDI flows are related to investments in the fixed capital of foreign enterprises that depending on the volume can cover (or partly cover) the losses of foreign enterprises.

The share of portfolio investments in the incoming financial flows is low and has not exceeded 10% in the last three years. In 2009 and in the 1st quarter of 2010, the balance of portfolio investments was positive mainly due to the financing attracted by the Latvian government in a form of bonds and promissory notes, as well as due to reduction of securities holding of the foreign debts by banks.

Figure 4.25

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



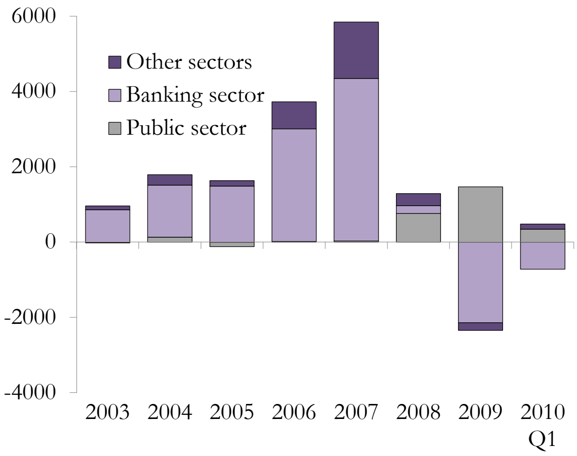
* portfolio investments and derivative financial instruments

A large share of the total foreign investments consists of other investments, i.e., financial transactions that are not included in the direct and portfolio investments. These are trade loans, other loans and borrowings, cash and deposits, etc. Since 2005, these investments have increased by 4.4 times. In the 1st quarter of 2008, for the first time in the last four years, the flow of these investments was negative. It was determined by the decline of the deposits of non-residents in the monetary financial institutions and the decreased borrowing level of the private sector. In general, a decrease of short-term flows was observed in 2008. In 2009, other investment flows were negative (-11.3% of GDP), mainly related to rapid decrease of the foreign liabilities of the banking sector. However, in the 1st quarter of 2010, the balance of other investments has been already positive (5.6% of GDP), and it was determined by the long-term government loans and reduction of other bank deposits.

The foreign capital attracted under the impact of the global financial crisis exceeded the volume of GDP by 11.6% in 2008. However, in 2009 and in the 1st quarter of 2010, the flows of foreign capital were negative.

Figure 4.26

Net Foreign Investment Flows by Sectors*
(million LVL)



* excluding foreign direct investments

The debt of Latvia to the rest of the world in the 1st quarter of 2010 was 161.8% of GDP, including government debt – 30.5% of GDP. Over the year government's external debt increased almost by 80 percent.

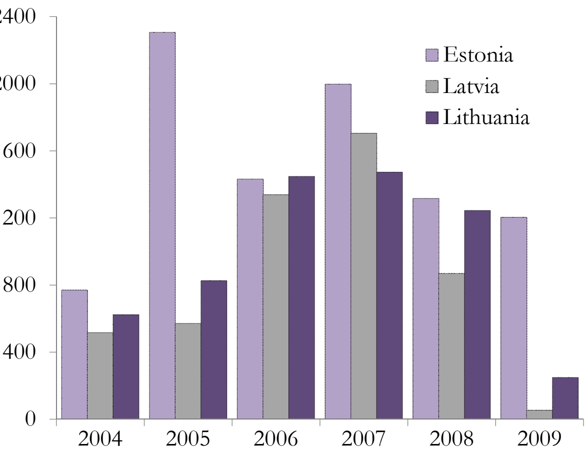
4.3.3. Foreign Direct Investment

Due to the impact of the global financial crisis, foreign capital flow in the economy of Latvia has significantly decreased. It has also influenced the FDI flows. However, the FDI flows in comparison with other financial flows were more stable.

The intensity of the FDI flows in Latvia, as well as in other Baltic States is rather cyclic. They increased considerably after accession of Latvia to the EU, however decreased when the economic situation deteriorated. Global financial and economic crisis affected both the entrepreneurs' investment capacity and their tendency to invest. According to the data published by the United Nations Conference on Trade and Development (UNCTAD) the FDI flows in the world have decreased almost twice over two years (since the end of 2007) and now are maintained at a very low level that is comparable to the level of 2006. A decrease of the FDI inflow is observed also in Estonia and Lithuania. In Estonia in 2009 compared to 2008, the amount of incoming FDI was only by 8.6% lower, and it was determined by significant investments in the financial intermediation sector. However, FDI flows in Lithuania and Latvia in 2009 were by 80% and 94% respectively lower than a year ago.

Figure 4.27

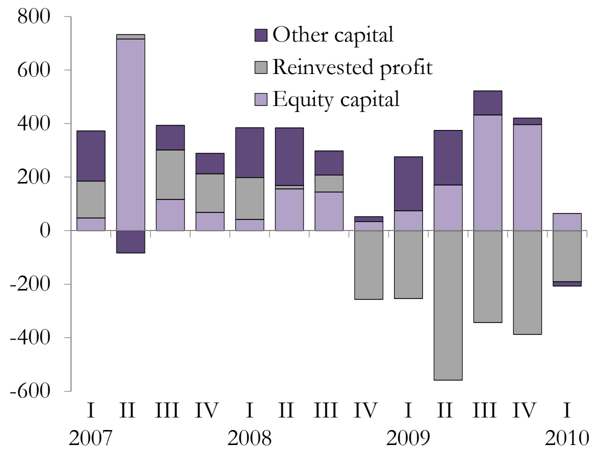
Inflow of FDI in the Baltic States
(million EUR)



Since 2008, the activities of Latvian investors abroad have decreased. In 2007, Latvian entrepreneurs have invested EUR 237 million in a form of direct investments, i.e., almost five times more than before the accession to the EU. In 2008, the direct investments of Latvian entrepreneurs in foreign countries decreased to EUR 166.3 million, but in 2009 they were negative.

Figure 4.28

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



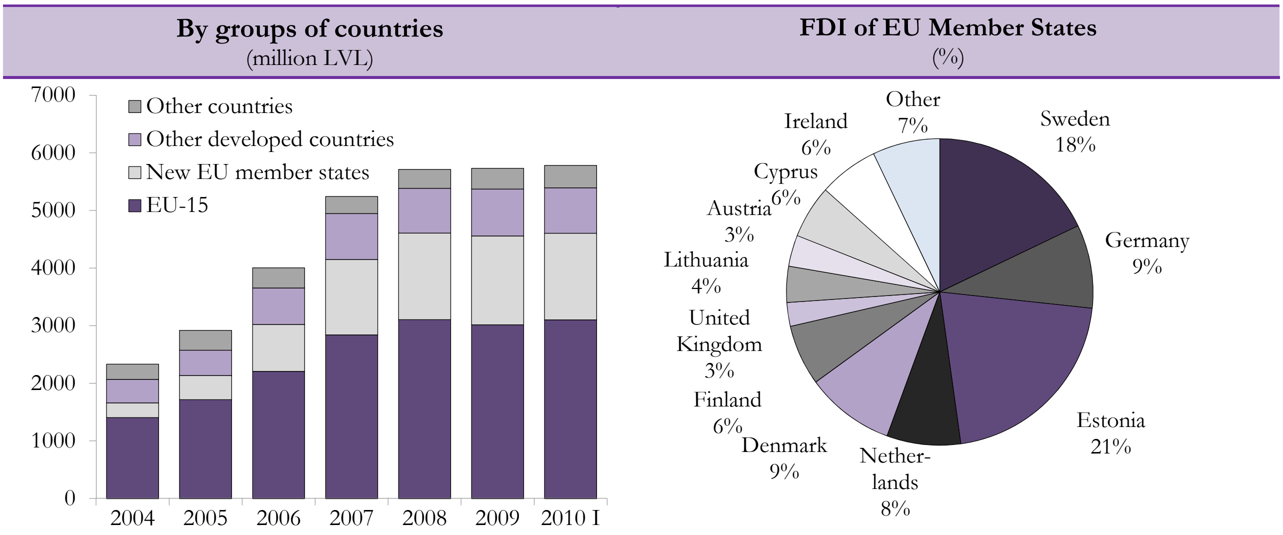
The structure of incoming FDI shows that since the 4th quarter of 2008 the direct investment enterprises operate with losses. In 2009, they reached LVL 1083.9 million (EUR 1542 million). The losses of foreign direct investment enterprises were fully compensated by investments in equity capital and other capital, therefore the flows of incoming FDI in the previous year were positive (LVL 36.3 million). In the 1st quarter of 2010, the investments in equity capital were almost three times smaller than the losses of direct investment enterprises due to which the flows of incoming FDI were negative.

According to the international investment balance of Latvia at the end of the 1st quarter of 2010, the FDI stock in the economy of Latvia reached LVL 5785.2 million, which is by 4% more than a year ago. Their share in the structure of accrued foreign capital have increased by 0.8 percentage points and at the end of March 2010 it was 24%, which was determined by the decrease of other investment flows in the foreign capital inflows.

Investments of the EU member states prevail in the geopolitical structure of the FDI stock of Latvia. At the end of March 2010, it amounted to 80% of the total FDI stock, and one-third of it is related to investments of the new EU Member States.

Figure 4.29

FDI Stock
(at the end of March 2010)



The biggest investor countries in the economy of Latvia are Sweden and Estonia. The FDI stock by these two countries at the end of March 2010 formed almost one third of the total FDI stock. They were mainly concentrated in the financial intermediation sector. Since the end of 2008, the FDI stock of the abovementioned countries in the financial intermediation sector has decreased by 4.5% and at the end of March 2010 formed 53% of the FDI stock in the sector that is by almost 3 percentage points less than a year ago. Among the largest investor countries are also Denmark, Germany and the Netherlands the investment volumes of which at the end of 2010 formed 19% of the FDI stock in the economy of Latvia. It should be noted that since 2004 the annual investments of German entrepreneurs were low, therefore their shares in the total FDI stock are decreasing. At the end of 2004, they formed 15.3%, but at the end of the 1st quarter of 2010 – just 6.5% of the FDI stock.

During the period of 2004-2007, the FDI stock both in goods and services sectors increased by more than two times. An especially rapid increase of the FDI stock was observed in the energy and construction sector – almost by 5 times. The dynamics of FDI was not so rapid in the manufacturing sector (it increased almost twice).

Table 4.7

FDI Stock by Sectors
(end of period, million LVL)

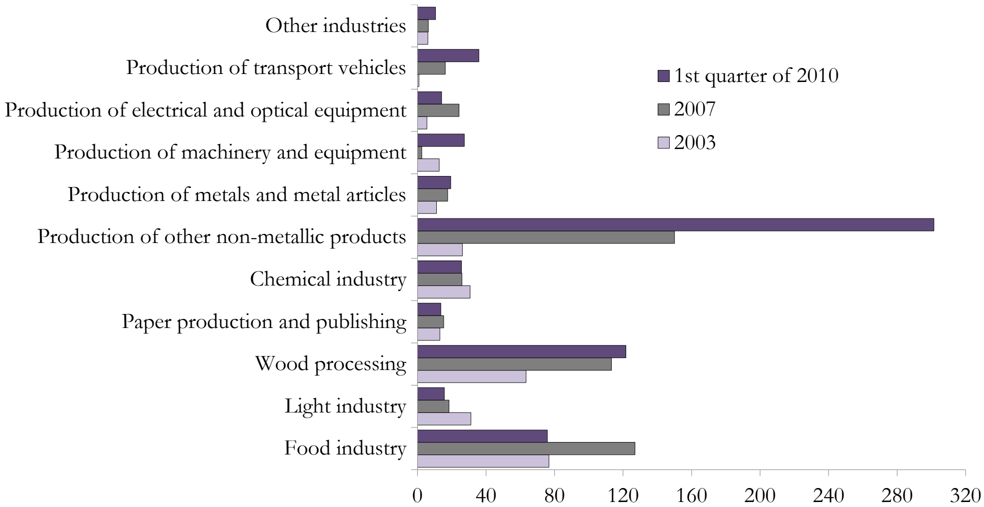
	2004	2005	2006	2007	2008	2009	1st quarter of 2010
Primary sectors	49.8	59.5	71.6	113.1	145.2	165.5	186.2
Manufacturing	276.1	376.0	395.8	516.8	611.0	654.5	661.1
Energy	164.7	327.6	348.1	270.7	204.9	190.5	227.7
Construction	36.5	49.7	67.6	85.5	107.1	126.6	108.3
Trade	395.7	437.8	562.3	676.4	862.0	856.5	737.1
Transport and communications	333.3	336.4	347.0	392.5	466.3	428.1	434.3
Financial intermediation	375.9	625.4	964.6	1486.2	1647.3	1645.1	1659.9
Other services	439.2	529.0	795.3	1223.5	1251.3	1371.3	1259.5

The growth rates of the FDI stock in 2008 were almost three times slower than in the previous years. The FDI stock in services has increased by 12% over the year (including financial intermediation – by 10.8%, trade – by 28%, transport and communications – by 18.8%), while regarding transactions in the real estate, the FDI stock remained on the level of the previous year. Yet, the decrease in the growth rates of the FDI stock in the production of goods was insignificant. In 2008, the FDI stock increased by 8.3% or almost by 1.5 times slower than in the services sectors. However, in 2009, the increase of FDI stock in services was rather small – by 1.8%, while in production it increased by 6.6%, including manufacturing – by 7.1 percent.

Figure 4.30

FDI Stock in Manufacturing

(end of period, million LVL)



After Latvia's accession to the EU, substantial changes are observed in the sub-sectors of manufacturing with regards to attraction of FDI. At the end of 2009 compared to the end of 2003, the FDI stock decreased almost by a half in the light industry, but in the chemical industry and in production of machinery and equipment by 28.6% and 20.5%, respectively. However, FDI have substantially grown in production of electrical and optical equipment (almost twice), wood processing (twice), and production of other non-metallic products (10 times). The increase of FDI in manufacturing in 2008 was by 18.4% (in 2007 – by 30%), in 2009 – by 7% and in the 1st quarter of 2010 – by 0.1%, which proves that the deepening crisis and its duration makes foreign investors more cautious in implementing their investment plans. It should be noted that the interest of foreign investors about this sector has not decreased, however the impact of crisis in the particular sub-sectors of manufacturing is very diverse. At the end of the 1st quarter of 2010 compared to the end of 2007 the level of FDI stock has decreased in the food industry (by 40.3%), production of electrical and optical equipment (by 42%) and in the light industry (by 15%). Similarly as in the previous years, investments in production of other non-metallic mineral products are increasing. At the end of the 1st quarter of 2010 compared to the end of 2007 investments increased by two times. The investments in production of machinery and equipment have increased by almost ten times, the FDI stock in production of transport vehicles has increased by more than twice. The changes of the FDI stock in other manufacturing sub-sectors are insignificant.

The investors from Denmark, Finland, Germany, Sweden, Ireland, Estonia, the Netherlands and the USA have made bigger investments in manufacturing. Investments of the abovementioned countries formed 70% of the FDI stock in manufacturing. It should be noted that the structure of FDI stock in manufacturing does not show any of the countries in a leading position. The situation has substantially changed due to the impact of the financial crisis. At the end of the 1st quarter of 2010, the capital of Ireland is dominating in the structure of FDI forming one third of the FDI stock in manufacturing, which was mainly affected by the rapid investment growth of Ireland. Since the end of 2007, investments increased almost four times. The volumes of FDI stock by investor countries have decreased, for example, Germany's and Denmark's – by 33% and 36.6%, respectively. It should be noted that since the end of 2007, the investments in manufacturing have substantially increased from Russia (almost 3.5 times) and Norway (almost twice). At the end of March 2010, they constituted 5.5% of the FDI stock in manufacturing.

The Investment and Development Agency of Latvia (IDAL) plays a significant role in attracting foreign investments. The investment attraction strategy of the IDAL is focused on qualitative maintenance of the projects of incoming investments and active operation related to attraction of investment projects when addressing the potential investors in accordance with the priorities set in the Economic Development Strategy of Latvia.

The IDAL continues to develop its range of services and supply on the basis of FDI market needs and ensuring a link between the IDAL and investors. Latvia is able to provide the investors with a favourable geographic location, advantages of natural resources, advantages in the sphere of science, as well as assistance of professionals from the IDAL in the process of project implementation.

The total amount of project investments in Europe has decreased a little in total in 2009 and in the 1st quarter of 2010 due to the impact of the global crisis when the demand for goods and services declined as well as when project financing opportunities narrowed. However, the number of requests for information of incoming foreign investments operated by the IDAL reached 132, showing almost constant foreign investor interest in comparison with 2008 (133 requests). Although the overall interest of investors is not decreasing, after the primary inquiry about the investment environment in Latvia, slightly less than 40% of investment requests develop into projects, in the framework of which the investors seriously evaluate Latvia as a place of projects' implementation. In 2009, the work proceeded with 51 such investment projects, including 30 new projects and 21 projects that were launched in the previous periods.

In 2009, positive decisions to implement projects in Latvia were made in services (administrative services, USA; IT, companies from Italy and Russia) and manufacturing (soft drinks Coca-Cola, Greece; construction of building modules Bau-How, Norway; metalworking, Norway; biotechnologies, Canada). When these projects will be implemented, investments in the amount of EUR 157.98 million are expected, by creating 500-1500 new jobs.

However, a lot of foreign investment projects are lost due to still unsolved problematic issues, for instance, lack of industrial land and infrastructure, imperfection of territorial planning, as well as due to the inadequate education system for the sectoral needs and growth and due to lack of qualified labour. In order for Latvia to be competitive among the other European countries, support instruments and investment incentives for the attraction of foreign investment are necessary like for example in other countries that compete with Latvia in the attraction of investment – support of state financing for investment projects important for the economy, grants for creation of new jobs, support of infrastructure, tax allowances.

In order to improve the progress of domestic and foreign investment projects, which are important for the country, the IDAL has started to create new approaches to the work in order to implement such projects, based on the investment attraction methodology "Polaris" that provides unified and coordinated activity from ministries, municipalities, infrastructure companies, and public institutions in realization of strategically important domestic and foreign investment projects, as well as to include also the private sector, university and research institutions in this process.

By analyzing the growth of sectors on the European scale and competitiveness of Latvia in comparison with the Baltic States, Poland and the Czech Republic, the IDAL currently has identified seven sectors in which Latvia has the largest opportunities to attract foreign investment, i.e., wood processing, metalworking and engineering, transport and logistics, green technologies, health care, life sciences (pharmacy and biotechnologies) and information technologies. Therefore in order to implement "Polaris" process qualitatively, the IDAL will cooperate with representatives of the private sector in order to identify the niches more precisely in the sectors, where investments are needed, as well as with research institutions in order to create offers of full-fledged investment projects with the highest possible value added.

4.4. Financial and Capital Markets

4.4.1. Monetary Policy and Exchange Rate

The *Law on the Bank of Latvia*[1] envisages that the main goal of the Bank of Latvia by implementing the monetary policy is to regulate the money in circulation in order to maintain price stability in the country. The central bank is an independent decision-making institution, which is not subordinated to the decisions or instructions of the government or governmental institutions. The Bank of Latvia performs its functions under the supervision of the Saeima.

Since the mid-February 1994, the Bank of Latvia had unofficially pegged the exchange rate of the lats (LVL) to the SDR[2] currency basket (1 SDR = LVL 0.7997) thus *de facto* implementing the fixed exchange rate policy. As of January 1, 2005, the peg of the lats to the SDR basket is replaced with the

[1] The Bank of Latvia is the central bank of the country.

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

peg to the Euro (1 EUR = LVL 0.702804). The change of the peg of the lats was determined by the plans of Latvia to join the European Exchange Rate Mechanism II (ERM II) and after fulfilment of the required criteria to join the Economic and Monetary Union (EMU[1]). On March 16, 2010 the Cabinet of Ministers, upon accepting amendments *On Latvia's National Euro Changeover Plan*, decided that January 1, 2014 is the target date for the Euro introduction in Latvia.

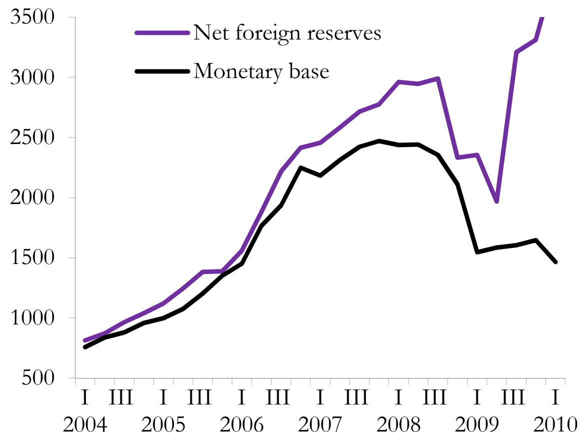
As from May 2, 2005 Latvia joined the ERM II with the already existing exchange rate of the lats against Euro. The ERM II allows standard fluctuations of the exchange rate within +/–15% around the central or peg rate. However, Latvia commits unilaterally to keep the exchange rate fluctuations margin within +/–1%, retaining the former range of fluctuations of the lats, which was habitual to the financial market since 1994, when the lats was fixed to the SDR, and was kept when the lats was re-pegged to the Euro on January 1, 2005.

The Bank of Latvia operates like the so-called currency board, freely buying and selling foreign currencies. The Bank of Latvia has managed to gain credibility without using the formal currency board system and to get experience while using a wide range of market-oriented monetary instruments fully compatible with the monetary policy instruments available to the European Central Bank.

In order to keep a fixed exchange rate, it is necessary to have a sufficient amount of foreign reserves. In Latvia, there have been no problems in this respect – net foreign reserves of the Bank of Latvia constantly cover the monetary base of Latvia, and their amount equals to the amount of goods and non-factorial services imported by the country within several months (see Figure 4.31).

Figure 4.31

Net Foreign Reserves of the Bank of Latvia and Monetary Base, Quarterly Profile
(million lats, at the end of the period)



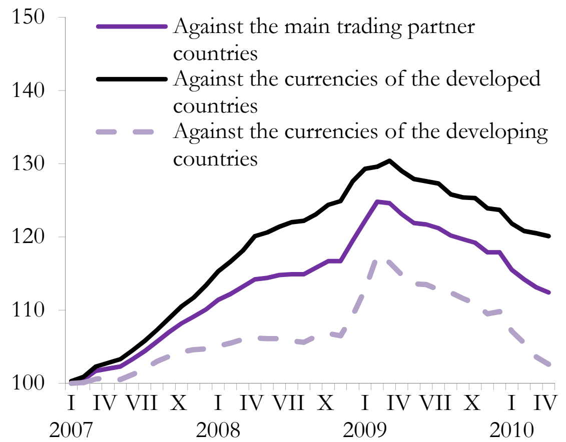
The coverage of monetary base (currency in circulation and deposits in the Bank of Latvia) with net foreign assets was 234% at the end of April 2010 (at the end of April 2009 – 133%).

Foreign currency reserves are invested in safe and liquid financial instruments, mainly in debt securities issued by the governments of the USA, Euro zone countries, United Kingdom and Japan, as well as by their agencies and international organisations. Foreign reserves of the Bank of Latvia (including gold reserves) amounted to USD 7191 million at the end of April 2010 (USD 6906 million at the end of 2009, USD 5248 million at the end of 2008, USD 1535 million at the end of 2003).

The Bank of Latvia calculates the real effective exchange rate of the lats[2] against the currencies of 13 countries, which are the main trading partners of Latvia[3]. It shows the relative export competitiveness of Latvia in the global markets (see Figure 4.32).

Figure 4.32

Index of the Real Effective Exchange Rate of the Lats*
(by months)



* calculated using the consumer price index. December 2006 is the base of the real effective exchange rate index (2006 = 100).

Due to the comparatively high inflation during the years of rapid growth, the real effective exchange rate of the lats increased against the currencies of the developed countries and the currencies of the developing countries. An especially rapid increase of the real effective exchange rate of the lats was in the 2nd half of 2008 and at the beginning of 2009, which was mainly related to the devaluation of national currencies of our trading partner countries. Since

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

[2] Real exchange rate of the lats includes changes of the nominal exchange rate of the lats against the currency of a trading partner of Latvia, as well as consumer price changes in Latvia compared with consumer price changes in the trading partner country. The real exchange rate is calculated by dividing the nominal exchange rate index with the ratio of foreign and domestic price indices.

[3] USA, Denmark, France, Italy, the United Kingdom, the Netherlands, Finland, Germany and Sweden are included in the group of developed countries, while Estonia, Russia, Lithuania and Poland are included in the group of developing countries.

March 2009, the real effective exchange rate of the lats decreases gradually, which is related to the decrease of the price level and wages as well as with the optimization of other production costs. The decrease of the real effective exchange rate of the lats is favourable for Latvian exporters.

4.4.2. Market Structure and Development

In the 1st quarter of 2010, 21 banks operated in Latvia and eight branches of foreign banks were registered, 2 of which are planning to start their activities in the 2nd and 4th quarter of 2010. Banking services in Latvia can also be provided by credit institutions or their branches, which are registered in the European Economic Area (referred to as EEA) countries.

The bank assets form the greatest share of the total assets in the financial and capital market of Latvia. At the end of the 1st quarter of 2010, the total amount of bank assets of Latvia has diminished by 3.4% in comparison with the respective period of the previous year. At the end of the 1st quarter of 2010, the total amount of the bank assets reached LVL 21.5 billion (at the end of the 1st quarter of 2009 – LVL 22.2 billion).

At the end of the 1st quarter of 2010, the greatest part of assets (70.7%) was formed by the bank credit, most of which is lending to private non-financial corporations (36.4%) and credit to households (28.6%). Lending for house purchase forms the greatest part of all credits to households. Lending politics of the banks and limited financial resources have merely affected the real estate market, the activity of which has almost stopped within the 2009, and also in 2010 significant growth is not expected.

The global financial market troubles have also affected the Latvian banking system. In order to help the second largest bank, in terms of assets, to avoid problems created by the global financial crisis, in November 2008, the state, with intermediation of the Mortgage and Land Bank of Latvia, took over the controlling stock of shares of AS “Parex banka” (see Box 4.1).

Box 4.1

AS “Parex banka”

Currently, 76.6% of the shares of AS “Parex banka” are owned by the state-owned VAS “Privatizācijas aģentūra”, but 19.7% – by the European Reconstruction and Development Bank, but the rest of the bank shares – by the minority shareholders.

On 17 November 2009, the Government agreed conceptually on restructuration or division of AS “Parex banka”.

On 23 March 2010, the Cabinet of Ministers adopted the restructuration plan of AS “Parex banka” which foresees detachment of a part of the “Parex banka” assets and formation of a new credit institution, and the capital in the amount of 100% would be owned by the state represented by PA.

On 1 June 2010, the government assigned PA to increase the stock capital of the new bank to the amount of state support prescribed in the restructuration plan, which currently amounts to approximately LVL 103 million. The capital of the new bank will be financed from the deposits of the state treasury in “Parex banka”. The current “Parex banka” will not need additional financial support in the future. The Cabinet of Ministers approved the position of Latvia for negotiations with EBRD – the second largest shareholder of “Parex banka” – about its engagement in the bank activities and the solution for the bank. The bank restructuration is expected to be completed by 1 July 2010, and both parts of the bank will be able to commence their legal operation.

At the end of 2009 and in the 1st quarter of 2010, all indices of banks of Latvia complied with the regulatory requirements. At the end of 2009, the banking sector liquidity indicator was 62.8% and it has not changed also at the end of the 1st quarter of 2010 (minimum normative requirement is 30%). If compared to the respective period of 2009, the banking sector liquidity indicator increased by 30.8 percent.

Although the crediting rates decrease, the resources become more expensive and the accessible resources for savings decrease. 13 banks of Latvia have increased their capital within the year 2009, but 5 banks have increased the capital of Latvia within the 1st quarter of 2010 in the amount of LVL 57.3 million already. 7 banks of Latvia and 1 foreign branch gained profit in the 1st quarter of 2010 (LVL 2.9 million), but in general the banking sector operated with losses which amounted to LVL 133.4 million at the end of the 1st quarter.

The losses occurred mainly due to accumulation of costs for unsecured credits.

At the end of 2009, the average capital adequacy ratio was high – 14.6% (the minimum requirement stipulated by law is 8%) and in the 1st quarter of 2010 it has slightly increased (14.9%). At the end of 2009, the return on assets (ROA)[1] was -3.5%, and at the end of the 1st quarter of 2010 – 2.5%. Meanwhile at the end of 2009, the return of equity (ROE)[2] was 41.6%, and at the end of the 1st quarter of 2010 – 29.8 percent.

At the end of 2009, 14 **insurance companies**, four of which provided life insurance and 10 – non-life insurance, as well as 11 branches of foreign insurance companies operated in Latvia.

The total amount of gross premiums signed in the insurance market reached LVL 223.3 million of 2009, which was by 33.8% less than at the end of 2008, while the volume of paid gross rewards was LVL 153.9 million or by 16% less than of at the end of 2008. At the end of the year 2009, the amount of gross premiums signed by the branches of foreign insurance

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

companies increased more than twice in comparison with the appropriate period of 2008 and reached 13.7% (LVL 35.5 million), in the total insurance market, and gross premiums reached 11.4% (LVL 19.7 million). At the end of the year 2009, the portfolio of gross premiums signed by the insurance companies concerned mainly life and health insurance – respectively 69.5% and 28.2%. At the end of 2009 (in comparison with the respective period at the end of 2008), the signed gross premium amount per one inhabitant of Latvia decreased by 22.9 percent.

The situation in the global financial markets substantially affects the Latvian **securities market.**

The Stock Exchange NASDAQ OMX Riga (former Riga Stock Exchange) was established at the end of 1993, and it is the only licensed regulated stock exchange organizer in Latvia. The main task of NASDAQ OMX Riga is to provide operation of the securities market and infrastructure. In 2009, it organized 183 public auctions of state securities, in which Latvia gained LVL 1.2 billion from the investors. In January 2010, 76% of all the security investors were legal entities, 16% – physical persons, 5% – foreign custodian banks (responsible for safeguarding securities as required by its clients) and 3% – investment funds (professional investors). The greatest part of the structure (investments in all emissions of public shares, which according to the applicable laws have to be registered in the Latvian Central Depository), is formed by Latvian investors (47%) followed by Switzerland (14%), Germany (14%), Russia (8%), Estonia (4%), and other countries. The activities of NASDAQ OMX Riga are licensed and controlled by the FCMC.

The Baltic securities market is a single securities market which is formed by NASDAQ OMX group stock exchanges in Tallinn, Riga, and Vilnius. The aim of the Baltic securities market is to preferably reduce the differences between separate securities markets of the Baltic States, thus enabling international trading and payments, as well as raising more investments for the region.

According to the Baltic indexes, in the first quarter of 2009, the share index decreased, however in the 3rd quarter rapid growth of the share price was observed, followed by a slight fall at the end of the year. In the 1st quarter of 2010, the share prices increased and the value of the Baltic indexes reached 408.9 points which is by 77.5% more than in the respective time period in 2009. OMX Vilnius index and OMX Tallinn index have shown the greatest growth. At the end of 2007, NASDAQ OMX Riga (1 January 2010 = 100) dropped from 595 to 271 points at the end of 2008. In the first months of 2010, OMX Riga index kept falling. At the beginning of the year 2010, OMX Riga index amounted to 278.9 points, but at the end of May, it increased and reached 335.6 points.

At the end of 2009, market capitalization of Latvian companies at the Riga Stock Exchange was LVL 925.5 million, and comparing to the results at the end of 2008 it increased by 12.9%. At the end of the 1st quarter of 2010, the market capitalization was LVL 565.6 million which is by 25.7% less than in the respective time period in the previous year and by 38.9% less than at the beginning of 2010. On 1 June 2010, the market capitalization was LVL 600.4 million.

At the end of the 1st quarter of 2010, the gains arising from dealing in financial instruments constituted 6% from the total banking income, most of which was formed by gains arising from dealing in foreign currencies (4.3%) and gains arising from dealing in other financial instruments (1.7%), but the gains arising from dealing in securities formed just 0.1% of all incomes. It shows that the stock market in Latvia is poorly developed, thus its influence on the economic development of the country is insignificant.

At the end of the 1st quarter of 2010, the gains arising from dealing in foreign currencies s is by 62.4% less than in the respective time period in year 2009. The gains arising from dealing in financial instruments form 6% of the total income. At the end of the 1st quarter of 2009, this income formed 10.8% of the total income.

4.4.3. Deposits and Credits

At the end of the 1st quarter of 2010, the total amount of the banking sector assets kept decreasing, and at the end of March 2010 it was by 3.4% or LVL 748.4 million less than in the respective time period of 2009 and by 1% or LVL 222.2 million less than at the end of 2009. At the end of the 1st quarter of 2010, LVL 669.2 million of currency was in circulation, which is by 7.9% less than at the end of the respective time period in 2009. The amount of currency in circulation has been slightly increasing during the past few months, and comparing to the results of March it has increased by 6.7% in April 2010 due to the payment of the part of previously retained retirement pension.

Table 4.8

Monetary Indicators of the Banking System of Latvia
(at the end of the period, million LVL)

	2007	2008	2009	End of the 1st quarter of 2010
Net foreign assets	-4482.8	-5914.6	**-3022.0**	-1939.7
Net domestic assets	10 654.0	11 846.1	8842.3	7920.9
Domestic credits	13 018.2	14 279.7	12 204.3	11 600.9
to government (net)	-87.4	-370.0	-1474.6	-1788.8
to companies and individuals	13 105.6	14 649.7	13 678.9	13 389.7
Other assets (net)	-2364.2	-2433.6	-3362.0	-3680.0
Broad money M2X	6171.3	5931.4	5820.3	5981.2
Currency in circulation (less vault cash balance)	900.0	866.1	667.3	669.2
Deposits of individuals and companies	5271.3	5065.3	5153.0	5312.0
including:				
demand deposits	2864.9	2308.0	2206.2	2297.3
time deposits	2406.4	2757.3	2946.8	3014.7
(changes in comparison with the corresponding period of the previous year, %)				
Domestic credits	31.8	9.7	-14.5	-13.6
including:				
to companies and individuals	34.0	11.8	-6.6	-7.4
Broad money M2X	12.6	-3.9	-1.9	4.2
Currency in circulation (less vault cash balance)	-7.1	-3.8	-23.0	-7.9
Deposits of individuals and companies	16.9	-3.9	1.7	6.0
GDP (in current prices)	**32.3**	**9.5**	**-18.2**	**-11.2**

Figure 4.33

Dynamics of Broad Money (M2X) and its Components, Quarterly Profile
(end of the period, million LVL)

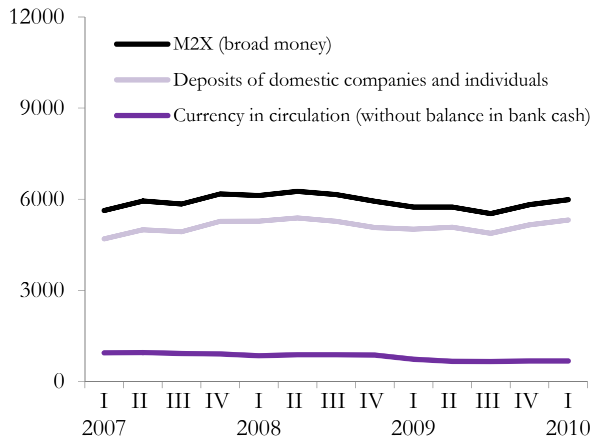
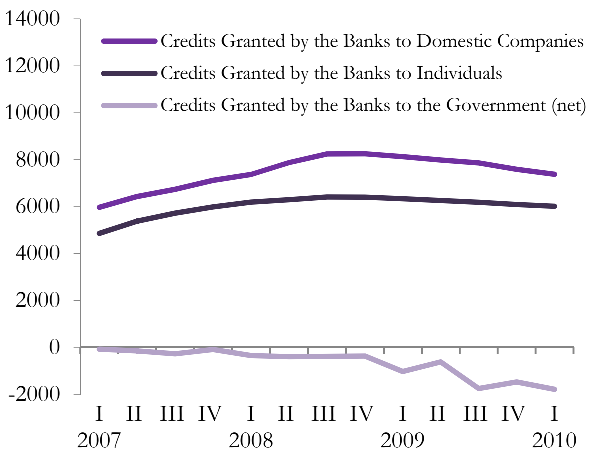


Figure 4.34

Dynamics of Credits Granted by the Banks to Domestic Companies, Individuals and Government, Quarterly Profile
(end of the period, million LVL)



At the end of 2008, the **deposits** attracted from the residents at the financial institutions, private non-financial corporations, households and state non-financial corporation started decreasing, which continued also in 2009, reaching the lowest point in the 3rd quarter of 2009 as the deposits decreased by 7.6% in comparison with the corresponding time period of the previous year.

As the financial situation of the financial market started stabilizing, the deposits increased anew at the end of 2009, and grew by 4.9% in comparison with the corresponding time period of 2010. At the end of the 1st quarter of 2010, the deposits of individuals and companies amounted to LVL 5312 million, which is by LVL 299.9 million more than in the corresponding time period of 2009. In the 1st quarter of 2010, the broad money increased by LVL 242.2 million or 4.2% in comparison with the corresponding time period of the previous year thus reaching LVL 5981.2 million.

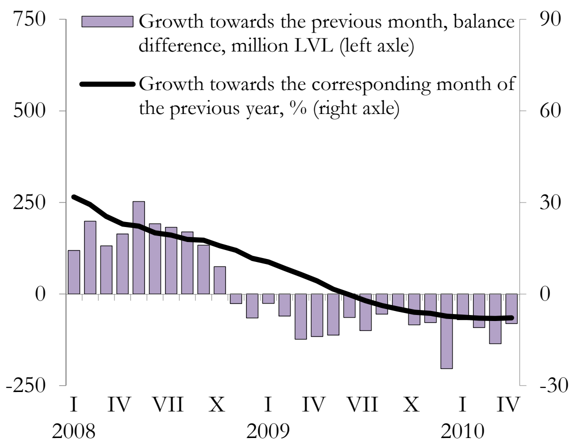
At the beginning of 2010, changes of the deposit currency structure continued. At the end of the 1st quarter of 2010, the amounts of residents' deposits in LVL decreased by 3.9% in comparison with the corresponding time period of year 2009 which formed 42.2% of all residents' deposits. The greatest part of residents' deposits (52.6%) is in EUR.

At the beginning of 2010, the balance of bank **credits** granted to domestic companies, individuals, and the government continues decreasing. The balance of credits granted to companies at the end of the 1st quarter of 2010, in comparison with the corresponding time period at the end of 2009, decreased by 9.2%, while the credits granted to households – by 5%. Since the beginning of 2009, a particularly rapid decrease has been observed with respect to the bank credits to the government, but at the beginning of 2010 it decreased again.

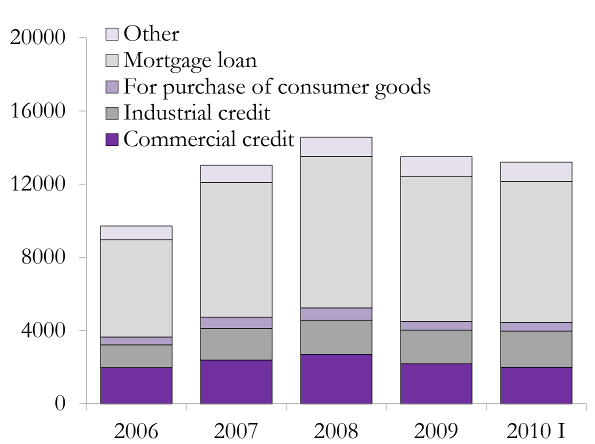
At the beginning of 2010, growth of credit balance declined significantly by 7.8% in comparison with the respective month of the previous year, and the growth of balance of credits granted within four months of the year 2010 has not changed much. In December 2009 the growth of the balance of the granted credits decreased rapidly in comparison with November 2009, and a significant decline was observed in March 2010.

Figure 4.35

Total Credits Granted to Resident Financial Institutions, Non-financial Corporations and Households
(total)



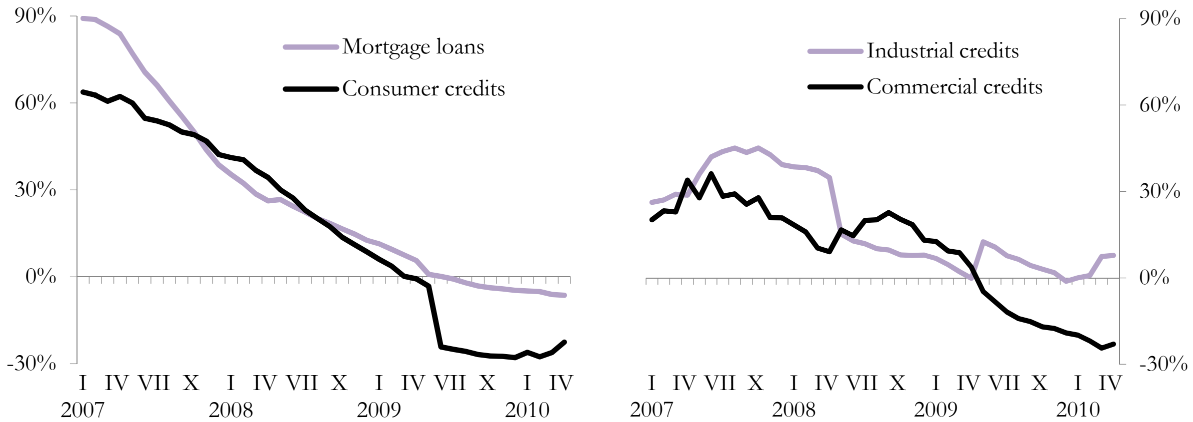
Amount and Structure of Credits Granted to Domestic Individuals and Companies
(end of the period, million LVL)



At the beginning of 2010, the structure of credits granted to domestic companies and individuals is dominated by mortgage loans, the proportion of which in total credit structure is 58%. However, the proportion of significant loans – commercial credits and industrial credits (for purchase of fixed assets and funding of long-term investment projects) – for increasing the current assets of companies overall was only 30 percent.

