

**Ministry of Economics
Republic of Latvia**

**ECONOMIC
DEVELOPMENT
OF LATVIA**

REPORT

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Dear reader,

Experts of the Ministry of Economics have prepared the next 30th **Report on 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.

In the first half of 2009, as the financial problems in the world remained, Latvia's economic recession continued. In the 1st quarter of 2009, the GDP was by 18% lower than the year before. The recession is observed across the EU, including our neighbouring countries. The global economic recession has affected the labour market too, and as a result there has been a decrease in the labour demand. The data of the State Employment Agency shows, that in June 2009 the registered unemployment level has reached 11.5% – more than 129 thousand unemployed persons have been registered.

Bearing in mind the deepening of the global financial and economic crisis, the government of Latvia is acting to stabilise and revive the financial system, to improve the efficiency of public administration by reducing its expenditures. In order to restructure the economy by increasing its competitiveness, productivity and production with high value added, the Ministry of Economics will submit to the government at the beginning of August 2009 a Mid-Term Economic Recovery Plan of Latvia (until 2015).

Currently, the *Economic Stabilisation and Growth Revival Programme of Latvia* (adopted by the Saeima on December 12, 2008 and updated on June 16, 2009), which includes the main directions for action of the government that are as follows:

- Strict and stable monetary policy based on the fixed exchange rate of the national currency against the single EU currency – euro. The government will do all the necessary steps to fulfil the Maastricht convergence criteria that would ensure introduction of the euro as soon as possible – by 2013;
- Strict fiscal policy – balancing of state and local government expenditures with the opportunities provided by revenues. In order to ensure a further decrease of the budget deficit, the aim to be reached via consolidation measures is to decrease the budget deficit in 2011 by up to 3% of GDP. The programme prescribes that, as from 2013, the consolidated budget, excluding expenditures related to absorption of EU and other foreign financial assistance, must be balanced or with a surplus;
- In the economy of Latvia (in both, the public sector – public administration and services, and the private sector), the decrease in the level of wages to align it with the developments of productivity. In addition to the reductions of wages and the number of the employed in the public sector, the government will encourage understanding and agreement with the private sector to promote the moderation of wages in all sectors;
- Fostering the efficiency of the public administration, reforms of education, health and other public services sectors decreasing and restructuring the human resources employed in these sectors and optimising the activities and the number of ministries and their agencies;
- Increasing the flexibility of the labour market, promoting retraining and stimulating the unemployed to return to the labour market;
- Improving economic competitiveness by concentrating the financing of the EU structural funds to increase support to exportable sectors and infrastructure projects. Simultaneously, the government implements the necessary measures to simplify the administration procedures of EU funds by fostering a more efficient use of resources and faster circulation of financial means. By attracting the financing of the EU structural funds, several programmes have been launched, such as *Development of New Products and Technologies, Introduction of New Products and Technologies in Production, Support to Technology Transfer Contact Points, Business Incubators, High Value Added Investments*. These programmes are aimed at promotion of knowledge-based economy, i.e., to facilitate knowledge and technology transfer in production in order to ensure production of the products with higher value added.
- Decreasing the administrative burden especially for small and medium-sized enterprises by simplifying the processes of tax administration, real estate registration, receiving construction permits, as well as by promoting a wider usage of the state integrated information systems among institutions and enterprises. The state and the municipal governments implement the measures to foster the development of entrepreneurship and to facilitate business registration and licensing procedures. In order to improve the processes of business insolvency and liquidation, the government has drafted amendments to the Insolvency Law;
- Stabilisation of the financial sector – provision of state support to strengthen the reliability and operability of credit institutions, also

implementing stricter supervision of credit institutions;

- Maintenance of social protection measures to reduce the social tension.

The *Economic Stabilisation and Growth Revival Programme of Latvia* in general prescribes the injection of LVL 600–700 million in the economy of Latvia in the form of support to entrepreneurship. In reality, several financial instruments are already in operation. Firstly, there are loans available for the improvement of enterprise competitiveness, where the total financing is LVL 202 million. This financial instrument is implemented by the Mortgage Bank of Latvia, and the loans are available. Secondly, the entrepreneurs can receive guarantees to improve their competitiveness. This financial instrument is implemented by the Latvian Guarantee Agency. By the end of June, applications have been approved from entrepreneurs for the total amount of LVL 25 million. There are also plans to introduce state guarantees for enterprise credits, support for risk capital and technology transfer, venture loan programme, launching of self-employment and entrepreneurship.

An important economy revival instrument is the export credit guarantee system that has been introduced as of June 1. The programme on the improvement of energy efficiency of apartment buildings has been also started its operation actually and is implemented with the support of the EU structural funds.

The year 2009 will bring changes to Latvia's economic structure and it will show the ability of our country and entrepreneurs to accept new challenges and find new solutions to ensure growth. The Ministry of Economics will closely monitor the implementation of the *Action Plan on Improvement of the Business Environment*, absorption of financing available in the framework of the EU structural funds programmes and provision of state support to the entrepreneurs.

The situation of Latvia's industrial enterprises will depend on the situation in the traditional export markets, as well as on the ability of the entrepreneurs to acquire new markets, therefore a special attention will be paid to supporting exports. It will be definitely reflected in the abovementioned Mid-Term Economic Recovery Plan of Latvia. It will be based on the determination of priority sectors and state support instruments for these priority sectors. It is expected, that the implementation of the abovementioned plan could start already this year.

In order to achieve the set goals, we will continue the dialogue with our social partners (entrepreneurs and non-governmental organisations representing them). This is the only possible way to provide sustainable growth in the long-term perspective.

In the Report, you will find information about both, the development of main economic and social indicators, growth of national economy sectors, external economic environment, and government's economic policy for promotion of growth and employment, foreign trade policy, utilisation of the EU structural funds and the Cohesion Fund, innovation and entrepreneurship policy and other economic reforms. In the conclusion, the authors of the Report provide recommendations on the improvement of the national economic policy.

The Cabinet of Ministers has not assessed all the issues addressed in the Report. Thus, 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 who is interested in the issues of 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 2009



Artis Kampars,
Minister of Economics

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ABBREVIATIONS

Abbreviations

| | | | |
|--------|--|---------|---|
| ACP | African, Caribbean and Pacific Group of States | EU SF | European Union Structural Funds |
| ACTA | Anti-Counterfeiting Trade Agreement | FCMC | Financial and Capital Market Commission |
| ASEAN | Association of Southeast Asian Nations | FDI | Foreign Direct Investment |
| BSR | Baltic Sea Region | FICIL | Foreign Investors Council in Latvia |
| CC | Competition Council | FTA | Free Trade Agreement |
| CE | Council of Experts | GCC | Gulf Co-operation Council |
| CEBS | Committee of European Banking Supervisors | GDP | Gross domestic product |
| CF | Cohesion Fund | HPP | Hydroelectric power plant |
| CHP | Combined Heat and Power | ICN | International Competition Network |
| CIS | Commonwealth of Independent States | ICPEN | International Consumer Protection and Enforcement Network |
| CRPC | Consumer Rights Protection Centre | ICT | Information and communication technologies |
| CSB | Central Statistical Bureau | IDAL | Investment and Development Agency of Latvia |
| CSMEC | Council of the Small and Medium-Sized Enterprises and Crafts | IMF | International Monetary Fund |
| DDR | Doha Development Round | IMIN | Internal Market Information Network |
| DMF | dimethylfumarate | ISPA | Instrument for the Structural Policies for Pre-accession |
| EC | European Commission | JOSEFIN | Joint SME Finance for Innovation |
| ECA | European Competition Authorities | JSC | Joint stock company |
| ECC | European Consumer Centre | LGA | Latvian Guarantee Agency |
| ECN | European Competition Network | LLC | Limited liability company |
| EEA | European Economic Area | LVS | Limited liability company "Latvijas standarts" |
| EIF | European Investment Fund | MBL | Mortgage Bank of Latvia |
| EMU | Economic and Monetary Union | ME | Ministry of Economics of Latvia |
| EPA | Economic Partnership Agreements | NACE | Statistical classification of economic activities in the European Community |
| EPP | Latvian Export Promotion Programme 2005-2009 | NEC | National Economy Council |
| ERDF | European Regional Development Fund | NGO | Non-governmental organisation |
| ERM II | European Exchange Rate Mechanism II | NSFD | National Strategic Framework Document |
| ESF | European Social Fund | OECD | Organisation for Economic Co-operation and Development |
| EU | European Union | OP | Operational Programmes |
| EU-15 | European Union before enlargement on May 1, 2004 | PCA | Partnership and Cooperation Agreement |
| EU-27 | European Union after enlargement on January 1, 2007 | POS | point of sale |

| | | | |
|------|--|--------|---|
| PPP | Public and private partnership | SOLVIT | Efficient Solving of Internal Market Problems |
| R&D | Research and Development | SPD | Single Programming Document |
| ROA | Ratio of profit/losses to assets | SRS | State Revenue Service |
| ROE | Ratio of profit/losses to capital and reserves | TDI | Trade Defence Instruments |
| RSE | Riga Stock Exchange | TRIS | Technical Regulations Information System |
| SADC | Southern African Development Community | UNWTO | World Tourism Organisation |
| SF | Structural Funds | USA | United States of America |
| SEA | State Employment Agency | VAT | value added tax |
| SJSC | State Joint Stock Company | WB | World Bank |
| SME | Small and medium-sized enterprises | WTO | World Trade Organisation |

State Abbreviations

| | | | |
|----|----------------|----|----------------|
| AT | Austria | IE | Ireland |
| BE | Belgium | IT | Italy |
| BG | Bulgaria | LT | Lithuania |
| CZ | Czech Republic | LU | Luxembourg |
| 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 states | SE | Sweden |
| FI | Finland | SI | Slovenia |
| FR | France | SK | Slovakia |
| HU | Hungary | UK | United Kingdom |

Measures

| | | | |
|-----------|---|-----|---|
| EUR, EURO | Euro, single currency of the EMU | SDR | Special drawing rights, IMF approved currency |
| LVL | Latvian lats (national currency of Latvia) | | |

Conventional designations

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

1. ECONOMIC SITUATION: BRIEF OVERVIEW

Rapid growth had been observed in Latvia during the period of 2005–2007, when GDP grew on average by 11% annually. The high growth rates were mainly ensured by the domestic demand, which was largely based on substantial inflow of foreign capital. Both, private consumption and investment increased considerably. Increase of exports played a less significant role in the growth.