Figure 4.36

Credits Granted to Financial Institutions, Non-financial Companies, and Households
(increase in comparison with the respective month of the previous year, %)



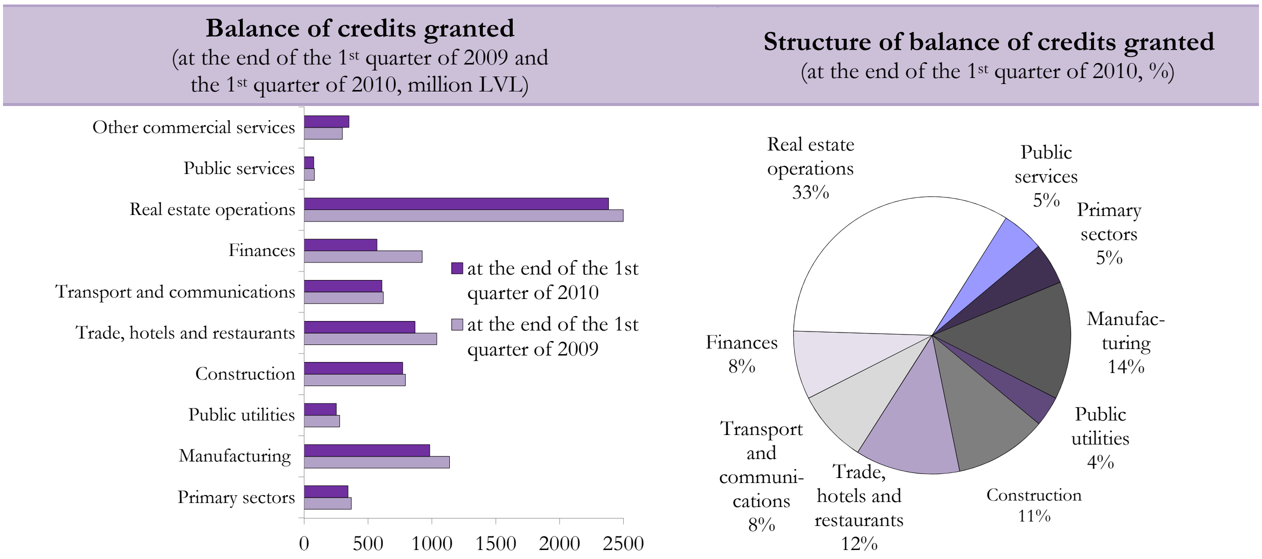
The amount of the granted mortgages grew very rapidly in the preceding years (by 39% in 2007 and by 13% in 2008). In 2009, granting mortgages basically stopped, and this tendency continued also in the 1st quarter of 2010 (at the end of April 2010, the mortgage loan balance decreased by 6.4% in comparison with the corresponding time period of year 2009).

Since May 2009, the consumer credit balance has rapidly decreased in comparison with the corresponding months of the previous year. At the end of December 2009, the balance of consumer credits was LVL 482.2 million, but at the end of April 2010 – LVL 504.1 million, which means that the credit balance for purchase of consumer goods has slightly increased in the first months of 2010.

The monthly balance of commercial credits has been decreasing since November 2008 and continued declining also in 2009 and at the beginning of 2010. In April 2010, the balance of commercial credits granted to residents decreased by 23% in comparison with the corresponding time period of 2009. The balance of industrial credits slightly increased at the beginning of 2010 possibly due to several signs of improvement in business sector, especially in respect of the growth of export potential. At the end of April 2010, the balance of industrial credits increased by 7.8% in comparison with the corresponding time period of the previous year.

Figure 4.37

Credits to Residents by Sectors of Economy



At the end of the 1st quarter of 2010, companies, public and private non-financial corporations were granted credits in total of LVL 7205.7 million, which is by 10.4% less than at the end of the 1st quarter of 2009, as there were credits granted in the amount of LVL 8039 million. The most rapid decline of credit balance was shown in the financial sector – at the end of the 1st quarter of 2010, in comparison with the corresponding time period of 2009, decrease by 38.3% was observed, in trade, hotel and restaurant sector by 16%, and in manufacturing industry by 14%. The balance of the granted credits increased only in the sector of commercial services (by 17.1%). The largest credit balances are still related to real estate activities – LVL 2383.8 million (33% of the total credits granted to the sectors of economy). Credits granted to the manufacturing, trade, hotels and restaurants, as well as to the construction sectors also constitute a comparatively large proportion. 7.7% of all credits granted to the residents are credits in lats. The majority of the credits (89.2%) are granted in EUR.

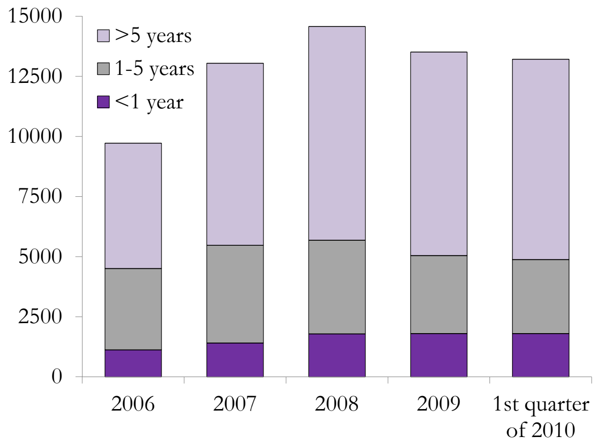
Over the recent years, the proportion of short-term and long-term credits has grown in the total maturity profile, which basically remains unchanged in the 1st quarter of 2009 and 2010. Although at the end of the 1st quarter of 2010, in comparison with the results at the end of year 2009, the balance of long-term credits decreased by 1.5%, though proportion in the credit portfolio increased, reaching 63.1% at the end of the 1st quarter of 2010 (at the end of year 2009 – 62.6%). Also, at the end of the 1st quarter of 2010, in comparison with the results at the end of 2009, the balance of short-term credits increased by 0.1%, and the proportion of total credit amount was 13.6% at the end of the 1st quarter of 2010.

The most rapid decline was observed in medium-term credits, which at the end of the 1st quarter of 2010 decreased by 5.1% in comparison with the results at the end of 2009 and by 21.1% in comparison with the results at the end of 2008. The proportion of medium-term credits in the total amount of credits was 23.3% at the end of the 1st quarter of 2010.

Figure 4.38

Term structure of Credits Granted to Domestic Companies and Individuals

(end of the period, million LVL)



At the beginning of the year 2010, the amount of credits which are granted by banks and without any overdue payments keeps decreasing. At the end of March 2010, the credits without overdue payments constituted 72.5% of all credits granted by banks, which is by 15.7% less than in the corresponding time period of 2009. Only 74.5% of credits were paid without delaying the payments. At the end of year 2008, the credits with delayed payments constituted 15% in the credit portfolio, in 2009 – already 25.5%, and in the 1st quarter of 2010 – already 27.5% or LVL 4.2 billion of the total credit portfolio of banks. At the beginning of the 2010, the paying capacity of the borrowers keeps decreasing.

At the beginning of 2010, the banks continued to cooperate with the clients facing difficulties to repay the credits. The amount of refinanced credits increased, and at the end of 2009 it was 16.1% of the total credit portfolio of banks, but at the end of the 1st quarter of 2010 it already reached 18% or LVL 2.7 billion of the total credit portfolio of banks. In the 1st quarter of 2010, the amount of refinanced credits and credits currently being recovered, which are secured by a real estate, keeps increasing. At the end of the 1st quarter of 2010, the bank reserves for bad debts amounted to LVL 1.6 billion or 10.8% of the total credit portfolio of banks which is by 14.3% more than at the end of the year 2009.

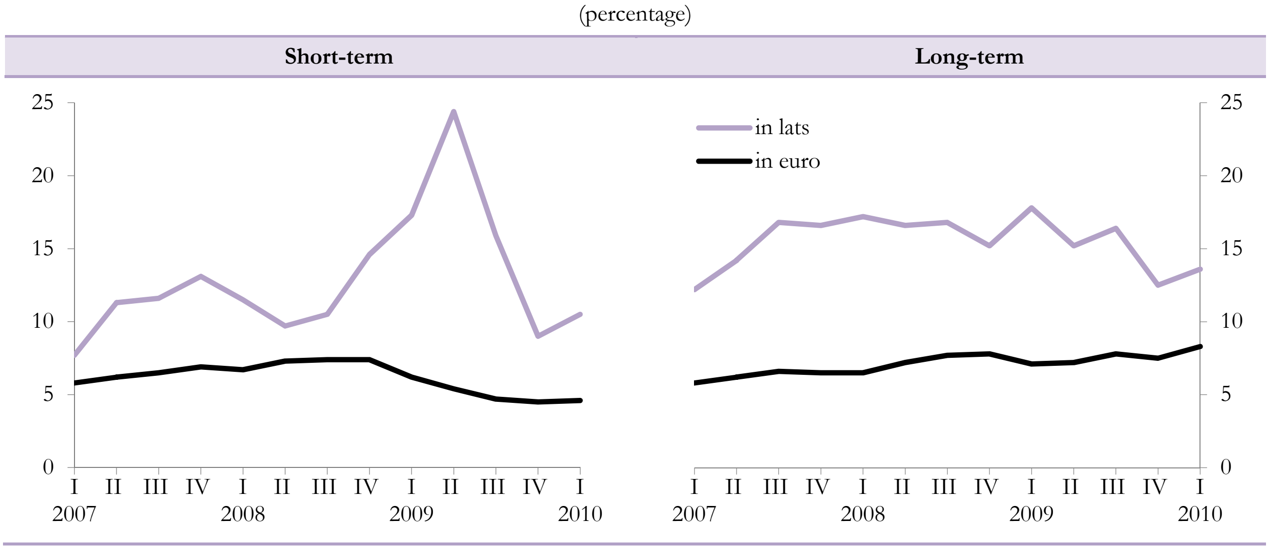
In the 1st quarter of 2010, the weighted average **interest rate** on short-term credits granted to companies and individuals was 10.5% which means that the situation seems to have slightly stabilized. In comparison with the corresponding time period of 2009, the weighted average interest rate on short-term credits granted to companies and individuals in LVL has significantly decreased because it amounted to 17.3% in the 1st quarter of 2009 and increased rapidly at the end of the 2nd quarter thus reaching 24.4%, but decreased at the end of 2009 to 9%. Over the year, more moderate fluctuations were observed with respect to the weighted average interest rates on long-term credits, and they decreased from 17.8% at the end of the 1st quarter of 2009 to 13.6% by the end of 1st quarter of 2010.

The interest rates on credits granted in EUR were as usual lower and their fluctuations less explicit. Respectively, at the end of the 1st quarter of 2010, the weighted average interest rate on short-term credits granted in EUR was 4.6%, but on long-term credits – 8.3%. Over 2009, the interest rates on short-term credits granted in EUR decreased gradually and in the 4th quarter it was 4.5%, while the interest rates on long-term credits granted in EUR remained essentially unchanged and even increased at the beginning of year 2010, and reached the highest ratio over the last years.

Figure 4.39

Weighted Average Interest Rates on Credits Granted in Credit Institutions, Quarterly Profile

(percentage)



In the middle of 2009, the weighted average interest rate in LVL in respect to long-term deposits in credit institutions increased thus reaching 12.9% at the end of 2009, but it decreased at the end of the 1st quarter of 2010 to 8.8%. The interest rates on short-term credits showed the most rapid growth in the 2nd quarter of 2009 thus reaching 11.1%, but they gradually decreased to 4.1% at the end of the 1st quarter of 2010.

The weighted average interest rate in EUR in respect to long-term deposits has slightly decreased at the end of 2009 and at the beginning of 2010 – from 5.4% at the end of the 1st quarter of 2009 to 5.1% at the end of the 1st quarter of 2010. However the interest rates on short-term credits decreased from 2.8% at the end of the 1st quarter of 2009 to 1.5% at the beginning of year 2010.

5. LABOUR MARKET

5.1. Employment and Unemployment

Significant changes in the labour market have taken place since the end of 2008, when the economic recession started to reflect in the employment rates.

The number of employed persons aged 15-74 has decreased by 137.4 thousand or by 12.2% in 2009, due to the significant decrease of labour demand. The employment rate decreased as well. It was 61.1% in 2009 compared to 68.6% in 2008 (for persons aged 15-64). The unemployment has increased rapidly. The unemployment rate has increased by 9.4 percentage points in 2009 and since the 3rd quarter of 2009 Latvia has the highest unemployment rate in the EU.

According to the data of the State Employment Agency (SEA), at the end of 2009, 179.2 thousand unemployed persons were registered, which is 16% from the economically active population of the country.

Economic recession has affected the economic activity of the population, which has been decreasing since the 2nd quarter of 2009. In general, the economic activity rate in 2009 still remains very high – 73.9%, which is by 0.6% lower than in 2008, but by 1% higher than in 2007.

Table 5.1

Key Indicators of Employment and Unemployment

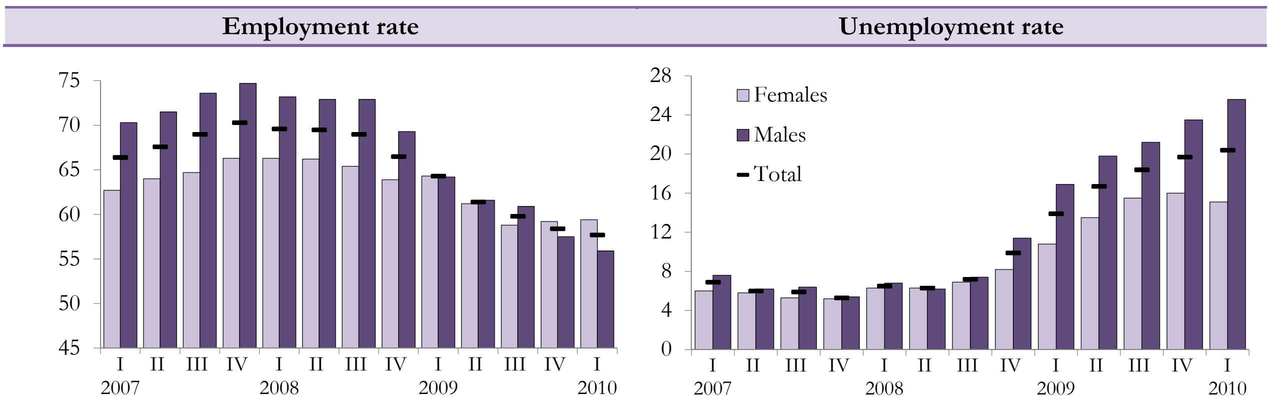
Indicators	2005	2006	2007	2008	2009
Number of employed persons (aged 15-74, thousand)	1035.9	1087.6	1119.0	1124.1	986.7
Economic activity rate (aged 15-64, %)	69.5	71.3	72.9	74.5	73.9
Employment rate (aged 15-64, %)	63.4	66.3	68.4	68.6	61.1
Unemployment rate (share of job-seekers aged 15-74, %)	8.7	6.8	6.0	7.5	16.9
Registered unemployed persons (end of period, thousand)	78.5	68.9	52.3	76.4	179.2

Although the employment and unemployment rates continued to deteriorate at the end of 2009 and at the beginning of 2010, these processes have slowed down. At the end of 2008 and in the first three quarters of 2009, the number of employed persons has decreased on average by 44.7 thousand persons per quarter, in the 4th quarter of 2009 – by 21.3 thousand, but in the 1st quarter of 2010 – by 15.9 thousand people.

Figure 5.1

Employment and Unemployment in Latvia

(%)



Positive labour market tendencies are expected later than positive growth of the economy. The employment rates will continue to worsen a little and the unemployment will grow slightly in 2010. Later, the situation in the labour market will gradually become stable, and in general, growth of labour demand will be observed. However, the growth will not be mainly based on the increase of the number of employed, but on the growth of productivity. Taking into account the abovementioned, the growth of the number of employed will be not so rapid.

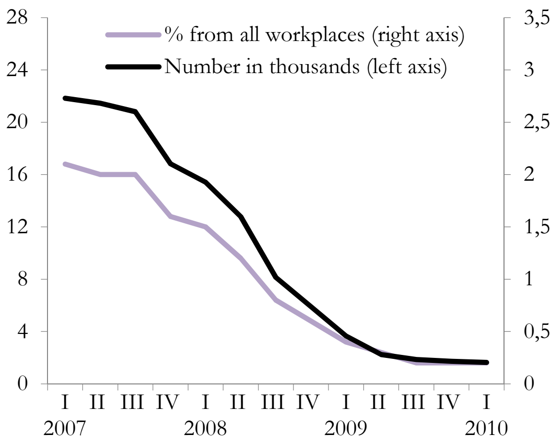
Male employment has decreased faster in 2009. The employment rates of males have decreased by 10.7 percentage points, females – by 4.6 percentage points compared to 2008. The female employment rate exceeds the male employment rate since the 4th quarter of 2009. The male employment rate was 55.9%, but the female employment rate was 59.4% in the 1st quarter of 2010.

The unemployment of males has increased rapidly due to the significant decrease of employment. The male unemployment rate has reached 25.6% exceeding the female unemployment rate by 10.5 percentage points in the 1st quarter of 2010. Decrease in the number of job vacancies also indicates to the rapid decrease of labour demand (see Figure 5.2.).

Since the beginning of the 2nd half of 2007, the number of job vacancies has started to go down. It means that the majority of Latvian enterprises have not been planning to increase production volumes since the mid-2007. The number of job vacancies has stabilized at the very low level after a rapid decrease in 2008 and 2009. There were 1.7 thousand job vacancies at the end of the year, which is by 3.4 times less than at the end of 2008.

Figure 5.2

Job Vacancies

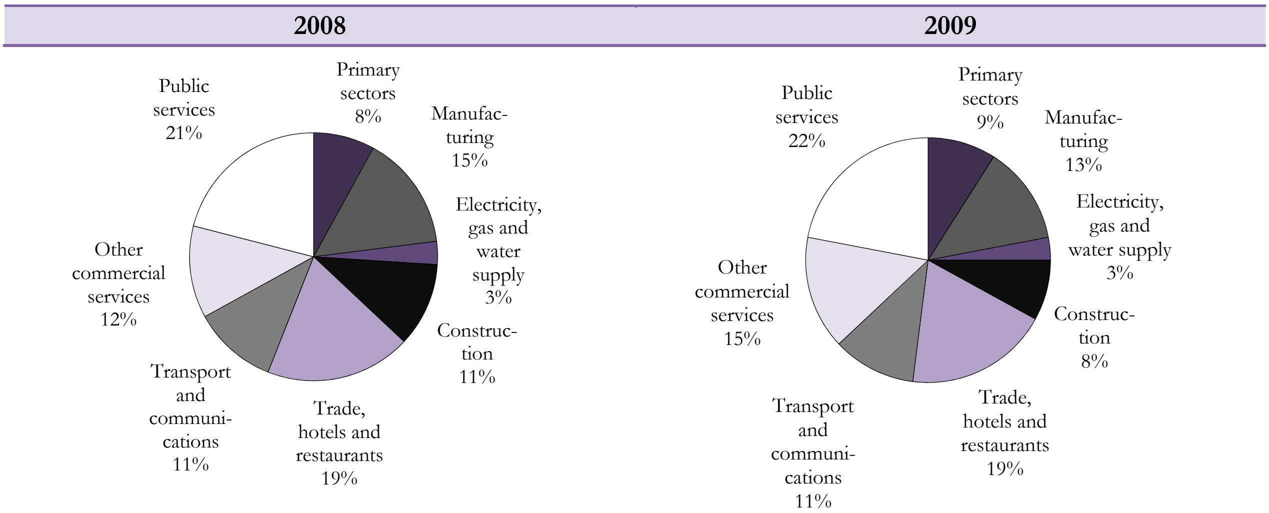


The structure of employed persons has changed a little in 2009 compared to 2008 (see Figure 5.3).

Figure 5.3

Structure of Employed Persons by Sectors of Economy

(aged 15-74, %)



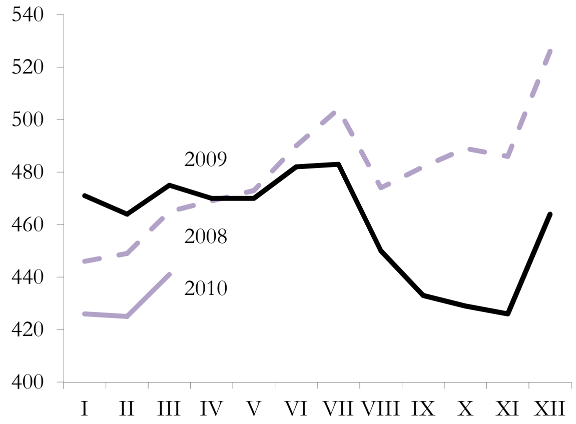
The decrease of labour demand in construction has left the most significant impact on the decrease of employment in 2009, where the number of employed has decreased by 51 thousand persons or by 40% within a year. The number of employed persons has significantly decreased in manufacturing (by 35.9 thousand persons or by 21.6%) and in trade (by 24.4 thousand persons or by 11.5%). The number of employed persons in public services has decreased by 5.3% (by 12.3 thousand persons). The number of employed persons in commercial services sectors has slightly increased during this period (by 1.8 thousand persons or by 1.3%).

5.2. Labour Costs and Productivity

The tendencies in the labour market show that the impact of the economic crisis is with a certain time lag. The decrease of economic activities in 2008 firstly reflected in the unemployment rate, while the level of wages was still rather high. However, the decrease of employment and wages has been observed in 2009 and at the beginning of 2010.

Figure 5.4

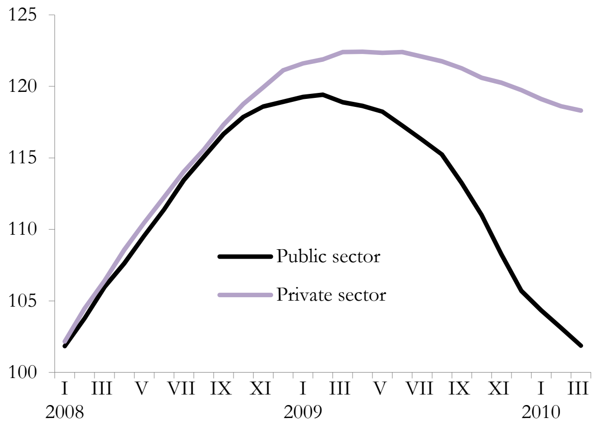
Average Gross Monthly Wage of Employed
(in lats)



A significant decrease of wages took place in the 2nd half of 2009. The wage level has slightly exceeded in the 1st quarter and at the beginning of the 2nd quarter of 2009 the level of the corresponding period of 2008, but in the 3rd and 4th quarter it has been by 6.4% and 12.1% lower, respectively. The wages decreased by 8.3% in the 1st quarter of 2010 compared to the corresponding period of the previous year.

Figure 5.5

Average Gross Monthly Wage of Employed in Public and Private Sectors
(12 month moving average)



The average annual gross wage in 2009 was LVL 460, i.e., by 3.8% lower than in the previous year (in 2008 – LVL 479), but almost by 16% higher than in 2007. Such wage adjustment is quite insignificant taking into account the depth of the economic recession.

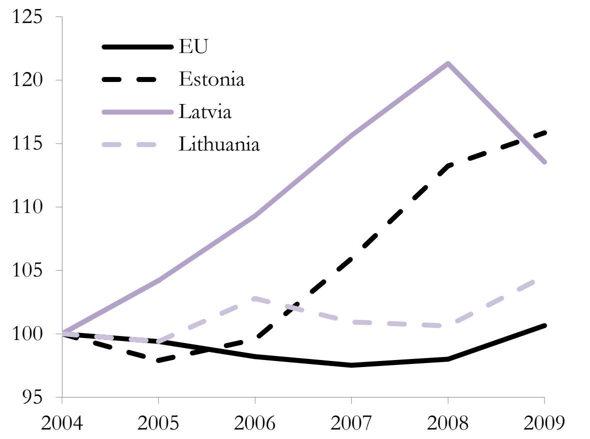
The wages in the public sector are decreasing faster, which is related to the budget consolidation measures. Wages in the public sector in 2009 were on average by 11% lower than in the previous year. Nevertheless, the decrease of wages in the private sector was not so notable (in 2009 by 1%), because the entrepreneurs preferred to reduce the number of employed persons in order to reduce costs. These tendencies are observed also in the 1st quarter of 2010: wages of the employed in the public sectors were by 14.1% and in the private sector – by 4.8% lower than a year ago.

The most significant reduction of gross wages in the private sector was in agriculture, trade, financial intermediation, as well as in individual commercial services sectors. The gross average wages in manufacturing were reduced by 1.9% in 2009, but wages in the transport sector remained on the same level as the year before.

The unit labour costs (ULC)[1] decreased significantly in 2009. The ULC is one of the indicators characterising the competitiveness (state in general and individual sectors). The dynamics of this indicator indicate that the competitiveness of Latvia has increased among the EU member states.

Figure 5.6

Changes of Real ULC in the EU and Baltic States
(2004=100)



Source: *Eurostat*

The real ULC in the EU has increased on average by 2.7% in 2009 compared with the previous year. Our neighbouring countries also showed positive dynamics of the ULC. The real ULC in Estonia and Lithuania increased by 2.3% and 3.9%, respectively, but in Latvia – decreased by 6.4%.

The changes in the ULC dynamics in 2008 and 2009 are mainly related to the cyclical factors unlike the years before the crisis, when changes in the ULC (growth) were determined by structural factors.

The real ULC still continued to grow in 2008, but not so rapidly. The decrease of demand in domestic and foreign markets had a negative influence on the situation in the markets of goods. The GDP decreased in 2008 by 4.6% compared to the year before, but the relevant adjustments in the labour markets did not take place at the same time, and it was the main reason for

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

growth of the real ULC. The real ULC in 2008 were almost by 5% higher than in the previous year.

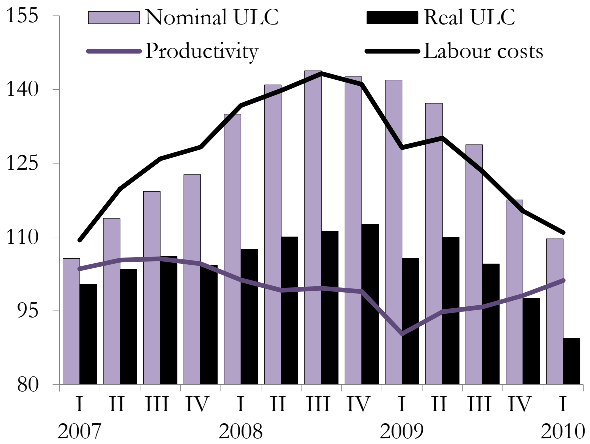
The most significant adjustments in the labour market started in 2009, which influenced dynamics of both, productivity and labour costs. The productivity has decreased by 5.7%, but the labour costs – by 5.9% compared to 2008. In the result, the real ULC decreased by 6.4 percent.

Dynamics of the real ULC in 2010 will be mainly determined by the situation in the labour market, i.e., dynamics of wages. High unemployment rate and budget consolidation measures will cause a pressure on the decrease of wages. However, the changes could be rather moderate, taking into account that it will not be possible to preserve low wages in the situation of free movement of labour.

Figure 5.7

Changes of Labour Costs in Latvia

(4th quarter of 2006=100)



Source: *Eurostat*

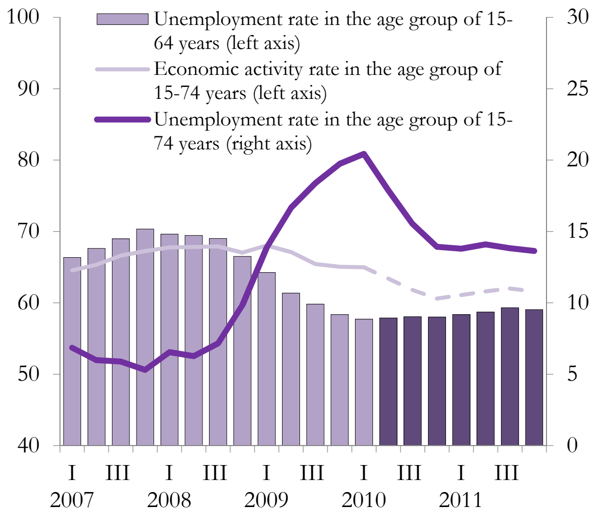
5.3. Labour Market Forecasts

The labour market forecasts for the period until 2015 have been developed in compliance with the economic development scenario (see Chapter 3.3.).

Despite the positive tendencies, the situation will remain tense in the labour market in 2010. In general, the number of employed will decrease by 6.5% in 2010. Although the labour demand will decrease, the unemployment indicators will not deteriorate anymore in 2010, because the number of economically active population will decrease. The situation in the labour market will stabilize in 2011, when the increase of the number of employed is expected. However, it will be more moderate than the overall growth rate of the economy, because the growth of output will be based not only on the increase of the number of employed, but also on the growth in productivity.

Figure 5.8

Labour Market Development Trends*



* the actual data is reflected until the 1st quarter of 2010

In total, the share of employed persons aged 15-64 in the total number of population in the respective age group may comprise approximately 57.9% in 2010, but in 2011 increase to 58.9%. The employment will continue to grow also during the next years and by 2015 the employment rate may reach 65-67 percent.

Contrary to employment, the unemployment indicators may improve faster, which will be mainly determined by the decrease of the number of economically active population. It is expected that the unemployment rate could decrease each quarter of 2010. However, despite the abovementioned fact, the average unemployment rate could be slightly higher than in 2009 – about 17 percent.

The unemployment rate will continue to decrease also in 2011, which will be mainly determined by the increase of economic activity of the population, however it will not decrease so fast as in 2010. The average unemployment rate can reach 14% in 2011.

Although the unemployment will decrease in the coming years, a high labour surplus will remain in the economy until 2015. The unemployment rate in 2015 could be 8-9.5 percent.

It is expected that such sectors like manufacturing, transport and communications, and primary sectors will recover faster from the crisis. It is forecasted that labour demand in manufacturing could increase by 2% already in 2010 and the increase could be approximately 13.5% until 2015 compared to 2009.

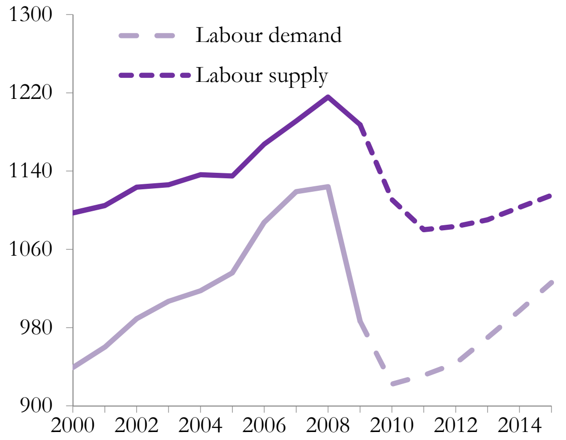
A slight increase of labour demand (by about 0.8%) is expected also in transport sector in 2010 compared to 2009. The number of employed persons in the sector could increase approximately by 19% until 2015 in comparison with the average level of 2009.

The growth in the primary sectors will be based more on the growth of productivity, thus it is expected that labour demand in comparison with 2009 will continue to decrease also in 2010. However, the number of employed persons in the primary sectors could increase gradually from 2011 and it could be by 6% higher in 2015 than in 2009.

Figure 5.9

Forecasts of Labour Demand and Supply*

(thousand persons)



* the actual annual data is reflected until 2009

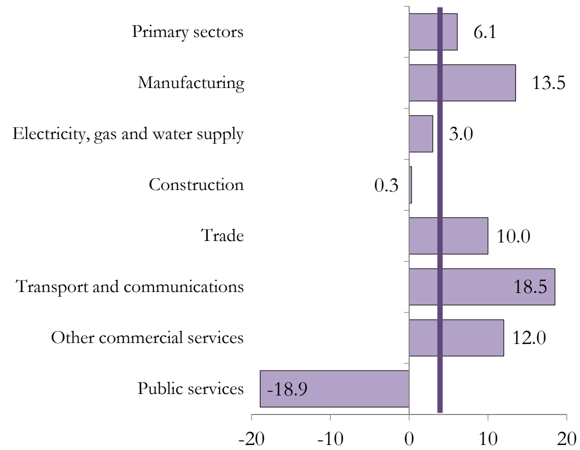
The number of employed in construction sector continues decreasing in 2010, which is mainly determined by the decrease of output in construction sector. The labour demand in construction could start increasing from the mid-2011, but still it will be low until 2012. The situation in construction sector could improve and the labour demand could increase from 2013 more rapidly if the confidence and the situation in the real estate market improves, as well as, if the banks revive crediting more actively, however, the level of 2009 could be reached only in 2015.

The labour demand will continue decreasing in the public services sector until 2015 contrary to the other sectors, which will be mainly determined by the necessity to reduce budget expenditures in the next few years. The number of employed in public administration in 2015 will be almost by 1/5 smaller than in 2009. The number of employed in the public services sector in general in 2015 will be by 19% lower than on average in 2009.

Figure 5.10

Changes in Labour Demand in 2015 compared to 2009 by Sectors

(%)



The current economic development tendencies show, that the economic recovery in Latvia and in the world is taking place much faster than it has been initially expected. Despite the fact, that there will be substantial labour surplus in the medium term, in a longer period of time new challenges are expected, which could radically change the situation in the labour market. It is expected that the number of the working age population (aged 15-74) will decrease in Latvia by more than 10% until 2020 compared to the level of 2009. At the same time, the demographic load could increase by 21%. Thus, the key long term challenges contrary to the medium term will be mainly related to the aging of the population and its consequences.

5.4. Employment Policy

The EU uses a coordinated approach to deal with the employment issues. Employment policy of Latvia as an EU Member State is implemented in the framework of the EU employment strategy. The main instrument for reaching the aims set within the employment strategy of EU is employment policy guidelines which the Member States must observe by establishing their employment policy.

The directions of activities of the Member States and measures for implementation of the EU employment strategy are reflected in the national reform programmes. The current Lisbon Strategy cycle was launched in spring 2008 as the European Council approved the *Integrated Guidelines for Growth and Jobs for 2008-2010*. Currently, the EU 2020 strategy is being designed on the EU level which is aimed to replace the *Lisbon strategy* approved by the European Council on March 2000 (see Chapter 6.1.)

On the national level, the State Employment Agency (SEA) is the authority implementing the state policy in the field of unemployment reduction and support to job seekers. **Active employment measures are the main instrument by which** SEA influences the labour market. The changing labour market needs determine the necessity for a regular revision and improvement of these activities.

According to the socio-economic situation and in order to reduce the social impact of the crisis, implementation of short-term activities by raising co-financing of EU-funds was launched in year 2009:

– work practice with a grant (planned to be implemented till the end of year 2011);
– professional training for employed persons subject to the risk of unemployment (will be implemented till the end of year 2010).

The measure *Work practice with a grant* is an employment programme of extraordinary cases – a labour market programme developed in accordance with the World Bank recommendations and actions in similar situations in other countries of the world. Since September 2009, the crisis employment measure has been launched for unemployed persons who are no longer receiving unemployment benefit. These persons receive a grant in the amount of LVL 100 for community work. The unemployed person is provided with a supervisor, equipment, as well as compensated transport costs. In 2009, 19 295 were involved in the measure *Work practice with a grant* and the funding amounted to LVL 8 million. In the 1st quarter of 2010, the number of unemployed persons involved anew in the measure was 8152 (the funding used during this period – LVL 3.7 million). It is planned to involve 40.9 thousand persons in the year 2010.

The short-term measure *Vocational training for employed persons subject to the risk of unemployment* is intended to support persons at the risk of unemployment. It offers training opportunities for employees in enterprises which are experiencing temporary idle time due to the economic crisis, providing these persons also with grants. This measure uses a coupon-system giving the person an opportunity to choose the training programme and training establishment. The measure was commenced in September 2009, and till the end of the year, 3253 persons at the risk of unemployment were involved (the funding used during this period – LVL 0.7 million). In the 1st quarter of 2010, 974 new persons were involved in the measure (the funding used during this period – LVL 1.3 million). It is planned to involve 5.4 thousand persons in the year 2010. The measure is planned to be implemented till the end of year 2010.

In the year 2010, it is planned to commence the following measures in order to gradually change the emphasis from the operative short-term measures reducing the social impact of the crisis to traditional active employment policy measures:

– education programmes for involvement of adults in lifelong learning;
– mastering the first and second level professional higher education programmes.

As from the 2nd quarter of 2010, a new measure *Education programmes for adult involvement in lifelong learning* will be commenced, which will take over the results and work of the measure *Education Programmes for employed persons subject to the risk of unemployment*, for example, in relation to coupon-system administration. The aim is to improve competitiveness of employees and self-employed persons (except for those serving in civil service), who have reached the age of 25 thus expanding accessibility of lifelong learning. Unlike the measure *Education Programmes for employees at the risk of unemployment*, the persons involved in the new measure will no longer receive a grant and they will have to co-finance the training coupon in the amount of 10% of its worth (releasing certain groups of persons from co-financing), in order for the participants to consider their decisions concerning education more properly.

It is planned to supplement the unemployed education with a new measure *Mastering the first and second level Professional higher education programmes.* It is aimed to support unemployed persons with incomplete or obtained higher education who want to complete the commenced studies or retrain by applying the education coupon method. The unemployed person is free to choose the training programme and training establishment. It is expected that 350 unemployed will use this opportunity in the year 2010; the envisaged funding amounts to LVL 0.4 million.

In addition to the mentioned measures, the SEA will continue to implement also the current active employment activities:

– professional training, re-training, and improvement of professional skills;
– paid temporary work (in 2010 and 2011 it will be completely replaced by the measure *Work practice with a grant*);
– measures to improve competitiveness;
– measures for particular groups of persons.

Additionally, other active measures are being implemented, such as measures for starting commercial activity or self-employment, work trials at a work place (in 2010 the measure was not implemented due to restructuring of available resources), training at the employer, as well as complex support measures.

During the years of economic growth, the need for active employment measures had decreased, while in 2009 due to the significant rise in unemployment, it considerably increased. In 2007, 64.4 thousand unemployed persons were involved in active unemployment measures, in 2008 – 84.4 thousand, while in 2009 the amount of the involved unemployed persons reached 237.9 thousand (one unemployed person may be involved in several activities).

Majority of these people were involved in measures to improve competitiveness. In 2009, 187.9 thousand unemployed persons participated in these measures. The rest of the measures were implemented to the following extent: 9.9 thousand unemployed persons participated in professional training, re-training, and improving of qualifications; 441 unemployed persons have started training with an employee; 11.8 thousand persons have been involved in temporary paid employment; 609 unemployed persons – in the measures for certain groups of persons; 266 unemployed persons – in measures for starting commercial activity or self-employment; 19.3 thousand unemployed persons – in the measure *Work practice with a grant*; and 7.5 thousand unemployed persons have participated in the complex support measures.

In 2008, the active employment measure *Measures for commencement of commercial activities or self-employment* was launched. With this measure, the unemployed persons are fostered to start commercial activity or self-employment. Unemployed persons participating in the measure prepare business plans, and if these plans are accepted, the necessary aid in a form of a subsidy is granted for the first year of activity, as well as assessment of implementation of the business plan during the first 2 years is provided. In 2008, 93 unemployed persons in Latgale and Riga region were involved in this measure; from the total number of developed business plans, 20 were accepted and their implementation has been launched. In 2009, 266 unemployed persons were involved in this measure, and 80 best business plans were supported by granting a subsidy for starting their implementation.

In the framework of **the measures for particular groups of persons**, subsidized employment for the unemployed is implemented by providing an opportunity for the unemployed persons to acquire and improve professional skills in workplaces, which have been created for a specific period. The target group of this measure is unemployed disabled persons and unemployed persons in unfavourable conditions.

Although the employment rate of women is comparatively high in Latvia, the employment rate of women and men still differs as compared to other EU Member States. The difference is also observed in the wages. The share of women employed in low paid work is substantially higher than for men.

After child care leave, women face several problems concerning integration into the labour market. The measure *Rising Motivation and Professional Training of the Unemployed Persons after Child Care Leave* is implemented in order to involve this target group in employment. In 2009, 96 unemployed persons participated in this measure, mainly the young mothers.

Due to the economic crisis, implementation of several measures, which were commenced in the previous years, had to be stopped in 2009.

For promotion of youth employment, the project *Employment Measure during Summer Holidays for Persons Acquiring Education in General Education, Special Education, or Professional Education Institutions* has been implemented for several years. The aim of this measure is to promote summer employment of pupils and to create an opportunity for them to acquire work experience. In the project, the SEA financed wages for the pupils from the state budget resources in the amount of 50% of the minimum established monthly wage and covered the expenses of the manager of the work practice. The expenses of employers included pupils' wages in the amount of at least 50% of the minimum monthly wage, tax payments, bonuses, lunches, etc. 11.2 thousand pupils were involved in this measure in 2008, including 173 pupils with special needs. Unfortunately, in summer 2009, due to the budget situation, SEA did not implement this measure.

In order to give an opportunity for young people of Latvian origin living abroad to acquaint themselves with work and life opportunities in Latvia, thus encouraging potential return to their ethnic motherland, as from 2007 a **summer employment project for young people was being implemented for young people of Latvian origin living abroad**. In 2009, the project was not implemented.

There are still significant regional differences in the labour market. The measure *Promoting regional mobility of persons employed by enterprises* has been developed to promote regional mobility of the employed, who have chosen a work place at a larger distance from their homes. Therefore, the unemployment risk related to movement of the employed persons between home and workplace would be reduced. The measure was launched in the 2nd half of 2008, however due to the decline of vacancies the measure was not widely used. In 2009, this measure was terminated due to the above-mentioned reason.

Along with the active measures, the SEA implements **preventive unemployment reduction measures** amongst which the most significant is the career consultations in order to help the clients better realise their professional direction.

Over this period, the career consultation services have been provided to 55 thousand persons, 45.1 thousand of whom were unemployed persons and job-seekers.

Due to the increasing economic globalisation, rapid development of technology, and negative demographic processes, increasingly more attention in the European employment strategy is paid to the issues of **labour market flexibility and employment security or flexicurity.** Already in March 2006, the European Council encouraged the Member States to pay more attention to implementation of reforms in the labour market and of social security reforms. These issues confirm their importance in the situation of economic crisis.

Flexicurity comprises 4 fields of activity, which must promote labour market flexibility and employment security by mutual co-operation. It is necessary to achieve that labour legislation and agreements are sufficiently flexible and correspond to the interests of both, the employer and the employee. In case of necessity, the active labour market policies must efficiently facilitate the transfer from one workplace to another or from the status of an unemployed person to employment. The lifelong learning systems should be improved enabling an employee to be employed during the entire period of the working age. At the same time, a modern social security system must be established, which would provide adequate assistance to residents in case of unemployment, as well as would facilitate mobility and faster return to the labour market.

In order to promote continued implementation of the flexicurity principle in Latvia, on May 15, 2009, the Saeima adopted amendments to the *Labour Law* that concern also flexibility and security in legal relationships of employment, as well as decreasing of the administrative burden in the field of employment legal relationships. Work on further amendments in cooperation with social partners and the State Labour Inspectorate will continue also in 2010.

Considering the rapid increase of the number of unemployed persons, changes of unemployment insurance were implemented in 2009 – the eligibility period for granting the unemployment benefit has been decreased from 12 to 9 months, and the unemployment benefit term has been extended, defining that the unemployment benefit term for all unemployed persons (irrespective of the insurance period) is 9 months.

The social dialogue plays an important role in implementation of the flexicurity principles. Several measures are being carried out to improve the social dialogue both on national and regional level. In order to ensure development of employment partnerships and social dialogue, the capacity of institutions involved in employment partnerships – Employers Confederation of Latvia, Free Trade Union Confederation of Latvia, local governments of Latvia and Latvian Association of Local, and Regional Governments – has been strengthened using the support of the EU Structural Funds.

It is important to ensure conditions for safe and healthy work environment, by **providing safety at work**. The goal of the guidelines envisages improvement of the working conditions in enterprises and reduction of the number of fatalities at work by 30% (per 100 thousand employed) by the year 2013 in comparison with the year 2007. By 2010, the number of fatalities at work must be reduced by 10% in comparison with the year 2007, thus gradually reducing the number of fatalities at work.

It must be noted that in 2009, the number of fatalities at work per 100 thousand employed persons decreased by 24%, in comparison with the year 2007.

In 2009, reduction of the commenced administrative burden in the field of labour protection was continued. Many regulations adopted by the Cabinet of Ministers optimize particular requirements, including the frequency of mandatory health examinations, as well as the procedure of how ordinary accidents at work are investigated and registered. There were optimized and specified requirements for labour protection in work places in order to reduce the administrative burden.

Latvia has a relatively high **rate of undeclared employment** in certain sectors, and these issues have become more aggravated due to the economic recession thus sustaining unfair competitiveness and reducing the social security of employees. In the last two years, budget restrictions have affected negatively also the opportunities of controlling state institutions (State Labour Inspectorate and State Revenue Service) to fight undeclared employment.

In order to limit the budget conditions effectively and use the accessible resources in a coordinated manner, a Draft Action Plan for 2010-2013 was elaborated for reducing unemployment. The Cabinet of Ministers approved the Action Plan on April 2010. The measures are implemented in the following key directions: application of the undeclared employment control mechanism; decreasing unfair competition; revision of the penalties policy with respect to undeclared employment; informing and educating the society about the negative consequences of undeclared employment.

6. Economic Policy and Priorities of Structural Policy

6.1. *EU 2020* Strategy

On March 3, 2010 the European Commission published communication *Europe 2020: A strategy for smart, sustainable and inclusive growth,* which outlines a vision of the European Commission regarding the *EU 2020* strategy. *EU 2020* strategy replaces the *Lisbon strategy* approved by the European Council in March 2000 (see Box 6.1).

Box 6.1

European Commission's communication *Europe 2020: A strategy for smart, sustainable and inclusive growth*

EU 2020 strategy is developed taking into consideration long-term challenges – globalization, limited availability of resources and the process of population aging. According to the European Commission, Europe needs a strategy that will help to overcome crisis and transform EU into smart, sustainable and inclusive economy, which ensures high employment level, productivity and social cohesion. *EU 2020* strategy offers a vision of how to develop a 21st century social market economy in Europe.

The European Commission's communication defines **three priorities of the *EU 2020* strategy:**

- *smart growth*: developing an economy based on knowledge and innovation;
- *sustainable growth*: promoting a more resource efficient, greener and more competitive economy;
- *inclusive growth*: fostering a high-employment economy delivering social and territorial cohesion.

The European Commission offers **five quantitative EU-level targets** to be reached by 2020:

- 75% of population aged 20-64 years should be employed;
- 3% of the EU's GDP should be invested in R&D;
- to reduce greenhouse gas (CO_2) emissions by 20% compared to 1990 (including the increase of CO_2 emissions reduction by 30%, if the conditions are right), to increase the share of renewable energy resources in energy consumption to 20% and increase energy efficiency by 20%;
- the share of early school leavers should be under 10% and at least 40% of the younger generation (aged 30-34 years) should have a tertiary degree;
- 20 million less people should be at risk of poverty.

According to the European Commission, the abovementioned targets are interrelated. In order to achieve them, the European Commission suggests translating them at the national level, taking into account the country-specific situation of each EU member state. The European Commission acknowledges that reaching quantitative targets of the *EU 2020* strategy needs implementation of a range of measures at national, EU and international level. For this purpose, the European Commission's communication offers **seven flagship initiatives***:*

- *Innovation Union*: envisages improving the framework conditions and access to finance for research and innovation so as to ensure that innovative ideas can be turned into products and services that create growth and jobs;
- *Youth on the move*: envisages to enhance the performance of education systems and to facilitate the entry of young people to the labour market;
- *A digital agenda for Europe*: envisages to speed up the roll-out of high-speed internet and reap the benefits of a digital single market for households and firms;
- *Resource efficient Europe*: envisages to help decouple economic growth from the use of resources, support the shift towards a low carbon economy, increase the use of renewable energy sources, modernise transport sector and promote energy efficiency;
- *An industrial policy for the globalization era*: envisages to improve the business environment, notably for SMEs, and to support the development of a strong and sustainable industrial base able to compete globally;
- *An agenda for new skills and jobs*: envisages to modernise labour markets and empower people by developing their skills throughout the lifecycle with a view to increase labour participation and better match labour supply and demand, including through labour mobility;
- *European platform against poverty*: envisages to ensure social and territorial cohesion such that the benefits of growth and jobs are widely shared and people experiencing poverty and social exclusion are enabled to live in dignity and take an active part in society.

In the second half of 2010, the European Commission plans to come out with concrete proposals regarding the abovementioned flagship initiatives.

Box 6.1 continued

The European Commission in its communication also indicates that economic, social and territorial cohesion will remain at the heart of the *EU 2020* strategy to ensure that all energies and capacities are mobilised and focused on the pursuit of the strategy's priorities. The European Commission also emphasises that the cohesion policy and structural funds, while important in their own right, are key delivery mechanisms to achieve the priorities of smart, sustainable and inclusive growth in the EU member states and regions.

In order to ensure implementation of the *EU 2020* strategy, the European Commission offers to improve the **governance framework** consisting of two pillars:

– *a thematic approach* related to the implementation of the abovementioned key flagship initiatives, surveillance of priorities' and quantitative targets' achievement;
– *country reporting* by helping EU Member States to return their economies to sustainable growth and public finances.

The European Commission's communication had been considered in the European Council's meeting on March 25-26, 2010. The leaders of the EU member states approved the directions of quantitative targets proposed by the European Commission and agreed on reference values of the employment target, energy and climate change targets, as well as research and development targets. As regards the reference values of other targets, the European Council asked the European Commission in cooperation with the EU member states to identify reference values of education targets and define more appropriate indicators for social inclusion (poverty reduction indicator), as well as concluded, that the EU member states should set national level targets according to their country-specific situation until the next European Council's meeting in June 2010.

The European Commission has been asked to develop an additional indicator characterizing the intensity of research and development and innovation. The European Commission is going to present its proposal regarding this indicator in autumn 2010.

Until the European Council's meeting of June 17, 2010, several EU level discussions concerning the following elements of the *EU 2020* strategy took place:

– EU-level quantitative targets and reference values, on which agreement was failed to be reached during the European Council's meeting on March 25-26, 2010;
– Bottlenecks to growth at the national level and EU level. The formation of the EU Economic and Financial Affairs Council has identified the key macro-structural bottlenecks for the EU member states on which an agreement between EU member states has been reached;
– Flagship initiatives. On May 19, 2010, the European Commission submitted a proposal on the flagship initiative *A digital agenda for Europe*. On May 31, 2010 EU Transport, Telecommunications and Energy Council approved the flagship initiative, thus supporting development of a completely functioning EU digital single market by 2015;
– Integrated Guidelines (see Box 6.2);
– The European Commission's proposal regarding strengthening of economic policy coordination in the EU. Among other things, it foresees to link the implementation process of the *EU 2020* strategy with the Stability and Growth Pact process for more efficient evaluation and surveillance of the economic policies of the EU member states.

The European Council on June 17, 2010 has formally approved the *EU 2020* strategy, thus reaching a political agreement on the Integrated Guidelines (see Box 6.2), as well as approving EU-level quantitative targets. As regards the education targets, the European Council supported reference values of the targets proposed by the European Commission's communication (i.e., the share of early school leavers should be below 10% and at least 40% of the younger generation (aged 30-34) must have a tertiary degree), adding that the EU member states have the national competence to identify and fulfil education targets. As regards poverty/social exclusion reduction target, the European Council approved the proposal of the European Commission, which suggests reducing the number of people at risk-of-poverty rate by 20 million people, emphasising that the EU member states are free to choose one of three indicators characterizing poverty/social exclusion (at risk-of-poverty rate, material deprivation and jobless households) by setting the national targets.

Until autumn 2010, the EU member states must prepare the national reform programmes on the implementation of *EU 2020* strategy representing the planned policy and structural policy measures to reach national quantitative targets, as well as measures aimed to eliminate bottlenecks to growth at the national level.

Box 6.2

Integrated Guidelines

According to the *Treaty on the Functioning of the EU* (TFEU), the European Commission presents proposals regarding EU Broad Economic Policy Guidelines (according to the Article 121 of the *TFEU*) and Employment Policy Guidelines according to the Article 148 of the *TFEU*), which comprise the Integrated Guidelines. The proposal of the European Commission is being discussed by different EU Council formations, where a discussion between EU member states and the European Commission takes place. The European Council prepares an opinion and agrees on the proposal of the European Commission. When the Integrated Guidelines are approved by the EU Council, the EU member states should develop the national reform programmes, which present the national level policy for implementation of the Integrated Guidelines. In other words, the Integrated Guidelines can be considered as a set of tasks based on which the EU member states prepare their national reform programmes on the implementation of the *EU 2020* strategy, and on the basis of which the European Commission carries out annual evaluation and issues recommendations to each EU member state. The Article 121.4 of the *TFEU* envisages that in case if the economic policy of a particular EU member state does not comply with the Broad Economic Policy Guidelines (which constitute a part of the Integrated Guidelines) and the EU member state fails to fulfil the Council's recommendations, the European Commission may address a policy warning to the EU member state, by pointing out that the respective EU member state does not fulfil obligations stipulated in the *TFEU*, by making its recommendations public.

The European Commission proposes 10 Integrated Guidelines:

Broad Economic Policy Guidelines

Guideline 1: Ensuring the quality and sustainability of public finances.
Guideline 2: Addressing macroeconomic imbalances.
Guideline 3: Reducing imbalances in the euro area.
Guideline 4: Optimising support for R&D and innovation, strengthening the knowledge triangle and unleashing the potential of the digital economy.
Guideline 5: Improving resource efficiency and reducing greenhouse gases emissions.
Guideline 6: Improving the business and consumer environment, modernising the industrial base to ensure the full functioning of the internal market.

Employment Policy Guidelines

Guideline 7: Fostering female and male participation in the labour market, reducing structural unemployment and promoting job quality.
Guideline 8: Developing a skilled workforce responding to labour market needs and fostering lifelong learning.
Guideline 9: Improving the performance of education and training systems at all levels and increasing participation in tertiary education.
Guideline 10: Promoting social inclusion and combating poverty.

It should be noted that EU Employment, Social Policy, Health and Consumer Affairs Council on June 7-8, 2010, as well as EU Economic and Financial Affairs Council on June 8, 2010 approved the Integrated Guidelines. However, at the European Council's meeting on June 17, 2010 a political agreement on the Integrated Guidelines had been reached. The EU Council is going to approve the Integrated Guidelines formally in the second half of 2010, when the opinion from the European Parliament, Committee of the Regions, as well as European Economic and Social Committee will be received.

Quantitative targets of Latvia with regard to the *EU 2020* strategy

On May 5, 2010, the Cabinet of Ministers approved *Latvia's position on the quantitative targets of Latvia with regard to the EU 2020 strategy*. Quantitative targets of Latvia (see Table 6.1) have been set taking into account the medium-term development scenario of the economy of Latvia, as well as the goals of the Sustainable Development Strategy of Latvia – *Latvia 2030*.

The achievement of the quantitative targets of Latvia with regard to the *EU 2020* strategy depends on the following conditions:

– overall growth of the economy, which is currently negatively affected by the crisis;
– demographic development, in the framework of which, according to projections, the number of the working age population of Latvia will continue to decrease until 2020;
– Latvian state budget possibilities, which until 2014 will be rather limited due to the necessary budget consolidation measures;
– possible EU support, including support from the EU funds in the framework of the new EU financial perspective after 2013. The support of the Cohesion Policy to convergence of less developed EU member states and regions, as well as dealing with the issues at the EU level regarding provisions of equal competition conditions to all EU farmers should be particularly mentioned here.

It should be noted that quantitative targets of Latvia presented in the Table 6.1 may be specified during the preparation of the national reform programme of Latvia on the implementation of the *EU 2020* strategy.

Table 6.1

Quantitative Targets of Latvia for 2020 with Regard to the *EU 2020* Strategy*

	EU-27		Latvia		
	Fact	Target	Fact	Targets	
	2008	**2020**	**2008**	**2020**	**2030**[1]
Employment level (age group of 20-64 years)	70.5	> 75.0	75,8	**73.0 ... 75.0**	To increase labour force participation and to use maximally all human capital available in Latvia, including older people
Investments in research and development (% of GDP)	1.9	3.0	0,6	**1.5 ... 2.0**	> 3
Higher education (share of population aged 30-34 years having tertiary degree)	31.0	40.0	27,0	**34.0 ... 36.0**	aged 20-29 years >90 per 1000 inhabitants
Share of early school leavers (age group of 18-24 years, %)	14.9	< 10.0	15.5	**13.4 ... 13.0**	Share of youth aged 20-24 years having completed at least secondary education > 90%
Persons at risk-of-poverty rate (%)[2]	17.0	Number of persons at risk-of-poverty rate decreased by 20 million	26.0	**21.0**	At risk-of-poverty rate < 16
Energy efficiency[3]	169 (2007)	Increase energy efficiency by 20%	310	**286**	< 150

* Targets may be specified within the preparation stage of the national reform programme of Latvia on the implementation of the *EU 2020* strategy.

[1] Targets set in the Sustainable Development Strategy of Latvia – *Latvia 2030*.

[2] The share of persons with an equivalised disposable income below the risk-of-poverty threshold, which is set at 60% of the national median equivalised disposable income (after social transfers).

[3] Energy intensity of the economy is measured as the ratio between the gross inland consumption of energy and the GDP (kg of oil equivalent per 1000 EUR) according to the *Eurostat* methodology.

Bottlenecks hindering growth of the economy of Latvia

Each EU Council formation according to its competence has discussed bottlenecks identified by the European Commission, for example, the discussion on the bottlenecks hindering labour market development and employment has been held at the EU Employment, Social Policy, Health and Consumer Affairs Council. Macro-structural bottlenecks of the EU member states have been identified in the EU Economic and Financial Affairs Council formation.

According to the assessment of the European Commission, Latvia has the following macro-structural bottlenecks or challenges:

– Reducing the high general government structural deficit;
– Ensuring a well functioning and stable financial sector in the light of the ongoing deleveraging of the private sector;
– Promoting rebalancing the economy towards the tradable sectors and raising productivity levels;
– Avoiding high unemployment from becoming structural and ensuring better matching in the labour market;
– Addressing the weaknesses in the business environment, ensuring efficient use of EU structural funds and adequate access to finance for companies with a view of favouring productive investment.

A link of the *EU 2020* strategy with economic policy and priorities of structural policy of Latvia

The *EU 2020* strategy is closely related to the economic policy and priorities of structural policy of the EU member states, because, according to the *Treaty on the functioning of the EU*, the EU member states should take into consideration the strategic development documents, such as strategies, guidelines, policy, etc., approved by the EU.

There are different medium-term and long-term policy planning documents, which are currently being developed/have been adopted/are planned in Latvia, including the Sustainable Development Strategy of Latvia – *Latvia 2030*, the *National Development Plan for 2014-2020,* etc. Taking into account the abovementioned, it is necessary to ensure better link of the *EU 2020* strategy's and the national reform programme of Latvia with the implementation of other medium-term and long-term policy planning documents of Latvia.

The specificity of the national reform programme of Latvia is related to the fact that development of such policy planning document in every EU member state is prescribed by the *TFEU* (see Box 6.2), within the framework of which the European Commission may address a policy warning, if economic policy of any particular EU member state is not in line with the Integrated Guidelines and targets set at the EU level.

Thus, the national reform programme of Latvia, unlike the abovementioned policy planning documents of Latvia, will be a particular policy planning document, which on the one hand will be based on the Integrated Guidelines for implementation of the *EU 2020* strategy approved in June 2010 and on the other hand – on targets, goals, priorities and directions of activity set forth in the abovementioned policy planning documents of Latvia.

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

6.2.1. Utilisation of European Union Structural Funds and Cohesion Fund

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

Programming period 2004-2006

In the period of 2004-2006, the total available financing for Latvia within the framework of the SF programmes was EUR 625 million or LVL 439.3 million.

By June 30, 2009, the final SF payments to funding beneficiaries had been made in the amount of LVL 464.8 million or 105.7% of the EU grant. The EC has been claimed LVL 424.7 million or 96.6% of the EU grant. The EC payments have been received in the amount of 95%, which is the maximum possible amount until completion of the programme (5% is the final payment of the EC).

Taking into account the EU regulatory framework which stipulates that the EC shall not pay more than 95% from the allocated SF funding before examination of the closing documents, the amount of the final payment is potentially up to 5% of SF grant which would be LVL 22 million for Latvia, provided that no deficiencies are found leading to financial adjustments. Considering the former practice of the EC with respect to making final payments, the payment may be expected not sooner than in 2011-2012 when the EC will have examined the closing documentation of the programme and verified a 100% eligibility of the declared costs.

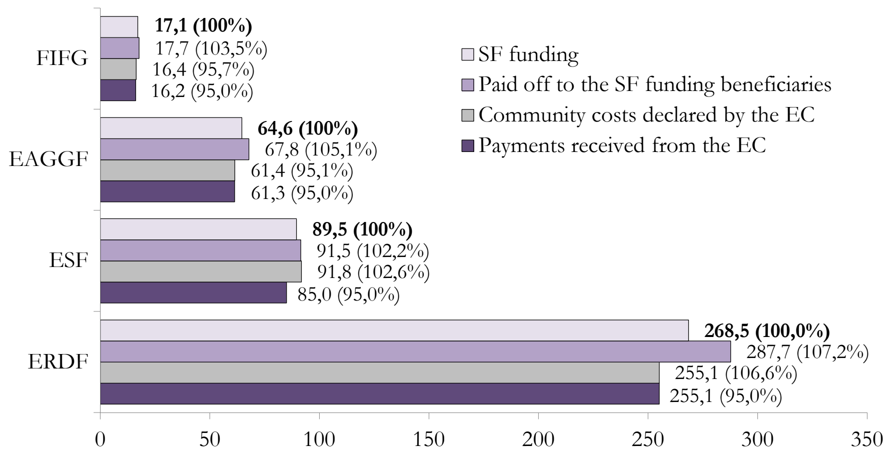
Taking into account that Latvia has contracted overcommitment and it is possible to declare eligible costs exceeding 100%, in case of the potential financial corrections of the EC, certain flexibility exists to replace the ineligible costs with eligible costs, still maintaining the possibility of receiving the maximum possible final payment.

Figure 6.1 shows the progress of the EU SF absorption until December 31, 2009.

Figure 6.1

EU Structural Funds absorption in the programming period 2004-2006 (full financial flow) till December 30, 2009*

(million lats and %)



* EUR exchange rate established by the Bank of Latvia has been used in the calculations (EUR 1 = LVL 0.702804)

In the period of 2004-2006, the total available financing for Latvia for the implementation of CF projects was LVL 499.5 million.

By March 31, 2009, the CF funding beneficiaries had been settled in the amount of LVL 369.9 million or 74% of the CF funding. In the EC has been declared LVL 403.3 million or 80.7% of CF funding. The EC payments have been received in the amount of LVL 386.9 or 77.4 percent.

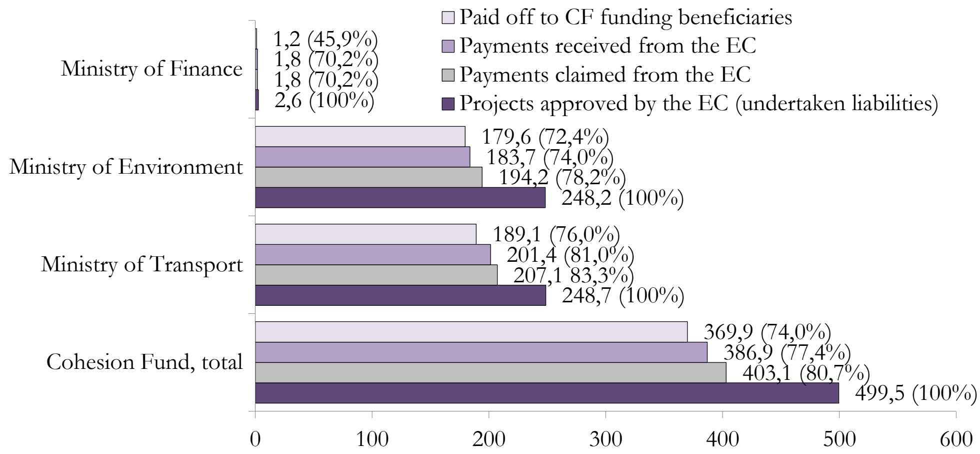
As the majority of CF projects will be implemented by the end of 2010, absorption indicators submitted so far are evaluated as satisfactory.

The CF absorption until March 31, 2009 is shown in Figure 6.2.

Figure 6.2

EU Cohesion Fund absorption in the programming period 2004-2006 (full financial flow) till March 31, 2010

(million lats and %)



Programming period 2007-2013

In the programming period of 2007-2013, the SF support is mainly directed towards education of inhabitants, technological excellence, and flexibility of enterprises, as well as towards development of science and research in order to promote knowledge-based economy and to strengthen other necessary prerequisites for sustainable economic development and living conditions for people in Latvia in general. In order for Latvia to reach the average EU development rates, with the support of the Fund, the national development strategy defined by the government in the *National Development Plan* must be implemented. At the frontline of the national development strategy is an educated, creative, and determined person. The main goal of the strategy is economy based on education, science, and competitive enterprises.

For efficient absorption of SF and CF resources in accordance with the SF and CF General Regulation, the programming is implemented on 3 levels (EU level strategy or *Community Strategic Guidelines*, strategy of the Member States or the *National Strategic Framework Document*, and *Operational programmes* of the Member States).

The *National Strategic Framework Document* for the programming period of 2007-2013 (NSFD) is the main national level SF and CF programming document, which ensures the link between the cohesion policy and national priorities, as well as justifies the choice of these priorities and defines the fund absorption strategy, management framework, ensures coordination between the *Operational Programmes* (OP) and other financial instruments.

NSFD, on which distribution of the SF and CF financing in the amount of EUR 4.53 billion available to Latvia within the period of 2007-2013 is based, was approved by the Cabinet of Ministers on June 19, 2007. But on September 20, 2007, it was also approved by the European Commission in order to start absorption of the programme and resources.

In accordance with the decision of the Council of the EU regarding the EU multiannual financial framework for the programming period of 2007-2013, Latvia has received EUR 4.53 billion for implementation of the cohesion policy goals with intermediation of EU funds (European Regional Development Fund (ERDF), European Social Fund (ESF)) and 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 551 million or LVL 387 million;
- 2. OP *Entrepreneurship and Innovations* (ERDF) – EUR 737 million or LVL 518 million;
- 3. OP *Infrastructure and Services* (ERDF+CF) – EUR 3.2 billion or LVL 2.25 billion.

Till March 31, 2010, projects for the amount of more than a half (or 55.8%) of all financing of EU funds available for Latvia within programming period have been approved, and agreements for LVL 1 559.5 million or 49% of financing of EU funds are concluded. March 31, 2010 funding beneficiaries had been settled in the amount of LVL 514.4 million or for 1%, which is more than in the last quarter. The growth is rather small however taking into account the rapid rise in return of funding beneficiaries at the end of 2009, the rise of this quarter is evaluated to be good.

The EU fund financial progress until March 31, 2010 is outlined in Table 6.2.

Table 6.2

EU fund financial progress in the programming period 2007-2013 till March 31, 2010

Fund	Funding of the EU funds	Concluded agreements		Paid to the funding beneficiaries		Received EC's repayments (incl. advances)	
	million LVL	million LVL	%	million LVL		million LVL	million LVL
ESF	387.0	237.7	61.3	69.9	18.1	75.2	19.4
ERDF	1714.9	743.9	43.4	272.1	15.9	315.9	18.4
CF	1 082.2	577.9	53.4	172.4	15.9	197.1	18.2
Total	**3 184.0**	**1559.9**	**49%**	**514.4**	**16.2**	**588.1**	**18.5**

Information regarding activities for 2007-2013 that are under the responsibility of the Ministry of Economics has been summarized in the Box 6.3.

Box 6.3

Activities under the responsibility of the Ministry of Economics

A total of LVL 492.4 million is available for the activities of the Ministry of Economics in the programming period 2007-2013, and is allocated as follows:

1. OP *Human Resources and Employment* – LVL 47.1 million;
2. OP *Entrepreneurship and Innovations* – LVL 311.9 million;
3. OP *Infrastructure and Services* – LVL 133.4 million.

Agreements concluded within the activities under the responsibility of the Ministry of Economics till May 1, 2010:

– Within activity *Support to Training of the Employed for the Promotion of Entrepreneurs Competitiveness – Support to Training Organised in Partnerships*, 13 agreements have been concluded with the total contract amount of LVL 1.9 million;
– Within activity *Support to Individually Organized Training for Enterprises*, 94 agreements have been concluded with the total contract amount of LVL 2.7 million;
– Within activity *Attraction of Highly Qualified Employees*, 3 agreements have been concluded with the total contract amount of LVL 106.2 thousand;
– Within activity *Technology Transfer Contact Points*, 8 agreements have been concluded with the total contract amount of LVL 1.6 million;
– Within activity *Development of New Products and Technologies*, 113 agreements have been concluded with the total contract amount of LVL 6.8 million;
– Within activity *Introduction of New Products and Technologies into Production*, 51 agreements have been concluded with the total contract amount of LVL 9.3 million; Aid for implementation of new products and Technologies in production;
– Within activity *Development of New Products and Technologies – Support to Strengthening of Industrial Property Rights*, 13 agreements have been concluded with the total contract amount of LVL 153.6 thousand;
- Within activity *High Value-Added investments*, 29 agreements have been concluded with the total contract amount of LVL 67.4 million;
– Within activity *Access to External Trade Markets – External Marketing*, 269 agreements have been concluded with the total contract amount of LVL 2.3 million;
– Within activity *Measures to Encourage Innovations and Business Start-ups*, 1 agreement has been concluded with the total contract amount of LVL 2 million;
– Within activity *Support to the Investments in Micro, Small and Medium-sized Enterprises Operating in the Specially Assisted Areas*, 227 agreements have been concluded with the total contract amount of LVL 17.4 million;
– Within sub-activity *Maintenance and Renewal of Town Planning Monuments of National Importance and Infrastructure Adjustment to Develop a Tourism Product*, 21 agreements have been concluded with the total contract amount of LVL 8.7 million (ERDF);
– Within sub-activity *Development of Cycling Tourism Product of National Importance*, 6 agreements have been concluded with the total contract amount of LVL 4 million (ERDF);
– Within activity *Improvement of Heat Insulation of Multi-apartment Residential Buildings*, 57 agreements have been concluded with the total contract amount of LVL 3 million (ERDF);
– Within activity *Improvement of Heat Insulation of Social Residential Buildings*, 23 agreements have been concluded with the total contract amount of LVL 2.4 million (ERDF);
– Within activity *Measures for Raising Efficiency of Central Heat Supply Systems,* 10 agreements have been concluded with the total contract amount of LVL 5.6 million (CF);
– Within activity *Development of Cogeneration Power Plants Utilizing Renewable Energy Resources,* 6 agreements have been concluded with the total contract amount of LVL 12.3 million (CF).

Within the framework of further described activities, the enterprises will receive funding in a form of an investment in the equity capital (in cases of venture capital investments programme), a loan (in cases of loan programme), and a guarantee (in cases of guarantee programme), rather than a grant, and thus the funding will be gradually repaid to the funds (loan fund, guarantee fund, investment fund) and will be accessible for repeated support to the enterprises. This way, the afore-mentioned instruments will operate as long-term support instruments.

Box 6.3 continued

Activity *Support for self-employment and business start-ups*

Programme envisages complete support to business start-ups and newly established companies, i.e. consultations, training, and financial loans and grants for starting an economic activity.

Support may be granted to working-age persons, including unemployed persons who have expressed the wish to start commercial activity or self-employment, as well as to newly established companies. For the purposes of this programme, newly established companies are companies that have lawfully registered their activity not earlier than 3 years before requesting the support within the framework of the programme.

Within the framework of the programme, persons willing to start an economic activity or having started it over the last year, can receive full range of support: (1) consultations with respect to preparation and implementation of a business plan; (2) training; (3) financial support – loans up to LVL 54 thousand; grants for starting economic activity (up to LVL 3.6 thousand, not exceeding 35% of the amount of the loan); grants for repaying the loan, up to LVL 2 thousand (not exceeding 20 % of the amount of the loan).

Within the framework of the programme, persons who have started their economic activity more than a year ago, but not more than three years ago before filing the applications for support, will be entitled just to consultations and a loan.

The total funding available for loans is LVL 17.5 million. Programme financing for grants, training, and consultations in the business plan preparation stage is LVL 4 million.

As of March 31, 2010, 676 agreements had been signed on preparation of business plans, 64 business plans had been submitted for granting loans for the total amount of LVL 1168 thousand.

Investment Fund

On July 16, 2008, an agreement between the government of the Republic of Latvia and the European Investment Fund (EIF) was concluded on introduction of the Investment Fund of the European Union structural funds. Financing for the Investment Fund is allocated from the SF resources earmarked for the programming period of 2007-2013 within the framework of the SF activity 2.2.1.1 Holding *Fund for the Investment in Guarantee, High-Risk Loans, and Venture Capital Funds and Other Financial Instruments.*

Within activity Holding *Fund for the Investment in Guarantee, High-Risk Loans, and Venture Capital Funds and Other Financial Instruments*, the following financial instruments are implemented:

(1) venture capital – the selection process has been concluded and the venture capital fund manager *BaltCap Management Latvia* has been selected and approved by the Council of the European Investment Fund. On January 22 of this year, EIF and *BaltCap Management Latvia* concluded an agreement for the foundation of the venture capital fund. It is envisaged that the fund established by *BaltCap Management Latvia* will launch investments to SMEs at the beginning of 2010, investing co-funding of private investors in the amount of EUR 10 million in addition to the European Investment Fund investment of EUR 20 million. At the moment, attraction of private capital is in progress;

(2) seed and start-up capital – the selection process has been concluded and the winner, seed and start-up capital fund manager – *Imprimatur Capital Baltics* – was approved by the Council of the European Investment Fund. Now, attraction of private capital is in progress. The launch of investments to SMEs could be in progress in the second quarter of 2010. In total, the funding available for seed and start-up capital investments is planned in the amount of EUR 20.4 million;

(3) high-risk loans – the bank selection process has been concluded, and the Board of the EIF has concluded an agreement with *AS "Swedbank"* and *AS "SEB Banka"*. In total, the funding available for SMEs is LVL 73 million.

Activity *Guarantees for Development of Enterprise Competitiveness*

Since April 20, 2009, when an agreement with SIA "Latvian Guarantee Agency" (LGA) was concluded, until May 1, 2010, 357 guarantees have been granted for the total amount of LVL 47 million, and by May 1, 2010 – 20 export guarantees for the total amount of EUR 1.18 million.

Export credit guarantees

As from June 1, 2009, the guarantees of export activities risks are issued to the enterprises by the Latvian Guarantee Agency for the term of two years. The guarantor will guarantee compensation in case of a non-payment by a foreign debtor and in cases of their insolvency. The guarantee will cover up to 90 % of the export activity value, but not exceeding the equivalent of EUR 1 million per one deal in Latvian lats at the exchange rate of the Bank of Latvia on the day of assigning the guarantee.

Currently the guarantees are issued only for the activities with the third countries, except EU Member States and some member states of Economic Cooperation and Development Organization – Australia, Canada, Iceland, Japan, New Zealand, Norway, Switzerland, and the United States of America, yet, after the receipt of approval from the European Commission, the guarantees will be issued also to these countries.

It is defined that the main criterion for providing guarantees is that the state of origin of the product to be exported shall be Latvia, meaning that an essential processing or treatment operation has been in place as a result of which a new product has been produced.

The established conditions for issuing the export credit guarantee do not exclude any of the economy sectors – it means that the support is available to enterprises of all sectors, including wood-processing, dairy companies, as well as enterprises of service sectors, for instance transports or logistics, etc.

The guarantees for business activities to the EU member states and Australia, Canada, Iceland, Japan, New Zealand, Norway, Switzerland, and the United States of America are issued to an enterprise or cooperative enterprise of agriculture services, if their export volume in the preceding year was at least EUR 500 thousand, but does not exceed EUR 2 million, the number of employees does not exceed 250 employees, or the turnover is EUR 50 million, if they have been exporting for at least two years and the export turnover is at least 20% of the total turnover. The guarantee to business activities to these countries will be issued after receiving an approval from the European Commission.

Box 6.3 continued

Activity *Loans for development of Enterprise Competitiveness*

Within the framework of this programme, funding is available to small, medium, and large enterprises, which have economically justified further action plans, but are lacking in financing of credit institutions due to increased risks.

Enterprises can receive a separate loan of liquid assets or an investment loan, or both. The total amount of a loan for improvement of enterprise competitiveness cannot exceed LVL 6 million for one enterprise.

Two types of loans are available:

(1) for investments – up to LVL 5 million (min. – EUR 500 thousand, not applicable in case if the funding is necessary for implementation of the EU SF projects), loan term – up to 10 years. The purchased fixed assets must be new, except in cases when the loan beneficiary is a small or medium enterprise, and cases when this enterprise is taking over the assets of another enterprise. The beneficiary of the loan will invest at least 25% from the total project costs in implementation of the projects using own resources or external funding not connected with any type of commercial activity aid;

(2) for liquid assets (incl. credit lines) – up to LVL 2.5 million (min. – EUR 150 thousand, not applicable in case if the funding is necessary for the implementation of the EU SF projects), loan term – up to 5 years.

The total loans funding is LVL 128 million comprised of: ERDF and public funding – LVL 43 million; the Mortgage and Land Bank of Latvia funding – LVL 15 million; the European Investment Bank funding – LVL 70 million.

As of 1 May 18, 2010, 313 loans had been granted for the total amount of LVL 119.7 million.

Activity *Improvement of Heat Insulation of Multi-apartment Residential Buildings*

On February 10, 2009, the Cabinet of Ministers adopted the Cabinet of Ministers Regulation No. 138 prepared by the Ministry of Economics Regulations on Operational Programme *Infrastructure and services* complement activity *Improvement of Heat Insulation of Multi-apartment Residential Buildings*.

Support can be received for those multi-apartment residential buildings, which were commissioned from 1944 until 1993 (including), are divided into apartment properties, and one owner owns not more than 20% of the total number of apartment properties. Savings of heat energy after renovation must be at least 20% per year from the standardized total consumption of heat energy.

Project applications have been accepted since April 14, 2009 until the notice of terminating acceptance of project applications, i.e. until the funding available within the framework of the activity will be used. Financing available within the framework of the activity is LVL 44.33 million.

As of May 13, 2010, 141 projects had been submitted for the total ERDF amount of LVL 6.6 million. *Inter alia*, 57 agreements have been concluded for the total ERDF amount of LVL 2.8 million, implementation of 6 projects for the total ERDF amount of LVL 204 thousand have been finished, but for the implementation of 29 approved projects agreements have not been concluded (for the total amount of LVL 1.3 million). 18 projects for the total amount of LVL 920 thousand are being evaluated.

Projects have been submitted from 40 settlements. The majority of applications are received from Valmiera (33), Ventspils (16) Riga (15), Liepaja (9), Limbazi (6) and Salaspils (5).

EU fund acquisition, implementation of aims and budget of the ESF, ERDF and CF till March 31, 2010

In total, implementation of the ESF state budget is fulfilled for the amount of LVL 20.1 million or 94% of the expected amount of state budget expenditures within the 1st quarter of 2010, and the total expected state budget expenditures have been utilized to the extent of 31.6% in 2010.

Comparing actual ESF acquisition indicators to expected acquisition in 1st quarter of 2010, implementation of the ESF can be evaluated positively – expected repayments in the amount of LVL 11.5 million, had been paid off to beneficiaries in the amount of 108.3% or LVL 12 million till March 31, 2010.

In total, implementation of the ERDF national budget in the 1st quarter of 2010 has been implemented for 73.2% of the expected national budget expenditures, but implementation of CF national budget has been implemented only by 50% of the plan for the 1st quarter of 2010.

EC repayment of the EU funds financing to the state budget revenue in 2010

The European Commission in the 1st quarter of 2010 has repaid EU funds financing to the state budget revenue in amount of LVL 114 million as intermediate payments, which forms 25% of the total expected annual revenue (LVL 457.9 million). However, the plan for the 1st quarter of 2010 is fulfilled to the extent of 87.6% of the expected quarterly revenue.

In the 1st quarter of 2010, return of ESF interim statement to state budget revenue has been received in the amount of 94.4% or LVL 26.4 million of initially expected – LVL 27.9 million. Return of ERDF intermediate statement – to the extent of 61.7% or LVL 28.7 of initially expected LVL 46.5 million, because first statement of expenditures of the operational programme *Entrepreneurship and Innovations* of 2010 was submitted in the middle of February, but return of CF intermediate statement has been increased by 5.9% or LVL 59 million exceeding the initial expected amount of LVL 55.7 million.

Information on acquisition in accordance with priority development directions set forth in the Strategic Development Plan of Latvia for 2010-2013

For the implementation of priorities specified in the *Strategic Development Plan of Latvia for 2010-2013* it is planned to attract 82.7% or LVL 2631 million from total amount of European Union structural funds and Cohesion Fund funding.

Till May 1 of this year, out of the above-mentioned LVL 2.6 billion, projects have been approved in the amount of 58.4% of the funding amount of EU funds, and out of these projects agreements are concluded for the amount of 50.1% of the EU funding amount. In its turn, till May 1, 2010, funding beneficiaries of the EU funds have received payments in the amount of 15.8% from those stated in the EU fund financing plan.

Amendments to the financial plans of the operational programmes in the 1st quarter of 2010

Operational programme *Human Resources and Employment* an amendments thereof

On January 27, 2010, amendments to the operational programme *Human Resources and Employment* stipulating decrease of national co-funding of Latvia in the priorities of operational programme – amount of cross-funding within the framework of activity 3.1 *Employment* to the extent of 2.8%, within the framework of activity 4.1 *Social Integrity* to the extent of 3.6%, within the framework of activity 5.1 *Best Regulation Policy* to the extent of 3.7% and within the framework of activity 5.2 *Strengthening of Human Resources capacity* to the extent of 1% - were approved by decree No. 50 of the Cabinet of Ministers

On February 24, 2010, amendments to the supplement of the operational programme *Human Resources and Employment* – by reducing amount of national co-funding of Latvia by LVL 16.7 million, by saving up state budget funds, specifying the amount of cross-funding within framework of activity 1.3.1 *Employment*, activity 1.4.1 *Social Integrity,* 1.5.1 *Best Regulation Policy* and activity 1.5.2 *Strengthening of Human Resources capacity* and specifying definition of target group for sub-activity 1.3.1.1.5 *Support to people at risk of unemployment,* providing equal opportunities in service accessibility to all persons – were introduced by the decree No. 100 of the Cabinet of Ministers.

On March 15, 2010, amendments to the supplement of the operational programme *Human Resources and Employment* – providing redistribution of funding for implementation of active employment measures in the amount of LVL 5.8 million from activities and sub-activities of the operational programme *Human Resources and Employment* that are under the responsibility of the Ministry of Welfare and in the amount of LVL 7 million from activities and sub-activities of the operational programme *Human Resources and Employment* that is under the responsibility of the Ministry of Economics – were introduced by decree No. 145 of the Cabinet of Ministers.

Operational programme *Entrepreneurship and Innovations* and supplement thereof

On February 16, 2010, the Cabinet of Ministers approved amendments to the operational programme *Entrepreneurship and Innovations* providing following amendments to the financial plan of the programme:

- in total, reducing the amount of Latvian public co-funding by EUR 66.6 million (LVL 46.8 million), as a result of which the national budget funds were saved up;
- to adjust the amount of Latvian private co-funding, because in several activities/sub-activities it was not specified at all or the amount specified did not correspond to actual situation, therefore overall it is raised for EUR 90.1 million (LVL 63.3 million);
- to redistribute ERDF funding in the amount of EUR 32.4 million (LVL 22.8 million) from activities of the operational programme *Infrastructure and Services* supplement to those activities of the operational programme *Entrepreneurship and Innovations* supplement that are the responsibility of the Ministry of Economics, which are focused on development of entrepreneurship.

Operational programme *Infrastructure and Services* and supplement thereof

In accordance with the decree No. 94 of the Cabinet of Ministers, on February 24, 2010, the following amendments to the financial plan of the programme *Infrastructure and Services* were made:

- to redistribute funding of the European Regional Development Fund in the amount of LVL 22.8 million from activities of operational programme *Infrastructure and Services* to those activities of operational programme *Entrepreneurship and Innovations* under responsibility of the Ministry of Economics, which are focused on development of entrepreneurship;
- reduce national co-funding for LVL 64.6 million, by not exceeding the maximum rate of co-funding specified in Annex 3 of *Regulation No. 1083/2006*;
- to shift funding for measures of energy efficiency and support to complex development of local municipalities.

The main reason for amendments to the operational programme *Infrastructure and Services* was the socio-economic changes in Latvian economy caused by the global economic crisis and efforts to adapt to the new situation, recognizing EU Structural Funds and Cohesion Fund as the most important instrument in overcoming the crisis.

Amendments to the operational programme *Infrastructure and Services* includes financial redistribution, by shifting the funding to those activities of EU Structural Funds and Cohesion Fund, which have the most direct impact on facilitating economic recovery.

6.2.2. Foreign Trade Policy

The *Treaty of Lisbon* stipulates that the common trade policy falls within the exclusive competence of the EU. After the Treaty has come into force the competence that previously was a shared competence of the EU and Member States has expanded covering all sub-sectors of trade in services, intellectual property rights related to trade, as well as foreign direct investments. The EC, on behalf of 27 EU Member States, both bilaterally and multilaterally negotiates with third countries by expressing a common position, which at the same time is harmonized with the Member States and the European Parliament, correspondingly in the Trade Policy Committee of the Council of the European Union and in the Committee of International Trade of the European Parliament.

Multilateral relations

Strengthening the Multilateral Trading System in the framework of the World Trade Organisation (WTO) is to be considered as the cornerstone of sustainable development of the global economy and it is the main priority of the EU Common Trade Policy.

The most important functions of the WTO include administration of multilateral contracts and settling mutual disputes of its members, as well as systematic trade liberalisation and coordination of the global economic policies with other international institutions, such as the International Monetary Fund and the World Bank.

Although the member countries of the organization have previously agreed to conclude multilateral trade liberalisation negotiations till 2011, in the first half of 2010, **in the framework of the WTO Doha Round (DDA)** no essential progress has been observed. Although several high-level meetings have taken place, among them meeting of the WTO's trade ministers within the framework of the World Economic Forum in Davos (Switzerland) on January 30, 2010, meeting of ministers in Geneva (Switzerland) on March, meeting of *G5* countries (USA, EU, China, India and Brazil) in Paris (France) on April 27-28 and the meeting of *G19* countries in Geneva on May 19-20, nothing indicates that a political compromise for the further development of negotiations will be reached before the summer break. However, to achieve this aim, it is necessary to eliminate positional difference among the developed countries and developing counties, especially in positions among the USA and developing countries (India, Brazil and China).