In 2008, GDP decreased by 4.6%. The deterioration of the economic situation in 2008 was determined by both, domestic (weakening of domestic demand stimulus) and external (slowing down of the global growth rates) processes affecting the economy. In the 1st quarter, GDP increased slightly (by 0.5%) in comparison with the respective period of the previous year, but already in the 2nd quarter it decreased by 1.9%. With the intensification of the global financial problems, the recession rates in the second half of 2008 speeded up in Latvia, too. In the next two quarters, GDP was significantly below the level of the same quarters of 2007 (by 5.2% and 10.3% respectively).

In the first half of 2009, as the financial problems in the world remained, Latvia's economic recession continued. In the 1st quarter of 2009, GDP was by 18% lower than the year before. Recession is observed in all EU Member States, including our neighbouring countries, where a significant reduction of GDP in the 1st quarter of 2009 has been witnessed (in Lithuania – by 13.6% and in Estonia – by 15.1%). The overall output in the EU decreased by 4.7% in the 1st quarter of 2009 compared to the 1st quarter of 2008, including in Germany – by 6.7%, in Sweden – by 6.6%, in Italy – by 6.5% and in France – by 3.1%. A minor growth has been observed in certain countries in the 1st quarter of 2009 (e.g. Poland and Greece), however, the growth rates have decreased since the mid-2008. Recession continues also in the US economy. In the 1st quarter of 2009, GDP decreased by 2.5% in comparison with the 1st quarter of 2008. While in Japan, in the same time period, the output went down by 8.8%.

In 2008 and in the 1st quarter of 2009, Latvia had the largest decrease in the whole EU. It is related to the high current account deficit of the balance of payments developed during the previous years of rapid growth and therefore the increase of vulnerability of Latvia's economy. At present, due to the decrease of financial inflow, there is a rapid decline of private consumption and investment, as well as substantial economic adjustments, which result in the improvement of the trade balance of goods and services along with the decline of economic activities upon decreasing domestic demand.

This is well reflected in the dynamics of the domestic demand, which continues to decrease rapidly:

domestic demand in the first quarter of 2009 was by 19.7% lower than in the respective quarter of 2008 (for comparative purposes it should be noted, that in the 4th quarter of 2008 domestic demand decreased by 15.9% in comparison with the 4th quarter of 2007).

In the 1st quarter of 2009, private consumption was by 17.4% lower than in the 1st quarter of the previous year. The reduction of state budget expenditures, slowdown of household crediting process and decrease of wages as well as increase of unemployment leads to conclusion that private consumption will continue decreasing.

Even more rapidly, in the 1st quarter of 2009, investments in fixed assets continued to go down (decline by 34.1%), which is still to a large extent related to the substantial decrease of activities in the real estate market. Investments in fixed assets in the 1st quarter of 2009 in comparison with the respective period of the previous year decreased significantly in the whole EU, e.g. in Lithuania – by 37.1% and in Sweden – by 14.3%. Due to the decrease of the profit of enterprises, rise in the price of credits and decrease of credit availability, as well as with low level of confidence, it can be expected that entrepreneurs will continue reducing investments. And the investments of the public sector are being decreased via reduction of the budget expenditures.

In the 1st quarter of 2009, the amount of public expenditures was by 1.2% lower than in the 1st quarter of 2008. This is the first quarter in the last years, when the public expenditures have decreased. In June, with significant reduction of expenditures of the budget for 2009, it can be forecasted that in the second half of the year the amount of public expenditures will decrease even more rapidly.

Due to the decrease of domestic demand, the external balance has improved. In the 4th quarter of 2006, the current account deficit of Latvia's balance of payments was 27.2% of GDP. In the 1st quarter of 2009, there was a surplus of the current account in the amount of 1.1% of GDP.

The remarkably negative Latvia's trade balance started to improve in the 4th quarter of 2007, when imports decreased and exports increased. This trend continued in 2008 mainly due to the significant decrease of imports. Revenues from exports in 2008 increased to a great extent due to the rise in prices, not volumes.

In general, the volume of exported Latvia's goods and services in 2008 decreased by 1.3% and imports decreased much more rapidly – by 13.6%. Due to the decrease of external demand and increasing protectionism in the export markets, the exports of goods continue to decrease: in the 1st quarter of 2009, exports of goods decreased by 25.7% in comparison with the 1st quarter of 2008. The imports of goods also

decreased rapidly – in the 1st quarter of 2009 it reduced by 36.6% in comparison with the 1st quarter of 2008.