Currently, there are 30[1] candidate countries **in the WTO accession process**, but not all processes show remarkable progress. The most active countries are Azerbaijan, Bosnia and Herzegovina, Laos, Lebanon, Serbia, Tajikistan and Yemen.

At the beginning of 2010, Montenegro and Russia were the closest to the accession to the WTO from the candidate countries. However, for the WTO members to decide on the accession of Montenegro to the organisation, at the moment, it must conclude the bilateral market access negotiations on trading goods with Ukraine that has been blocking the process conclusion since December 2008. However, since June 2009, when Russia, Belarus and Kazakhstan published a statement with respect to the establishment of a common customs union as of January 1, 2010 it has significantly prolonged the accession process of Russia and Kazakhstan to the WTO, and it is related to the harmonisation of trade conditions and changes in the trade regimes, as well as with variable plans in relation to accession process harmonisation of these countries.

Bilateral relationships in the framework of the EU Common Trade Policy

Along with the work in the framework of the WTO, the EU pays significant attention to strengthening the bilateral relationships with the third countries. It is mainly characterised with strengthening of the bilateral contractual security base by concluding and administering general non-preferential cooperation agreements which comprise general trade conditions, as well as with certain conditions, preferential trade agreements with countries interested in bilateral economic integration. The preferential agreements envisage detailed harmonisation of external trade conditions for efficient and intensified reduction of trade barriers between the contracting parties.

At the moment, a number of **EU non-preferential agreements** are in force, including partnership and cooperation agreements (PCA) with Armenia, Azerbaijan, Georgia, Russia, China, Moldova, Ukraine and others. These agreements cover a general cooperation framework on the basis of multilateral trade system norms without stipulating intensified economic integration of the contracting parties. Thus, on November 13, 2009 the EU and Iraq agreed on a conclusion of a PCA, the signing procedure and provisional application whereof will be launched in the first half of 2010.

At the same time, the EU has concluded a number of **agreements** comprising **preferential** trade conditions. Until now, such agreements have been concluded with the Balkan countries[2], European Economic Area countries[3] and Switzerland, as well as Chile, South Africa and Mexico.

At the moment, a number of negotiations on the EU preferential trade agreement, among them, negotiations on the free trade agreements (FTA), are in process with the Andean Community countries[4], the Central America countries[5], the countries of the Association of Southeast Asia Nations[6] (ASEAN),

[1] Afghanistan, Algeria, Andorra, Azerbaijan, the Bahamas, Belarus, Bhutan, Bosnia and Herzegovina, Comoros Islands, Equatorial Guinea, Ethiopia, Iran, Iraq, Kazakhstan, Laos, Lebanon, Liberia, Libya, Montenegro, Russia, Samoa Islands, Sao Tome and Principe, Serbia, Seychelles, Sudan, Syria, Tajikistan, Uzbekistan, Vanuatu, Yemen

[2] Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia and Turkey

[3] Iceland, Liechtenstein and Norway

[4] Bolivia, Colombia, Ecuador, Peru

[5] Costa Rica, Guatemala, Honduras, Nicaragua, Panama and El Salvador after their accession to the Central America economical integration process

[6] Burma, Brunei, Cambodia, Indonesia, the Philippines, Laos, Malaysia, Singapore, Thailand and Vietnam

South Korea, the countries of Southern Common Market[1] (*Mercosur*), India, Canada, Libya, the Gulf Cooperation Council countries[2] (GCC), Ukraine and Mediterranean countries[3], as well as negotiations on economic partnership agreements (EPA) with the African, Caribbean and Pacific Group of States (ACP). In the near future, it is planned to launch negotiations on preferential trade agreements with Armenia, Georgia and Moldova, and after the accession of corresponding countries to the WTO – also with Azerbaijan and Russia.

It should be noted that the EU-China FTA has been initiated on October 15, 2009 and it is planned that it could be applied on a temporary basis from autumn 2010 till the moment when the ratification procedure will be concluded. Negotiations on trade among the EU-*Mercosur* that were stopped pro term in September 2004 due to unwillingness of the parties to mutually cede on ambitious market access provisions have been restarted on May 4, 2010. However an agreement on concluding negotiations on trade has been achieved within the framework of EU-Central America Association agreement negotiations on May 18, 2010.

Bilateral economic relationships of the EU and its most significant global partners are promoted with the mentioned agreements, as well as in the framework of standard Regulatory Dialogues.

Thus, implementing the policy strategy adopted by the EU in 2006 with respect to economic relations with **China**, in 2007, negotiations were launched on conclusion of the PCA, and that also includes the revision of the EU-China Agreement on Trade and Economic Cooperation concluded in 1985. In 2008 the EU-China High Level Economic and Trade Dialogue was established aimed at solving issues of strategic importance in the framework of trade and economic relationships between the EU and China, as well as promoting the development of different sectors. In the framework of this dialogue, the EU and China discuss mutually important issues with respect to investments, market accessibility, protection of intellectual property rights, etc.

A significant instrument for promotion of the EU and **Japan** bilateral relationships is the EU-Japan Regulatory Reform Dialogue launched in 1995 with the aim of decreasing regulatory barriers impeding mutual trade and investment flow. The standard meeting of the Regulatory Reform Dialogue took place in Tokyo (Japan) on February 4, 2010. In the meeting, proposals submitted by the EU covering such issues as transparency of public procurement in Japan, competition provisions in the postal sector and quality and safety standards on foodstuffs were reviewed.

The EU economic cooperation with the **USA** takes place in the framework of the Transatlantic Economic Council (TEC) established in 2007. TEC's task is to achieve harmonisation of the EU and US regulations, as well as to promote development of the trade and enterprise dialogue between the parties in such fields as intellectual property, trade security, financial markets, innovations and technologies, as well as investments. Up to now, four meetings of the TEC have taken place, the most recent – in October 2009.

Promotion of the third country market accessibility

Within the framework of the EU Market Access Strategy, renewed on 2007, corresponding instruments for determination, reduction and/or elimination of trade barriers ensuring market access have been applied, in order to ensure more effective market access for the EU exporters, *inter alia* also for the Latvian exporters in the third country markets.

For strengthening the market access, partnership is continued also in 2010 by promoting cooperation between the EC, EU Member States, business representatives, economic diplomats and other interested parties. In the first half of 2010, already 13 Workgroups[4] and 31 Market Access Teams[5] participated, solving those particular issues for the EU entrepreneurs, which are related to trade barriers in the third countries, as well as matters of various sectors and regions.

In complying with the third country trade restrictions by applying stricter and new measures, the harmonized and purposeful action is essential for trade barrier identification, information exchange, faster evaluation and prevention. For this purpose, the EC continues supervision of trade policy instruments of world countries starting in 2009. The sixth so-called *Early Warning Report* on existing and planned measures restricting trade in the third country markets was drawn up in May 2010. The abovementioned reports are issued and updated on a regular basis basing on the EC Market Access Team, which acts in the markets of third countries, as well as on information rendered by the EU Member States, business associations and exporters, including information rendered by Latvia. In accordance with the latest report, a number of countries, especially Russia, Argentina, USA and China, have implemented or are planning to strengthen the internal market protection measures. These measures are usually implemented as an increase

[1] Argentina, Brazil, Paraguay, Uruguay and Venezuela
[2] Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates
[3] Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Syria and Tunisia
[4] Formed workgroup in the area of the EU Market Access – SPS/Products of Animal Origin; SPS/Products of Plant Origin; Vaccine/Japan; Medical devices/India, China, Korea, Taiwan, Brazil and Turkey; Electronics and Information and Communication Technologies/Turkey and China; Tyres; Motor vehicle industry, Postal services; Distribution services; Textiles; Wine and spirituous beverages; Leather; Chemistry sector
[5] EU Market Access Teams acts in Argentina, Australia, Brazil, Chile, Canada, Colombia, China, Egypt, India, Indonesia, Israel, Iceland, Japan, Kazakhstan, Korea, Mexico, Morocco, New Zealand, Nigeria, Norway, the Philippines, Russia, South Africa, Switzerland, Taiwan, Turkey, Tunisia, USA, Ukraine, Venezuela, Vietnam

of import duty, import licensing, public procurement procedure, investment restrictions, non-transparent certification procedures, support measures for domestic exporters, protection measures for internal markets and anti-dumping measures.

Taking into account the importance of the EU's trade policy reducing trade barriers in the third countries and development of planned international trade environment, a discussion on topical common trade policy matters pointing out their importance to Latvian export development was performed by the Latvian entrepreneurs on June 17, 2010. This discussion was performed within the framework of the annual business forum organized by the Ministry of Economics and the IDAL and it was supported by the EC Directorate General for Trade.

Economic cooperation agreements of Latvia and the third countries and regions of the third countries

In order to activate the bilateral economic cooperation after the accession to the EU, Latvia has concluded bilateral economic cooperation agreements with Russia, China, Belarus, Ukraine, Kazakhstan, Azerbaijan, Georgia, Moldova, Uzbekistan, Kyrgyzstan, Turkmenistan, Tajikistan and Armenia.

These agreements are the most important umbrella agreements regulating bilateral economic cooperation and comprising cooperation in industry, tourism, transport, pharmaceuticals, agriculture, financial services, communications, professional training, investment policy, technologies and innovation and other fields.

Economic cooperation agreements concluded between Latvia and the third countries require establishment of an Intergovernmental Commission (IGC) and/or Joint Committee, which ensures supervision of validity of these agreements and opportunities to analyse how to improve further cooperation (see Box 6.4)

Box 6.4

Current activities of intergovernmental commissions of Latvia and third countries

The main current activities from 2009 until the beginning of 2010 were the following:

– The 4th meeting of the **Latvia-Russia** IGC in the areas of economic, scientific and technical, humanitarian and cultural cooperation will take place in Pskov on June 4, 2010. The Latvia-Russia business forum for entrepreneurs took place on June 3, 2010.
  The meeting of Latvia-Russia IGC co-chairpersons took place in Moscow on April 20, 2010, in order to discuss the topical issues that should be included in the agenda of the 4th Latvia-Russia IGC meeting. The ministers discussed perspectives for the promotion of bilateral economic cooperation and recognized the importance to promote exchange of information on the export and investment opportunities, as well as to broaden the business contacts. It was decided to activate harmonization process of the agreement in order to facilitate trips by the frontier territory inhabitants. Within the meeting, the ministers discussed possibilities to simplify export of foodstuffs and other products from Latvia to Russia, as well as to deepen cooperation in the transport sector, *inter alia*, increase the amounts of cargo carriage by railroad. The IGC co-chairpersons also discussed issues related to expansion of the Latvia-Russia economic cooperation contractual base and expressed an interest to conclude a bilateral cooperation agreement on double taxation, cooperation in the tourism sector, environment protection, etc. as soon as possible.
  The 5th meeting of the IGC Economic Cooperation Workgroup took place in Moscow on April 28, 2010, within the framework of which the parties discussed matters of economic situation in both countries, measures implemented by the governments in order to recover economy and to raise competitiveness, increase turnover of bilateral trade, the possibilities to promote supplies of Latvian foodstuffs in Russia, as well as directions of cooperation in the area of energy, tourism, construction, standardization, accreditation and metrology.
  Within the framework of IGC, a Regional Cooperation Workgroup was formed, thereby fulfilling the agreement reached during the 3rd IGC meeting. The aim of the Workgroup will be to promote regional economic cooperation, *inter alia* investment projects for regional cooperation between Latvia and Russia, and cooperation between the governments of Latvia and Russia. The meeting of the heads of IGC Regional Cooperation Workgroups, in which the parties agreed to organize the first meeting in Pskov on June 3, 2010, took place on May 20, 2010;
– On November 20, 2009, the 7th meeting of **Latvia-China** Joint Committee took place in Riga. The agenda of the meeting included topical issues on bilateral economic cooperation of both countries in trade, investments, industry, transport, transit and logistics, tourism, agriculture. Taking into account the fact that the imports from China to Latvia significantly exceed exports, the parties came to an agreement to consider further export possibilities of Latvian goods into the market of China. After discussing development of cooperation in the area of transport, representatives of Latvia and China recognized the necessity to pay more attention to the development of inland cargo transport, as well as they paid attention to the good possibilities of Latvian ports to organize transit of Chinese goods from Latvian ports to Russia and other CIS countries. Moreover, possibilities for further development of container traffic between the Baltic region and China, to attract cargo flow from China in the direction of EU, were discussed. The existing cooperation between Latvia and China in the sphere of industry was evaluated positively, and the parties recognised that it would be useful to expand cooperation in the areas of food industry, pharmaceutics, engineering industry and metal working, information and communication technologies and engineering. The parties agreed to bilateral cooperation by forming workgroup on agriculture in order to develop cooperation in agriculture.

Box 6.4 continued

– On April 22-23, 2010, the 3rd meeting of the **Latvia-Kazakhstan** IGC on the areas of economic, scientific and technical cooperation took place in Riga. During the meeting the representatives of both countries approved already implemented measures, especially in the area of cargo carriage by railroad, by pointing out the successful activity of the container train "Baltika-Transit". During the meeting, experts of both countries discussed matters on the customs union created by Russia, Belarus and Kazakhstan, the planned accession of Kazakhstan to the WTO, as well as cooperation in such areas as investment development, trade, electronic signature and rendering of other certification services, language software technologies, evaluation of construction materials and construction products according to EU standards, education, and health care services. The commission supported the proposal of the Employers' Confederation of Latvia to create Latvia-Kazakhstan Business Council in order to promote economic cooperation and business contacts between the entrepreneurs of both countries. The following IGC meeting is planned in 2011.
The Latvia-Kazakhstan Business forum took place at the same time as the IGC meeting. Within the framework of the forum the present persons were informed about the business environment in Latvia, economic development of Kazakhstan and future perspectives, impact of customs union created by Russia, Belarus and Kazakhstan on trade and economic relationships between Latvia and Kazakhstan, etc. A bilateral meeting of entrepreneurs from Latvia and Kazakhstan was held in the continuation of the forum. Kazakhstan's delegation within the framework of visit attended the Freeport of Riga, Riga International Airport and the airline corporation "AirBaltic".

Although Latvia and Russia have concluded an agreement on economic cooperation, there is active cooperation also with the regions of the Russian Federation. On April 9, 2008 an agreement on economic cooperation with the government of Vologda Oblast was concluded, and it is planned to sign an agreement with Pskov Oblast on June 2010. Negotiations are currently held also with the governments of Kirov, Ivanovo and Yaroslavl Oblast, as well as with the government of Bashkortostan Republic regarding a conclusion of an agreement in the field of economic cooperation. In the second half of 2010, the IGC meetings will be performed with Ukraine and Belarus.

Sectoral issues of the EU foreign trade

Steel

The elasticity and multiple processing of the steel makes it one of the most widely used industrial raw material in the world. The sector of metal industry forms a part of the general European competiveness in all links of the value chain, besides, the EU is the second largest steel producer in the world after China.

The EU is currently applying quantitative restrictions on imports of particular steel products from Russia and Kazakhstan. In October 2007, the EU and Russia concluded an agreement on steel trade for 2007 and 2008, as well as agreed on its extension for 2009 and 2010, envisaging an annual increase of 2.5% in quotas. In 2010, the quotas for Russia were determined in the amount of 3.2 million tons. As regards Kazakhstan, autonomous measures are currently being applied, and the import quota has been determined in the amount of 0.2 million tons. After accession of Russia and Kazakhstan to the WTO, the EU steel agreements with these countries will lapse automatically. The EU applies the Prior Surveillance system for the import of particular steel products from all third countries for the purpose of steel flow monitoring.

Textiles

Products of the textile industry are among the most marketed goods in the global economy. The EU is the second largest exporter of textile goods in the world after China, dominating in the world in high income and high quality textile goods and clothing markets. The main EU activities in the area of textiles and clothing are related to the removal of barriers for the export of European textile goods to growing markets and development of corresponding regulations for protection of intellectual property rights.

For a long time, in the multilateral negotiations of the WTO, the textile and clothing sector was an exception for the progressive trade liberalisation of industrial goods until 1995, when the developing countries achieved that the WTO Member States gradually introduce complete trade liberalisation of textile goods over a period of 10 years. However, until December 2007, the EU textile trade restrictions on certain textile goods particularly sensitive towards the rapid growth of import flows from China were extended, but as of January 1, 2009 the licensing requirement for imports of textile goods originating from China has been fully cancelled. Since May 5, 2010 the double-checking system (licensing) without quantitative restrictions applied to the imports of certain textiles originating from Uzbekistan has been cancelled. Therefore, the EU is currently applying quantitative restrictions only to the imports of textiles from Belarus and North Korea. It must be noted that these countries are not the WTO Member States, besides they are recognised to be violators of human rights and democracy principles.

Trade Defence Instruments

Trade Defence Instruments of the European Community

In the EU, as well as in the majority of other countries in the world importing goods and raw materials from abroad, a system of trade defence instruments (TDI) is in place, providing for anti-dumping, anti-subsidy measures and domestic market defence measures.

The aim of the anti-dumping and anti-subsidy measures is to protect the producers in the EU from losses caused by unfair competition from the enterprises of the third countries or subsidies granted by governments. The determinant reason for application of domestic market protection measures is an increase of imports causing losses to domestic producers, but which do not manifest the signs of unfair competition.

At the beginning of 2010, in the EU, in total 135 anti-dumping and 8 anti-subsidy measures were applied to various products of other countries. More than a half of the abovementioned measures were applied to China, India, Indonesia, Russia, Taiwan, Thailand and Ukraine. Mainly iron and steel, as well as chemical industry products are subjected to the defence measures.

Although in Latvia the producers and consumers of goods alike are affected by the TDI procedures, the most essential economic interests of Latvia involve imports and industrial use of the goods subjected to the TDI. In the first half of 2010, the most significant are the following:

- anti-dumping inspection with respect to imports of ammonium nitrate from Ukraine. Since Latvia joined the EU, Latvia has never supported implementation of duties to the import of ammonium nitrate, because half of all ammonium nitrate consumed by Latvia is imported from another country subjected to anti-dumping duty – Russia – and the EU's imposed duty causes substantial increase of price for its end-users – farmers. Increase of prices for artificial fertilizers is forcing many farms in Latvia to choose cheaper alternatives or to reduce the doses of fertilizers unjustifiably, thereby the crop capacity has been affected essentially and resulting from that, also the competitiveness of the farms;
- anti-dumping inspection with respect to imports of cargo scanning systems from the People's Republic of China. Taking into account the fact that the cargo scanning systems are mainly used by the state customs offices, it is essential for Latvia to maintain alternative sources for their acquisition, because there are only three such sources in the world. Latvia did not support implementation of such duty because the usage of cargo control scanners is one of the most effective measures how to control undeclared goods and to take preventive measures that are necessary for the performance of everyday works within the customs offices.

Trade Defence Instruments applied by the third countries

Similarly to the EU, which applies trade defence measures, also other third countries may apply defence mechanisms, either against all exporters of the respective EU product (e.g., defence measures of the internal market) or against exporters of the specific product of a particular EU Member State (e.g., anti-dumping measures).

The economic interests of Latvia are most considerably affected by the anti-dumping measures introduced by the USA in 2001 with respect to imports of steel bars from the EU. In accordance with repeated reports of the WTO Disputes Settlement Institutions, the anti-dumping duty calculation method used by the USA has been recognised as unjustified and non-compliant with the WTO's norms, and must be revised in the near future. Although the USA since June 2, 2009 has slowly started implementation of the WTO's recommendations, the result is still unsatisfactory. On January 29, 2010 the EC has asked the WTO for permission to implement sanctions against the USA exported products to the EU, relating to the non-fulfilment of liabilities. In the corresponding stage, discussions on a particular list of goods are not held, but the amount of sanctions is discussed.

6.2.3. Internal Market of the European Union

The EU internal market – a cornerstone of European integration – is acknowledged to be one of the most significant and successful EU projects. The EU internal market currently comprises 30 countries (including European Economic Area countries – Norway, Iceland and Liechtenstein) with approximately 500 million consumers and it encompasses a territory without internal borders where free movement of goods, persons, services and capital is ensured. After long and serious work, a unified set of regulations is obtained within the framework of the EU for performers of economic activity – border control has been cancelled, more competitive business environment is established, 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 for residents, an opportunity to introduce single currency has been established, as well as many other benefits have been provided. However, the potential of the internal market has not been fully exploited yet and its improvement is continuing by promoting sustainable and stable development of the EU economy and prosperity for EU citizens.

In Latvia, implementation of internal market directives is taking place successfully and sufficiently high results have been achieved regarding the transposition efficiency of the directives. Among 27 countries, Latvia has taken the 12th place with the deficit of directive transposition of 0.7%, thus already ensuring the 2009 Lisbon target to transpose 99% of the directive requirements or to allow the directive transposition deficit of 1%. Latest information regarding the process of directives transposition in Latvia will be rendered by the European Commission in this summer.

In Latvia, the process of implementing the principles of free movement of goods and services and the right of establishment, which arise from Articles

28-30 and Articles 43-55 of the *Treaty Establishing European Community*, is supervised and coordinated by the Ministry of Economics by constantly identifying legal regulations that may potentially or actually hinder implementation of the freedoms in the EU internal market, *inter alia*, by assessing the legislative acts currently in a draft stage.

The procedure for announcing technical regulations (*Directives 98/34/EC* and *98/48/EC*), which prescribes the obligation of EU Member States to submit draft technical regulations to the European Commission and other EU Member States, as well as European Economic Area countries for further assessment, serving as a preventive, single and transparent monitoring instrument, in order to assess and avert inclusion of such requirements into the normative acts, which have the potential to create barriers to free movement of goods, as well as to the freedom to provide information society services. Any business, not only the responsible authorities of the EU, may take part in this 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 exports of products or the cross-border provision of information society services. Information on draft technical regulations of the Member States is freely accessible on the *Technical Regulations Information System (TRIS)* database. TRIS database is a free service and can be accessed on *www.europa.eu* portal. The majority of the notified draft technical regulations are available in all EU languages.

From May 1, 2004 until June 1, 2010, Latvia has notified the European Commission about 88 draft technical regulations and received detailed opinions from the European Commission in 17 cases. In most cases, the detailed opinions of the European Commission related to the fact that draft laws and regulations did not comprise the principle of mutual recognition, which prescribes that products legally manufactured or placed in circulation in one of the EU Member States or Turkey, or legally manufactured in one of the European Free Trade Association countries, which is a contracting party to the European Economic Area Agreement, should be recognized in Latvia.

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 practices of the national competent authorities, after a recommendation of the European Commission and with the support of the EU Member States, the European Parliament and Council Regulation (EC) No. 764/2008 *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 was enforced on September 2, 2008. Thereby, a substantial step was taken towards introduction of a new legal instrument at the EU level. The 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 set the procedure, whereby the principle of mutual recognition must be observed in the work of public authorities by applying the national technical regulations to the goods lawfully manufactured in the European Economic Area countries, or put into free circulation, distribution of rights and obligations among the national competent authorities and performers of economic activity within the framework of 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 information points for the informative support of performers of economic activity. The function of the product information contact point in Latvia is currently performed by the Ministry of Economics (e-mail: *pcp@em.gov.lv*).

In order to promote business activity and innovations in the service sector, as well as to promote gradual modernisation and simplification of public administration, one of priorities set for Latvia within the EU is promotion of **free movement of services**.

The European Parliament and Council *Directive 2006/123/EC* on services in the internal market is essential for Latvia among EU legal acts of the recent years, and must be implemented by the state before the end of 2009. The *Law on free rendering of services* was enforced on May 4, 2010, which allows implementing the requirements of the directive in horizontal legislation. The directive is aimed at creation of legal regulations, necessary to promote implementation of rights of establishment and free movement of services within the EU internal market. Implementation of this Directive may give a positive contribution in the sector of cross-border economic activities in the services sector, as well as in improvement of business environment, particularly in decreasing the administrative burden for businesses.

In order to implement the requirements of the Directive, on April 28, 2009 the Cabinet of Ministers adopted a concept *Establishment of a one-stop-shop in compliance with provisions of the Directive 2006/123/EC of the European Parliament and of the Council of December 12, 2006 on services in the internal market*, which provides creation of one-stop-shop by the state institutions, allowing service providers to perform administrative procedures remotely by using electronic means. By implementing the principle of one-stop-shop, the performers of economic activity will be able to reduce the administrative procedure costs and increase the quality of services provided. By using the advantages of one-stop-shop, service providers and customers will receive the information about requirements and procedures laid down by the state faster and easier. Currently, single control points operate in 22 Member countries (including in Latvia, portal *www.latvija.lv*).

Amendments to the existing normative acts were introduced in addition to implementation of the concept and to fulfilment of requirements by the Services Directive, setting the procedure for issuing permits and reviewing the number of documents to be filed, implementing the principle of good administration and the principle of information openness, as well as ensuring the procedure of document movement in electronic form, between the performers of economic activity and the responsible institution, as well as between the administrative institution and the performer of economic activity.

In order to facilitate starting and performing business activity, the existing administrative barriers and procedures are continuously reviewed by accordingly eliminating and simplifying the requirements for the issue of permits (licences, certificates, certifications and other documents), as well as by creating an opportunity to settle all the required procedures electronically. The permits terminated in certain spheres are planned to be replaced by open-ended term licenses and the permit prolongation procedures are being simplified, as well as the list and amount of the documents to be submitted is reviewed.

In order to improve the administrative cooperation abilities of the public administration institutions of the European Communities, since November 2007, in Latvia, the **Internal Market Information (IMI)** system has been established and is available, system ensures secure and fast exchange of data among the European institutions allowing effective communication despite the barriers created by differences of languages and administrative structure. The Member State authorities can verify authenticity of company documents submitted by persons and issued in another Member State or solve other problems by communicating with the country of origin using IMI, which means that the entrepreneur does not need to go back to the country of origin to receive an additional certification and to certify it at a notary, etc. At the moment, work on ensuring IMI system's *Warning mechanism* activity and identification of involved institutions within the Member States is carried out. *Warning mechanism* of the IMI system has been worked out in order to ensure effective supervision and protection of services receiver by informing the Member States on activities of services that can inflict harm on personal health, safety, or environment. Currently, 45 institutions are registered in the IMI system: 8 – in the sphere of professional qualification; 34 – in the sphere of services; 3 – in the sphere of professional qualification and services. The national coordinator of the IMI system and the coordinator of the IMI system's *Warning mechanism* is the Ministry of Economics. As of May 2010, 26 requests for information were registered in Latvia within the IMI system.

In the first half of 2010, in the **SOLVIT Coordination Centre of Latvia** 13 cases have been submitted, from which 9 are closed, but 4 are still being solved. Two of the closed cases have been solved, one is closed as unsolved, 6 cases have been rejected because they did not conform to the provisions for SOLVIT case solution. The number of complaints on residence permits for the family members of Latvian citizens, as well as on benefits in other Member States has noticeably increased within the 2009 and in the first half of 2010. Also in 2010, SOLVIT continues the information campaign started in the previous year by informing the society on the activity of SOLVIT in various seminars, as well as by using mass media. The task of the SOLVIT network is to find a quick and practical solution for EU internal market problems emerged as a result of operations of public institutions by incorrect transposition of legal regulations of the European Community. SOLVIT solves problems of both residents and entrepreneurs, and SOLVIT services are free of charge.

6.3. Sector-Specific Development Policies

6.3.1. Industrial Policy

Industrial policy in Latvia is developed in accordance with the policy development directions of the European Union and is closely connected with innovations, business activity, education, science and other policies. Thus, in identifying and solving the issues that are urgent for local industrial enterprises, it is important to cooperate constantly with the organizations, which represent the industrial enterprises.

Currently discussions are held about and work performed with the *EU2020* strategy and its Integrated Guidelines. The development of the national reform programmes of the EU member states will be based on the key elements of the *EU2020* strategy (see Chapter 6.1.).

One of the Integrated Guidelines of the *EU2020* strategy envisages the necessity of improving the business and consumer environment as well as modernizing the industrial base. It is stipulated that the member states have to support an industrial base that is up-to-date, varied, competitive, and effective as regards to resources and energy. For this reason, the member states have to do everything in order to partially enlighten the industrial restructuring, fully observing the EU competition regulations. In order to achieve this goal not only the available EU resources have to be combined, but also full cooperation with different industrial sectors and other involved parties must be in place.

The national position of Latvia *On the Integrated Guidelines* expresses the opinion that the transition to a modern industrial base has to be gradual and carefully considered, besides such a course of action cannot become an additional burden for the industrial enterprises of the EU member states thus reducing their competitiveness. An adequate financial support has to be ensured for more successful industrial transition to a modern, eco-efficient economy, for example, mobilizing resources of the Structural Funds already available in the EU member states, as well as the perspective resources.

On March 1-2, 2010 the EU Competitiveness Council adopted *Council Conclusions on the Need for a New Industrial Policy*. Conclusions state that for the European economic development and increase of competitiveness such an industrial base has to be developed, which is integrated and competitive, but at the same time strong, modern and versatile, and which would promote excellence, innovation, business and sustainable development.

According to the conclusions, the horizontal industrial policy initiatives have to be viewed within the sector context, taking into account both the different conditions in various industrial sectors and the need to ensure closer coordination between the industrial and technological policies of the member states. At the same time, the conclusions include the explicit need to ensure better and unimpeded access to raw materials, including promotion of sustainable management of raw materials. For the first time, the European Commission in these conclusions is invited to develop a special *Strategy in the Sector on Clean and Energy Efficient Vehicles*.

On May 25-26, 2010 the EU Competitiveness Council adopted *Council Conclusions on Clean and Energy Efficient Vehicles for a Competitive Automotive Industry and Decarbonized Road Transport*. These conclusions of the Council are the first step in launching development of clean and energy efficient transport initiative at the European level. Latvia's main position concerning this issue is to implement clean and energy efficient European transport policy in such a way, that those EU member states, where the automotive manufacturing or access to respective infrastructure is not developed, also would benefit from this implementation. For this reason, it is essential to summarize and employ previously elaborated concepts and competences already existing in each member state, in order to ensure sooner availability of clean, energy efficient and environmentally friendly vehicles in the market and to promote full involvement of all member states in the implementation of the initiative.

Amendments to the **EU Emission Trading System** Directive adopted at the end of 2008 (*Directive 2009/29/EC*) are especially important for the energy-intensive sectors. One of the key issues in the Directive is to establish a common system for allocation of emission quotas and to identify those energy-intensive sectors that are subject to increased carbon leakage risk or risk to delocalize production outside the EU due to additional costs and loss of competitiveness that may be caused by direct or indirect participation in the EU emission trading system. The Directive includes quantified criteria for determining the sectors subjected to the carbon leakage risk, taking into account their involvement in the international trade and expected increase of expenses.

On September 18, 2009, the Working Group of the Committee on Climate Change of the European Commission voted on the European Commission draft decision regarding the list of sectors subjected to significant carbon leakage risk, which will be entitled to apply for free CO_2 emission quotas. The vote confirmed such energy-intensive sectors and subsectors important for Latvia as steel production, cement production, glass and glass fibre production, as well as production of plywood and wood-chip boards.

In order to explore development possibilities of the **military industry** of Latvia, a study *Development Opportunities of Defence and Related Sector Industry in Latvia* was performed in autumn of 2009 (see Box 6.5). The study was concluded with an international conference. The study analyzed offset policy in the EU member states and provided suggestions for offset policy development and implementation in Latvia. In order to apply offset to procurements of military goods (listed in a special list according to the Article 346 of the *Treaty on the Functioning of the European Union*), amendments were prepared in the Article 4 of the *Public Procurement Law*. The amendments introduced in the *Public Procurement Law* formed the basis for development of regulations of the Cabinet of Ministers on offsets. The decree of the Minister of Economics established a working group, which was due to elaborate a draft of regulations of the Cabinet of Ministers till July 2010. The working group comprises experts from different public institutions, as well as organizations representing employers and industrial enterprises from various sectors.

As regards international projects, the Ministry of Economics and the Investment and Development Agency of Latvia are involved in implementation of the cross-border leading programme *Baltic Sea Region Programme for Innovation, Clusters and SMEs Networks* (BSR Stars) launched within the framework of the Operational Programme's priority *Full usage of the Regional Research and Innovation Potential* of the EU Baltic Sea Region Strategy. The programme envisages launching implementation of several components, including development of the transnational cluster cooperation in the Baltic Sea region. For implementation of the programme, several working groups were developed (*Task Force*) and the Ministry of Economics participated in the cluster working group.

From September 2009 till December 2009 the Ministry of Economics supported implementation of 9 projects within the framework of the *Cluster Development Programme*. In order to apply for co-financing, the applicant had to meet the following basic requirements: must operate in any of the determined national economy sectors; must guarantee involvement of an expert experienced in similar project management; and must meet such economic criteria as export proportion, turnover amount, and number of employees.

Box 6.5

Study *Development possibilities of defence industry and related sectors in Latvia*

The study analyzed the actual and potential capacity of Latvian industrial and research sectors to provide goods and services to the armed forces of Latvia, the EU and other NATO Member States and to participate in the defence industry supply chains.

The analysis of the study shows that in Latvia the defence industry sector does not exist in its traditional sense as a system for production of arms, ammunition, and military goods. The majority of the analyzed sectors is represented by enterprises participating in the defence markets indirectly, either by supplying the armed forces with civil goods or by operating on different levels of the defence industry supply chain.

Although in Latvia the defence industry is not directly represented, the study has led to a conclusion that the defence markets offer additional opportunities for the industry of Latvia, especially as an export market for Latvian goods and services. The study does not recommend artificial development of the military production on the state policy or investment base, but rather to develop it by using the existing opportunities that can be evolved in the future as additional opportunities by using the defence market.

A special section of the study was devoted to the offset policy. An offset is defined as a claim put forward to the foreign military production supplier to compensate the public expenditures created by production supply of military nature by performing activities that promote the local industries, development of services and research sectors, as well as the improvement of the state's external balance of payments. It is based on an agreement where the supplier agrees to compensate the value of the purchase to the purchasing state economy by ensuring participation of the local enterprises in the production process, buying the production of the local enterprises, promoting investments in the state economy or in any other way ensuring the return of funds back to the purchasing state economy.

The analysis of the offset policy in the EU Member States and the development of the regulatory and political framework in the EU allow concluding that offsets could be used for certain defence equipment procurements when procurements of LVL 5-10 million are being planned. In Latvia, the task of the offset policy would be establishment of long-term relationships among Latvian enterprises and defence industry following the principles set forth in the Code of Conduct on Offsets of the European Defence Agency (EDA), in order to support participation of SMEs and unconventional suppliers in the European Defence Technological and Industrial Base, to promote the industrial cooperation and to support the lower level suppliers in accordance with the Code of Best Practice in the Supply Chains.

In 2010 the Ministry of Economics continues also to support cluster development. From April 1, 2010 till April 26, 2010 a call for proposal *Conclusion of Co-Financing Contract for the Implementation of Cluster Development Programme* was announced. The societies and establishments registered in the Latvian Register of Enterprises could apply for concluding the contracts and for funding. For the call for proposals, the Ministry of Economics received 9 project applications for cluster development. After project evaluation and approval, the Ministry of Economics will start the conclusion of contracts for granting co-financing. The aim of the *Cluster Development Programme* is to promote cooperation of unrelated sector enterprises and related institutions (education and research institutions) supporting implementation of common projects, thus promoting faster growth of competitiveness of the sectors and indirectly enterprises themselves, increase of export volumes, and innovations and production of new products.

Implementation of structural reforms in the higher education is continued in order to link the national economy priority sectors with education and science system by developing applied research in the sector of new technologies, and to create prerequisites for scientific research in priority sectors and sectors with development perspectives.

The informative report *On the Necessary Structural Reforms in the Higher Education and Science in order to Increase the International Competitiveness of Latvia* submitted by the Minister of Economics was reviewed and accepted for information in the meeting of the Cabinet of Ministers on January 12, 2010. But the *Draft of Action Plan for the Necessary Reforms in Higher Education and Science* developed by the Ministry of Education and Science was announced during the meeting of State Secretaries on April 15, 2010. The Action plan is the starting point in implementation of long-term structural reforms as a short-term policy planning document. The project of Action plan includes four main directions of action: (1) improvement of research and scientific operation quality; (2) modernization of the material and technical base of higher education and science institutions and increasing the efficiency of resource usage; (3) internationalization of higher education and increase of export capability; (4) integration of higher education and science sectors in the national economy and society development.

Currently at the European level, **the space industry** holds strong positions and it is highly technologically developed and offers various space technologies, for example, manufacturing of satellites for commercial purposes. Also in the future, space and space-related services are considered to be a perspective direction of the industry and business. In order to promote elaboration of state national space policy and its implementation, the Ministry of

Education and Science has established the *Working Group for National Space Technologies Development*. At the moment, the working group is elaborating the draft informative report for submission to the Cabinet of Ministers. This draft could form a basis for development of the national space policy framework in the future.

The necessity for space policy framework at a national level is also a requirement of the European Space Agency (ESA), in order for Latvia to become a full member state of the ESA. To establish the legal basis for cooperation of Latvia and ESA on study and peaceful usage of outer space, as well as to create prerequisites for implementation of common projects, the ESA and the Government of the Republic of Latvia has signed a contract already in summer of 2009 on the study and utilization of outer space for peaceful aims. As Latvia becomes a cooperating state of the ESA (PECS) or in the more distant future – a full member state, not only the Latvian research institutions, but also its enterprises would be able to participate in the ESA project tenders for development of space research, technological development and innovation.

Several enterprises in Latvia having sufficient potential to take part in development and provision of space-related technologies and services have already been explored. The most perspective enterprises are, for example, the LLC "Bruker Baltic", which can offer engineering of material, components and optics for space technologies, the LLC "Sidrabe", which operates in the sector of designing and manufacturing of non-standard vacuum coating devices, the JSC "Neomat" produces nano-powders, which can be used in aviation and space technologies, and the LLC "RD Alfa", which manufactures integrated electronic systems, as well develops and stock-produces high quality microchips for aerospace programmes. Among the strongest Latvian research institutions being able to participate in the ESA projects, the following should be named: Institute of Physics of the University of Latvia and Institute of Astronomy of the University of Latvia, several institutes of the Riga Technical University, the Latvian State Institute of Wood Chemistry and the Ventspils International Radio Astronomy Centre of the Ventspils University College.

An important aspect for improved industry competitiveness is the usage of **industrial design** in enterprises, thus increasing the value added of the end product and international competitiveness. For implementation of the *Competitiveness and Innovation Framework Programme 2007-2013*, several activities are being carried out, e.g., the creation and maintenance of the industrial design portal *www.designlatvia.lv*, consultations and design audits in enterprises. For example, within the framework of the project *Design Bus* (*Dizaina autobuss)* by the Investment and Development Agency of Latvia, also in the year 2010, the Latvian designers have an opportunity to visit manufacturing enterprises of different sectors in Latvia. In May 2010, 17 Latvian designers visited the following enterprises: "Edelveiss EG", "Grandeg" and "Ripo1". The aim of the project is to promote cooperation among designers and entrepreneurs, to promote exchange of experience, knowledge and ideas that would be transformed into competitive products and services.

The Investment and Development Agency of Latvia has supported Latvian designers by developing a common Latvian fashion design panel in one of the most important international fashion and design accessory exhibitions *Rooms*, which took place in Tokyo, Japan on February 8-10, 2010. This year was the first when Latvian representatives took part at the exhibition, where the participation was approved by a panel of judges that was established by exhibition organizers.

Such internationally and nationally recognized Latvian brands and fashion designers were presented at the exhibition as Mareunrol's, Frazzo, KatyaKatya Shehurina, Hypnosis, and Irēna Gaša. During the exhibition, the designers established more than 150 new contacts, and in addition, some of the collections have already received the first orders and soon will be available for purchase in the shops of Japan.

In the first half of 2010, the Investment and Development Agency of Latvia organized a visit of Japanese purchaser, the owner of the shop "Riga Collection" to Riga. As a result of this visit, not only new contacts were established, but also production was purchased from 15 Latvian enterprises. Individual visits of the design enterprises "IBBA" and "Ars Tela" to Austria, Germany and Italy were also organized.

6.3.2. Energy Policy

The main directions of the energy policy (see also Chapters 3.2.3. and 6.9.) are aimed at improving security of energy supply of the country by encouraging diversification of supplies of the primary energy resources and creating conditions for increasing self-provision of power generation, as well as preventing isolation of the regional power market through new interconnections. Creation of competition conditions, promotion of use of renewable and local energy resources and environmental protection also play a substantial role.

On June 27, 2006 the Cabinet of Ministers approved the *Energy Development Guidelines for 2007-2016*. The Guidelines contain the government policy, development objectives and priorities in the sphere of energy both in the medium-term and long-term period.

In **power supply**, more than 90% of all power generated in Latvia is generated by the AS "Latvenergo", which also ensures import and supply of power to the consumers. Since September 1, 2005 all functions of the power transmission system operator are performed by AS "Augstsprieguma tīkls". Since July 1, 2007, all functions of the power distribution system operator are taken over by AS "Sadales tīkls". The sole owner of both joint-stock companies is AS "Latvenergo".

Latvia being an EU Member State has to ensure compliance with the single requirements set in the EU legal acts concerning the energy sector in the country (see Box 6.6). In the sphere of power supply, it means that the power sector in Latvia operates in compliance with the provisions of an EU directive concerning promotion of utilisation of renewable energy resources for production of electricity, joint power market regulations, cogeneration based on the useful heat demand, as well as safety of power supply, and investment into the infrastructure.