Simultaneously with the improvement of the situation of the current account of the balance of payments, the balance of the financial account rapidly deteriorates, especially in the last two quarters. It is mainly due to the significant decrease of foreign financial resources attracted by commercial banks. The

flows of foreign direct investment have also fallen. Since the second half of 2008, there has been a rapid decrease of foreign capital inflow, and in the 1st quarter of 2009, the financial account balance has been negative that reflects the outflow of capital, due to which in the last three quarters the reserves have rapidly decreased.

Table 1.1

Latvia: Key Indicators of Economic Development

| | 2005 | 2006 | 2007 | 2008 | 2009 f |
|---|-------|-------|-------|-------|--------|
| (changes over the previous year, %) | | | | | |
| Gross domestic product | 10.6 | 12.2 | 10.0 | -4.6 | -18.0 |
| Private consumption | 11.2 | 21.2 | 14.8 | -11.0 | -21.0 |
| Public consumption | 2.7 | 4.9 | 3.7 | 1.5 | -9.5 |
| Gross fixed capital formation | 23.6 | 16.4 | 7.5 | -13.2 | -24.0 |
| Exports | 20.2 | 6.5 | 10.0 | -1.3 | -12.0 |
| Imports | 14.8 | 19.4 | 14.7 | -13.6 | -29.0 |
| Consumer prices | 6.7 | 6.5 | 10.1 | 15.4 | 2.8 |
| (% of GDP, unless indicated otherwise) | | | | | |
| Central government budget fiscal balance | -0.4 | -0.5 | -0.4 | -4.0 | -9.0 |
| Central government debt | 12.4 | 10.7 | 9.0 | 19.5 | 30.0 |
| Current account balance | -12.5 | -22.5 | -22.5 | -12.6 | 2.0 |
| Foreign direct investments in Latvia received during the year | 4.5 | 8.1 | 7.0 | 4.0 | 0.5 |
| Employment rate (share of economically active persons in the total population aged 15–64 years, %) | 63.4 | 66.3 | 68.4 | 68.6 | 64.0 |
| Unemployment rate (share of job-seekers in the number of economically active persons aged 15–74 years, %) | 8.7 | 6.8 | 6.0 | 7.5 | 15.7 |

f – forecasts

The decrease of output has been observed in all basic sectors of the economy in the 1st quarter of 2009. The economic activities decreased most significantly in trade, manufacturing and construction.

The decrease of output in the manufacturing is determined by both, the decline of the domestic demand and narrowing export opportunities of Latvian manufacturers due to the falling external demand. The production volume of manufacturing in January–May of 2009 was by 24.7% lower than in the respective period of the previous year. The decrease of output can be observed in all sectors of manufacturing. The most substantial decrease is observed in the light industry, production of electrical and optical equipment, production of transport vehicles, as well as production of machinery and equipment. The lower decrease rates are observed in the production of food and wood processing industry. In 5 months of 2009, the sales volumes of manufacturing in the domestic market decreased by 29.4%, and the volumes of exported production decreased by 22%. The sales volumes have decreased substantially in all sectors of manufacturing.

In the 1st quarter of 2009, the construction volumes decreased by 28.2% in comparison with the 1st quarter of 2008. The volumes of building

construction have decreased by 42.7%, whereas the volumes of engineering structure construction have increased by 7.5%.

The decrease of the turnover of retail trade is continuing. In the first five months of 2009, in comparison with January–May of 2008, the total turnover of retail trade fell by 26%, especially in the sales turnover of durable goods.

According to the conjuncture survey results, the **optimism of entrepreneurs has slightly increased in relation to assessment of the economic situation and further growth opportunities.** The economic sentiment indicator of Latvia hit the bottom in March 2009 (52.0), whereas in June the economic sentiment indicator was already 58.2 points. The confidence indicators are improving also in other EU Member States.

With the decline of domestic demand and the decrease of the impact of supply-side factors, **since the mid-2008, the consumer price inflation has been gradually decreasing.** In January–June 2009, the level of consumer prices has increased by 2.1% in comparison with December 2008. It is by 7 percentage points less than in the respective period of the previous year. Thus, in six months the 12-month

inflation has decreased and reached 3.4% (in December 2008 it was 10.5%). It is expected that during the next months inflation will continue falling and in autumn the 12-month inflation will be negative. Deflation is expected also in 2010, and during the year prices may decrease by some per cent.

The situation in the global financial market has negatively influenced Latvia's financial sector. Due to the raise in the price for money resources, crediting has decreased, whereas the limited availability of money reduces household consumption and weakens the development opportunities of enterprises. The decrease of financial inflow into the economy of Latvia negatively affects the state budget revenues.

The revenues of the state budget in the first five months of 2009 were LVL 2047.4 million, which is by 16.9% lower than in the first five months of 2008, and it is mainly due to the decrease of the tax revenues of the state budget by LVL 289.7 million. The expenditures of the state budget in the first five months of 2009 were LVL 2385.2 million, which is by LVL 195.1 million or 8.9% more than in the first five months of 2008. In January-May 2009, the state consolidated budget deficit amounted to LVL 337.8 million, which was mainly due to the state budget deficit.

Tax revenues continue to fall. In the first five months of 2009, the tax revenues amounted to LVL 1540.5 million, which was by LVL 436.7 million or 22.1% lower than in the respective period of 2008. The most significant decrease in lats has been experienced in the revenues from the value added tax.