Box 6.6

Harmonisation of normative acts with the EU directives

The key fields in harmonisation of legal acts with the EU legislation are oil and oil product reserves, security of supply, energy efficiency and introduction of market principles in the energy sector:

– **creation of oil product reserves.** On March 23, 2010 a new *Concept on Creation of State Oil Product Reserves* was approved by the Cabinet of Ministers. The decree No. 179 *On Concept on Creation of State Oil Product Reserves* of the Cabinet of Ministers of March 29, 2010 states that the Ministry of Economics should work out legislation till May 1, 2010 and till August 1, 2010 becoming effective on September 1, 2010, and the Ministry of Economics will start to fulfil the functions of Central reserves maintenance structure. From September 1, 2010, creation of centralized state oil product reserves will be implemented, fully transposing the requirements incorporated by the Council *Directive 2006/67/EC* of July 24, 2006 imposing an obligation for the Member States to maintain minimum stocks of crude oil and/or petroleum products, as well as partially transposing requirements incorporated by the Council *Directive 2009/119/EC* of September 14, 2009 2006 imposing an obligation on the Member States to maintain minimum stocks of crude oil and/or petroleum products;
– **power sector.** The *Electricity Market Law* and the regulations of the Cabinet of Ministers issued in association with the said law establish legal procedure for effectively operating a market in which power is supplied to all energy users safely, qualitatively and at justified price, and rights are ensured to choose the power traders freely, as well as to promote production of power by using renewable energy resources, and to create preconditions for increase in power supply safety. On August 15, 2009, Regulations No. 883 of the Cabinet of Ministers of August 11, 2009 *Regulations Regarding Permits for Increasing Electricity Production Capacities or the Introduction of New Production Equipment* came into force replacing the Regulations No. 695 of the Cabinet of Ministers of August 29, 2006 *Regarding Permits for Increasing Electricity Production Capacities or the Introduction of New Production Equipment*. In order to support power generation from renewable energy sources, in compliance with the Regulations No. 198 of the Cabinet of Ministers of February 24, 2009 *Regulations on Electricity Generation From Renewable Energy Resources and Energy Price Determination*, decisions have been passed in 2009 on assigning the right to sell electricity generated from renewable energy resources in the form of mandatory procurable electric energy volume – to 59 biogas power stations with the total installed power of 55.35 MW, by providing the annual procurement volume of electric energy up to 426275.636 MWh, to 32 biomass power stations with the total installed power of 32.28 MW, by providing the annual procurement volume of electric energy up to 236077.461 MWh, to 33 wind power stations with power of 162.5 MW, by providing the annual procurement volume of electric energy up to 212264.926 MWh, 2 solar power stations with the total installed power of 0.91 MW, by providing the annual procurement volume of electric energy up to 614 MWh, and to 53 hydroelectric power stations with the total installed power of 6494 MW, by providing the annual procurement volume of electric energy up to 25521.658 MWh. In total, in 2009, decisions to assign the right to sell electric energy generated from renewable energy resources in the form of mandatory procurable electric energy volume have been issued to 179 electric power stations with the total installed capacity of electric energy production 257.534 MW, by providing the annual procurement volume of electric energy up to 900753.681 MWh. Regulations No. 198 of the Cabinet of Ministers of February 24, 2009 *Regulations on Electricity Generation From Renewable Energy Resources and Energy Price Determination* will become invalid on April 1, 2010 according to the enforced Regulations No. 262 of the Cabinet of Ministers of March 16, 2010 *Regulations on Electricity Generation From Renewable Energy Resources and Energy Price Determination.*
– Regulations No. 221 of the Cabinet of Ministers of March 10, 2009 *Regulations* Regarding *Electricity Production and Price Determination Upon Production of Electricity in Cogeneration* are effective stipulating the criteria according to which cogeneration power stations are qualified to gain rights to sell the generated electricity within the framework of mandatory procurement or to receive a guaranteed payment for the power capacity installed at the cogeneration station, which also implement the European Commission Decision (December 21, 2006) establishing harmonised efficiency reference values for separate production of electricity and heat in application of the *Directive 2004/8/EC* of the European Parliament and of the Council on the promotion of cogeneration based on a useful heat demand in the internal energy market and amending *Directive 92/42/EC*;
– on May 15, 2008, the law *Amendments to Electricity Market Law* came into force. The amendments envisage that in case if safety of the state electricity supply is threatened by insufficiency of production capacities and there has not been possibility to compensate it by submitting permits for power production, which results from the report of the power transmission system operator, the government shall announce a tender on establishment of new production capacities or reconstruction of the existing equipment.. The winner of the tender will obtain the right to receive payments for the new power capacities. At the same time, the respective power producer will be entitled to participate in the electric energy market and sell the produced power at the agreed price to any participant of the electric energy market.

Box 6.6 continued

– Until 2020, it is necessary to implement in Latvia a new generating base powers for the amount that is not less than 400 MW, therefore Regulations No. 1112 *Regulations on Tender for Payment of Electricity Production Capacity to be Implemented* were adapted by the Cabinet of Ministers on December 22, 2008. Subject of the tender – payment of implementable production capacity for the purposes of Article 87 of the *Treaty establishing the European Community* is to be considered as state aid and allocation of the state aid shall be harmonized with the European Commission. On January 27, 2010, European Commission recognized that the state aid mechanism transposed in the regulations of the Cabinet of Ministers for the creation of a power station using solid fuel (coal and biomass) is compatible with the internal market. The Cabinet of Ministers will make decisions on announcement of tender, as well as on the results of tender, but the Public Utilities Commission will announce and organize the tender;
– requirements of the European Parliament and Council *Directive 2009/72/EC* of July 13, 2009 concerning common rules for the internal power market repealing *Directive 2003/54/EC* shall be enforced in the national legislation of Latvia before March 3, 2011. The objective of the *Directive 2009/72/EC* is to separate power trade and activities related to the power transmission system more distinctly. In accordance with the requirements of the *Directive 2009/72/EC*, partition of proprietary rights of the transmission system operator (TSO) shall be ensured in one of the following ways:
  (1) to perform full ownership unbundling – assets of the TSO and transmission system shall be separated from the Latvenergo holding;
  (2) to appoint an independent system operator – unbundling of TSO from the Latvenergo holding, by maintaining assets of the management system within the framework of the Latvenergo holding;
  (3) to appoint an independent transmission operator in accordance with the requirements set forth in the Directive – unbundling assets of TSO and transmission system in the Latvenergo subsidiary company, for which special independency requirements in relation to the Latvenergo holding have been brought forward.
  In order to determine the most suitable activity model for Latvia, such criteria as continuity of transmission system operator's functions, compliance of requirements stated in the Section 20^1 of the *Energy Law* on maintenance of transmission assets in the Latvenergo holding and on prohibition to alienate shares of Latvenergo, compliance of liabilities undertaken against the creditors and as small as possible negative finance impact on the Latvenergo holding, state budget, and tariffs will be evaluated;
– **gas sector.** On 26 May 2005, the Saeima adopted *Amendments to the Energy Law* determining the principles for operation of the natural gas market. The aim of the law is to create conditions for competition in the natural gas market in Latvia as well as to harmonise the regulatory normative acts with the requirements of the EU legislation. Transitional provisions of the law prescribe that the legal norms regulating the principles of natural gas market operations, the time and procedure for taking effect are determined by a special law. The law on the procedure of enforcement of particular sections of the *Energy Law* prescribes that the said provisions of the *Energy Law* will become effective on April 4, 2014.
  Delivery and utilisation of natural gas are regulated by the Regulations of the Cabinet of Ministers of February 16, 2008 *Regulation regarding Delivery and Utilisation of Natural Gas*.

Taking into account that on May 15, 2008, upon Saeima having amended *Electricity Market Law*, the corresponding delegation was amended as the Cabinet of Ministers passed regulations on the trade and usage of power, and the Cabinet of Ministers passed the Regulations No. 793 *Regulations Regarding the Trade and Use of Electricity* on July 21, 2009, which establish the procedure of how power is supplied to the users and how its supply is terminated and set the rights and obligations of power traders, system operators, and users when supplying and using power, as well as governs the payments for the received services, procedure of the change of traders, procedure of power supply to related users, users' rights to receive universal service of power supply.

At present, AS "Latvijas Gāze" is the only enterprise in the **natural gas market** in Latvia carrying out transmission, distribution, storage, and sale of natural gas in compliance with the licences issued by the Public Utilities Commission.

The gas supply system of Latvia is not connected to the EU common gas supply system, and Latvia has only one gas supplier – AS "Gazprom". The business environment of gas supply 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 Valdajs-Pleskava is not sufficient to ensure gas supply to the Baltic States and to the Northwest region of Russia during winter. Consequently, the gas market in Latvia could only be open formally.

Up to now, the procedure for particular sections of the *Energy Law* taking effect regulated the time of the sections of the *Energy Law* taking effect where with the natural gas market will be liberalized, namely, January 1, 2010. Taking into account the information set forth in the European directives, any "new market" of natural gas, where the initial supply pursuant to a long-term supply agreement has been performed not more than 10 years ago, gains the rights not to perform liberalization of the natural gas market. The first natural gas supply rendered in the framework of a long-term supply agreement of July 18, 2003 was on April 5, 2004 therefore the natural gas market liberalization date has been set for April 4, 2014. Amendments to the law on the procedure for particular sections of the *Energy Law* taking effect were adopted by Saeima on December 3, 2009.

In the field of **renewable energy**, 2009 was especially important, because the *Directive 2009/28/EC* of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing *Directives 2001/77/EC* and *2003/30/EC* has taken effect imposing obligations on the Member States in the field of renewable energy resources. Upon recognising the necessity to promote use of renewable energy resources in Latvia, the government of the Republic of Latvia has assigned a task to the Ministry of Economics to start drafting a law on renewable energy resources.

In accordance with the provisions of the *Directive 2003/30/EC* of the European Parliament and of the Council of 8 May 2003 on the promotion of the use of biofuels or other renewable fuels for transport (hereinafter – Directive) and requirements stated in the *Biofuel Law* adopted on July 15, 2005), until December 31, 2010 the proportion of biofuel in Latvia must be at least 5.75 % from the total amount of fuel used in the transport.

The Ministry of Economics is developing amendments to the normative acts to determine a 5 % biofuel addition to fossil fuels (according to capacity) in order to fulfil objectives stated in the directive and *Biofuel Law* in relation to biofuel use for transport.

In accordance with the delegation set forth in Section 18 of the *Law on Energy Performance of Buildings*, adopting the provisions of *Directive 2002/91/EC* of the European Parliament and of the Council of 31 March 2004 on the energy performance of buildings, *Regulations on Energy Efficiency Requirements of Existing Centralized Heating Systems in Possession of Licensed Power Supply Merchant and Examination Procedure of Conformity thereof* were adopted by the Cabinet of Ministers on October 20, 2009.

Investments in the energy sector

In order to increase efficiency of thermal energy production, to decrease the loss of thermal energy in transmission and distribution systems, and to foster replacement of the imported types of fossil fuels with renewable fuels or domestic fuels of other types, the Regulation of the Cabinet of Ministers of February 17, 2009 Regulations on activity 3.5.2.1 *Measures Regarding the Increase of Efficiency of Centralised Heat Supply Systems* of the first selection round of project applications, stating procedure in which the activity programs are implemented*, activity* 3.5.2 *Energy* of priority 3.5 *Promotion of Environmental Infrastructure And Environmentally Friendly Energy* of Supplement to the Operational Programme *Infrastructure and Services.* Implementation of activity 3.5.2.1 has been launched. Within the framework of the first selection round (from April 14, 2009 and May 26, 2009) of project applications, 11 project applications for the CF financing in the amount of LVL 6 704 690 were approved.

In order to increase considerably the production volumes of electricity and thermal energy from renewable energy resources, diversify deliveries of primary energy resources, and increase self-provision of electricity, thus reducing dependence of Latvia on the import of primary energy resources, Regulations of the Cabinet of Ministers of February 17, 2009 Regulations on activity 3.5.2.2 *Development of Cogeneration Power Plants Utilising Renewable Energy Resources* of Supplement to the Operational Programme *Infrastructure and Services* of stating the procedure in which the activity programs are implemented, 3.5.2.2 *Development of Cogeneration Power Plants Utilising Renewable Energy Sources* of measure 3.5.2 *Energy* of priority 3.5 *Promotion of Environmental Infrastructure and Environmentally Friendly Energy* 3.5.2.2 has been launched. Within the framework of the first selection round (from April 14, 2009 and August 31, 2009) of project applications, 10 project applications for the CF financing in the amount of LVL 21 366 900 were approved.

Co-financing is envisaged from the EU Cohesion Fund resources in the amount of EUR 94.9 million within the framework of the measure 3.5.2 *Energy* of priority 3.5 *Promotion of Environmental Infrastructure and Environmentally Friendly Energy* of Supplement to the Operational Programme *Infrastructure and Services* (of SPD).

In the framework of the open tender of project applications *Modernisation of Heat Supply Systems in Accordance with Environmental Requirements and Rise of Energy Efficiency in Production and Distribution, as well as Concerning the End Consumer Side of the Heat Supply System* of SPD Sub-activity 1.1.4.2, 87 project applications were submitted and assessed. Co-financing of the European Regional Development Fund (ERDF) was granted to 29 projects. The projects envisage modernisation of heat supply systems according to environmental requirements and rise of energy efficiency in production and distribution, as well as concerning the end consumer side. 6 projects are approved and are being implemented in the framework of the national programme *Improvement of Heat Supply Systems, Reducing the Content of Sulphur in the Fuel* of SPD Sub-activity 1.1.4.1.

6.3.3. Construction and Housing Policy

The main aim of the construction policy is to promote development of sustainable construction sector by ensuring favourable and competitive business environment, decreasing administrative barriers, improving the system of public purchases in the construction sphere, ensuring operative circulation of the construction information, and increasing productivity of entities rendering construction services, as well as promoting introduction of energy efficient and environmentally friendly construction.

The construction sector in Latvia has always been one of the leading economic sectors, and at the time when the state strives to reach the model of sustainable development emphasising the export, the construction sector should also adapt to this situation and it should be able to compete not only within internal market, but also in external markets. In order to stay competitive in the construction sector in the international market as well, it has to develop itself continuously, because only construction-based innovative technologies and construction materials, architectonic quality and qualified labour force has potential to compete in external markets successfully.

Draft *Construction Law*

One of the most significant preconditions of sustainable construction is the legal base for the construction that would facilitate the entire range of construction processes and make them transparent, starting from the intention to construct and concluding with commissioning. The Ministry of Economics has worked out a new draft *Construction Law* that has been submitted for reviewing in the Saeima.

The draft law has been worked out in order to establish up-to-date and modern legal base of the construction process that would promote development of the construction sector, as well as promote participation of the civil society in the decision-making thus ensuring maximum protection of interest of the construction initiator and the society, which is based on the essence of the draft law – the construction implements territory plan.

The draft law proposes to reduce the number of construction harmonization procedures including four of the most significant principles that should be observed by construction participants, the state and municipal institutions within the construction process, and promote sustainable development of the construction sector in the state:

– *principle of architectonic quality:* when designing the buildings, qualitative aspect of architecture has to be implemented highlighting the individual identity of nature and urban landscape and integrating in the cultural environment, creating qualitative living-space, as well as existing cultural heritage has been observed and maintained;
– *principle of openness:* construction process is open and the society is informed about the planned construction and about the decisions taken;
– *principle of sustainable construction:* qualitative aspect of living environment has been formed within the construction process, *inter alia* providing energy resources necessary for the building and for people – existing and further generations, and promoting the usage and adjustment of existing buildings and natural resources;
– *principle of accessibility:* within the construction process the environment is planned to be suitable for people to get around conveniently and to use the buildings according to their function.

Box 6.7

<u>Development trends of Latvian construction</u>

In the 1st quarter of 2010, the construction production volumes (in current prices) were 107.1 million lats. In the 1st quarter of 2009, the construction production volumes in accordance with the seasonally balanced data in comparable prices have decreased by 1% in comparison with the 4th quarter.

In the 1st quarter of 2010, the construction production volumes in accordance with balanced data of working days in comparable prices have decreased by 43.4% in comparison with the respective quarter of the previous year. Inter alia building construction volumes have decreased by 42.5%, engineering structures volumes – by 43.9%. The largest decrease in construction and repair volumes has been in the main pipeline construction, power and communication line construction – by 75.3%, residential house construction – by 74.5%, local pipeline and cable line construction – by 61.8%. However the construction volume of bridges and tunnels has increased by 37.3% in comparison with the respective period of the previous year.

CSB data show that in the 1st quarter of 2010, the Building and Construction Authorities have issued 259 construction permits for single family building construction, capital repairs, reconstruction and renovation of total area 55.7 thousand m^2 and it is by about 41.7% less than in the 1st quarter of 2009. Of the total number of permits issued for single family building construction, 64% are allotted in order to start new house construction (in 1st quarter of 2009 – 59% from the total number of issued construction permits).

The volume of construction works (in current prices) performed by Latvian builders abroad within the 1st quarter of 2010 amounted to LVL 8.5 million (in the 1st quarter of 2009 – 7.2 million lats) and it is by about LVL 1.3 million more that in the 1st quarter of 2009. However in the 1st quarter of 2010, the foreign builders in Latvia have performed construction works only in the amount of LVL 332.4 thousand, and it is by about LVL 987.5 thousand less than in the 1st quarter of 2009 (LVL 1.3 million).

According to the data provided by the Ministry of Economics, in the 1st quarter of 2010 140 construction merchants were registered in the Construction Merchants Register and it is by about 115 construction merchants less than in the 1st quarter of 2009 (255 construction merchants). However in the 1st quarter of 2010, 5 018 construction merchants were registered in the Construction Merchants Register.

Those employers may register in the Construction Merchant Register who employ at least one person with permanent practice certification in any of the construction spheres. On May 1, 2010, 7529 persons have received a Certificate in Construction Practice and 729 persons have received a Certificate in Architectural Professional Practice.

Changes in normative acts regulating construction

The normative-legal base of construction is constantly improved. Box 6.8 comprise construction norms and improvements performed within the last year. The most significant changes are concerning:

– ***registration of construction merchants*** – the Ministry of Economics in collaboration with non-governmental organizations of the construction sector has introduced significant corrections in the procedure of registering construction merchants. Regulations No. 238 of the Cabinet of Ministers adopted on March 9, 2010 Amendments to Regulations No. 453 *Regulations for the Registration of Construction Merchants* of the Cabinet of Ministers adopted on June 28, 2005 specify that the specialist who is the responsible official for construction can be employed by other merchants at the same time but not more than by three. It is envisaged that the established norm will help to eliminate infringement of rights in construction (*inter alia* public purchases in construction), as well as reduce illegal employment, cases of non-payment of taxes, and forbid participation of those merchants who in fact do not have corresponding specialists in the sphere;

– ***energy efficiency*** – amendments to the *Law on Energy Performance of Buildings* provides that due to liquidation of the Construction, Energy and Housing State Agency on July 1, 2009, the tasks on policy development and implementation previously divided between the Agency and the Ministry of Economics have been passed to the Ministry of Economics; it must be ensured that the building users are provided with opportunities to consult about inspection of central heating boilers and air-conditioning devices and efficiency improvement. The stated norm is included according to the Clause 8 and 9 of the *Directive 2002/91/EC*;

– ***classification of buildings*** – Regulations No. 1620 of the Cabinet of Ministers adopted on December 22, 2009 *Regulations on the Classification of Buildings* specify building classification, object classification and structure, as well as specify the main type of building use. The building classification has been worked out based on the Construction Types Classification (CC) of the Statistical Office of the European Communities, as well as taking into account Annexes 26 and 37 to Regulations No. 182 of the Cabinet of Ministers adopted on March 20, 2007 *Regulations Regarding Specification of Real Property Object* and Annexes 1 and 2 to Regulations No. 305 of the Cabinet of Ministers adapted on April 18, 2006 *Regulations regarding Cadastral Appraisal.*

In the second half of 2009 and at the beginning of 2010, many amendments to normative acts regulating the construction have been made due to reorganization of the State Construction Inspection on July 1, 2009, thereby optimizing the institutional structure of the construction sector.

Box 6.8

Improvement of normative base of construction:

1. *Amendments to the Energy Performance of Buildings law* adopted on March 4, 2010;
2. Regulations No. 389 of the Cabinet of Ministers adopted on April 27, 2010 Amendments to Regulations No. 451 of the Cabinet of Ministers adopted on December 23, 1997 *Regulations regarding the Latvian Construction Standard LBN 203-97 "Design norms for Concrete and Reinforced Concrete Constructions"*;.
3. Regulations No. 247 of the Cabinet of Ministers adopted on March 16, 2010 Amendments to Regulations No. 181 of the Cabinet of Ministers adopted on April 30, 2001 *Procedures for the Conformity Assessment of Construction Products in the Regulated Sphere* ;
4. Regulations No. 220 of the Cabinet of Ministers adopted on March 9, 2010 Amendments to Regulations No. 26 of the Cabinet of Ministers adopted on January 13, 2009 *Regulations regarding the Energy Auditors* ;
5. Regulations No. 238 of the Cabinet of Ministers adopted on March 9, 2010 Amendments to Regulations No. 453 of the Cabinet of Ministers adopted on June 28, 2005 *Regulations regarding the Registration of Construction Merchants*;
6. Regulations No. 92 of the Cabinet of Ministers adopted on February 2, 2010 Amendments to Regulations No. 75 of the Cabinet of Ministers adopted on February 10, 2004 *Regulations regarding the Latvian Construction Standard LBN 303-03 "Regulations for the Supervision of Construction"*;
7. Regulations No. 44 of the Cabinet of Ministers adopted on January 19, 2010 Amendments to Regulations No. 852 of the Cabinet of Ministers adopted on October 17, 2006 *Regulations regarding the Latvian Construction Standard LBN 299-06 "Hydraulic Structures of Hydroelectric Power Stations"*;
8. Regulations No. 20 of the Cabinet of Ministers adopted on January 12, 2010 Amendments to Regulations No. 112 of the Cabinet of Ministers adopted on April 1, 1997 *General Construction Regulations*;
9. Regulations No. 1620 of the Cabinet of Ministers adopted on December 22, 2009 *Regulations regarding the Building Classification*;
10. Regulations No. 1563 of the Cabinet of Ministers adopted on December 22, 2009 Amendments to the Regulations No. 190 of the Cabinet of Ministers adopted on April 22, 2003 *Construction Order for the State Protected Buildings*;
11. Regulations No. 1386 of the Cabinet of Ministers adopted on December 8, 2009 Amendments to Regulations No. 342 of the Cabinet of Ministers adopted on June 25, 2003 *Regulations regarding the Latvian Construction Standard LBN 304-03 "Regulations for the Supervision of Construction Works by Author"*;
12. Regulations No. 1337 of the Cabinet of Ministers adopted on November 24, 2009 Amendments to Regulations No. 424 of the Cabinet of Ministers adopted on May 30, 2006 *Procedure for Issuance and Annulment of Safety Certificates of Hydraulic Structures of Hydroelectric Power Stations*;
13. Regulations No. 1335 of the Cabinet of Ministers adopted on November 24, 2009 Amendments to Regulations No. 363 of the Cabinet of Ministers adopted on October 28, 1997 *Special Building Regulations for the Port Hydrotechnical Constructions*;
14. Regulations No. 1565 of the Cabinet of Ministers adopted on November 22, 2009 Amendments to Regulations No. 446 of the Cabinet of Ministers adopted on October 23, 2001 *Provisions of Construction Works in the Network of Motorways*;
15. Regulations No. 1105 of the Cabinet of Ministers adopted on September 29, 2009 Amendments to the Regulations No.256 of the Cabinet of Ministers adopted on April 4, 2006 *Implementation and Construction Order of Electronic Communication Networks.*

The aim of the housing policy is to improve the base of normative acts in the sphere of administration of residential buildings and to support energy saving measures in residential buildings, thereby promoting quality improvement and sustainability of commissioned residential buildings.

Effective administration of the housing fund

Until now, qualitative administration and management of residential buildings in many cases have been performed at poor quality thus becoming an ever more topical matter of discussion in the society. Rather often, the managers do not take care of the buildings at all. Therefore, deterioration of technical state of the residential buildings was fostered and that can cause danger to life, health, safety, and property of persons or to environment.

Law on Management of Residential Housing was enforced on January 1, 2010. This is the only law that relates to administration of all residential buildings. This law determines the administration activities, tasks that need to be performed in the residential buildings, provisions of administration agreements, professional qualification of the manager, as well as the rights, obligations and responsibility of the residential building manager.

In order to implement separate norms of the *Law on Management of Residential Housing*, the draft regulations of the Cabinet of Ministers (see box 6.9) have been worked out.

Box 6.9

Improvement of normative base for administration of residential buildings

On the basis of delegation given in the *Law on Management of Residential Housing* the following draft regulations of the Cabinet of Ministers have been worked out:

1. *Regulations regarding the Sanitary Maintenance of the Residential Building;*
2. *Regulations regarding the Inspection, Technical Maintenance and Regular Repair of Residential Building and the Existing Devices and Communications;*
3. *Procedure of Planning and Organising Activities Regarding Renovation and Reconstruction of Residential Buildings;*
4. *Regulations regarding the Record-keeping and Updating Building Case*;
5. *Regulations regarding the Minimum Requirements for Ensuring Energy Efficiency of Residential Buildings*.

Improvement measures regarding energy efficiency of residential buildings

Since 2009, apartment owners may receive co-financing from the state and the European Regional Development Fund (ERDF) in order to improve the heat insulation of multi-apartment residential buildings, promoting sustainability of the housing fund and reduction of thermal energy consumption within the residential buildings, at the same time improving the quality of life of the dwellers.

The state's co-financing for the energy efficiency measures are allocated to:

– energy audit for the multi-apartment residential building – 80% of the energy audit expenses, but not exceeding the limit of LVL 400 ;
– specification of energy efficiency evaluation in accordance with provisions of the normative acts – in the amount of LVL 100 ;
– development of technical project for the multi-apartment residential building or preparation of simplified renovation documentation, if the standard solution is not available – 80% of preparation expenses on technical project or simplified renovation documentation, but not exceeding the limit of LVL 2500;
– preparation of conclusion on technical inspection for the multi-apartment residential buildings – 80% of expenses on conclusion of technical inspection, not exceeding the limit of LVL 400.

Total amount of the state co-financing for the mentioned measures within 2010 is LVL 5540 thousand. In May 2010, to support improvement of heat insulation measures in 59 residential buildings, the state co-financing has been used approximately in the amount of 8.1% of the available sum.

ERDF co-financing towards the energy efficiency measures of multi-apartment residential buildings are allocated to:

– start up of construction works in parts of joint property owned by the property holders of multi-apartment residential building apartments ensuring fulfilment of energy efficiency improvement measures specified in the energy audit report;
– preparation of project documentation and construction supervision and author's supervision of the design.

Within the frameworks of the activity, the available ERDF co-financing has been increased by LVL 44.3 million in 2010 and correspondingly the co-financing of the funding beneficiaries – LVL 32.1 million. ERDF's co-financing has been allocated in the amount of LVL 128.8 thousand within four months of 2010.

The maximum permissible intensity of the financing is 50% or 60% (if 10% of the apartment owners are considered of low-income households) of the total expenses of the project.

In order to facilitate obtaining the information on house renovation processes and on benefits for the developers of housing renovation project, thereby reducing the number of unclear questions, a *Memorandum of Cooperation* by the initiative of the Minister for Economics has been signed and an informative campaign *Live Warmer* was started. A memorandum was signed by representatives of associations from 9 sectors, Riga Technical University, Regional Energy Agency and three banks. The aim of this memorandum is to increase circulation of qualitative information among the inhabitants of multi-apartment houses and entrepreneurs, by explaining the benefits gained from renovation of residential buildings and educating them about provision of qualitative renovation process. Within the framework of the campaign, all interested persons were informed about the residential building energy efficiency, quality standards of materials, and their development technologies, opportunities to receive ERDF co-financing, and topicalities in the field, thereby promoting availability of qualitative services. Till May 2010, within the framework of the mentioned campaign, in Latvia, in collaboration with the Latvian Association of Local and Regional Governments, 11 seminars which were attended by more than 900 interested persons ERDF's co-financing towards the heat insulation measures of social homes are available in order to enlarge energy efficiency of the local authority housing fund, and at the same time improving quality and sustainability, ensuring adequate housing for socially vulnerable groups

ERDF's co-financing towards the energy efficiency measures of social homes are allocated to:

– preparation of project documentation and construction survey and author's survey of the project;
– to reduce use of energy resources in building by ensuring fulfilment of at least two energy efficiency improvement measures specified in the energy audit report;
– renovation or reconstruction of the building if implementation of at least two measures specified in the energy audit report are ensured.

ERDF's co-financing within the framework of the activity constitutes LVL 4 million and co-financing by local authority budget is not less than LVL 1.3 million.

The maximum permissible intensity of the financing is 75% of the total expenses of the design.

Due to the fact that selection of the project applications in the mentioned activity took place in April, 2010, now, the collaborating institution of the activity – the State Agency "Investment and Development Agency of Latvia" – is evaluating 47 received project applications from 23 regions.

6.3.4. Tourism Policy

The main goal of the Latvian tourism policy is to promote growth of the tourism sector turnover and its share in the economy, as well as to increase the export capability of tourism services in the medium term, stimulating changes in the structure of demand and supply.

In 2009, the Ministry of Economics, other ministries and social partners of the tourism sector continued active work to solve different issues concerning the tourism sector. The Latvian Tourism Advisory Council (LTAC) will continue its work to promote cooperation between the ministries, local governments, enterprises, as well associations and foundations, and to foster development of tourism. The Expert Commission of the Latvian Tourism Advisory Council also continues its work to solve issues related to tourist safety and ensuring efficient information exchange among the competent authorities.

Box 6.10

The most significant changes in legislative acts regulating tourism

The following significant changes have been made in 2009-2010:

– reduced value added tax rate for guest accommodation services in tourist accommodations from 21% to 10% (*Amendments to the Law on Value Added Tax* of March 25, 2010);
– relief provided to domestic producers – simplified requirements for acquisition of approved warehouse keeper activity licences, right to receive relief for registration of excise duty security, as well as provided that alcohol trade in outdoor cafes shall be regulated by binding rules of local municipalities (*Amendments to the Handling of Alcoholic Beverages Law* of March 25, 2010);
– the procedure is specified for displaying prices of alcoholic beverages offered for **immediate consumption** on the premises (Regulations No. 332 of the Cabinet of Ministers of April 6, 2010 Amendments to the Regulations No. 178 of the Cabinet of Ministers *Procedure of displaying prices of products and services in cafes* of May 18, 1999");
– new Regulations of the Cabinet of Ministers elaborated specifying the obligations and responsibility of tourism agent and tourism operator, making provisions for development of tourism agents and operators database, establishing the procedure for registration in the database, as well as providing security guarantee for money paid by customer (Cabinet of Ministers *Regulations No. 353 on rights and obligations of tourism operator, tourism agent and customer, procedure for development and implementation of tourism package services and information to be provided to the customer* of April 13, 2010);
– Amendments to the *Tourism Law* regarding activities of guides, as well as tourism agents and tourism operators (*Amendments to the Tourism Law* of December 10, 2009);
– on November 20, 2008, the Regulations No. 943 of the Cabinet of Ministers *Procedures for the Certification and Provision of Services of Tourist Guides* became ineffective (*Amendments to the Tourism Law* of December 10, 2009 and *Amendments to the Law On Regulated Professions and Recognition of Professional Qualifications* of January 14, 2010).

In 2010, the work is continued at the Advisory Council of the Latvian Tourism Development Agency (LTDA) comprised of authorised representatives from the Ministry of Foreign Affairs, Riga City Council, professional and regional tourism associations, as well as from the advertising sector.

Taking into account economic changes and new market situation caused by the crisis, the LTDA has elaborated the new *Latvian Tourism Marketing Strategy 2010-2015* (approved on March 16, 2010), which specifies the vision and goals of Latvian tourism development, defines basic principles of Latvian tourism product development and marketing activities in target markets. Taking into account the goals and vision of tourism development set out in the marketing strategy, a new image of Latvian tourism was worked out and presented on March 22, 2010.

On June 14, 2010 Regulations No. 353 of the Cabinet of Ministers adopted on April 13, 2010 developed by the Ministry of Economics *Regulations on rights and obligations of tourism operator, tourism agent and customer, procedure for development and implementation of tourism package services and information to be provided to the customer* will enter into force. Simultaneously, on June 14, 2010 free registration of tourism agents and tourism operators begins in the tourism agency and operator database developed by the Ministry of Economics. Tourism agents and operators, who already have started business activities before the date of enforcement of regulations, shall register in the database within three months starting from the regulations enforcement date till September 14, 2010.

The Ministry of Economics in cooperation with representatives of the sector has launched development of a numbering system of cycling routes, which is aimed to ensure opportunity to use traffic sign No. 842 of LVS "Ceļa zīmes" (Road signs). The traffic sign will be used according to a voluntary principle, in order to achieve that in the future the use of unified cycling route signs could be implemented in the territory of Latvia.

On March 24, 2010 the Ministry of Economics and tourism sector associations signed an agreement on principles and measures of mutual cooperation for fostering development of Latvian tourism. Representatives of NGO tourism sector undertake to ensure creation of at least 2000 workplaces in accommodation sector, as well as to ensure reduction of prices for guest accommodation services in the amount of 5 to 10% within 12 months from the enforcement of the reduced value added tax rate.

Box 6.11

Latvian tourism development indicators

The tourism sector has a significant role in the national economy of Latvia. According to the tourism satellite account calculations of the Central Statistical Bureau, the share of tourism-specific sectors in the total value added has gradually grown – from 5.9% in 2004 to 8.3% in 2007.

The tourism sector is a significant source of export income, which gives considerable contribution to national gross domestic product. According to the CSB satellite account calculations, the share of incoming tourism consumption within goods and services exports in 2007 was 10%, while in 2004 it was 8.9%.

In 2009, the number of border crossings of foreign tourists reached 4.7 million, which is by 14.5% less than in 2008 (5.5 million). Like in the previous years, the average duration of tourist visits in Latvia was 1.3 days, but average expenditures per day rose to LVL 56. Along with the decrease in the number of border crossings of tourists, the total number of foreign tourists' expenditures in Latvia decreased, reaching LVL 344.1 million, which in comparison with 2008 (LVL 403.2 million) is by 14.7% less.

Although, taking into account the negative balance in outgoing tourism, the tourism balance of payments has been improving, its indicators were still negative – expenditures of Latvian residents abroad in 2009 exceeded the expenditures of foreign tourists in Latvia by LVL 64.3 million.

According to the information provided by the CSB at the end of 2009, there were 559 tourism accommodations in Latvia, which is by 68 accommodations more than at the end of 2008. However the number of persons served in hotels and other tourist accommodations in 2009 decreased by 28.4%, reaching 1113.9 thousand.

Within the framework of the state budget programme *Implementation of Tourism Policy*, funding is allocated every year for the development of tourism to ensure the implementation of the state tourism policy as provided in the *Tourism Law*. In the framework of the state budget programme *Implementation of Tourism Policy*, LVL 529 thousand were earmarked in 2010.

International cooperation in the field of tourism

In 2010, Latvia continues to develop and strengthen closer cooperation in the field of tourism with other countries. Issues related to promotion of cooperation in the field of tourism are regularly included in the agendas of foreign visits of intergovernmental commissions and state officials.

In order to ensure further international integration of Latvian tourism sector, representation of state interests and adoption of better practice examples, international cooperation is being developed, e.g., participation in the UN World Tourism Organisation, Tourism Advisory Committee and Working Group on Sustainable Tourism of the European Commission.

The state policy for tourism development is implemented by the **Latvian Tourism Development Agency** (see Box 6.12).

Box 6.12

Activities of the Latvian Tourism Development Agency in the first half of 2010

By implementing the action plan, the LTDA:

- elaborated and approved *Latvian Tourism Marketing Strategy 2010-2015*, which determines the Latvian tourism priority target markets and priorities of tourism product development;
- created a new Latvian tourism image and its communication platform, which promotes recognition of Latvia as a final tourism destination in international market and fosters competitiveness of Latvian tourism products;
- organized participation of Latvia in 9 international tourism exhibitions in foreign tourism markets in cooperation with Latvian tourism sector (in Lithuania, Estonia, Russia, Finland, Sweden, Belarus, the Netherlands, Germany, USA);
- organized a work seminar for tourism professionals in Russia on business tourism (MICE) opportunities in Latvia;
- organized 5 journalist visits, in which representatives of 15 mass-media participated, as well as started planning and organize several other visits;
- started update and improve the content of Latvia's tourism portal *www.latviatourism.lv* according to the new tourism image of Latvia;
- launched the campaign of promoting the Baltic tourism products *Big Travelling around the Baltic States 2010* in cooperation with Lithuanian and Estonian national tourism organisations, including in it 10 objects from Latvia and organising an extensive marketing campaign;
- continued the promotional campaign of local tourism *Look, Latvia is speaking* launched in November 2009 aiming to encourage local tourists to travel around Latvia even after the end of the active tourism season;
- published monthly Latvian tourism newsletters in English, Russian and German, distributing them to foreign tourism professionals and journalists;
- maintained a tourist hotline 1188, to provide necessary information and help in emergency situations to foreign tourists 24-hours a day;
- launched implementation of a foreign tourists' survey in order to find out their opinion about the Latvian tourism service quality, sources of information, motivation and satisfaction level with respect to their trips to Latvia in cooperation with the Latvian tourism education institutions;
- continued work on introducing the quality system of Latvia's tourism services *Q-Latvia*, developing assessment criteria for services and training programme in e-environment;
- started work on implementation of the European Commission project *European Destinations of Excellence 2010* (EDEN) in Latvia, evaluating applications submitted for the projects, the topic of 2010 is the *Use of water resources in tourism*;
- ensured implementation of *Leonardo da Vinci* project *Improving Tourism Quality* activities;
- engaged in implementation of Estonian-Latvian cross-border cooperation project **Go Cycling** *through Vidzeme and Southern Estonia* aimed at promotion of international cycling routes developments in Latvia.

The LTDA will continue implementation of marketing and tourism product development in high priority tourism markets in accordance with the *Latvian Tourism Marketing Strategy 2010-2015*, as well as will continue integration of the new Latvian tourism image into the tourism marketing material of Latvia and will ensure its promotion campaigns for the tourism sector in the second half of 2010.

6.4. Business Environment

The World Bank study *Doing Business* (DB), as well as the *Study of Administrative Procedure Impact Upon Business Environment* are the most popular measures for evaluation of business environment, with the aid of which the opinion of entrepreneurs about factors preventing their activity is clarified and a list of tasks that need to be fulfilled is prepared within the frameworks of the annual *Action Plan to Improve the Business Environment*.

In 2010, Latvia in the DB rating holds the 27th position in the world. It is by 2 positions higher than in the study of 2009. This year Estonia in DB rating holds the 24th position, but Lithuania – 26th position.

In accordance with the *Strategic Development Plan of Latvia for 2010-2013* (approved by the Cabinet of Ministers on March 23 this year) developed by the Ministry of Regional Development and Local Government, the objective of Latvia is to reach the 19th position in 2013.

The objective of the Action Plan for 2010 (approved by the Cabinet of Ministers on March 24, 2010) is "faster, cheaper, fewer procedures" focusing on such fields as electronic administering, starting a business, tax administration, foreign trade, registering estate property, improving regulation of construction.

22 measures have been included in the Plan, 9 of these measures have been fulfilled in the 1st quarter, and implementation of the other measures is continued.

Amendments to the *Commercial Law* are adopted by the Saeima and came into force on May 1 this year, and they envisage the following amendments to the **field of starting a business**:

- term of office of officials representing Ltd. – termless; of officials representing JSC – extended to 5 years;
- as a payment confirmation of the fixed capital – not only a notice from the bank;
- samples of signatures of the company officials will not have to be submitted.

The Register of Enterprises has performed all the necessary measures in order to ensure issuance of merchant's registration certificates electronically starting from May 1 of this year.

Figure 6.3

Positions of Latvia and other EU countries in the World Bank study *Doing Business* for 2010

Business Environment (in general)

The amendments to the *Commercial Law* in relation to **promotion of micro-enterprises activity** (enforced on May 1 of this year) propose:

- Registration of Ltd. can be started from 1 LVL (founders/participants up to 5 physical persons; participants are fulfilling functions of the board; the participant simultaneously can be a participant only in one such Ltd.);
- registering the Ltd., state duty not exceeding expenditure for administrative costs, as well as the fee for advertisement (will not exceed the actual cost of the advertisement) will be reduced;
- the state duty payment for registration of changes in the fixed capital will not be required to be executed;
- the payment for advertisements of fixed capital increase will not be required to be executed.

From February 10 of this year, the norm determining the state duty for registration of micro-enterprises in the amount of LVL 50 was enforced. However on May 5th of this year, during the meeting of the Cabinet of Ministers a decision was made to determine a payment on the announcement of entry performed in the Commercial Register in relation to the foundation of new micro-society for the amount of actual advertisement costs, namely, LVL 12.16.

Draft law *On Tax for Micro-enterprises* was reviewed by the Saeima in the 1st reading on April 29 of this year. Amendments to the *Law On Unemployment Insurance* and to the *Law On State Social Insurance* were submitted together with the packet of draft law.

In the field of tax administration, in the near future, it is planned to:

- reduce the number of days necessary for registration of VAT payers;
- elaborate norms favourable for development of distribution centres;
- determine the usage of VAT invoices as a source document in accounting.

In the field of real estate, a draft law on Amendments to the Law *On Local Governments* has been adopted by Saeima in the 2nd reading, envisaging that the local governments should justify their pre-emption rights not only with a need to use this property for implementation of functions of the local government, but also with documents of territorial development planning of the corresponding real estate for implementation of this function. Likewise, the authority for the Cabinet of Ministers to regulate the process of using pre-emption rights, by stressing the necessity to reduce the terms for the exercising the pre-emption rights, was specified in the approved wording of the 2nd reading.

In the field of construction, the *Construction Law* was adopted by the Cabinet of Ministers on May 18 of this year. The draft law proposes simplification of the construction administration process, refusing the numerous intermediate decisions in order to harmonize construction within a period of 70 days.

In order to improve efficiency and transparency of purchases **in the field of electronic administration,** the Cabinet of Ministers on April 20 of this year approved a Plan for *Improvement of Electronic Purchase System Usage for 2010-2012* that prescribes a number of measures to promote usage and development of electronic purchases (e-purchases), and according to the e-purchase type (electronic auction, e-competition and electronic catalogue) it would allow simplifying the purchase process and ensuring more favourable provisions for supply or rendering of services, as well as would ensure a number of other advantages.

In order to develop the necessary legal base, on April 1 of this year, a *Draft Concept on Implementation of One-Step-Agency Principle in Accessibility of State and Local Government Services* was announced during the meeting of the State Secretaries. The Draft project contains a plan of action on how to improve delivery of state and local government services until 2013 and how to ensure accessibility thereto across the country – in person or remotely (by organizing service delivery in a uniform system according to uniform principles in compliance with the administrative-territorial division of the country taking into account the base of 118 local governments).

The *Law on Legal Force of Documents* has been worked out (announced by the Saeima on May 19 of this year) in order to establish the requirements necessary for processing and issuing original document, its derivation and duplicate for it to gain legal power.

The informative report *On Implementation Process of Tasks Determined for Simplification of Administrative Procedures of Action plan in Field of Service Rendering and in Relation to Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on Services in the Internal Market* was reviewed by the Cabinet of Ministers on February 9 of this year. Within the framework of the said plan, only 34 tasks out of 69 planned tasks were fulfilled, 21 tasks are in the stage of implementation, and the implementation of 14 tasks has not been started yet. Amendments to the normative acts are introduced in accordance with the plan prescribing cancellation of restrictions of free services rendering.

The portal *latvija.lv* has been determined as the single state portal which renders electronic services in Latvia. It contains information about services rendered by the state administration institutions. Currently, the single state portal for electronic services *latvija.lv* provides information about 1279 services and more than 160 of these services are available electronically.