In the beginning of 2009, the growth rates of the issued loans continued to fall. This trend has been observed since the second half of 2007. In the end of May 2009, the total volume of the issued loans in comparison with the end of May 2008 has increased only by 1.6%. It must be noted that in the end of May 2008, the residual balances of the issued loans increased by 22.2% per annum. The slowdown of crediting dynamics is mainly due to the decreased amount of mortgage loans. The residual balance of the issued mortgage loans was only by 0.9% higher in May 2009 compared to May 2008, but as regards the industrial and commercial loans, they increased by 1.9%.

Decrease of the economic activities has started to influence the employment indicators stronger. The employment rate started to decrease in the 4th quarter of 2008, when the number of the employed persons fell by 5.5% in comparison with the 4th quarter of 2007. In the first half of 2009, with the reduction of economic activities, the number of the employed persons continued to drop – in the 1st quarter there were 1046.7 thousand employed persons or by 8% less than in the 1st quarter of 2008.

The registered unemployment level reached 7% in the end of 2008, which was by 2.1 percentage points more than in the end of 2007. In the first half of 2009, the number of registered unemployed persons continued to

increase rapidly. According to the data of the State Employment Agency (SEA), in June 2009 the level of registered unemployment reached 11.5% – more than 129 thousand unemployed persons have been registered. However, according to the Eurostat calculations, harmonised unemployment rate in May 2009 reached 16.3% and is one of the highest rates in the EU.

The recovery of Latvia's economy in the coming years will to a large extent depend on how fast the global financial system and the main foreign trade partner countries will recover. In this respect, there is a rather deep uncertainty among the economists of the world, especially with respect to the depth of the crisis. The forecasts are revised frequently changing the growth indicators for 2009 and 2010. The majority of economic experts (IMF, WB, European Commission, etc.) forecast the start of economic recovery not earlier than in the second half of 2010, if the situation in the financial markets stabilises at least by the end of 2009.

Taking it into account, **the Ministry of Economics forecasts, that the GDP will decrease by 18% in 2009.** Speaking about sectors, in 2009 and 2010 the most substantial decline of output will be observed in construction sector. High decrease of trade services and manufacturing is expected. The recession will have the minor impact on transport and communication services.

Despite the improvement of the situation in the second half of 2010, **in 2010, negative GDP growth rates will remain. The growth of Latvia's economy could begin again in 2011** and it will be closely related to the gradual increase of economic activities in our export partner countries, especially in the EU.

In general, recovery of the labour market is expected a year after the recovery of the economic growth since it will be based on growth of productivity, not on the number of employed persons, and the social problems related with the high level of unemployment will prevail over the next 3–4 years. The most rapid decrease of labour demand is expected in 2009 and 2010. It is forecasted, that in 2009 the number of the employed persons will fall in all sectors. As a result, the number of the unemployed will double in comparison with 2008. Thus, the unemployment level in 2009 could be 14% on average, whereas in 2010, 14–15% on average from the number of economically active persons. Decrease of unemployment can be expected only in 2011, when the unemployment level will drop to 11–14% from the number of economically active persons.

In 2009 and 2010, the economic development can be affected by several risks. It is possible that the decreased external demand due to the global financial crisis is deeper than currently forecasted by the European Commission and other international organisations, since there is still a deep uncertainty in the world with respect to the future development and the impact of the financial crisis on the real sector.

2. DEVELOPMENT OF WORLD ECONOMY¹

The financial crisis and decrease of financial activities have seriously affected all countries in the world. The economies of the developed countries have experienced unprecedented recession – in the 4th quarter of 2008, the actual GDP fell by more than 7%. Similar decrease is expected for 2009.

The US economy mainly suffered due to the financial crisis and the slowdown in the housing sector, whereas the Eastern European and Asian countries were especially affected by the slowdown of global trade, as well as the increasing problems of availability of financial resources and mortgage crisis.

Table 2.1

| GDP Growth (percentage over the previous year) | | | | |
|---|------------|------------|-------------|-------------|
| | 2007 | 2008 | 2009 f | 2010 f |
| World | 5.2 | 3.2 | -1.3 | 1.9 |
| of which: | | | | |
| USA | 2.0 | 1.1 | -2.8 | 0.0 |
| Japan | 2.4 | -0.6 | -6.2 | 0.5 |
| EU | 3.1 | 1.1 | -4.0 | -0.3 |
| of which: | | | | |
| Euro-zone | 2.7 | 0.9 | -4.2 | -0.4 |
| United Kingdom | 3.0 | 0.7 | -4.1 | -0.4 |
| CIS | 8.6 | 5.5 | -5.1 | 1.2 |
| China | 13.0 | 9.0 | 6.5 | 7.5 |

Source: “The World Economic Outlook, April 2009”, International Monetary Fund; f – forecast

The economies of the developing countries are heavily influenced by the financial crisis, just like the developed countries are suffering. In the last quarter of 2008, growth in these countries on average was negative – by 4%. The losses were due to the financial and trade sectors. The Asian countries were affected by decreased external demand, while the European and CIS countries suffered from decreased foreign capital inflow.