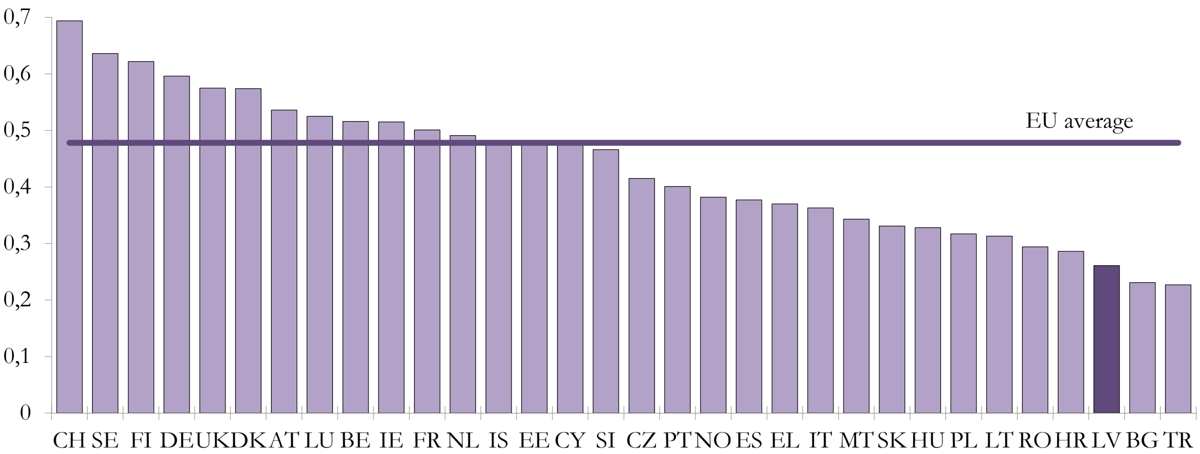
Within the framework of a performance audit of the State Chancellery, work has been started on identification of requirements of the most essential state administration institutions (both state and local governments), implemented controls, supervision, examinations, certification and accreditation for the purpose of preparing proposals of the reforms that would reduce administrative barriers. Within the framework of the measure, information provided by merchants and evaluation given by institutions, as well as requirements of the normative acts of Latvia and compliance thereof to the regulations of the European Union are updated. At the same time, in cooperation with the Performance audit group an EU funding project *Reduction of Administrative Barriers and Improvement of Public Services Quality* has been implemented. Within the framework 11 entrepreneurship sectors have been extensively evaluated, as well as 44 merchants, 5 local governments and 25 institutions have been surveyed. It is planned that the final report will be reviewed by the Performance Audit Commission in accordance with the determined final term, namely, July 1 of this year.

6.5. Innovation and New Technologies

In research *European Innovation Scoreboard 2009* published in 2010 among 32 countries, which were included in the research, Latvia takes the 30th place (in research of 2009 – 30th place, in 2008 – 35th place among 37 countries), lower total indexes in the field of innovation are shown by Bulgaria and Turkey.

Figure 6.4

Innovation Index in 2009



Source: European Commission, European Innovation Scoreboard 2009

Although the innovation index of Latvia is considerably lower than the average innovation index of EU 27 Member States, the average growth of these indices compared to the previous year in Latvia is 4.8%, which is significantly larger than the average growth of the 27 Member States – 1.8%. Recent improvements mainly can be observed in the field of human resources provision, and the number of registered European patent and Community trademark has increased. A little lower increase is observed in export of medium and high technology products.

The main activity directions for innovation development set down in the *Business Competitiveness and Innovations Framework Programme for 2007-2013* envisage to improve public understanding of innovation, promote knowledge and technology transfer, foster cooperation between science, education and private sectors, as well as to support development of new products and technologies.

In 2010, mainly the activities launched during the previous years are continued in order to foster industrial research, development of new products, and introduction into the market.

In order to promote technology transfer, the Investment and Development Agency of Latvia continues to support the activity of 8 technology transfer contact points (University of Latvia, Riga Technical University, Latvia University of Agriculture, Riga Stradins University, Ventspils University College, Rezekne Higher Education Institution, Daugavpils University, and Art Academy of Latvia). The main directions of the activity of technology transfer contact points are providing information concerning scientific institution services, knowledge and technology transfer, preparation of commercialisation offers of research results, organisation of cooperation seminars, conferences, and contact information exchanges among the entrepreneurs and scientists.

The Investment and Development Agency of Latvia in cooperation with the Latvian Technological Centre continues to support activity of the *Enterprise Europe Network* in Latvia. The network provides information and practical advices related to policy of trade, European Union legislation and business development; as well as it provides consultations to entrepreneurs regarding technology transfer and innovation, as well as regarding participation in the European Union 7th Framework Programme for Research and Technology Development.

In 2010, the Investment and Development Agency of Latvia continues its support to 164 projects approved in the framework of the EU Structural Funds programme *Development of New Products and Technologies* and *Support to Introduction of New Products and Technologies into Production*.

In 2010, to implement the EU Structural Funds programme *Support to Introduction of New Products and Technologies into Production* next project selection is planned to be organized for the total support amount of LVL 27.6 million.

In order to inform the public and improve understanding, in 2010, the Investment and Development Agency of Latvia continues implementation of the EU Structural Funds programme *Measures to encourage Innovations and Business start-ups*. The goal of the programme is to inform and encourage a maximum number of individuals, especially youth, to start business activities, raise the prestige of business, as well as to foster understanding of the society about the role of innovations in promoting competitiveness, inform the society about events related to innovations and potential thereof, thus encouraging as large part of the society and businessmen as possible to turn to development and use of innovative solutions. In the framework of the innovative business motivation programme, in 2010, it is planned to implement the following main measures:

- practical training measures for starting an innovative business;
- increasing understanding of teachers with respect to the opportunities of innovative businesses by promoting practical training;
- implementation of the training programme *Pupils' Training Enterprises*;
- organisation of workshops for authors of innovative ideas and provision of mentoring programmes;
- organisation of debate competitions on issues of innovative business;
- organisation of competitions for business plans and ideas for starting innovative business and development of innovations in business.

In 2010, the *Support Programme for Competence Centres*[1] will be launched and implemented in accordance with regulations of the Cabinet of the Ministers Regulation on Sub-activity 2.1.2.1.1 of the supplement to the operational programme *Entrepreneurship and Innovations* approved on April 13, 2010. In the framework of the programme, purchase of long-term investments, experimental developments and provision of project management will be the supported. The maximum permissible amount of public funding per one project application is LVL 6.25 million. The programme will be financed from resources of the European Regional Development Fund, and the total public funding for the programme is LVL 36.3 million. The project applications will be accepted at the Investment and Development Agency of Latvia from August 2, 2010 to September 30, 2010.

[1] Competence Centre is a legal entity, which incorporates scientific and field cooperation partners, and at least one scientific cooperation partner and three mutually unrelated field cooperation partners-entrepreneurs are engaged in it.

6.6. Information Society

Information society is a social development phase based on free mutual exchange of information, developing a knowledge-based economy. Information society consists of the technological base (infrastructure, software), range of information services available to the society, and the level of individual skills and knowledge. As a result of development of information and telecommunication technologies (ICT), information and knowledge are increasingly used in work and labour relations, education and everyday life.

According to the data of the Central Statistical Bureau of Latvia (CSB), the share of ICT sector in the GDP reached 4.2% in 2008. In 2008, 3078 companies operated in the ICT sector in Latvia, employing 24 947 persons, enterprise turnover reached LVL 2.6 billion, staff costs – LVL 200 million. The value added of ICT production reached LVL 45 million, provision of ICT services – LVL 562 million. The foreign trade balance of ICT was negative: LVL 242.1 million, because the imports exceeded exports considerably, which were LVL 444.3 million and LVL 202.2 million, respectively.

In the *Europe's Digital Competitiveness Report* published in 2009, which analyses the progress of *i2010* strategy in 2005-2009, it is pointed out that the development of the information society in Latvia still lags behind from the average EU indicators, although internet use and user skills are comparatively good. The internet users are active users of the newest services on the internet. In terms of broadband internet speed, Latvia was the 6th among the EU Member States in 2008. However, in terms of broadband internet accessibility and the number of internet connections in households in rural areas, Latvia lagged behind significantly from the average EU indicators. The number of enterprises with broadband internet connections was also low (62%), ranking Latvia at the 23rd place among the EU Member States. It was one of the reasons why e-commerce and e-business in Latvia lags behind from the average EU indicators.

Box 6.13

The usage of computers and internet in Latvia

According to the data of the CSB survey *Computer and Internet Usage in Households*, 60% of all households (households with at least one person in the age group of 16-74 years) had computers and 58% of households had internet connection in 2009. The best situation with accessibility to internet was for households in the regions around Riga (computers – 69%, internet – 65%) and in the Riga region (computers – 66%, internet – 64%), while in the other regions the situation was worse – in Zemgale region (computers – 59%, internet – 61%), Kurzeme region (computers – 54%, internet – 54%), Latgale region (computers – 51%, internet – 44%), and Vidzeme region (computers – 50%, internet – 48%). In total, 61% of inhabitants in the age group of 16-74 years used a computer and internet on a regular basis (at least once a week). However, 50% of all households had broadband internet connection.

At the beginning of 2009, 93% of all enterprises having 10 and more employees had computers, 86% of such enterprises had internet connection and 42% of enterprises had their own internet website. In 2008, 62% of companies having 10 and more employees used internet for communications with the public and local government institutions. In 2009, 29% of all employees of enterprises used computer on a regular basis, while computer connected to the internet had been used regularly by 25% of employees.

At the beginning of the academic year 2009/2010, the number of computers per 100 full-time students at higher education institutions and colleges was 18 (at the beginning of academic year 2008/2009 – 14 computers). At the beginning of the academic year 2009/2010, 10 computers were available per 100 pupils in professional education institutions, but in general education schools – 9.4 computers. From the total number of all education institutions, all higher education institutions and colleges, 87% of professional education institutions and 99.7% of general education schools had an internet connection.

Along with Latvia's accession to the EU, the EU initiatives related to the development of the information society have become binding for Latvia (see Box 6.14).

One of the main tasks mentioned in the *National Lisbon Programme of Latvia for 2008-2010* is to facilitate expansion of ICT and its efficient use in order to develop a fully integrated information society. For the implementation of this task, two main directions were distinguished – to improve internet accessibility and to develop and ensure an efficient e-government.

In the European Commission's communication *A Digital Agenda for Europe* adopted on May 19, 2010 a new aim is set – according to the *EU 2020 strategy* to gain economic and social benefits from digital single market based on fast and particularly fast internet. *A Digital Agenda for Europe* includes more than 90 legislative initiatives and a number of EU, regional and member states' measures of horizontal level of seven areas in three dimensions of the *EU 2020 strategy*: social, environmental and global dimension (see Box 6.14).

The development of information society in Latvia is determined by the following policy planning documents:

– *Latvia's E-Government Concept* approved by the Cabinet of Ministers on May 7, 2002, in which development strategy of e-government, as well as initial action plan and necessary means for its implementation were defined;
– *Information Society Development Guidelines for 2006-2013* approved by the Cabinet of Ministers on

July 19, 2006, in which short-term and long-term policy goals, as well as future direction and necessary financing were defined;
- *Concept of a Principle of a Single Contact Point in Accordance with the Provisions of the Services Directive (2006/123/EC)* approved by the Cabinet of Ministers on May 28, 2009, in which aims, tasks, and development directions for the introduction of a principle of single contact point in the management of administrative institutions are defined;
- *The Concept on Electronic Identification Cards* approved by the Cabinet of Ministers on January 12, 2010 that foresees to introduce the electronic identification card;
- *Electronic Government Development Plan for 2010-2013* (reviewed on April 29, 2010 in the meeting of the State Secretaries) is a short-term development planning document for the next three years drawn for the implementation of the *Information Society Development Guidelines for 2006-2013* in order to continue the action plan in the area of e-government development and to provide succession of *Electronic Government Development Programme for 2005-2009*.

Box 6.14

European Union initiatives in developing the information society

In order to support development of a digital economy, on June 1, 2005, the European Commission launched a new initiative, which is a strategy for the following 5 years – *i2010: A European Information Society 2010*. It is aimed at promoting growth and jobs in the sectors related to information society and media. The initiative contains 3 priorities:
- to create an open and competitive single market for information society and media services within the EU;
- to increase the EU investment in ICT research by 80%;
- to achieve transformation of the European society into an information society.

On November 18, 2009, in Malmö (Sweden) the ministers responsible for the e-government signed a declaration that provides common future vision and policy priorities that must be implemented by 2015. The main goals that must be achieved by the member states together with the European Commission within the next 5 years are the following:
- to provide an opportunity for enterprises and population for easier access to information when using e-government services and to involve them more actively in the policy development process;
- to promote mobility in the single market by unifying the e-government services for the foundation of enterprises, studying, working, living and retiring in Europe;
- to increase efficiency of e-government by reducing administrative burden, improving government organization processes and using ICT for the improvement of energy efficiency that will make a bigger contribution in the sustainable economy with low carbon dioxide emissions.

The European Commission approved a communication *A Digital Agenda for Europe* on May 19, 2010 and announced it as one of the seven flagship initiatives of the *EU 2020 strategy*. The aim of this program is to gain economic and social benefit from a digital single market based on fast and particularly fast internet. Seven priority actions are outlined in the programme: establishment of a digital single market, bigger interoperability, improvement of internet security and users' confidence, faster access to the internet, more investments in research and development, broadening of digital competence skills and inclusion, as well as application of information and communication technologies in order to solve problems topical for the society, for example, climate change and ageing of the society. Advantages include simpler electronic payments and invoices, opportunity to use fast remote health services, and energy efficient lighting. The communication contains an action plan in seven fields of Digital Agenda, at the same time pointing out that Digital Agenda is a document worked out in the current situation, and that it will develop along with the experience and rapid changes in technology and society. Taking into account the abovementioned, the measures included in the communication are planned to be implemented mainly in 2010-2015.

Development of information society and e-government is analyzed in the following informative reports:
- *Informative Report on the Situation in the Electronic Government and Information Society in Latvia* (reviewed by the Cabinet of Ministers on March 4, 2008);
- *Informative Report on the Introduction of Single Contact Point Principle for the Availability of Administrative Services* (reviewed by the Cabinet of Ministers on September 15, 2009);
- *Informative Report on the Implementation of the Electronic Government Development Programme for 2005-2009* (reviewed by the Cabinet of Ministers on March 23, 2010);
- *Informative Report on the Opportunities of the Use of Microsoft Infrastructure Software and Optimization of Information Technologies Infrastructure in the Ministries and their Subordinate Institutions* (reviewed by the Cabinet of Ministers on April 6, 2010);
- *Informative Report on the State Information Systems and their Development Opportunities* (reviewed in the meeting of the State Secretaries on May 13, 2010).

Funding from the EU structural funds, as well as state and local governments' budget will be used for the development of electronic government and information society (see Box 6.15).

Box 6.15

Priority projects for the development of electronic government and information society

According to the Decree No. 147 of the Cabinet of Ministers of March 15, 2010 *On the priority projects' list for the development of electronic government and information society*, a list of priority projects of ministries, institutions under their jurisdiction and supervision on the development of electronic government and information society for the planning period of 2007-2013 of EU funds was approved. The list contains 65 projects with the total eligible costs in the amount of LVL 98.9 million, of which 44 projects with the total eligible costs of LVL 62.2 million, and 21 planned projects with the total eligible costs of LVL 36.7 million. State budget financing forms 15%, but 85% is co-financing from the EU funds. The implementation of the projects is planned within 1.5-3 years.

The largest financing (at least LVL 2 million) is provided for such projects as the 2nd level of the development and introduction of Joint State Archives Information System (LVL 3.5 million), development of Biometric Data Processing System (LVL 3.5 million), the 2nd level of development of the Portal *www.skolas.lv* (LVL 3.1 million), the 2nd level of development of Digital Library (LVL 2.7 million), development of Client-Guided Service System for the Ministry of Agriculture and its subordinate institutions (LVL 2.5 million), development of Information System on Construction (LVL 2.5 million), the 1st stage for the development of Information System of Electronic Health Card and Integrity Platform (LVL 2.5 million), E-services and development of its infrastructure (LVL 2.4 million), development of Geospatial Information System of the State Land Service geospatial data (LVL 2.3 million), the 2nd stage for the development of the Unified Environment Information System (LVL 2.3 million), development of Electronic Attendance Booking (*e-booking*), the 1st stage for the Electronization of Health Care Job Flow (*e-referrals*), development of Society Health Portal, ensuring information security and protection of personal data (LVL 2 million), as well as development of the Joint Geospatial Information Portal and linking of the sectoral GIS with the portal (LVL 2 million).

Electronic services

According to the *Eurostat* data, Latvia in 2009 had introduced 65% of 20 basic electronic services (EU average – 74%). As most of the EU member states have already introduced all 20 basic electronic services, the EU develops currently a new methodology that will allow analyzing accessibility of e-government also in the future. The internet portal *www.latvija.lv* is a single contact point for the services of the state and local governments in Latvia. Since December 28, 2009, entrepreneurs can access electronically to 78 services provided by the public institutions. In total, information about more than 1300 services is available in the public services catalogue. Since June 2010, it is possible to register an enterprise in the Register of Enterprises electronically.

Since June 1, 2009, the Ministry of Regional Development and Local Government is responsible for the implementation of electronic government. Information on e-procurement and development of e-services is available now 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 – on the website of the Ministry of Regional Development and Local Government (*www.raplm.gov.lv*)

According to the data of the State Regional Development Agency, the total sum of general agreements on procurement in 2009 reached LVL 3.4 million (in 2008 – LVL 6.2 million), the number of goods in e-catalogue reached 40 thousand. The largest part was made by the procurements of computer technologies, printing equipment and medicaments.

In September 2006, the sate JSC "Latvijas Pasts" introduced the e-signature service and started the issue of e-signature smart cards. 30 thousand e-signature smart cards were issued until the end of 2008. Since the further purchase of smart cards will be performed by institutions at their own budget expenses, it is expected that at the end of 2010, the number of smart card holders will decrease to 5 thousand.

Taking into account the small amount of available electronic services and financial loss caused by introduction and maintenance of e-signature, on June 1, 2009 the state JSC "Latvijas Pasts" transferred the function of providing certification services to the JSC "Latvian State Radio and Television Centre".

On January 12, 2010, the Cabinet of Ministers approved the *Concept on Electronic Identification Cards* developed by the Ministry of Regional Development and Local Government, envisaging introduction of electronic identification cards. The card will be a person's identification and travel document in the EU, as well as the means for a person's electronic identification and authentication for electronic services, and also an e-signature carrier. The cards will be issued by the Office of Citizenship and Migration Affairs. The functions of reliable certification services provider will be carried out by a service provider selected in the framework of a tender procedure.

Taking into account the small number of e-signature smart card users and budgetary restrictions, on January 12, 2010, the Cabinet of Ministers repealed the Decree No. 810 *On the concept of establishing an electronic election system* of December 17, 2007. Establishment of an electronic election system will take place only after introduction of the electronic identity card.

Broadband internet

According to the *Eurostat* data, in Latvia in 2009 the number of broadband internet access lines has reached 17.5 (EU average – 23.9) per 100 inhabitants (a broadband internet access line is a line, in which the data transfer rate is higher or equal to 144 kbit/s).

According to the latest published data in the internet on the speed measure on the website *speedtest.net* of the internet research company "Ookla Net Metrics" in June 2010, Latvia with the download speed 23.3 Mbit/s takes the 2nd place and with the upload speed 12.23 Mbit/s – 3rd place among 180 countries. Such results are reached due to investments of the largest Latvian telecommunication enterprises in the development of optical cable. For instance, the optical network internet of the enterprise "Lattelecom" currently is available to 200 thousand households, but by the end of 2010 it is planned to provide access to it for 300 thousand households that are mainly located in Riga and in the largest towns in Latvia.

In spring 2008, within the framework of the project *Development of broadband communication infra-structure in rural areas* of the Ministry of Transport, the JSC "Telekom Baltija" (Triatel) built a mobile data transmission network that provides opportunity to use broadband data transmission services almost anywhere in the territory of the Republic of Latvia by ensuring download speed of at least 256 kbit/s.

In the beginning of 2009, the LLC "BITI" carried out a *Research on the Provision of Equal Access Opportunities to Electronic Communications Services in the Whole Territory of the Country (Development of Broadband Network).* It was concluded that internet download speed available in rural areas for the end users does not correspond to the present needs anymore, but the costs of installation and subscription exceed the costs for equivalent services in towns by several times. In order to ensure administrative centres of regions with appropriate broadband speed, the places where it is advisable to develop infrastructure of optical fibres were identified.

It is planned to improve the broadband internet infrastructure by attracting ERDF financing from the action programme *Infrastructure and Services*, and that would ensure the use of the internet with the download speed of at least 2 Mbit/s in the whole territory of Latvia.

Combating computer piracy

According to the data of the international computer programme copyright protection organisation "Business Software Alliance", the level of computer piracy in Latvia remained at 56% in 2009 (the level has not changed since 2006), while the losses to Latvian economy caused by piracy have decreased to LVL 12 million.

E-Commerce

According to the *Eurostat* data 15.9% of all enterprises in 2008 having 10 and more employees had made purchases over the internet, but 5.2% of enterprises had sold services and goods over the internet. The turnover of goods and services purchased over the internet in Latvia constituted 4% of the total purchases in 2008, but the turnover of goods sold over the internet amounted to 4.4% of the total net turnover. According to the *Eurostat* e-commerce amounted to 12% from the total turnover of EU enterprises in 2008 (in 2009 – 13%).

In the 1st quarter of 2009, 26% of the population or 38% of internet users had made purchases or ordered goods or services over the internet for own needs at least once in a life. Purchases over the internet are mainly made by the population in the age group of 25-34 years (51% of internet users in this age group).

6.7. Small and Medium-Sized Enterprises

Small and medium-sized enterprises (SMEs) comprise a major part of the national economy and play a significant role in GDP growth and employment in Latvia like elsewhere in Europe (see Box 6.16).

Box 6.16

The number of small and medium-sized enterprises in Latvia

There were 72.4 thousand economically active individual enterprises and commercial companies (provisional information) in Latvia in 2008 (excluding agricultural and fishing farms and self-employed persons, who perform economic activities), of which 99.5% belonged to the category of SMEs. The distribution of economically active SMEs in Latvia is the following: micro enterprises – 79.3%, small enterprises – 16.8%, medium-sized enterprises – 3.4%, large enterprises – 0.5%.

An important indicator characterising the economic activity is the number of economically active enterprises and commercial companies per 1000 inhabitants. This indicator in Latvia has grown constantly over the last 7 years from 17 in 2001 to 32 in 2008.

However, it is of the same importance to emphasize the number of performers of individual work (self-employed persons), which amounted to 42.8 thousand (provisional information) in 2008 (19 per 1000 inhabitants), and the number of agricultural and fishing farms, which equalled to 13.3 thousand in 2008 (6 per 1000 inhabitants). Taking into account the fact that there is no single methodological practice among the EU Member States for calculating the indicator characterising the economic activity as the number of enterprises per 1000 inhabitants, it is difficult to conduct objective comparative analysis of this indicator. The current practice of the responsible EU institutions shows that calculation of the number of enterprises per 1000 inhabitants includes not only businesses and commercial companies, but also self-employed, agricultural and fishing farms, etc.; therefore, applying an analogous practice accordingly, it has been calculated that in 2008 Latvia had 57 performers of economic activity per 1000 inhabitants.

According to the statistical data of "*Lursoft*" and the Register of Enterprises of the Republic of Latvia, 9228 individual enterprises and commercial companies were registered in 2009, while 5715 were liquidated. In 5 months of 2010, 4055 individual enterprises and commercial companies have been registered, while 1422 have been liquidated.

Aid to SMEs in Latvia is regulated by the *Law on Control of Aid for Commercial Activity,* which came into force on January 1, 2003.

Box 6.17

Definition of SMEs

Law on Control of Aid for Commercial Activity provides the definition of SMEs (according to the *European Commission Regulation* No. 70/2001 and amendments by the *European Commission Regulation* No. 364/2004, as well as pursuant to the *European Commission Recommendation* No. 361 of May 6, 2003)*:*

medium-sized enterprises:
- number of employees: 50-249;
- annual turnover does not exceed EUR 50 million;
- total annual balance sheet value is under EUR 43 million;

small enterprises:
- number of employees: 10-49;
- annual turnover does not exceed EUR 10 million;
- total annual balance sheet value is under EUR 10 million;

micro enterprises:
- number of employees: 1-9;
- annual turnover does not exceed EUR 2 million;
- total annual balance sheet value is under EUR 2 million.

On January, 27 2004, the Cabinet of Ministers approved the *Policy Guidelines for Development of Small and Medium-Sized Enterprises in Latvia* establishing the basic principles of government activity, long-term objectives, and sub-objectives, as well as the main directions of activity of the SMEs development policy. The goal of the guidelines is to promote favourable business environment, encourage initiatives of entrepreneurs and lessen the general risk, prevent obstacles to entrepreneurship, and foster stability and efficiency of the financial system and of the capital market in order to improve competitiveness of enterprises in the market.

The guidelines foresee implementation of a policy based on the best practices of the developed countries in accordance with the directions of activity outlined in the *European Charter for Small Enterprises* and other EU documents (see Box 6.18), at the same time taking into account the specifics of SME development problems in Latvia.

On June 28, 2007, the Cabinet of Ministers approved the *Programme on Promotion of Entrepreneurship Competitiveness and Innovation for 2007-2013* developed by the Ministry of Economics.

The programme includes activity policy for promotion of business competitiveness, innovative activities and industrial development setup, describing the vision of competitiveness, innovation and industry development for the next 7 years. The main objectives of the programme are to provide favourable conditions for business development, to promote increase in capacity and efficiency of the *National Innovation System*, to achieve substantial growth of industrial competitiveness and productivity, fostering increased volumes of manufacturing products with high added value.

Box 6.18

Activities of the EU for promotion of entrepreneurship

On June 25, 2008, the European Commission approved the statement *A Small Business Act for Europe*, mainly aimed at integrating the use of *Think Small First* principle in preparation of political documents, improving overall political approach to business activity, particularly promoting development of small and medium-size enterprises and helping to eliminate impediments preventing its development. The Act includes proposals for 10 politically binding guidelines and several specific regulations.

In 2009, the European Commission launched organisation of new initiative – *European Small and Medium-sized Enterprise (SME) Week* aiming to provide the existing and potential entrepreneurs with information and means necessary for sustainable success and ensuring the competitiveness in dynamic economic environment of Europe.

European SME Week 2010 is devoted for implementation of objectives of *Small Business Act for Europe*. Officially *European SME Week 2010* took place from May 25 to June 1, when different conferences, seminars, trainings, discussion forums and award ceremonies were organized in 37 European countries to provide the society with information about activities of the European Union, Member States and regional and local municipalities institutions for adjustment of business activity, to promote the business activity, and to show recognition to entrepreneurs for their contribution to European welfare, creation of new workplaces, innovations and competitiveness.

In order to ensure experience exchange and new knowledge for further business development to potential and existing enterprises, *European SME Week 2010* events took place in Latvia in May and June. In the context of *SME Week 2010 in Latvia*, conferences, contact exchanges, regional and thematic seminars were organized on topics such as service rendering in EU member states (*Services Directive*), legal issues of export (export contracts), public procurement in the European Union, introduction of customer management system in an enterprise, etc. Discussions were carried out concerning available support for business start-up and expansion, practical advice for implementation of business ideas was provided, as well as the initiator of *European SME Week 2010* idea in Latvia – SIA "Madara Cosmetics" was honoured during these events. In general, more than 15 informative events for entrepreneurs were organized in Latvia, engaging over 3000 entrepreneurs.

On October 30, 2009, the Cabinet of Ministers approved the *Concept on Support Measures for Micro Enterprises* with the aim of creating necessary preconditions to encourage unemployed people to start business activity, to improve business environment, which fosters operations of micro-enterprises, reducing the unemployment level, thus increasing the share of entrepreneurs in the total number of employed citizens. In order to implement the aim of the Concept, the following fields of activity are necessary:

– reducing the costs related with launching commercial activity of micro-enterprises;
– implementing tax policy, which is friendly for micro-enterprises;
– ensuring that the micro-entrepreneur is able to do his own accounting;
– ensuring availability of funding for micro-enterprises;
– ensuring availability of complete information for micro-enterprises.

Currently, the Concept is successfully being implemented, and the first amendments to relevant normative acts are made. A range of amendments was approved along with adoption of the state budget for 2010 in the Saeima at the end of 2009. For instance, specified procedure of value added tax payment for enterprises with turnover up to LVL 70 thousand on "cash principle" and prolonged taxation period for a quarter.

Significant measures were taken also at the beginning of this year. To reduce business start-up costs, the state duty for registration in the Enterprise Register and for certification of signature is reduced by 50 percent.

When amendments to the Commercial Law came into force in May 2010, the costs of business start-up were significantly reduced, stipulating that a limited liability company can be established with the equity capital below LVL 2000. At the same time, it was stipulated that for registration of the abovementioned Ltd the following is set:

– state duty is LVL 15, charge for advertisement LVL 12.60;
– there will be no state duty for registration of changes to equity capital and advertisements related to increase of equity capital.

<u>The Mortgage Bank of Latvia</u>, which is the only 100% state-owned bank in Latvia and fulfils the functions characteristic for a development bank, has a substantial role in trading support instruments.

Box 6.19

<u>Transformation of the Mortgage Bank into Development Bank</u>

On December 3, 2009, the Cabinet of Ministers accepted the concept *Transformation of State Joint Stock Company "The Mortgage and Land Bank of Latvia" into Development Bank*. The aim of the concept was to select the optimum versions for transformation of the Mortgage Bank into a development bank, reducing the number of transactions of commercial bank and focusing the work of the bank on directions currently crucial to the national economy. In accordance with the decision of the Cabinet of Ministers the 1st model of the concept was approved providing foundation of a development bank on the base of the Mortgage Bank and gradual discontinuation of commercial functions not later than until December 31, 2013. The Mortgage Bank will phase out the amount of commercial loan portfolio and at the end of 2013 it will realize the remaining unpaid commercial loan portfolio or transfer it for servicing to another financial institution according to situation of that particular moment. Within the field of commercial activity the bank will grant commercial loans only to current clients corresponding to the amount existing loan volume and for restructurization of the bank's current commercial clients' existing loans. According to the approved model of the concept, the bank will continue implementation of the existing state support programmes, as well as in cooperation with the sectoral ministries will develop new support programmes, while the government will decide on implementation of these programs.

<u>Transformation of the Mortgage Bank</u>

In accordance with Action Plan, bank branches will be identified in the transitional period, in which commercial loan portfolio and other support products of the Development Bank will be concentrated. Branches of the Development Bank will be concentrated in the biggest cities of Latvia – regional centres. It is provided that in the course of the transformation process, the Mortgage Bank will annually implement new support programmes in the amount of LVL 70 million according to the priorities defined by the government in such fields as financing of small and medium-sized enterprises (SME), financing of business activity start-up, promotion of micro-enterprise and self-employment, financing of innovative, technologically intensive and high added value projects, funding for production of goods and rendering of services competitive in the international market, implementation of energy efficiency measures, development of agriculture and rural areas, particularly focusing on fostering and engaging the specific socially sensitive population groups (for example, the disabled, unemployed, new families, national minorities) in self-employment and commercial activity. The plan of measures of the Mortgage Bank transformation envisages drafting of a law on the Development Bank and amendments necessary to legislation in force, as well as phasing out of the commercial segment of the bank by December 31, 2013.

In 2010, the Mortgage Bank continues implementation of both existing and new development programmes, in the framework whereof specific groups of merchants and citizens are supported:

– co-financed by ERDF *Support Programme on Improvement of Competitiveness of Enterprises*;
– co-financed by ESF *Support Programme on Improvement of Competitiveness of Enterprises*;
– Micro Crediting Programme of Latvian Small and Medium-Sized Enterprises;
– SME Growth Loan Programme;
– Programme of Agricultural Current Assets.

At the moment, the most significant support programme implemented by the Mortgage Bank is the *Support Programme on Improvement of Competitiveness of Enterprises* approved by the Cabinet of Ministers on May 2008. Initially, within the framework of the programme, technologically intensive manufacturing enterprises, as well as establishment of new enterprises was supported by providing investment and current assets loans to small and medium enterprises oriented towards international market, manufacturing products, or providing services with high added value,. Having regard to global financial crisis, which started in the fall of 2008, in February 2009, the Cabinet of Ministers made amendments to conditions of the programme, extending the range of enterprises eligible for support – together with the small and medium-sized enterprises, also large enterprises with economically substantiated action plans and without access to financing from the crediting institutions due to increased risk may receive the support. Within the framework of the programme, loans for investment and current assets will be granted with the maximum loan amount for one enterprise not exceeding LVL 6 million. The loans are mainly envisaged for implementation of projects of processing enterprises and for enterprises which are attracting funding of the EU Structural Funds grant programmes. It is expected that until December 2013, the Mortgage Bank will grant loans for improvement of enterprise competitiveness in the amount of LVL 210 million[1]. Within the framework of the support programme on improvement of competitiveness of enterprises, since its launching 314 loans have been granted in the amount of LVL 119.9 million, including 35 loans in the amount of LVL 36.9 from ERDF funding[2]. The fields receiving most funding are forest exploitation, timber processing, electricity production, and metal working, food production, printing and publishing, and accommodation services.

The programme *Support to Starting Self-Employment and Entrepreneurship* co-funded by *ESF,* approved by the Cabinet of Ministers on March 2009*,* provides complex support to business start-ups and newly established companies, i.e. consultations, training, and financial loans (up to LVL 54 thousand) and grants[3] for starting an economic activity. Support may be granted to the working-age persons, including unemployed persons who have expressed the wish to start commercial activity or self-employment, as well as to the newly established companies. For the purposes of this programme, newly established companies are companies that have lawfully registered their activity not earlier than 3 years before requesting the support under the programme. The project amount envisaged in the business plan may not exceed LVL 60 thousand, and the beneficiary must provide co-financing for implementation of the business plan to the extent of at least 10% from the total amount of the plan at the same time. Total funding of the programme is LVL 23 million, including funding from the ESF's and state budget – LVL 14 million, and co-financing of the Mortgage Bank of LVL 9 million. In the framework of the total funding of the programme, LVL 17.5 million is envisaged for loans, while LVL 4 million – for grants, training, and consultations. It is planned that within the framework of the programme, activity 1200 start-ups will be trained by 2013, while funding (loans and grants) will be received by 600 persons.

Practical implementation of the programme has been launched in August 2009. Since launching of the programme, 1641 potential entrepreneurs have shown interest in it, while cooperation agreements have been concluded with 744 entrepreneurs, 228 customers have submitted business plans, including 101 start-ups projects, which have already been funded for the total loan amount of LVL 1.57 million. For 92 projects, grants for the total amount of LVL 429.1 thousand have been awarded. Within the framework 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[4] since January 2010. The training is available for persons wishing to start an economic activity or having started it during the last year. The training according to modular approach is available on such modules as basics of business activity (organisation of small business), management basics, and legal regulation of entrepreneurship, finance management of the enterprise, economic activity accounting and taxes, marketing basics. So far, 435 participants have been trained in 37 training groups. Out of the said number, 34 groups have already completed the course, thus the number of participants having completed the training is 278. So far, training has been organized in Riga, Jelgava, Rezekne, Valmiera, Cesis, and Daugavpils.

In December 2008, the Cabinet of Ministers approved the *Latvian Small and Medium-Sized Enterprises Micro Crediting Programme*. The programme is aimed at introducing a mechanism of micro crediting for small and medium-sized enterprises and self-employed

[1] Currently, the total amount of programme resources is LVL 128.8 million. The programme funding comprises resources of Northern Investment Bank (NIB) (LVL 70.2 million), ERDF (LVL 43.3 million), as well as funding of the Mortgage Bank (LVL 15.3 million).

[2] Information in this case and in case of other described programs after the situation on May 23, 2010

[3] A grant for starting of an economic activity (up to LVL 3600, but not exceeding 35% from the amount of the loan); a grant for repayment of a loan (up to LVL 2000, but not exceeding 20% from the amount of the loan).

[4] In the region of Riga, training is provided by a company incorporation "Grāmatvedības un finanšu koledža" and "Biznesa komplekss"; in Vidzeme and Latgale regions – incorporation of SIA "Mācību un konsultāciju centrs ABC" and SIA "Mensarius"; in Kurzeme and Zemgale regions – SIA "Stockholm School of Economics in Riga".

persons, as well as at promoting access to micro credits for starting business activity or its development. Micro credits for the amount of LVL 3 thousand are envisaged for implementation of business projects – loans for investments and current assets – for enterprises with up to 10 employees, as well as for self-employed persons. The total budget of the programme is LVL 565 thousand, including a contribution from the Ministry of Finance in the amount of LVL 452 thousand and financing from the Mortgage Bank in the amount of LVL 113 thousand. Since February 2009, when the implementation of the programme was launched, the Mortgage Bank has already granted 194 loans for the total amount of LVL 538 thousand, thus the programme is implemented to the amount of 95%. Basically, within the framework of the programme projects related to service rendering and retail have been funded.

In September 2009, the Cabinet of Ministers adopted regulations *On Loans for Promotion of Development of Micro, Small and Medium-Sized Enterprises and Agricultural Services Cooperatives*. In accordance with these regulations, in February 2010, the Mortgage Bank launched implementation of the *SME Growth Loan Programme*. It is aimed at improving access to funding for persons who are performing economic activity and are registered in Latvia, thus fostering economic development. It is envisaged that within the framework of the programme, until 2013, for the promotion of development of micro, small, and medium-sized enterprises and agricultural services cooperatives, loans current assets and investments of LVL 142 million will be available. The maximum loan amount per person performing economic activity will not exceed LVL 300 thousand; the maximum loan amount for current assets is LVL 200 thousand. Investment loans will be available with the loan term of up to 10 years, the current assets loans – up to 5 years. So far within the framework of the programme, 31 loans for the amount of LVL 2.2 million have been granted.

In May 2010, the Mortgage Bank launched the *Current Assets Loan Programme for Producers of Agriculture Produce*. Producers of agricultural produce, agricultural service cooperatives, as well as groups of vegetable producers may receive current assets loans from LVL 5 thousand up to LVL 700 thousand with a term of up to 1 year. Guarantees of Rural Development Funds may be attracted to the loans. It is provided that the current assets loans in the total amount of LVL 10 million will be granted within the framework of the programme before December 31, 2011. Although the programme is launched quite recently, 13 loans in the amount of LVL 571 thousand have been already granted.

The Mortgage Bank is planning also further development and implementation of new support programmes. For instance, in accordance with the Informative Report *On Undistributed Funding of Latvian and Swiss Cooperation Programme* revised by the Cabinet of Ministers, the Mortgage Bank in cooperation with the Ministry of Economics, Ministry of Welfare, Ministry of Culture, and Ministry of Agriculture has been entrusted to prepare a summary of *Micro Crediting Programme* project, which will be harmonized with the government of Switzerland, which, in order to implement the programme, is willing to co-finance for the amount of CHF 6.68 million. It is envisaged that within the framework of the programme, micro enterprises will be able to receive micro credits in the amount of up to LVL 10 thousand, provided that the loan term does not exceed 5 years. It is expected that the micro crediting programme might be launched in May 2011 and will be effective for the upcoming four years.

The "Latvian Guarantee Agency" (LGA) is a state-owned enterprise with the aim of supporting accessibility to funding for enterprises registered in Latvia. LGA offers two guarantee programmes for improvement of competitiveness:

– *Loan Guarantees*, with an aim to help enterprises attract credit resources in cases, when their security is insufficient to receive credit resources;
– *Export Loan Guarantees*, with an aim to support exporters covering political and commercial risks related to export transactions.

On March 10, 2009, the Cabinet of Ministers adopted Regulations on additional activity 2.2.1.3 *Guarantees for the Improvement of Enterprise Competitiveness* of 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 projects, by ensuring guarantees in situations when the guarantee at the disposal of the enterprise is not sufficient to attract the credit resources in the necessary amount and when the banks evaluate the enterprise as too risky, as well as to facilitate competitiveness of businesses, promote absorption of new markets and consolidation in the existing ones.

On April 20, 2009, the LGA and Ministry of Economics signed a contract on implementation of OP project *Guarantees for the Improvement of Enterprise Competitiveness* of activity 2.2.1.3 *Guarantees for the Improvement of Enterprise Competitiveness* of measure 2.2.1 *Access to Financial Resources* of priority 2.2 *Access to Finances* of Supplement *Entrepreneurship and Innovations*. The ERDF financing accessible in the framework of the activity is LVL 60 million.

On March 24, 2009, the Cabinet of Ministers adopted *Regulations on Guarantees for the Improvement of Enterprise Competitiveness* stipulating that LGA provides guarantees for such financial services as investment loans, current assets loans, financial leasing, and local factoring. The guarantees cover up to 80% of the principal amount of the financial service, but not more than EUR 3 million to one enterprise. The maximum term of a guarantee to loans for investments and financial leasing is ten years, and three years for the current assets loans and local factoring.

Since the beginning of the programme, there has been considerable activity of businesses, because by May 24, 2009, the LGA had received applications for guarantees from 236 companies, 155 of the applications have been approved and 85 are already issued.

Guarantees issued in the period until May 24, 2010 under the programme *Loan Guarantee Programme* of the activity 2.2.1.3 *Guarantees for the Improvement of Enterprise Competitiveness*:

- Number of applications – 236 enterprises;
- Amount of applications – 120,3 million LVL;
- Number of the issued guarantees – 124 enterprises;
- Amount of the issued guarantees – 47 million LVL;
- Amount of the guaranteed credits – 94.8 million LVL.

On May 12, 2009, the Cabinet of Ministers adopted regulations *On Short-term Export Credit* establishing coverage of short-term export credit guarantees, beneficiaries, as well as the procedure for granting guarantees and the procedure under which the guarantor covers the loss. The LGA's export credit guarantee covers up to 90% from the deferred payment amount, but not exceeding EUR 1 million or an equivalent amount of another currency. The deadline of the deferred payment may not exceed 2 years.

Since the beginning of the programme, significant changes in criteria of enterprise conformity eligible to qualify for receipt of export loan guarantees have been made. With the December 12, 2009 amendments to regulations of the Cabinet of Ministers regarding essential conformity criteria it is specified that the country of origin of all export goods shall be Latvia.

Guarantees issued in the period until May 24, 2010 in the framework of activity 2.2.1.3 *Guarantees for the Improvement of Enterprise Competitiveness* for the *Export loan guarantee programme*:

- Number of applications – 61 enterprises;
- Number of the issued guarantees – 26 enterprises;
- Amount of the issued guarantees – 1.41 million LVL.

6.8. Competition Policy

The Competition Council (CC) is responsible for development and implementation of the competition policy in Latvia. Its goal is to promote opportunities for market participants to perform economic activities under free and fair competition conditions, as well as to facilitate development of competition in the public interests in all economic sectors.

The CC operates in compliance with the *Competition Law,* other normative acts and institution's action plan, which includes such essential directions of actions as

- protection of competition,
- promotion of competition.

<u>Protection of competition</u>

Protection of competition comprises activities directed against the following violations of the *Competition Law*: prohibited agreements and abuse of dominant position. The CC also supervises mergers of enterprises.

In the first quarter of 2010, the CC has adopted 10 decisions from which 2 are in relation with mergers of enterprises and 8 – abuse of dominant position; these cases do not involve violations of the competition rights, and CC has launched investigation of 6 new cases.