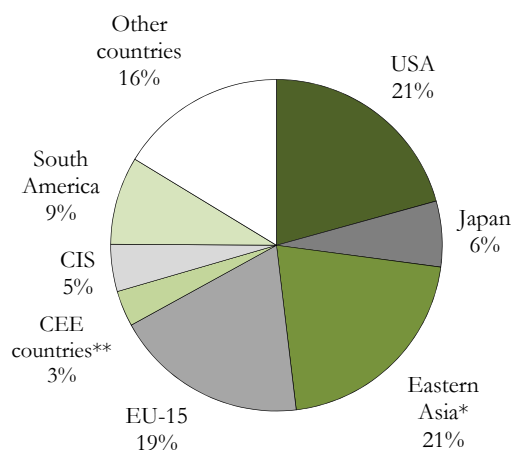
Along with the decline of the global growth, the pressure of inflation has reduced significantly. Commodity prices decreased rapidly, which resulted in especially great income losses for both, the economies of the Middle East and the CIS, as well as many exporting countries in the Latin America and Africa. At the same time, with increasing stagnation, the growth rates of wages and profits are decreasing, and thus the total 12-month inflation in the developed countries in the beginning of 2009 fell below the 1% margin.

In accordance with the forecasts of the IMF, the stabilisation process of the financial markets will be longer than predicted, despite the strict political decisions. Therefore, the tension in the previously stable financial markets will prevail at least until the second half of 2010, and the amount of bad assets loss will become clear. The injections of the public capital will allow solving insolvency problems decreasing the risk of business partners and market instability, and renewing the liquidity of the market. In general, the crediting of the private sector in the developed countries will fall in 2009 and will not grow in 2010. Whereas the emerging and developing countries during these years will have a very restricted access to foreign financing and it will recover very slowly and gradually.

Thus, the perspectives of global growth are assessed as particularly uncertain. It is believed that the economic powers of the countries may not be sufficiently active to stop the negative trends in the markets and real economy, taking into account the restricted and insufficient state support.

Figure 2.1

Breakdown of the World's GDP by Groups of Countries in 2008
(structure, GDP by purchasing power units)



Source: “The World Economic Outlook, April 2009”, International Monetary Fund.

* China, South Korea, Malaysia, Singapore, Thailand, Philippines

**Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Malta, Poland, Romania, Serbia, Montenegro, Slovakia, Slovenia, Turkey

¹ In this chapter, data from the “World Economic Outlook”, International Monetary Fund were used.

A rather deep recession is forecasted for the developed countries. After very negative indicators of the 1st quarter of 2009, in general, a milder recession is forecasted, based on fiscal impetus support, as well as the fact that the decrease of stocks will be slower. In 2010, output will gradually increase, however, it will not still reach full potential, which means that unemployment could grow even above the 9% level.

In the US and the United Kingdom, restricted accessibility of credits will prevail, which will directly influence the financial sector, mortgage market, as well as household expenditures.

The Eurozone countries will possibly suffer from greater recession than the US due to sharp decrease of exports and continued decrease of domestic demand. The economic recession of Japan is particularly radical

and is mainly related to the decreased external demand and small investments in fixed assets.

In the emerging and developing countries, the average growth still may remain positive – in 2009 by 1.6% and in 2010 it could reach 4%. Nevertheless, in certain countries, a negative growth is projected for 2009. The deepest recession may be in the CIS countries due to the significant outflow of capital and contraction of revenues from exports. The Eastern European countries are currently trying to adapt to the decreased foreign financing, as well as to the decreased demand from Western Europe. Export countries of Eastern Asia similarly to Japan are suffering from the rapid drop of exports of industrial goods. Growth in China and India is forecasted positive, even though with significantly decreased rates, mainly due to the still high domestic demand.

Although a great effort is applied and resources invested in the recovery of the financial system, by using macroeconomic policy leverages to support the aggregate demand, the global growth in 2009 is forecasted as negative – by 1.3%, which is the deepest recession in the period after the war. It is forecasted that due to the crisis the income of 75% of the world population will decrease. The growth will renew in 2010.