The priority of the CC is identification and prevention of breaches of the *Competition Law* – prohibited agreements and dominant position abuse. Performing investigation on abuse of a dominant position related to possible offering of goods (services) below costs, the CC assesses the long-term effects of the possible prohibited actions on the market and its structure, efficient competitors and the consumer, as it was related to actions of SIA "Cemex" (see Box 6.20). This case was referred to the dominant market participant's special responsibility in not restricting competition in the respective market and not harming the consumer with its actions.

Box 6.20

The CC does not find violation in SIA "Cemex" actions in ready-mixed concrete market

On February 26, the Competition Council adopted a decision to close investigation on possible violation of the *Competition Law* in actions of SIA "Cemex". Taking into account the market conditions – recession of the state economy and the related decrease in the market amount, as well as the strong competitors and their actions in the market, the Competition Council had no reason to establish abuse of dominant position by SIA "Cemex" in the wholesale market of grey cement in order to benefit by forcing other market participants out of the ready-mixed concrete market.

Investigation of the case was started in 2008 based on the application of SIA "Eksim Trans", SIA "Baltijas Betonmix", SIA "Betons 97", and ***Association*** of Latvian manufacturers of building materials on possible unfair competition actions of SIA "Cemex", which involved decreasing ready-mixed concrete prices with the aim to force competitors out of market.

During the investigation, the Competition Council concluded that the duration of SIA "Cemex" low price policy in the ready-mixed concrete market has not been sufficient to have an impact on competitiveness of effective competitors. Thus, upon assessing the economic situation of SIA "Cemex" and other market participants in the ready-mixed concrete market (including the fact that besides SIA "Cemex" there is an enterprise from a group of vertically integrated enterprises in the market) and their actions (competitors were able to apply low prices, and the market shares of certain enterprises in the ready-mixed concrete market have increased) alongside with the particular market conditions (economic recession and decrease in the market amount), the institution did not establish violation of the *Competition Law* in the actions of SIA "Cemex".

Although a violation of the law was not found, SIA "Cemex" holds a dominant position in Latvia's wholesale market of grey cement. Vertical integrity of SIA "Cemex", by simultaneously producing cement and operating in the wholesale market of cement as a raw material for ready-mixed concrete and Latvia's trade market of ready-mixed concrete, gives it advantage in the ready-mixed concrete market. SIA "Cemex" has the possibility to use their market power in cement market also in ready-mixed concrete market, as well as to influence the competition in it, i.e. apply low ready-mixed concrete prices, which do not bear the costs and cover the resulting losses (cross-subsidizing) from the profit in the cement market, in which SIA "Cemex" holds a dominant position.

In the decision, the Competition Council pointed out that SIA "Cemex" has a special responsibility, with their operations, including price policy, not to restrict competition in ready-mixed concrete market and not harm the consumer. SIA "Cemex" has to be aware that in long-term applying a strategy of low prices (below the costs) in ready-mixed concrete market in order to restrict competition, the operation of SIA "Cemex" alongside with the market changes could be qualified as a violation of the *Competition Law*.

Promotion of competition

This direction of activities includes market sector supervision and research, as well as culture of competition development in the society. The task of CC is to work purposefully in order to collect and analyze all-inclusive information on the competition situation in different markets, to promote competition in markets, where there is no competition or it is insufficient, and to improve understanding of the society about the positive influence of competition on society's well-being.

In the framework of market supervision, by collecting information on intentionally chosen markets, CC analyses the competition situation, and, if necessary, develops and submits proposals for improvement of the situation to the responsible institutions, as well inspects, whether there are any violations of the *Competition Law* in the supervised markets.

In the first quarter of 2010, the CC has completed two market supervisions – supervision of the road construction market, which included analyses of situation in the spheres of construction, reconstruction, and periodic maintenance of motor roads, streets, and forest roads during 2005-2009 (see Box 6.21) and supervision of knitwear and cloth accessories market. The information collected within the framework of the road construction market supervision enabled the institution to initiate two cases on possible violations of the *Competition Law*. In one of these cases, a prohibited agreement between two road construction enterprises was discovered, but in the other investigation the case was closed after a written determination of the enterprise to fulfil the legal duties, which eliminate the possible negative influence of its performed actions (*de facto* implemented merger and not reporting the respective merger) on competition.

Due to the fact that the CC recognises the necessity to ensure a legal environment for business development, which is encumbered at the moment, during the economic recession, as well as the necessity to timely discover distortion of competition in fields, which concern wide range of consumers – many activities in the market supervision are envisaged for 2010, which allow to effectively obtain and analyze information about the competition situation in most important markets for consumers, as well to look for solutions for its improvement. 9 market supervisions have been started in the first quarter of 2010 in fields like, for example, pay-per-view television, sugar realization, baby food trade, management of real estate, fuel retail sale and passenger transport services. In total, 14 market supervisions are still continued.

With respect to the amendments of the *Competition Law* from March 23, 2010, regulations of the Cabinet of Ministers No. 272 Amendments in regulations of the Cabinet of Ministers from September 28, 2008 No. 795 *Competition Council statutes* were adopted, which envisage liquidating two positions of the CC members.

Taking into account that during the last years the CC has discovered several cartel agreements among the public procurement candidates, as well as to help discover and prevent such agreements in state and local government procurements, informative material was prepared describing the features that could indicate a prohibited agreement among the procurement candidates. Since the public procurement managers working with received proposals are in a position to notice the abovementioned signs most quickly, the material was sent to the state and local government institutions. It is also available on the website of the Competition Council *http://www.kp.gov.lv/uploaded_files/KPPP055Karteli_iepirkumos.pdf.*

Box 6.21

The results of the CC supervision of road construction market

Information included in the final report on supervision shows that the majority of the total amount in road construction is formed by public procurements. Accordingly, the activities and competition in this market to a great extent depend on state financial capacity and state policy in the road construction field, as well as on professionalism and decency of the particular procurement organizers, thus the market can not be adjusted by solely strengthening competition.

From the perspective of competition, negative is the fact that during cooperation (either by developing joint proposal or by involving a subcontractor after winning in the procurement) the market players in a short period of time obtain sufficiently detailed, sensitive business information about their competitors and are able to forecast competitors' actions in the market. At the same time, the CC referres to the fact that the possible solutions, for example, division of procurement in several implementation stages choosing several independent market participants as winners in the tender, have to be carefully evaluated in the context of corruption risk and efficiency of organizing the procurement.

In the field of road construction, the CC has defined road construction, reconstruction, renovation and periodic maintenance market in Latvia as a separate market, concluding that there are 17 operational commercial companies. The share of turnover and amount of performed actions of these enterprises form an essential part in the total turnover and amount of road construction field.

During the period from 2005 to 2008, the amount of financing has increased in all sections of the field every year in comparison with the previous. The total turnover of the abovementioned 17 commercial companies (excluding subcontractors) in 2006 has also increased by 39%, in 2007 – by 21%, and in 2008 – by 20%, in comparison with the previous year. In 2009, the turnover has decreased substantially – in 8 months it forms only 47% from the turnover in the respective time period of 2008.

The average commercial profitability of the market participants in 2005 was 6.6% (certain commercial companies have worked with losses), in 2007 – 9.8%, in 2008 – 8.4%. According to the tendencies in 2009, essential changes have taken place – many commercial companies work with losses or minimum profit, at the same time certain commercial companies still work with substantial commercial profitability.

In the examined market, there is a high level of concentration with an increasing tendency. One of the reasons for the increase of concentration in the previous years is that only a restricted number of candidates are able to qualify for large-scale procurements – the main market participants. If the amount of works in the field will not increase in the near future, some of the enterprises could be forced to end their economic activity; due to this, the number of market participants will decrease in the future.

Market participants and other interested parties have possibility to study the information on the most important events in operations of competition supervision institutions of the European Competition Network (ECN) member states, including Latvia, about the most interesting investigated cases, performed researches and market supervisions, current events in legislation and other essential issues regarding competition policy, which are included in the ECN newsletter. It is prepared every two months and is available on the website of the Competition Council (*http://www.kp.gov.lv/?object_id=522*) and the website of the European Commission.

6.9. Regulation of Public Utilities

The Public Utilities Commission is a multi-sector regulator performing regulatory functions in the sectors of energy, electronic communications, postal services and railway transport, water management and municipal waste management. The task of the Commission is to ensure the opportunity to receive uninterrupted and safe services to all users at economically reasonable prices and to ensure the possibility for enterprises to develop provision of public services with profitability according to the economic situation. The Commission adopts its decisions independently and is not subject to decisions of the government or other public institutions. The members of the Commission's Board are appointed by the Saeima, and only the court may declare decisions taken by the Commission unlawful and cancel them. Activities of the Commission are financed from the state duty paid by enterprises for regulation of public utilities on the basis of the annual net turnover of the regulated public utilities.

Functions of the Commission include regulation of the regulated sectors and enterprises that operate therein, protecting the interests of users and fostering development of public utility providers, setting tariff calculation methodology and approving tariffs in accordance with the laws of each sector, issuing licenses and registering electronic communications and postal entrepreneurs, promoting competition in the regulated sectors, carrying out extrajudicial settlement of disputes, and supervising compliance of the provided services with license and general authorisation conditions and specified quality requirements.

Situation and policies of the regulated sectors

Electricity and gas supply (see also Chapters 3.2.3. and 6.3.2.)

The dominant role in electricity supply is held by AS "Latvenergo", which generates more than 90% of electricity produced in Latvia and ensures the supply of electricity, as well as delivery to those users, who have not chosen another supplier. As from September 1, 2005, all functions of the electricity transmission system operator are carried out by AS "Augstsprieguma tīkls", fully owned by AS "Latvenergo", but as from July 1, 2007 the functions of distribution system operator are carried out by AS "Sadales tīkls", fully owned by AS "Latvenergo".

Electricity is also generated by about 138 small hydropower stations with the total capacity of 25 megawatt (MW), 20 wind power stations with the installed capacity of 29 MW, and 54 cogeneration plants with the installed capacity of 140 MW. About 20 other merchants have received licences to carry out distribution and sale of electricity.

As from July 1, 2007, Latvian electricity market is fully open to competition and since the second half of 2008, the largest electricity users buy electric energy at an agreed price, several electricity users have changed their electric power supplier.

On July 13, 2009, European Parliament approved a set of laws aiming at promotion of higher competition and thereby – a wider choice, energy efficiency and power supply safety and lower prices in energy market. It establishes new requirements for network operator decoupling and investment supervision, independence of member states regulators, as well as provides establishment of cooperation organisation for energy regulators at European scale.

The supply of natural gas in Latvia is ensured by a vertically integrated merchant AS "Latvijas Gāze".

In accordance with the amendments of the Law *On Excise Duties*, since July 1, 2010, the excise duty will be applied to natural gas used as fuel or petrol. Natural gas used in combined plants producing electric energy and heat energy, and natural gas used for operation of industrial production technological equipments and provision of climate technologically necessary for industrial premises will be exempted from excise duty. Thus it is expected that heat supply tariffs will grow, however natural gas taxation will not affect electric energy tariffs.

Natural gas tariffs change automatically depending on the price fluctuations of the purchased gas. The fact, that at the end of 2009 the gas price was pegged to the average nine months price for oil products was very advantageous to the users, because the average index reached the lowest level only in September, although since March 2009 the oil prices have been growing. A large part of the gas pumped into Inčukalns Gas Storage has been purchased at a rather profitable price therefore until the end of the 2009-2010 heating season the applicable natural gas price will remain low. However dynamics of oil and oil product prices and changes of US dollar/euro exchange rate during the first half of 2010 allow forecasting considerably higher gas prices in the fall of 2010, if compared to the fall of 2009.

Electronic communications and postal services

319 merchants of electronic communications were registered and actively operated in the sector of electronic communications as of May 18, 2010. In the postal sector, VAS "Latvijas Pasts" provides general postal services, while approximately 50 service providers operate actively in the sector of express mail.

From April 1, 2010, the decisions of the Commission on gradual reduction of call completion tariffs for electronic communication enterprises having material impact on the market were enforced. It is expected that application of the decisions will reduce total amount of merchants income, but in the upcoming years will promote decrease of voice call tariffs for service users calling to other operator networks. In compliance with the requirements of the Regulation, also Latvian mobile network operators will implement the mechanism till June 1, 2010 in order to warn the user on bills of potentially large sum of money by using data transfer services within roaming.

On November 25, 2009, the European Parliament and Council approved a set of laws aiming at promotion of higher competition and improvement of internal market of electronic communication services, by strengthening the mechanism of European Community regarding regulation of those operators, who have significant influence on markets. Regulation with respect to universal service has been revised as well. Regulation of the European Parliament and Council provides new requirements regarding independence of operators of the member states, as well as it is planned to establish an institution and office of the European Electronic communication regulators.

On July 3, 2009, the new *Law on Postal Services* was enforced, which stipulates a single legal framework in the field of postal services provision for all players of the postal services market, in order to ensure universal accessibility to postal services and continuity of their provision, promote competition, by applying transparent, non-discriminatory and proportionate regulatory procedures, ensure free provision of postal services, as well as to protect the interests of postal services users. In relation to the new law the Commission has developed several regulations, orders, procedures, and methodologies, including *Universal Tariff Calculation Methodology for Postal Services*. Since February 2, 2010, the Commission has assigned universal postal service obligations to VAS "Latvijas Pasts".

Railway

In the railway sector, the VAS "Latvijas Dzelzceļš" ensures maintenance of public railway infrastructure. Domestic passenger transportation is carried out by AS "Pasažieru vilciens" and SIA "Gulbenes – Alūksnes bānītis". In the sector of cargo transportation, there are also several operators, such as SIA "LDz Cargo" AS "Baltijas ekspresis", and AS "Baltijas tranzīta serviss". SIA "LDz Cargo" performs also international passenger transportation.

On January 1, 2010, the fee for using public railway infrastructure for conveyances in 2010 was enforced. In comparison with 2009, the railway infrastructure charge applied is decreased by 0.5% to 7.2% depending on the category of train.

Heating, water supply and sewerage, waste management and disposal

In accordance with amendments to the *Law on Regulators of Public Utilities* of June 11, 2009, the Commission took over the regulatory functions in the sectors of heating, municipal waste management and water management from local government regulators or local government councils (boards) by November 1, 2009. In accordance with the *Waste Management Law*, the Commission carries out full regulatory functions with respect to disposal of municipal waste, while with respect to collection, transport, loading and storing, it only sets the tariffs until conclusion of an agreement between the local government and the enterprise selected according to the procedure provided for in the legislative acts regulating public procurement.

The Commission has developed and after wide discussions with the representatives of relevant sectors in the first half of 2010 it has approved a new tariff calculation methodology for heat energy supply and water management, new tariffs for particular heat supply, water supply and sewerage, as well as for waste management merchants.

According to adopted amendments to the *Law on Regulators of Public Utilities* the Commission has established new regional structural units in Latgale, Kurzeme and Vidzeme planning regions, which are correspondingly located in Daugavpils, Saldus, and Cēsis.

6.10. Export Promotion Policy

Guidelines for Export Promotion of Latvian Goods and Services and Attraction of Foreign Investment in 2010-2016 determine the basic principles, aims, and results to be achieved in the policy of export promotion and attraction of foreign investment. The guidelines define three main directions of action: increasing export competiveness, support instruments, and contractual security.

Concrete measures in these directions of action are envisaged in the framework of the *Action Plan for Export Promotion of Latvian Goods and Services and Attraction of Foreign Investment in 2010-2011*, which was approved by the Cabinet of Ministers on March 31, 2010.

The Plan includes measures that allow the merchants to increase their export competiveness, by supporting development of new products and their introduction in the market, production of high value-added products, increasing qualification of the labour force, improvement of transport infrastructure quality etc. The Plan envisages a wide variety of information consultative support measures, especially working on individual and practical training of the existing exporters and new exporters. The Plan envisages accessibility of particular financial instruments both for producers of industrial and agricultural goods in order to strengthen the focus of economic activity on the segments in which involvement of the private sector is insufficient.

Promotion of export and investments is implemented via **direct export promotion measures**. Also in 2010, a wide range of support services is available to the Latvian exporters in order to increase the export capacities and promote exports of Latvian goods and services. Merchants receive consultations about issues relating to export, among them about foreign markets and specific trade requirements, as well as they could participate in the seminars about export skills and informative seminars about foreign markets. Also, the trade missions and individual business visits to potential cooperation partners abroad are organized. Export and investment projects are also identified and implemented.

At the moment, 10 **external economic representations of Latvia** (in Germany, United Kingdom, Sweden, France, Russia, the Netherlands, Denmark, Norway, Japan, and Poland) are currently operating by promoting exports and the flow of investment projects to Latvia, providing support to Latvian enterprises in establishing and maintaining business contacts, providing information about the requirements of the respective foreign market, implementing the marketing measures of export promotion and attracting investment abroad, as well as the measures of finding cooperation partners by identifying the potential investors and business partners.

The representation activity is coordinated by the Council on Activity Coordination of Foreign Economic Representation of the Ministry of Economics, regularly reviewing topical issues regarding work of Foreign Economic Representation of Latvia and submitting proposals for further activity and development of the Representation Net to the Ministry of Economics.

Within the framework of the measure *Business Support Activities* of the EU Structural Funds activity programme *Business and Innovations* for 2008-2013, the activity 2.3.1.1 *Access to International Trade Markets – External Marketing* was implemented and the operation of export credit insurance system is ensured. Within the framework of activity *Access to International Trade Markets – External Marketing*, wide support for implementation of external marketing measures to merchants is planned to be executed, for example, participation in exhibitions, contact exchanges, trade missions, organization of seminars and conferences. Within the framework of sub-activity *Access to International Trade Markets – External Marketing*, financing in the amount of LVL 6 million is available in the year 2010.

Short-term export credit guarantees are provided to improve competitiveness of Latvian enterprises in export to the markets (issued for up to two years) of third countries. The guarantees allow increasing the total export volume (particularly to countries with high risk degree), extending own export markets (CIS region, economies with rapid economic growth etc.), as well as consolidation in existing markets. As of June 1, 2010, Latvian Guarantee Agency has received 61 applications of export-credit guarantees from 26 enterprises. Out of all received applications, 33 guarantee projects have been approved for the total amount of LVL 2.06 million, 22 of the agreements for the total sum of LVL 1.35 million have been already concluded. Since conclusion of the first export credit guarantee agreement with guarantee coverage, the deliveries for the amount of LVL 3.4 million have been performed/ declared. All enterprises that have concluded the agreements represent the manufacturing industry (production of communications equipment; production of household electric appliances; production of veneer plates and wood panels; production of soap, cleaning tools and abstergents; production of foodstuffs). Guarantees have been issued for export to such countries as Russia, Nigeria, Belarus, Azerbaijan, Somalia, Georgia, and Kazakhstan.

Box 6.22

<u>Participation of Latvia in the international exhibition *World Expo 2010*</u>

From May 1, 2010 until October 31, 2010 Latvia participates in the international exhibition *World Expo 2010* in Shanghai in the People's Republic of China (PRC).

World Expo is the most important exhibition in the world that is aimed at creation and popularization of the state image. The basic theme of the *World Expo 2010* is *Better City, Better Life*. 192 countries of the world are participating in the exhibition and during the exhibition (184 days) approximately 33-35 large-scale events and approximately 20 000 various activities are planned. The expected number of visitors that has been calculated is 70 million people or approximately 400 thousand visitors per day.

Latvia is participating at the exhibition *World Expo 2010* under the sub-theme of *Innovations of Science and Technology in the City* and the theme of presentation – *Flying Latvia, where East meets West* was chosen in order to attract Expo visitors of non-traditional solutions using innovative technologies, and at the same time introducing Latvia and Riga as a centre of regional international flights, as a venue of Eastern and Western business. The main element of the exposition in the Latvian pavilion is the *Aerodium* vertical wind tunnel.

On May 26, 2010, during the official visit to the People's Republic of China (PRC), the Prime Minister Valdis Dombrovskis opened the pavilion of Latvia.. Also, the National day of Latvia in the exhibition *World Expo 2010* is planned on October 21, 2010.

6.11. Protection of Consumer Rights and Market Surveillance

The consumer rights protection system in Latvia is in a constant process of strengthening and development in order to ensure efficient market surveillance and protection of the consumer rights.

<u>Improving the Normative Base</u>

On January 15, 2008, *the Consumer Rights Protection and Market Surveillance Programme for 2008-2010* was approved by the Cabinet of Ministers, which develops the existing consumer rights protection system, as well as prescribes the priorities in this field. The following main directions of activity are set in the programme:

- improvement of the normative base concerning the consumer rights protection;
- creating favourable business environment by implementing adequate and efficient market surveillance and supervision of the normative acts concerning consumer rights protection;
- informing the consumers and entrepreneurs about consumer rights protection issues, as well as promotion of consumer education;
- improvement of domestic and cross-border extrajudicial dispute settlement procedures;
- facilitating the activity of consumer rights protection associations.

On January 12, 2010, the *Concept to Create an Effective Consumer Rights Protection Mechanism in the Field of Non-Bank Crediting* was approved by the Cabinet of Ministers. The concept envisages implementation of a licensing mechanism for **non-bank creditors** establishing that the consumer crediting is not allowed without the above mentioned licence. At the same time, there is a necessity to reduce the number of persons who are dealing with consumer crediting by conferring such rights only to the merchants. Implementation of licensing will not only ensure the consumer protection against violation of the normative acts on consumer rights protection but also ensure fair competition in the market of non-bank creditors applying mediation of created effective supervision mechanisms.

Draft law on Amendments to the *Consumer Rights Protection Law* was proclaimed by the Ministry of Economics in the meeting of State Secretaries on January 28 of this year. The amendments to the *Consumer Rights Protection Law* specify that consumer crediting services can be rendered only by the merchant, who has received a special permit (licence) for consumer crediting. The requirement to receive the licence does not apply to a merchant, who is considered a credit institution in accordance with the normative acts on credit institution activity supervision, as well as to merchants, who do not offer to conclude consumer credit agreements for the acquisition of their goods and services (instalment payment service).

At the same time, this draft law transposes the *Directive 2008/48/EC of the European Parliament and of the Council of April 23, 2008 on Credit Agreements for Consumers and Repealing Council Directive 87/102/EEC* that implements new regulation corresponding to the economic situation with regards to **consumer crediting**.

The draft law envisages the following:

- an obligation on the creditor to evaluate the consumer's ability to fulfil liabilities stated in the agreement;
- the consumer's rights to waive the concluded crediting agreement, and provisions and exceptions of exercising these rights if the rights of withdrawal cannot be applied;
- the consumer's claim regarding acquisition of goods and services using a crediting agreement;
- delegation to the Cabinet of Ministers to establish requirements for the content of information and rendering procedure, information contained in the consumer crediting agreement, a method for calculating the annual percentage rate, consumer information within the duration of crediting agreement, early repayment of the credit and fair reduction of the total credit costs, requirements applied to separate types of crediting agreements, as well as obligations of crediting intermediary in compliance with the requirements of the directive before concluding consumer crediting agreement.

Draft Law on Out of Court Debt Collection was proclaimed in the meeting of State Secretaries on April 1, 2010 in order to ensure fair and proportionate (reasonable) out of court debt collection and a possibility for third persons to evaluate fulfilment of payment liabilities undertaken by a physical person.

The draft law envisages to establish a procedure, according to which the creditor or renderer of collection services should organize communication in out of court debt collection, solve issues of reimbursement of debt collection costs and use of data of physical persons in out of court debt collection procedure, as well as state the requirement for the renderers of debt collection services to receive a special permit (licence) for rendering of collection services.

Within the framework of a pilot project sponsored by the World Bank, in summer of 2009, the World Bank started development of a research **on Consumer Protection and Finance Possibilities in Latvia**. As a result of work performed by the World Bank experts, *Diagnostic Review of Consumer Protection and Financial Capability for Latvia)*[1] has been worked out. Diagnostic report calls for improvements in five major fields – institutional structure, information about the consumer, practice of financial enterprises, dispute settlement system and finance education. The World Bank experts have prepared an action plan in order to implement recommendations; fulfilment of tasks included in the plan will be supervised and coordinated by inter-institutional working group established by the Ministry of Economics.

Supervision of Consumer Rights

The Consumer Rights Protection Centre (CRPC) is the main coordinating institution in the field of consumer rights protection and supervision and during the 1st quarter of 2010 it:

- rendered 14 271 consultations, from which 12 502 were given in the regional department of Daugavpils (Call Centre). There are 13050 consultations of all rendered consultations, which are rendered to consumers but 1221 – to legal persons;
- examined 744 consumer complaints and applications.

By comparison – during the 1st quarter the following have been submitted in the CRPC: in year 2006 – 350 complaints, in year 2007 – 491 complaint, in year 2008 – 671 complaint, in year 2009 – 770, but in year 2010 – 744 complaints. The reduced number of submitted complaints in year 2010 could be explained with the increase in accessibility and fast growth of consultations rendered by the CRPC. At the same time, the number of complaints could be affected by the liquidation of Liepaja and Ventspils regional departments on December 2009, wherewith the consumers of these regions still have not found out where to submit complaints.

Out of all complaints examined within the 1st quarter of 2010, in 70 cases the solution was favourable to the consumer, in 12 cases a decision favourable to the consumer has been adopted, 14 complaints were unjustified, an explanation has been provided to the consumer regarding 210 complaints, 34 complaints have been forwarded according to their jurisdiction for examination in other institutions, 14 complaints have been withdrawn by consumers requesting termination of case examination, in 22 cases CRPC has refused to examine the complaint, 368 complaints are currently under examination.

Out of 187 complaints received concerning the purchase of goods that are noncompliant with

[1] Diagnostic Review is available on the World Bank web site *http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/EXTECAREGTOPPRVSECDEV/0,,contentMDK:21361393~pagePK:34004173~piPK:34003707~theSitePK:570955,00.html#diagnostic*

agreement provisions for the approximate amount of LVL 80 thousand the majority of complaints have been about shoes, electric goods, and mobile phones, followed by complaints about textiles, furniture, apartments and houses, cars and other various goods.

156 complaints have been received regarding services that are noncompliant with agreement provisions in total corresponding to the amount of LVL 43 thousand, from which the majority concerns electronic communications, air transport, rent and public utilities, remotely concluded contracts, construction, individual furniture orders and tourism services, followed by complaints regarding vehicle repairs, dry cleaning and other services.

CRPC employees cooperate with employees of various institutions in Latvia and other European Union countries when reviewing consumer complaints.

Within the report period, the CRPC has rendered 14 271 consultations, which is by 194 consultations more than within the same period in 2009.

Supervision of Unfair Commercial Practice, Advertisements, and E-commerce

In the 1st quarter of 2010, the CRPC has commenced examination of 58 cases concerning commercial practice and advertising, including 28 cases upon individual applications and 30 – at their own initiative.

The majority of cases have been launched in the field of electronic communications services, financial services, in the trade of cosmetics and hygiene goods, in relation to special offers of various goods/services (for example, optics), and in the field of distance agreements.

Within the framework of cases initiated in the 1st quarter of 2010, the CRPC proposed to eliminate breaches of 5 cases voluntarily, in 2 cases the breaches with respect to unfair commercial practice or advertising have been eliminated upon CRPC's request, while in 1 case a written determination to eliminate voluntarily the breaches found by CRPC has been received. The CRPC has made a decision to terminate 18 cases, including such decisions in which an appeal for merchants to comply with requirements of normative acts in their commercial practice has been stated. The CRPC has reviewed 20 administrative violation cases in the field of commercial practice and advertisement, by applying administrative penalties for the total amount of LVL 16 thousand.

In the 1st quarter of 2010, examination of 16 cases in the field of e-commerce has been started, including 14 – at their own initiative. The majority of breaches have been found in relation to failure to provide information about the seller/ service provider (13 cases), failure of information – not indicated or indicated incorrectly on contract provisions (10 cases), as well as failure of not indicating information at all or indicating incorrectly regarding consumer rights of withdrawal (9 cases). In 11 cases, a request has been sent to the renderers of information society services to eliminate the detected breaches voluntarily, and mostly these requests have been satisfied voluntary or the research of these cases are continued. In 2 cases, CRPC has made decisions, which contain legal obligations to perform particular activities in order to eliminate the breaches.

Box 6.23

Misleading commercial practice by sending advertisement materials with prepared invoices on subscription of press to the consumers

At the end of 2009, the CRPC stated that on October and November 2009 VAS "Latvijas Pasts" has sent advertisement materials adding prepared invoices on subscription of corresponding press to the consumer. The CRPC found that the VAS "Latvijas Pasts" has negatively affected economical activity of consumers by sending advertisement material adding an invoice of particular content to the consumer: indicating the name, surname, address of the corresponding consumer, subscription number of invoice, the date when the invoice has been issued and the invoice number, as well as the title of the subscribed press and subscription period and a reference to pay the invoice before the due date. By doing so, misleading information has been presented to the consumer implying that he/she has ordered the particular service – service for press subscription, even if it is not true, making the consumer believe that the particular invoice has been prepared on the basis of his own choice and order, and the invoice should be paid by him. The consumer's choice and freedom of action thereby has been restricted.

After evaluation of the character and amount of the commercial practice, the CRPC has imposed a penalty on VAS "Latvijas Pasts" in the amount of LVL 2000.

Misleading and aggressive commercial practice by rendering services of pay-by-space parking to the consumers

Upon receiving a considerable number of complaints from the consumers, as well as upon performing examination at its own initiative, CRPC established that SIA "Parking Service Latvia" carries out unfair commercial practice by rendering services of pay-by-space parking to the consumers.

It was established in case examination that upon entering several SIA "Parking Service Latvia" pay-by-space parking lots, it is not possible to realize that there is a set charge for parking, and if the consumer has not paid for the pay-by-space parking place, then a blocker has been put on his/her car wheels.

Upon establishing that SIA "Parking Service Latvia" in relation to the consumers has performed/is performing unfair – misleading and aggressive – commercial practice, CRPC initially with interim measures and with a final decision imposed legal obligation– to terminate unfair commercial practice immediately, manifested in a form of not providing the consumer with relevant information for making adequate decision about pay-by-space parking and of putting-on/not removing wheel blockers before the consumer pays the penalty, as well as applied administrative penalty in the amount of LVL 5000.

Protection of Common Interests of Consumers and Supervision of Agreements

During the 1st quarter of 2010, 169 complaints in relation to protection of common interests of the consumer have been received: 146 complaints have been received regarding allegations of unfair agreement provisions, 23 complaints concerning other alleged consumer rights breaches.

The majority of complaints, i.e. 87, have been received on consumer crediting agreements and creditor actions, 14 complaints regarding agreements on electronic communications services, 10 complaints regarding goods or services purchase agreements, 5 complaints regarding provision of other financial services, 4 complaints regarding management agreements, 4 complaints have been received regarding insurance agreements, 2 complaints regarding real estate purchase agreements (preliminary agreements), 1 complaint – agreement on package tourism services 1 complaint – on a remotely concluded agreement, and 18 complaints regarding other agreements.

1 decision has been adopted regarding unfair agreement provisions in a mortgage agreement, requesting the credit institution to terminate application of unfair provisions incorporated in the agreements concluded with the consumers and to implement amendments in the draft agreements offered to the consumers.

The most frequent unfair agreement provisions are the following: disproportionately high contractual penalties, unjustifiably restricted liability of the seller or the service provider, unjustifiable imposition of market risk on the consumer, unjustifiable imposition of obligations on the consumer, overly extensive rights of the seller or the service provider to withdraw unilaterally from the agreement or to apply a contractual penalty, arbitration court clause.

Box 6.24

Unfair agreement provision envisaging the rights of the bank to review the interest rate unilaterally without a justified reason

The CRPC established that the mortgage agreement of AS "Baltic International Bank" sets forth that "After signing this agreement, the client authorises bank to change the interest rate for credit use in accordance with the provisions of Clause 3.10 of this contract, (...)" and that the "Bank is entitled to change interest rate for credit use 1 (one) time per year. In case if Bank exercises these rights."

The CRPC recognized the corresponding agreement clauses as unfair agreement provisions, since justified reasons are not provided on basis whereof the bank is entitled to increase the interest rate, as well as the consumer has no option to terminate agreement if the offered interest rate is too high, as well as reasonable credit payment term has not been indicated in such case.

According to the decision No.1-lg of March 30, 2010, CRPC instructed the bank to stop implementation of the mentioned provisions in relation to cases when there is no justified reason to increase the interest rate, as well as to revise the agreements offered to the consumers.

Cross-border Trade

As the amount of population emigrating from Latvia and the amount of tourists visiting Latvia is increasing, a positive solution of the problems of consumers connected with the purchased low quality goods and services and cross-border consumer protection is becoming increasingly topical.

The European Consumer Centre of Latvia (ECC Latvia) is established as a separate CRPC department co-financed by the European Commission.

Within the 1st quarter of 2010, the ECC Latvia has examined 43 complaints, 58 simple complaints, and has provided 91 consultations in relation to solution of consumer cross-border complaints. In case of a cross-border complaint, support is provided to a consumer in order to find the responsible institution to solve the consumer's complaint, but no decisions are made against foreign entrepreneurs.

37% of the complaints received were related to air traffic services, 9% – e-commerce, 5% – tourism services, 49% – other goods and services. 3 complaints have been handed over to CRPC for reviewing, 25 – forwarded within the ECC framework of cooperation, and 15 – are being reviewed.

An informative educational game on consumer rights in the EU *Journey in Consumer Rights* was elaborated in 2009 and distributed at the beginning of 2010, in order to educate the consumers about the consumer rights in the EU. It is a board game in which the players after performing corresponding steps should answer questions regarding consumer rights, obligations in the European Union, as well as regarding sustainable consumption. The game should be used, so that school students, as well as other audience within a game, in an engaging and interesting way, could learn about the matters regarding consumer rights. The game will be distributed in secondary schools of Latvia, where it can be used within the educational process of various subjects.

Market Surveillance

In the 1st quarter of 2010, 687 examinations were performed, 298 of them were surveys in market situation research in particular groups of goods (construction materials, electric appliances, electronic communications terminals etc.), but 240 examinations were performed for the control of price indication requirements in trading sites, however 137 examinations were performed in particular groups of goods in order to make sure that the supplied goods correspond to the requirements stated in the normative acts, as well as 12 activities were performed with the delivery and acceptance of samples of goods. In total, 312 models of goods were examined:

electronic goods – 77 models, self-defence products – 25, pressure equipment – 32, construction products – 2, toys and children's goods – 25, transportable pressure vessels (gas cylinders) – 66, electronic communication terminals (mobile telephones) – 66, lighters – 9, other goods – 6 models.

In the 1st quarter of 2010, within the framework of **project on procedure how prices are indicated** the CRPC more intensively examined observance of requirements for price indication at retail enterprises in Latvia. Within the framework of this project, 240 inspections were performed in Riga, Ogre, Sigulda, Jurmala, Aizkraukle, Valmiera, Ventspils, Liepaja, and Tukums. Price indication was examined for 734 goods of various types, mainly foodstuffs, footwear, cosmetics and textiles. In 43 (18%) inspections, violations of price indication procedure were found. The greatest problems were connected with failure to indicate prices at retail places, wherewith consumers cannot have absolute and truthful information.

On April 5, 2010, CRPC has started up a surveillance project **Personal protective equipment**. Within the framework of the project, CRPC in cooperation with the Central Customs Board of the State Revenue Service on the boarder of Latvia has discovered 19 pieces of personal protective equipment of various models incompliant with the requirements. In total, CRPC has requested not to put into free circulation the following incompliant goods: sunglasses – 12 models, goggles – 2, knee and elbow pads – 3, swimming goggles – 1, helmet – 1 model.

Project on improvement of pressure equipment safety and correspondence. In accordance with the data of the State Fire and Rescue Service, within the period of 2009-2010, 12 accidents caused by liquefied gas cylinders used in household, and due to explosion of these cylinders 11 persons have suffered and 2 persons have died in Latvia. In March 2010, officials of the CRPC performed inspections at places for filling up and sale of liquefied gas cylinders. The market survey at 28 trade places was performed within the period when the project was prepared. As a result of examinations, breaches were found at 5 gas cylinder trade places in which the gas cylinders were offered for sale, in case of 75 cylinders the validity period of technical surveillance periodic inspection has expired, therefore there is a risk factor of that these cylinders do not comply with safety requirements. Sale of the said gas cylinders has been stopped, and 4 administrative violation cases have been initiated in relation to enterprises – gas cylinders fillers (gas cylinder filling station).

As a result of market survey, inspections were performed in 19 trade enterprises, as well as 22 coffee machines and 10 models of boiling pans were examined. Noncompliance to the requirements of the normative acts was found in case of three models of boiling pans in three enterprises, sale of the said goods has been stopped.

With regards to one wholesale enterprise, a decision was made to initiate proceedings of an administrative violation case, 2 enterprises performed voluntary measures and took out of circulation two models of goods recognized as noncompliant to requirements of the normative acts as a response to noncompliance stated by the CRPC, as well as destruction of goods was ensured.

State metrological supervision

Within the 1st quarter of 2010, 2676 thousand units of measurement equipment were subjected to metrological monitoring in 89 companies in order to establish **conformity of the units of measurement equipment to the normative requirements at their location of use**, including:

- 219 units of measurement equipment in 66 trading enterprises;
- 2457 units of measurement equipment in 23 manufacturing enterprises.

In 36 enterprises, breaches of normative requirements were found, and as a result of the checks, 68 units of measurement equipment or 2.5% of the total number assessed were recognised as noncompliant with the metrological requirements, including units of measurement equipment used with violations of repeated verification deadlines stipulated in legal enactments and the readings whereof exceed the permitted measurement errors stated in the normative acts.

For noncompliance with the metrological requirements administrative protocols were issued to 13 physical and legal entities and decisions were adopted in accordance with Article 99 of the *Administrative Violations Code of Latvia.*

Control of pre-packed goods content amount and conformity of labelling thereof has been performed at production and wholesale enterprises, including such priority groups of goods as sweets (candies etc.), bread, and processed meat products.

Control of pre-packed goods has been performed in 23 production enterprises, 150 lots of goods have been inspected (139 lots were subjected to a static control test and labelling control, 11 lots – to labelling control).

Non-compliances were established:

- in 7 enterprises, violations of normative acts were established in relation to actual content amount of pre-packed goods – 9 lots of goods or 6.4 % of the total amount of inspected lots of goods did not conform to the normative requirements. Sale of 6 lots was suspended (it is allowed to sell them after performing corrective actions and repeated inspection);
- noncompliant labelling of pre-packed goods in relation to a reference of the content amount has been established in 11 enterprises (from 27 lots of inspected goods). Administrative protocols have been issued to 4 legal persons concerning non-conformity of the amount of

pre-packed goods with the normative requirements, as well as decisions adopted in compliance with Article 99 of the *Latvian Administrative Violations Code*.

6.12. Quality Assurance

6.12.1. Quality Structural Policy

The main task in the area of quality assurance is to promote proper application and observance of requirements of the legislative acts in the regulated and non-regulated sphere, as well as to improve the base of legislative acts in accordance with the European Union requirements, taking into account the needs of the national market and economy, ensuring compliance of the products and services and fostering increase of competitiveness of the enterprises and reduction of obstacles to international trade.

National quality assurance system in Latvia is regulated by the *Law on Conformity Assessment*, *the Standardisation Law*, and *the Law on Uniformity of Measurements* and by the related regulations of the Cabinet of Ministers deriving from the above laws.

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 accordance with the needs of the Latvian national economy in order to protect the consumers and environment from low-quality products and services, and to promote growth of competitiveness of enterprises and reliability of products and services provided by Latvian entrepreneurs;
- improvement of the respective informative and consultative base;
- supporting participation of national institutions of accreditation, standardization, and metrology in international organisations, keeping their international recognition, and compliance of 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 conducted measurements;
- encouraging introduction of environmental quality management and other voluntary quality systems in enterprises in order to ensure manufacturing of higher-quality products and provision of higher-quality services, as well as competitiveness of Latvian companies in international markets;
- promotion of effective market surveillance, in order to provide equal conditions to all market participants and protect consumers from potential unfair competition of enterprises.

Having regard of limited state budget funding available for quality assurance, amendments of laws and regulations in field of standardization, accreditation, and metrology have been made stipulating that since July 1, 2009, the respective offices (Standardization Bureau, Latvian National Accreditation Bureau and Metrology Bureau) of the Limited liability company with share capital “Centre of Standardization, Accreditation and Metrology”, which are under supervision of the Ministry of Economics carries out the functions and tasks of national standardization, accreditation, and metrology institutions.

6.12.2. Accreditation, Standardization, Metrology

Since July 1, 2009, Limited liability Company “Standardization, Accreditation and Metrology Centre” carries 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 other related laws.

Standardization

The Standardization Bureau (LVS) of Ltd “Standardization, Accreditation, and Metrology Centre” manages and coordinates activities of Latvian enterprises and organisations in the standardisation sphere in compliance with the *Standardization Law*.

The main functions of the LVS are to set up Latvian fund of standards and issue Latvian standards in cooperation with international and European organisations 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 associated member of the International Electrotechnical Commission (IEC).

The priority directions of LVS operations in 2010 are distribution of standardization information, particularly focusing on needs of small and medium-sized enterprises, updating and maintaining the Latvian Standard Fund, improvement of the electronic trading system of standards, and cooperation with international, European and national standardization organisations.

Until May 1, 2010, in the LVS 31712 standardization documents have been registered, including 26632 European standards adopted in the status of a Latvian standard. In 5 months of 2010, 50 standardization technical committees and 4 working groups coordinated by the LVS have adapted 558 European standards, and 19 mandatory applicable standards have been translated into Latvian. Standardization information services have been provided to 1458 legal and physical persons.

Continuing work on improvement of the electronic trading system of standards, already more than 40% of all standards are sold via e-shop, providing e-services to 570 clients.

The automatic electronic information notification system introduced by the LVS provides also free service to clients; the *Monthly Report on the Standards Registered in Latvian Standard Status and Cancelled Latvian Standards* in the fields concerning the clients is available to 550 regular clients.

The LVS participates in the development cooperation projects coordinated by the Ministry of Economics. The possibility to conclude an agreement on cooperation in the field of standardization information exchange with the State Committee on **Standardization***,* Metrology and Patents and the Standardization, Accreditation and Metrology Centre of the **Republic of Azerbaijan is discussed**. Cooperation with the Georgian National Standardization Institution is discussed as well.

Currently, within the framework of the concluded agreement, information exchange with standardization institutions of Belarus and Uzbekistan is taking place.

LVS continues establishment of technical infrastructure in order to provide convenient access to standardization information for enterprises.

Pursuant to the approved plans for the future activity of LVS, the priority directions of LVS activity in 2010 are the following:

– supplementation and update of the Latvian standards fund;
– improving of the LVS's information technologies for improved quality of client service, having particular respect to SME's needs;
– improvement of the electronic trading system of standards;
– cooperation with international, European and national standardization organisations.

Accreditation

The Latvian National Accreditation Bureau (LATAK), which is a structural unit of Ltd "Standardization, Accreditation, and Metrology Centre" ensures the operation of the national accreditation system. LATAK in compliance with 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 and repealing Regulation (EEC) No. 339/93 acts as a national accreditation institution.