3. GROWTH

3.1. GDP Dynamics and Aggregate Demand

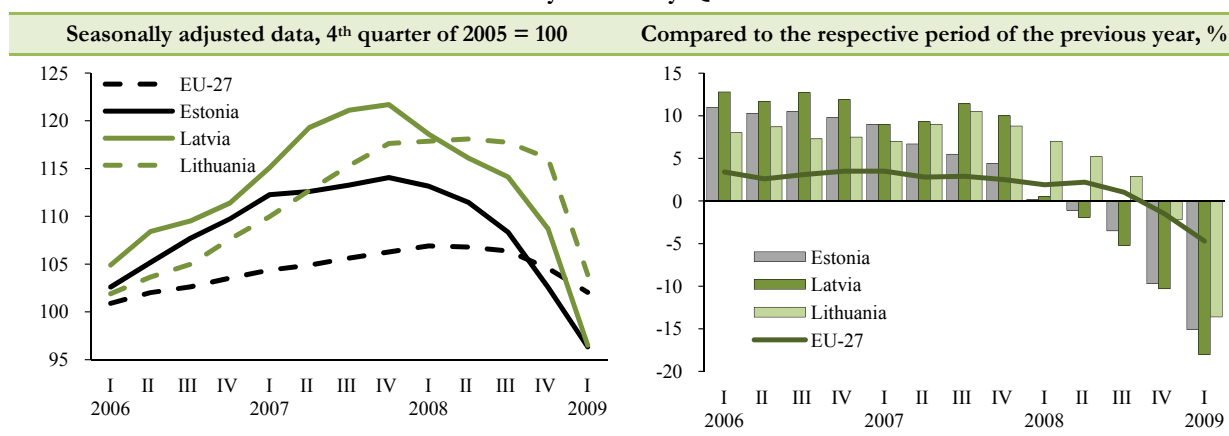
3.1.1. Development Trends

After the period of rapid economic growth, which has lasted for several years and during which the

annual GDP growth rates exceeded even 10%, recession has started in the economy of Latvia. It started in the 1st quarter of 2008, when the domestic demand decreased.

Figure 3.1

GDP Dynamics by Quarters



A rapid decrease of the economic activities started in 2008. The GDP decreased by 2.6% in the 1st quarter of 2008 in comparison with the previous quarter (according to the seasonally adjusted data), but still slightly exceeded the level of the respective quarter of the previous year (by 0.5%). In the next quarters of the year, GDP was significantly below the level of the same quarters of 2007 (by 1.9%, 5.2% and 10.3% respectively). During the 1st quarter of 2009, the speed of recession increased considerably and GDP decreased by 11.2% more in comparison with the 4th quarter of 2008 (according to the seasonally adjusted data) and it was by 18% lower than in the 1st quarter of 2008.

Deterioration of the economic situation in Latvia is determined by the processes of global financial crisis, which substantially decreases both, domestic and external demand.

In 2008, reduction of economic activities was observed in the whole European Union, especially in the 4th quarter of 2008. In general, GDP has decreased by 1.7% within the EU during the 4th quarter of 2008 (according to the Eurostat seasonally adjusted data against the previous quarter) and by 2.4% more in the 1st quarter of 2009.

In the 1st quarter of 2009, GDP considerably decreased in such big economies as Germany (by 3.8%), Sweden (by 0.9%), Italy (by 2.6%) and France (by 1.2%). In Lithuania and Estonia, the recession in the 1st quarter of 2009 was by 10.5% and 6.1%, respectively.

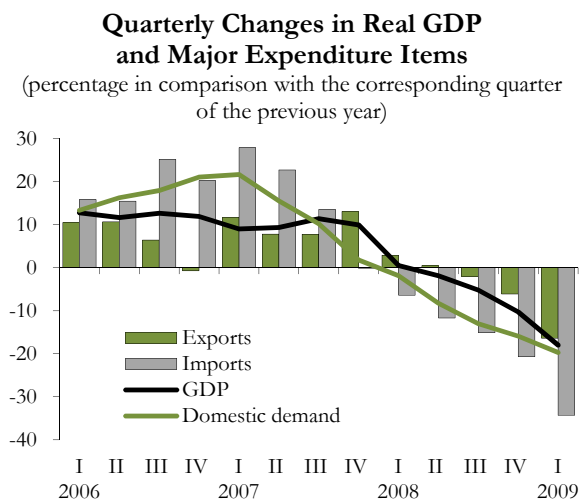
Yet, the recession of the economy in Latvia during this financial crisis is the most severe. The influence of depth of the financial crisis is intensified by a markedly unbalanced position of Latvian external sector, which established in the previous years of the rapid growth. A considerable growth of private consumption and investment, which was observed in more rapid rates 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 increased vulnerability of the economy of Latvia. Due to the decrease of financial inflow, there is a rapid decline of private consumption and investment, as well as substantial economic adjustments, which result in the improvement of the trade balance of goods and services along with the decline of economic activities upon decreasing domestic demand.

Table 3.1

GDP of Latvia by Expenditure Items
(percentage change over the previous year)

| | 2008 | | | 1 st quarter of 2009 against 1 st quarter of 2008 | | |
|-------------------------------|------------|--------------|------------------------|--|--------------|------------------------|
| | structure | growth rates | contribution to growth | structure | growth rates | contribution to growth |
| Gross domestic product | 100 | -4.6 | -4.6 | 100 | -18.0 | -18.0 |
| Private consumption | 58.4 | -11.0 | -8.0 | 64.5 | -17.4 | -12.9 |
| Public consumption | 20.0 | 1.5 | 0.2 | 22.2 | -1.2 | -0.2 |
| Gross fixed capital formation | 30.2 | -13.2 | -4.7 | 20.2 | -34.1 | -10.2 |
| Inventories | 4.5 | – | -0.6 | -2.4 | – | -9.9 |
| Net exports | -13.1 | – | 8.5 | -4.4 | – | -15.2 |
| – exports | 41.8 | -1.3 | -0.5 | 40.7 | -16.4 | -7.6 |
| – imports | -54.9 | -13.6 | 9.0 | -45.1 | -34.3 | 22.8 |

Figure 3.2



The level of domestic demand (private consumption + public consumption + gross capital formation) was by 10.2% lower in 2008 than in the previous year. While during the 1st quarter of 2009 in comparison with the respective period of the previous year, its decrease was already by 19.7%. Along with the decline of the growth rates of private consumption and investment, decrease of imports is also observed, while the growth of exports is maintained. As a result, the share of contribution of the net exports to the overall growth is relatively high.