According to the *Law on Conformity Assessment*, the main functions of the LATAK are:

– to evaluate, accredit, and supervise the testing and calibration laboratories and certification and inspection institutions for conformity to the prescribed requirements of the normative acts, Latvian national standards, European Union or international standards;
– to organise examination of skills and coordinate inter-laboratory comparative testing in compliance with the international requirements;
– to represent Latvia in international accreditation organisations;
– to maintain and update the informative base of accredited institutions.

Over the recent years, the increase in the number of accredited institutions is indicative of the importance and stability of the accreditation process in the sphere of conformity assessment. Although many institutions refuse accreditation due to economic reasons, increasingly more institutions choose to confirm their competence by accreditation. Many institutions extend their field of activity as well. At the moment, the status of accreditation is maintained for 200 accredited institutions. New accreditations have been awarded to laboratories in the field of veterinary medicine and medicine, to inspection institutions for performing tests on vapour suction in filling stations, to certification institutions for certification of fuel, measuring instruments and welding processes. The conformity of one institution is maintained in compliance with the *Principles of Good Laboratory Practice*. LATAK continues provision of accreditation services in Ukraine, where one institution for personnel certification has been accredited.

LATAK has confirmed conformity of the accreditation system in six spheres of accreditation to the Multilateral Recognition Agreement (MLA) of European Co-Operation for Accreditation (EA). In order to constantly conform to these requirements, employees of LATAK participate in several committees – EA Inspection and Certification Committee, EA Laboratory Committee, meetings of the MLA Committee and General Assemblies.

In the framework of international cooperation, collaboration is also developed with accreditation institutions of Belarus, Ukraine, and Uzbekistan. Cooperation with the Georgian accreditation institution has been successfully initiated, providing assistance in implementation of the European and international requirements in accordance with the concluded cooperation agreement.

LATAK has also fostered participation of national laboratories in the international inter-laboratory comparative testing programmes and organised examinations of skills.

Metrology

Since July 1, 2009, the Metrology Bureau (MB) of Ltd "Standardization, Accreditation and Metrology

Centre" has been carrying out the tasks of the national metrology institution specified in the *Law on Uniformity of Measurements*. The aim of operations of the Metrology Bureau is to ensure and develop credibility and traceability of measurements in the country.

In 5 months of 2010, for maintenance of national measurement standards, the following was performed:

- update of the uncertainty estimation of two national voltage standards;
- developed calibration programme of national mass standard in **Danish** National **Metrology Institute**;
- drift assessment of ten artefacts of national linear measure standards;
- basing on the data analysis of document *Circular T* by the International Bureau of Weights and Measures (hereinafter – BIPM), time scale of the national time standard was adjusted.

During electric measurements, twelve resistance standard coils were calibrated. During linear measurements calibration of comparator "IZA-7" and seventy three reference linear measures was carried out. During mass measurements calibration of three mass comparators, as well as eight reference standard scales (E1) was performed.

Eight certificates for measurement equipment types are issued. The list of approved measurement equipment types is regularly updated on the internet home page of the Metrology Bureau.

The time standard data (national time scale UTC (LV)) supply to BIPM continues. Mutual exchange of time data with 15 laboratories of the European Union member states has continued.

Quality management system of the Metrology Bureau has been presented to the Technical Committee for Quality (TC-Q) of the European Association of National Metrology Institutes (EURAMET). Peer-review of the quality management system of the Metrology Bureau designated by EURAMET has been carried out.

The Metrology Bureau continues cooperation with EURAMET, as well as with the International Organization of Legal Metrology (OIML) and the European cooperation in legal metrology (hereinafter - WELMEC). The Metrology Bureau has prepared and submitted WELMEC proposals for extension of the sphere defined in the *Directive 2004/22/EC* of the European Parliament and of the Council of 31 March 2004 on measuring instruments.

The Metrology Bureau has organized and conducted seven training seminars for metrology engineers. Consultations have been provided in the field of regulated metrology to enterprises SIA "NRDATA", "TRENCH GERMANY ltd.", and "F.A. SERVING GmbH".

6.13. Privatisation

The goal of privatisation is, by changing ownership of a state or local government proprietor, to create favourable environment for operation with private capital in the interests of development of Latvian economy and to narrow the activities performed by the state and local governments as entrepreneurs.

As the goal of mass privatisation implemented in Latvia is basically achieved, the Saeima adopted the *Law on Completion of State and Local Government Property Privatisation and Utilisation of Privatisation Certificates*, which came into force on September 1, 2005 prescribing the procedure of completing the privatisation process, land reform and ensuring completion of the use of privatisation certificates (see Box 6.25).

<u>Privatisation of state-owned property units and land</u>

Privatisation of state-owned property units or land is carried out and privatisation proposals are summarized by the state joint stock company Latvian Privatisation Agency under the *Law on Privatisation of Property Units Owned by State and Local Governments*.

A decision to bring a state-owned property unit (including capital shares) or vacant land lot to privatisation is taken by the Cabinet of Ministers, while a decision to bring a built-up land lot (on which there are buildings owned by another person) to privatisation is taken by the Privatisation Agency. The decision is taken on the basis of a privatisation proposal submitted by any physical or legal person.

627 proposals for privatisation or privatisation continuation of real estate, 57 proposals for privatisation of state capital shares, and 4321 proposals for privatisation of land lots have been registered by the *Register of Privatisation Proposals* of the Privatisation Agency from September 1, 2005 (when the *Law on Completion of Privatisation* came into force) till April 1, 2010. After August 31, 2006, the Register of Privatisation Proposals registered those privatisation proposals, which were submitted by mistake to other state and local government institutions by this date and transferred in accordance with the competency to the Privatisation Agency later.

A physical or legal person eligible to acquire personal or real property in Latvia can be the subject in privatisation of state-owned property (real estate, capital shares, land). Payments for the property units have to be made in Latvian lats (LVL) and/or privatisation certificates.

Box 6.25

Law on Completion of State and Local Government Property Privatisation and Utilisation of Privatisation Certificates

The *Law on Completion of Privatisation* prescribes:

– the deadline is August 31, 2006, by which any legal or physical person may propose to bring any state or local government property to privatisation;
– the procedure, according to which a privatisation proposal submitted by a person is reviewed and a decision is adopted to bring the state or local government property to privatisation;
– that privatisation may be denied and the property remains in ownership of the state or local government if the property is necessary in order to perform public administration functions or commercial activity of the state or local government;
– that the Cabinet of Ministers had to adopt decisions regarding the handing over of a property owned by the state or local government by December 30, 2010;
– that the state joint stock companies "Latvenergo", "Latvijas pasts", "Starptautiskā lidosta "Rīga"", "Latvijas dzelzceļš", "Latvijas gaisa satiksme", and "Latvijas valsts meži" will not be privatised or alienated;
– the deadlines, by which the persons willing to redeem land allocated for permanent use have to submit land redemption application (November 30, 2007) or by which the land boundary plan or confirmation of the land redemption payment done in privatisation certificates before conclusion of the land redemption agreement has to be submitted to the State Land Service (September 1, 2008), as well as by which the application for a decision with respect to allocation of the property for payment has to be submitted (August 31, 2010), and that the land purchase agreement has to be concluded by December 30, 2010;
– that privatisation certificates do not have an expiry term, but may be used only in the framework of the privatisation process;
– the procedure of ending the issuance of privatisation certificates. The final deadline is December 28, 2007, by which persons could submit an application to allocate privatisation certificates.

In order to ensure successful and open progress of the privatisation completion processes, the Cabinet of Ministers has set the procedure on how the institutions conducting privatisation and land reform have to establish publicly available registers of privatisation proposals and land redemption.

From April 17, 1994 till April 1, 2010, the privatisation regulations had been approved in the statutory procedure for 2453 state property units (excluding land). 94 companies were transformed to public joint stock companies, thus releasing 439.14 million shares into public circulation. The income obtained from privatisation of state property units (with the exception of land, selling of shares emerged as a result of capitalisation of debts and alienation of capital shares) amounted to LVL 1.660 billion, of which LVL 394.62 million and the nominal value of LVL 1.266 billion in privatisation certificates. The new owners assumed the obligations of privatised state companies (enterprises) for more than LVL 187.2 million. The amount of the specified investments was LVL 146.2 million, while the amount of investments actually invested reached LVL 267.5 million.

The Privatisation Agency carries out privatisation of state-owned lands since 1997. 4864 state-owned land lots with the total area of 7371, 86 ha were privatised (purchase agreements signed) by April 1, 2010. The total sales price for the privatised state lands reached LVL 196.97 million, of which LVL 94.31 million in cash and LVL 102.66 million in property compensation certificates. As of October 1, 2010 income from privatisation of these land lots amounted to LVL 177.58 million, of which LVL 82.59 million in cash and LVL 94.99 million in property compensation certificates.

Privatisation of property units and land lots owned by local governments

A decision concerning real estate owned by a local government is taken by the council of the local government (city, region, rural municipality). The decision is taken on the basis of a privatisation proposal submitted by any physical or legal person.

A physical or legal person eligible to acquire personal or real property in Latvia within the process of privatisation of local government properties can be the subject in privatisation of local government property (real estate, a deemed part of the real estate, enterprise, capital shares, land). Payments for local government property units have to be made in lats (LVL) and/or privatisation certificates.

Privatisation of local government property in the local government area is ensured by the property privatisation commission of the respective local government (rural municipality, city, district, region).

Compliance of privatisation projects, regulations, and announcements approved by a local government with the provisions of the *Law on Privatisation of Property Units Owned by State and Local Governments* and the *Law on Completion of Privatisation* is ensured by the Ministry of Economics.

From February 17, 1994 till April 1, 2010, the Ministry of Economics has reviewed and accepted for information 3244 privatisation projects for the total conditional price of LVL 148.9 million (*inter alia*, payments in certificates for the nominal value of LVL 57.4 million).

From January 1, 1997 till April 1, 2010, the Ministry of Economics has reviewed and accepted privatisation regulations in respect to 1671 built-up and vacant local government lands (announcements of privatisation of built-up land lots separately as from September 1, 2005) with the total value of land lots in the amount of LVL 26.4 million (of which LVL 13.3 million to be paid in property compensation certificates).

According to Paragraph 7 of Article 5 of the *Law on Completion of Privatisation*, after August 31, 2006 the local governments shall submit quarterly data to the Ministry of Economics regarding the received privatisation proposals for municipal property units and built-up and vacant land lots, decisions on bringing these property units and land lots to privatisation, the sale price, and the amount of privatisation certificates to be used for payment.

Privatisation of residential buildings

Privatisation of residential buildings in Latvia was initiated in 1995. It was implemented by the Central Privatisation Commission of Residential Buildings (since January 1, 2004 – State Agency "Housing Agency"; since January 1, 2008 – the Construction, Energy, and Housing State Agency; and since July 1, 2009, it is continued by the AS "Latvian Privatisation Agency"), as well as by the residential building privatisation commissions of the local governments in compliance with the procedure stipulated by the *Law on Privatisation of State and Local Government Residential Houses*.

In accordance with information provided by the local governments and national statistics, there are 30 510 residential buildings with 504 426 apartments to be privatised in Latvia, including 25 298 local government residential buildings with 454 136 apartments and 5212 state-owned residential buildings with 50 290 apartments.

The privatisation process of the state-owned residential buildings – decisions on bringing 5093 residential buildings to privatisation have been adopted until January 1, 2010 which amounts to 97.72% of the total amount of state-owned residential buildings. 5071 residential buildings have been offered for privatisation. Privatisation announcements have been sent to 50 062 tenants of state-owned apartments, but 22 852 announcements on conclusion of purchase contracts have been sent to the persons, who have obtained apartments in ownership until privatisation of a residential building. Ownership of 23 044 apartments has been transferred by the decision until privatisation of a residential building. 44 217 state-owned apartments have been privatised until January 1, 2010, which constitutes 87.92% of the total amount of state-owned apartments. In 2009, 43 apartments were privatised.

The privatisation process of residential buildings owned by the local government– 24 470 local government residential buildings have been prepared and offered for privatisation. Privatisation announcements have been sent to 440 232 tenants of local government apartments, but 165 995 announcements on conclusion of a purchase contract have been sent to the persons, who have obtained the apartments in ownership until privatisation of the residential building. In 2009, 167 residential buildings with 2018 apartments were offered for privatisation. 171 456 apartments have been transferred to ownership with local government decisions until privatisation of the residential building. Ownership relations have been arranged for 43 234 owners of the apartments privatised with the shares of agricultural enterprises, who live in 1722 residential buildings privatised with shares. Until January 1, 2010, 402 268 local government apartments have been privatised, which constitute 85.65 % of the total number of local government apartments.

By January 1, 2010, 9868 residential buildings were transferred to the **management of apartment owners**, including 6029 local government residential buildings and 3839 state residential buildings. As a result of this process, 523 apartment owner associations and unions have been established in Latvia, of which 414 are located in seven largest cities, and 109 – in the regions of Latvia. Authorisation agreements for property management by apartment owners have been signed for 3078 residential buildings.

Land reform

The principal goal of the land reform is to rearrange the legal, social, and economic relations of land use and ownership from the planned economy to the market economy.

The state land reform includes allocation of free land pertaining to the state for permanent use, restoration of ownership rights, redemption of the land allocated for permanent use, and privatisation (alienation) of land owned by the state or local government. Redemption of land allocated for permanent use is being carried out in relation to the rural and urban land reform, which is under way in the country.

Allocation of urban land for the use to residential building owners or orchard users, who have received the land for establishing an orchard with building rights, has been completed. The city land commissions have reviewed conclusions concerning the rights to acquire ownership of land for payment and have concluded their entry in the **Urban Land** Redemption Register. Decision-making regarding allocation of land property for payment has been concluded and the decision-making process concerning termination of rights to use land and conclusion of land lease agreements with persons who had conducted the cadastral survey or pre-payment by September 1, 2008, but had not submitted a proposal for decision-making regarding allocation of land property for payment by August 31, 2009. Persons, who had submitted a proposal for decision-making regarding allocation of land property by August 31, 2009, after it was received, had to conclude the land redemption (purchase) agreement by December 30, 2009 in accordance with the Regulations No. 686 of the Cabinet of Ministers of August 25, 2008 *Procedure on the Conclusion of Land Redemption (purchase) Agreement*. VAS "Latvijas Hipotēku un zemes banka" has concluded 72 969 agreements by the end of December 30, 2009.

By March 30, 2010, city governments have received information from the Mortgage Bank about persons who had not concluded land redemption (purchase) agreements by December 30, 2009, wherewith starting decision-making on termination of rights to use land and conclusion of land rent agreements with the users of city land, who had performed cadastral survey or prepayment by September 1, 2008. Also, they had submitted a proposal for decision-making regarding allocation of land property for payment by August 31, 2009, but had not concluded land redemption (purchase) agreement with the Mortgage Bank by December 30, 2009.

In accordance with information stated in the *Law on Completion of Privatisation*, submission of proposals for redemption of **lands in rural areas** in the State Land Service (SLS) for redemption of the land allocated for permanent use has been performed in two application periods – from September 1, 2005 till August 31, 2006 and from August 1, 2007 till November 30, 2007.

When the land redemption proposal is received, the SLS examined the person's rights to acquire ownership of the claimed land for payment. If the person had rights to redeem the land, the SLS made a decision and included the land unit claimed for redemption in the Rural Land Redemption Register. Also, permanent users of the land, who due to restrictions of normative acts within the period of the land redemption proposal reviewing had no rights to redeem the land, but such rights could originate before decision-making regarding allocation of land property for payment (land unit claimed for redemption was included in the Rural Land Redemption Register with the condition that the person shall provide the SLS with the documents confirming the rights to redeem the land before the decision-making regarding allocation of land property for payment).

If the land boundary plans have been registered in the Information System of the State Cadastre of Real Estate by August 31, 2006, the SLS included cadastrally surveyed land units allocated for permanent usage without the person's request.

Law on *Amendments in the Law on Completion of State and Local Government Property Privatisation and Use of Privatisation Certificates* came into force on October 15, 2009.

Before the mentioned amendments, the *Law on Completion of State and Local Government Property Privatisation and Use of Privatisation Certificates* envisaged that the claimers of rural area lands, who performed land survey and submitted a land boundary plan for registration in the Information System of the State Cadastre of Real Estate by September 1, 2008, had to submit the proposal for decision-making regarding allocation of land property for payment to the SLS regional department by August 31, 2009. Also, for those claimers of land redemption, who had performed prepayment by September 1, 2008 and after that had performed a land cadastral survey or the said claimed land for redemption was included in the Rural Land Redemption Register with a condition that before the decision-making regarding allocation of land property for payment the person shall provide the SLS regional department with the documents confirming their rights to redeem the land, the proposal on decision-making regarding allocation of land property for payment had to be submitted by August 31, 2009.

Currently, the mentioned amendments to the law envisage the following term extensions for redemption of rural area lands:

- by May 31, 2010 – rights to submit a proposal for decision-making regarding allocation of land property for payment to the corresponding SLS regional department applies to those claimers who had submitted a boundary plan of the land claimed for redemption in order to register in the Cadastral Information System by August 31, 2009;
- by August 31, 2010 – rights to submit a boundary plan of the land claimed for redemption, in order to register in the Cadastral Information System, and a proposal for decision-making regarding allocation of land property for payment, if the prepayment of land for redemption has been performed by September 1, 2008;
- by August 31, 2010 – person, whose claim on land unit in the Redemption register has been included with a condition, shall submit the following documents at the SLS regional department:
- documents confirming the rights to acquire land property for payment;
- a boundary plan of land claimed for redemption in order to register in the Cadastral Information System;
- proposal for decision-making regarding allocation of land property for payment.

By April 1, 2010:

- documents confirming rights to redeem the land were not submitted by 1229 persons of 1726 land units with the total area of 4873 ha included in the Rural land redemption register with a condition;
- 645 persons have performed prepayment for 883 land units in the area of 3037 ha registered in the Rural land redemption register, but have not submitted a land boundary plan for the registration in Information System of the State Cadastre of Real Estate and a proposal on decision-making regarding allocation of land property for payment;
- 6890 persons have not submitted proposals on allocation of land property for payment for 10 036 land units with the area of 46 025 ha

that are included in the Rural land redemption register and have been cadastrally surveyed.

Rural area land transfer to ownership for payment, as well as redemption (purchase) agreement conclusion with the Mortgage Bank is continued. In total, the Mortgage Bank has concluded 238 590 agreements, 618 of these agreements within the 1st quarter of 2010 on sale of land – the total area of 1737 million hectare, including in the 1st quarter of 2010 – the total area of 12 892 hectares.

Paragraph 1, 2 of Article 18 of the *Law On the Completion of Land Reform in Rural Areas*, Article 6 of the *Law on State and Local Governments Land Property Rights and Their Registering in the Land Registers*, and Regulations No. 453 issued on the basis of the said law *Procedure of Determining Rural Area Land Pertaining to State or Local Government, which further shall be used for Completion of Land Reform, as well as Land Owned by and Pertaining to the State and Local Government* establishes, that the state and local governments by September 30, 2008 had to perform inventory of rural area land owned by and pertaining to the state and local governments, repeatedly evaluate their necessity for performance of state and local government functions, and must submit decisions on land ownership or pertinency to the state or local government or for completion of land reform in the State Land Service (SLS). Regulations No. 1030 *Procedure on Reviewing Requirements Submitted to the Central Land Commission* of the Cabinet of Ministers came into force on December 20, 2008. The said regulations envisage a procedure according to which the former land owners or their heirs can restore land ownership rights to land planned for completion of land reform.

If the former land owners or their heirs expressed interest to restore their ownership rights to land, then within the framework of the *Law On the Completion of Land Reform in Rural Area* by December 28, 2007 they had to submit proposals to the Central Land Commission (CLC), but documents confirming ownership and hereditary rights had to be submitted by September 1, 2008.

Before starting the process of land ownership rights restoration, the State Land Service 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;
– whether property compensation certificates have been received;
– whether proposals on restoration of ownership rights have been submitted in the corresponding local government by June 20, 1991;
– whether the documents confirming ownership and hereditary rights on the claimed land have been submitted by June 1, 1996;
– whether the land has been allocated for permanent use or rights to permanent use have been terminated and a land lease agreement on this land has been concluded with the local government.

After performance of the mentioned examination, the CLC decided on the priority group for reviewing the applicants' requests.

The former owners and their heirs, who had submitted a claim for the restoration of ownership rights and documents confirming ownership or hereditary rights by June 20, 1991, but have not received the land or compensation certificates, are considered as the first priority claimers. Also, former land owners who had started to redeem (redeemed) the real estate left in Latvia by German emigrants from the General Agriculture or State Land Bank by July 21, 1940 – 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 restoration of 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 rights or hereditary rights after July 1, 1996.

Out of 1066 claimers of restored ownership rights, for the total land area of 12 982.64 ha recognized by the Central Land Commission: to the first priority category – 151 claimers of restored ownership rights for the land area of 2 474.92 ha, to the second – 35 claimers of restored ownership rights for the land area of 407.85 ha, but to the third – 880 claimers of restored ownership rights for the land area of 10 099.87 ha.

The first priority claimers out of all land claimers planned for the completion of land reform constitute 14 %, the second priority claimers – 3%, but the greatest number of land claimers planned for completion of the land reform are the third priority claimers – 83 percent.

By April 1, 2010, the process for restoration of ownership rights to the first priority claimers has been started, after the completion of this process the process of the subsequent priorities on restoration of ownership rights will be continued.

Privatisation certificates

A privatisation certificate is a state-issued dematerialised security that can be used only once as the mean of payment for a state or local government property to be privatised.

Privatisation certificates are issued and used according to the *Law on Privatisation Certificates*. By April 1, 2010, a total amount of 104.4 million privatisation certificates have been issued to 2.45 million people for the time they have lived in Latvia, including 794.7 thousand privatisation certificates granted to 41.4 thousand politically repressed persons. 8 million property compensation certificates have been issued to 117.2 thousand former owners or their heirs, including 691.7 thousand certificates for property appropriated for state needs at the privatised specialised state agricultural enterprises, 4896.2 thousand for land in rural areas, 969.3 thousand for property ownership, 814.4 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 in an illegal manner.

In the 1st quarters of 2010, 60.25 property compensation certificates have been granted to 1 former owner or his heirs.

By December 1, 2007, in accordance with the provision set in Article 27 of the *Law on Completion of Privatisation*, 58 thousand persons lost their rights to transfer 1.64 million privatisation certificates to their accounts.

Table 6.3

Use of Privatisation Certificates
(by April 1, 2010)

Type of property	Amount	Number of privatisation vouchers	Including property compensation vouchers
		(million)	(thousand)
Apartment houses	444 thousand privatised housing units	37.9	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	820.0
Land	311.6 thousand land lots	16.7	5137.0
Total:		**106.3**	**6790.4**
% of total certificates issued		94.6%	84.8%

Pursuant to the *Law On Land Privatisation in Rural Areas*, 11 076 decisions have been made by April 1, 2010 on payment of cash compensations for former land property in rural areas. Compensations in the total amount of LVL 17.46 million have been paid to 8411 persons, cancelling 0.62 million property compensation certificates.

Cash compensations in the total amount of LVL 4.64 million were paid to 26.2 thousand politically repressed persons as a payment for privatisation certificates by April 1, 2010. In compliance with the provision prescribed in Article 27 of the Law on Completion of Privatisation of State and Municipal Asset units and the Use of Privatisation Vouchers, 3.2 thousand persons have forfeited their rights to cancel 15 thousand privatisation vouchers.

By April 1, 2010, 106.33 million privatisation vouchers or 94.6% of the total number of issued vouchers have been used for privatisation of state and municipal asset units (see Table 6.3).

2.25 million privatisation vouchers or 2% of the total number of issued vouchers, including 0.137 million compensation vouchers were on the accounts of 386 thousand physical persons as of April 1, 2010.

As of April 1, 2010, accounts of legal entities held 1.33 million privatisation vouchers or 1.2% of the total number of issued vouchers, including 0.011 million property compensation vouchers.

In April 2010, holders of privatisation vouchers could use services of 14 licensed intermediary capital companies for transactions in the market of privatisation vouchers. Total monthly transactions with privatisation vouchers (buying from natural persons and selling) performed by intermediary capital companies in the 1st three quarters of 2010, fluctuated from 18.47 thousand privatisation vouchers in January to 36.99 thousand privatisation vouchers in February, and from 0.54 thousand property compensation vouchers in February to 1.14 thousand property compensation vouchers in March.

6.14. Advisory Councils of the Ministry of Economics

6.14.1. National Economy Council

National Economy Council of the Ministry of Economics (NEC) is an advisory institution established by its founder organisations – 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, which takes part in the process of solving issues relating to business policy and acts in accordance with Subparagraphs 6.11 and 7.2 of Cabinet Regulations No. 271 *Regulations of the Ministry of Economics,* adopted 23 March , 2010 , and *Agreement on Co-operation in the National Economy Council* concluded on February 17, 1999 and NEC Bylaw No. 1-11-3.

In order to represent the interests of the sectors professionally as well as to improve collaboration between the Ministry of Economics and other state institutions, the NEC invites Sectoral Associations representing entrepreneurs of the respective sector and their interests, as well as independent experts – economists, representatives of education and science.

The objective of the NEC operations is to promote establishment and implementation of policy of favourable environment for business activity in Latvia, to foster introduction of principles of sustainable development of national economy and to promote the process of sustainable development of the state and participation of society in it, to facilitate fulfilment of the goals set by the *Lisbon Strategy* in Latvia and to involve public institutions, local governments, and social partners in fulfilment of these goals, to identify circumstances hampering entrepreneurship and to perform all necessary activities to eliminate such circumstances, participate in development of laws and regulations promoting commercial activity and policy planning documents, and promote innovations and foreign trade.

NEC reviews and monitors settlement of issues and development of draft normative documents, national economy development concepts, state budget and other documents, which are important for economic development of Latvia. NEC prepares proposals and adopts recommending decisions on these issues. NEC carries out a dialogue between entrepreneurs and the Ministry of Economics, as well as other public institutions and non-governmental organisations.

The decisions adopted by NEC are of recommending character.

Box 6.26

NEC personnel

In accordance with the decision of the Managing Authority, NEC personnel is approved by the Minister for Economics.

The NEC Managing Authority is a consulting and co-ordinating institution that takes part in settlement of issues referring to business policy and is responsible for assessment and approval of issues in the agenda of the NEC action plan and NEC meetings, as well as for ensuring and improving efficiency of the NEC operation.

Composition of the NEC Managing Authority is approved by the Minister for Economics. The Managing Authority consists of five representatives of the NEC founders, who are NEC members at the same time:

– representative from the Ministry of Economics;
– representative from the Free Trade Union Confederation of Latvia;
– representative from the Employers' Confederation of Latvia;
– representative from the Latvian Association of Local and Regional Governments;
– representative from the Latvian Chamber of Commerce and Industry.

NEC consists of 25 NEC experts designated by the NEC Managing Authority, among them the Minister for Economics, NEC Chairman and representatives of entrepreneur organisations, public institutions, and other organisations. Representatives of the Small and Medium-Sized Enterprises and Crafts Consultative Board of the Ministry of Economics and the Foreign Investors Council in Latvia participate in NEC meetings as observers.

Decisions on changes or additions to composition of the NEC are taken by the NEC founders in meetings of the NEC Managing Authority.

NEC is chaired by the Chairman elected by the members of the NEC Managing Authority from among the members in a rotation sequence for a term of office of one year.

NEC meetings are held on average once per month.

The work of NEC is organised by the Secretariat of the National Economy Council, operations of which are ensured by the Ministry of Economics.

In between the NEC meetings, recommending decisions of NEC are taken by the NEC Managing Authority.

The NEC co-operates with the Saeima, ministries, and other public institutions in order to incorporate NEC's proposals that are necessary for improvement of business environment into normative acts prepared by the responsible institutions.

On May 21, 2009, the Ministry of Economics and the Ministry of Finance signed a co-operation memorandum on *Growth, competitiveness and employment*. The co-operation memorandum is aimed at co-operation and concerted action in implementation of objectives of *National Development Plan* and *Lisbon Strategy* – promotion of growth of economy and employment of Latvia, as well as active participation in development and implementation of sustainable strategy of Latvia.

In order to ensure professional representation of the interests of economic sectors in an effective dialogue with the Ministry of Economics, the NEC and other business organisations and public institutions, the Ministry of Economics has set up a co-operation model with the economic sectors.

In the Economics Council proposals are reviewed for improvement of legislation submitted by the institutions – associations – representing the entrepreneurs. Sectoral associations evaluate draft legislation and render conclusions. The Ministry informs the drafters of normative acts about proposals submitted by the NEC, for the improvement of legislation.

Right now 14 Sectoral Associations in the Economic Council are represented – chemistry and pharmaceutics, finance, transport – transit, logistics, power industry, information and communication technologies – IT cluster, trade, electronics, light industry, wood industry, engineering industry, tourism, hotels and restaurants, food, polygraphy.

By signing the protocol of agreement, the parties agreed to unite their resources for development of the programming documents, to take measures towards implementation of the programmes for improvement of economic development and business environment adopted as a part of the governmental declaration, and that Sectoral Associations will assess and give opinion on draft legislation elaborated by the Ministries.

Box 6.27

NEC on priorities of economic policy

The NEC still considers taxation policy and administration, labour force education, macroeconomic stability and non-predictability of amendments to the legislative acts as one of the most problematic spheres. During the NEC meeting, at the beginning of March this year, the Ministry of Finance for the first time publicized the *Draft Guidelines for the Development of State Tax and Duty System for 2011-2016*. Members of the NEC have pointed out a number of imperfections and expressed the following proposals:

- document prepared by the Ministry of Finance should be linked to other planning documents;
- agreement on particular principles should be reached by clearly defining the objective of tax system changes;
- the draft should be based on analytical materials of macroeconomic forecasts and indices of gross domestic product;
- number of exceptions, preferences and tax regime in the CIT shall not be reduced in order to promote export capacity of enterprises;
- the tax policy primarily should be oriented to general improvement and facilitation of business environment;
- the option of tax burden replacement from direct taxes to indirect taxes – from labour taxes to consumption and capital – should be observed;
- documents should be supplemented with performance of monitoring of changes in tax policy of other countries, by regularly tracking the implemented changes in order to compare, and as a result – the tax rates in Latvia could be analyzed more accurately;
- it should be achieved that the tax system in Latvia is understandable and favourable, etc. to the tax payers.

The NEC states that the normative acts must be assessed already during their drafting process, in order to identify and prevent possible violations of the competition rights, technical barriers to trade and discriminating conditions within the sector of free movement of goods and services, as well as in the sphere of company law, state support and procurement supervision must be improved obtaining high transparency level for projects of state support..

Establishment of efficient and competitive sectoral structure must be facilitated. Research, development, and innovation must be promoted, especially in the private sector, measures which would facilitate co-operation of education, research, and national economic sectors by ensuring transfer of knowledge and technologies must be elaborated and implemented.

Faster and broader absorption of structural funds and new export markets and consolidation in the existing ones must be promoted. The export promotion institutional base must be provided, as well as raising its capacity, development of external economic representations, accessibility of financial instruments and support to companies in export marketing. State structural reforms should be implemented.

The NEC members and experts participate in the following boards, committees, and working groups:

- Consultative Board for Development Co-operation Policy Issues of the Ministry of Foreign Affairs;
- Supervisory Board of the Lisbon Strategy of the Ministry of Economics;
- Construction Council of the Ministry of Economics;
- Coordination Council of the External Economic Representations of Latvia;
- European Union Structural Funds Supervision Committee of the Ministry of Finance;
- Advisory Council of Investment and Development Agency of Latvia.

In the first half of 2010, 5 National Economy Council meetings have taken place in which the following most important issues have been reviewed regarding:

- Draft *Strategic Development Plan of Latvia for 2010-2013;*
- discussion and monitoring of the draft *Action Plan to Improve the Business Environment for 2010;*
- *Guidelines for Development of State Tax and Duty System* for the upcoming years and schedule for its development;

– implementation of medium term budget planning in Latvia;
– draft of the *Law on Value Added Tax*;
– implementation process of the *Export Guarantee Program* and planned amendments;
– progress and results of workgroup "combating shadow economy and ensuring fair competition";
– results of "e-skills" week.

6.14.2. Council of Small and Medium-Sized Enterprises and Crafts

The Council of Small and Medium-Sized Enterprises and Crafts (CSMEC) is an advisory institution of the Ministry of Economics.

The CSMEC consists of 21 representatives authorised by the organisations representing small and medium-sized enterprises (SMEs), *inter alia*, the institutions, societies, organisations, and associations representing SMEs from different national economy sectors, as well as associating SMEs and representing their interests. The Ministry of Economics, Investment and Development Agency of Latvia, and Entrepreneurship Co-ordination Centre of Riga City Council participate in the status of observers.

The composition and statutes of the CSMEC are approved with the Decree No. 560 of the Ministry of Economics of December 11, 2007.[1]

The goal of activity of the CSMEC is promotion of development of SMEs and establishment of favourable business environment for SMEs in Latvia.

The main functions of the Council in compliance with the regulation are to review and follow settlement of such issues (draft normative documents, national economy development policy documentation, state budget and other documents) that are essential to create and implement environment policy favourable to SMEs entrepreneurship and to promote SMEs development, as well as to prepare proposals and make recommending decisions on these issues, to carry out a dialogue between the entrepreneurs, the Ministry of Economics, other public institutions, and non-governmental organisations, as well as international organisations, which affect operation and development of SMEs.

The Council carries out a dialogue with the institutions representing the entrepreneurs, the Ministry of Economics and state institutions that are responsible for the improvement of business environment in Latvia.

Through co-operative efforts with the Ministry of Economics, the entrepreneurs are invited on a regular basis to assess the SME development issues and draft programming documents shaping SME development policy before adoption by the government; they are informed about the seminars and conferences regarding SMEs.

The Council states that it would be necessary to establish friendly tax policy, single database of public administration and its subordinate bodies etc. for the support of microenterprises.

In order to strengthen the role of the CSMEC in improvement of the business environment, as well as to ensure that the non-governmental sector is adequately represented in absorption of the EU Structural Funds and support programmes, members of CSMEC are delegated for participation in following councils, committees, and working groups:

– EU Structural Fund Steering Committee of the Ministry of Finance;
– Sub-committee of the European Regional Development Fund and the Cohesion Fund of the Ministry of Finance;
– Sub-committee of the European Social Fund of the Ministry of Finance;
– Coordination Council of External Economic Representation of Latvia of the Ministry of Economics;
– Advisory Council of the Investment and Development Agency of Latvia of the Ministry of Economics;
– Business Development Board of Riga City Council.

[1] Currently, the Ministry of Economics is updating the content of CSMEC by reviewing objectives, functions, and activity principles established in the Council regulation, as a result of which CSMEC meetings are not summoned.

7. Recommendations

Currently, the most important task regarding the economic development of Latvia is to maintain the current positive tendencies and to create conditions, which would increase the competitiveness of Latvian entrepreneurs in the open goods and services markets, as well as to develop preconditions for producing knowledge-intensive products, which will provide higher income in the future.

The state support should be targeted and selective in the limited budget conditions. The tendencies of the national economy in the previous years have shown that market mechanisms as such do not ensure restructuring of sectors, which would ensure sustainable development.

In order to ensure sustainable development in the long term, it is necessary to create a knowledge-based economy in Latvia, the development base of which is creation of values by using knowledge (education and research, innovation and creativity, digital economy), as well as to ensure sustainability of the social budget by taking into account the problem of population ageing and energy diversification, and to create environmentally friendly – "greener" economy.

At the same time, Latvia will have to overcome the long-lasting tense situation in the labour market by using targeted policy. On the one hand, over the next few years, competitiveness of Latvia will be mainly based on price competitiveness, including low labour costs, and on the other hand, the future economic development will be to a larger extent determined by the growth in productivity (slower increase of employment). Thus, a high risk of growing social tension remains (poverty, exclusion) and labour outflow, which may affect not only the population with low professional qualification that was characteristic in the previous years, but also the highly qualified labour force.

Taking into account the abovementioned, in our opinion, the immediate tasks of the economic policy are as follows:

- **for securing macroeconomic stability:**
  - to ensure strict fiscal discipline according to the determined budget deficit reduction in the *Economic Stabilisation and Growth Revival Programme of Latvia*;
  - to draft a fiscal discipline law, which would determine the medium-term fiscal policy objectives, thus facilitating implementation of a responsible fiscal policy;
  - to ensure fulfilment of the Maastricht Convergence criteria, so that Latvia could join the Euro Area on January 1, 2014;
- **for improving the business environment:**
  - to restructure tax system, by ensuring that it becomes more socially fair and business-friendly. In the medium-term it is necessary to transform the tax burden from entrepreneurship and employment to the real estate and consumption;
  - to increase the efficiency of the State Revenue Service (SRS) by continuing its restructurization into an institution, which would support entrepreneurs;
  - to simplify insolvency procedures by accelerating the revision of insolvency applications, simplifying preparation of insolvency applications, dealing with issues concerning the selling of debtors' property more rapidly;
  - to ensure introduction of the one-stop shop agency principle in respect to the availability of the state and municipal services;
  - to promote development of e-government and e-services. The establishment of the state mega-system ("the list of registers") must be completed, the e-signature must be introduced in all public institutions, functionality of the e-signature must be expanded and the usage of electronic purchasing must be facilitated;
  - to create business environment friendly for establishment of micro-enterprises by realizing the concept on *Support measures for micro enterprises*, introducing fixed micro-enterprise tax, and implementing several measures that will facilitate registration, activity, and tax declaration of micro-enterprises;
  - to develop new construction process regulation providing reduction in the number of engaged public administration and local government institutions and time spent for project coordination. To introduce a construction information system;
  - to improve the official statistical information flow at the state level, as well as mutual coordination of data and terms included in the state register and other information systems;
- **for ensuring competition and determining administratively regulated prices:**
  - to tackle the most significant competition breaches as efficient as possible, focusing on abuse of dominant position in the retail trade sector;
  - to perform preventive measures and inspections for identifying prohibited agreements in the sectors important for the national economy by paying particular attention

   to the public and local government procurements;
   – to continue evaluation of the effect of legislative acts and their drafts on the competition situation in various markets in order to reduce administrative burden;

– **for improving protection and supervision of consumer rights:**
   – to introduce a licensing system of non-bank lenders, while ensuring their stricter supervision;
   – to strengthen protection of consumers in the field of financial services by introducing a new regulation that is more appropriate for the economic situation as regards the conditions of consumer crediting;
   – to develop conceptually new regulation for the arrangement of the out-of-court debts recovery;

– **for promoting investment, business start-ups and access to finances:**
   – to promote accessibility to finances for enterprises, by implementing guarantee instruments and projects co-financed from the EU Structural Funds;
   – to pay more attention to the allocation of financing to development of entrepreneurship in the early stage (measures for the access to the pre-seed and seed capital, opportunities to receive loans with preferential terms) and access to finances in the form of a risk capital;
   – to facilitate the establishment and development of new production units identifying and preparing new potential manufacturing projects and attracting foreign direct investment;
   – to address foreign entrepreneurs more actively and inform about the advantages of Latvia in order to attract productive long-term foreign investment, which would have a positive financial influence also on Latvian enterprises-suppliers, and would promote creation of qualitative long-term jobs;
   – to promote unified and coordinated action of ministries, local governments, infrastructure enterprises and public institutions with regard to the implementation of local and foreign investment projects by involving the private sector, scientific institutions and universities in this process as well;
   – to promote exchange of information between Latvian companies looking for strategic investors and foreign companies willing to expand their business in the European market;

– **for developing knowledge-based economy:**
   – to facilitate cooperation of scientists and entrepreneurs by creating competence centres in order to promote cooperation between research and manufacturing sectors for the implementation of industrial research, new products and technologies as well as to support transfer contact points for the purposeful development of the necessary research competence at universities and research institutions and to improve introduction of research results in production;
   – to support development of new products and technologies by fostering enterprises to develop industrial research, introduce new products, services and technologies in production;
   – to support entrepreneurship with high value added;
   – to improve normative acts that regulate research activity defining that research institutions can be the owners of the intellectual property resulting from state-funded research;

– **for the application of the EU funds:**
   – to reduce the time necessary for administrative procedures, by simplifying the procedure of development and approval of implementation conditions;
   – to direct EU structural funds towards viable projects, taking into account priority sectors;

– **for promoting exports:**
   – to continue ensuring access to export credit guarantees in order to increase access to the markets with higher risk degree and to promote exports of goods and services of Latvian origin;
   – to support participation of entrepreneurs and their unions in international exhibitions and trade missions, in order to foster access to new markets;
   – to develop and expand the network of Latvia's foreign economic representation offices by providing a wide and easily accessible range of export support services for Latvian entrepreneurs abroad;
   – to ensure representation of Latvia's external economic interests in negotiations with the third countries, in order to improve the contractual agreements of international trade and to reduce trade barriers encountered by entrepreneurs in export markets;

– **for establishing flexible labour market:**
   – to solve structural problems of employment by supporting the efforts to obtain suitable higher qualification in accordance with the requirements of the labour market and improving internal mobility of the labour force;
   – to review the regulation of legal labour relations, including obligations related to the payment of premiums and compensations, working time regulation, promoting conclusion of collective agreements at the level of sectors;
   – to reduce undeclared employment by relieving the tax burden on employment and by improving supervision of observance of the

labour law provisions, increasing the awareness level of the society regarding the labour law issues, strengthening the role of trade unions and employers' associations;
  - to improve the regulatory system of labour demand and supply by ensuring preparation of medium-term and long-term forecasts of the labour market, using the population census of 2011 as an important data source for the improvement of this system;

- **for improving energy efficiency:**
  - to promote the activity of apartment owners in heat insulation of buildings by allocating co-financing for energy audits of the buildings, for drafting technical survey opinions, for preparation of technical projects or simplified renovation documentation;
  - to promote the heat resistance improvement measures for buildings;

- **for ensuring efficient, safe and sustainable energy supply:**
  - in electric power supply to separate ownership on the transmission level in order to develop activity of electric power market, to promote investments in infrastructure indiscriminately, ensure fair access to the network for the new participants and transparency in the market;
  - to determine stable environment for long-term investments and to promote long-term production, use and exports of domestic renewable energy, to promote the use of technologies that reduce greenhouse gas emissions by using EU structural funds' co-financing, obligatory purchase of electric energy and other support mechanisms;
  - to develop the base electric power station projects by choosing the types of electric power stations, which will ensure resource supply guarantees and sustainability, as well as increase the state self-provision of energy;
  - to increase efficiency of end consumption of energy;
  - to promote development of energy services market;
  - to develop the energy infrastructure projects by implementing the *Baltic Interconnection Plan*, within the framework of the EU Baltic Sea Region Strategy.

A consistently implemented structural policy will promote revival of the economy of Latvia, which will form the basis for increasing the standard of living of the population. Successful development and economic growth in Latvia will depend not only on the work of public institutions, but also on personal initiative of any person anywhere in Latvia in the conditions of mutual understanding and dialogue within the society.