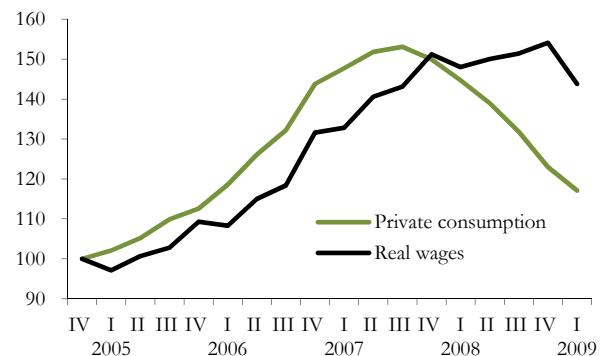
3.1.2. Private and Public Consumption

Decrease of private consumption started already in the 4th quarter of 2007, when it decreased by 2.1% in comparison with the previous quarter (according to the seasonally adjusted data). The recession increased during the following quarters and in the 4th quarter of 2008 it reached 6.6%. In the 1st quarter of 2009 the recession decreased to 4.8%.

Contrary to the previous years, when households afforded to increase consumption more rapidly than the increase of real wages, the growth of private consumption in 2007 was approximately equal to the growth of real wages, but in 2008 private consumption already decreased despite the growth of real wages (see Figure 3.3). The real wages were increasing during the whole 2008 with a slight decrease in the 1st quarter of 2008, but in the 1st quarter of 2009 they decreased already considerably – by 6.6% in comparison with the previous quarter.

Figure 3.3

Growth of Real Wages and Private Consumption, Quarterly Profile
(4th quarter of 2004 = 100)



A substantial decrease in private consumption in 2008 was largely determined by the limitation of household crediting. Crediting slowed down already in the second half of 2007. The volumes of the granted consumption credits and mortgage loans decreased, but almost until the end of 2008, the credit balances continued to increase slightly. Yet, already in December 2008 they went down. The decreasing trend continued also in the 1st quarter of 2009. During the previous rapid growth years, the availability of credit resources has influenced significantly also the possibility to increase the domestic demand, and by

decreasing possibilities, the domestic demand rapidly decreases.

In the 1st quarter of 2009 and also in the future, the reduction of private consumption will be more significantly influenced by the decrease of real wages and by the increase of unemployment.

The changes in the number of employed people and changes of real wages in relation to the decrease of economic activities started in the second half of 2008, when employment decreased and unemployment level started to increase. It increased from 6.5% in the 1st quarter of 2008 to 9.9% in the 4th quarter of 2008 and 13.9% in the 1st quarter of 2009. Tense situation in the labour market can remain until 2011, when the growth will start again. Therefore, private consumption will remain on a low level for at least two years.

Public consumption or public services, the value of which is determined by the volume of the provided public services, amounts to approximately one fifth of the aggregate domestic demand. Within the years of the rapid growth, the volume of public services increased at a slower pace than private consumption. In 2008, public consumption remained on a high level – 20% of GDP. It should be noted that it was 16.6% in 2006 and 17.4% in 2007. In 2008, its volume was by 1.5% higher than in 2007. In the period of economic recession cycle, especially if it is related to the decline of domestic demand, it is important not to reduce the public consumption too rapidly, therefore maintaining the domestic demand.

3.1.3. Investments

Accession of Latvia to the EU became a significant factor for accelerating the investment process. The

rapid investment dynamics was fostered by the availability of cheap financial resources determined by both, the intensified foreign capital inflow and improvement of the financial situation of enterprises due to the relatively low tax burden and high domestic demand. During the period of 2004–2007, the investment volumes in Latvian economy almost doubled. According to the *Enrostat* data, the average annual investment growth rates during this period exceeded the average annual investment growth rates in the EU member states almost four times. Latvia's backwardness in comparison to other EU member states in terms of the volume of investment per employed person also decreased considerably: in 2004, the investment volume per employed person amounted to EUR 3 thousand (30% of the EU average level), in 2007 – EUR 6 thousand (50% of the EU average level).

The volume and dynamics of investment is greatly determined by profitability of business investment projects, financing possibilities and the current situation in the markets, as well as future expectations of entrepreneurs.

Deterioration of the situation in the global financial markets at the end of 2007 and at the beginning of 2008 decreased the credit rating of the banking sector, which negatively affected investments both, directly by restricting external sources for financing investment to entrepreneurs, as well as indirectly, i.e., as a result of decreasing demand, the financial situation of enterprises also deteriorated, thus restricting the internal sources for financing investment.

The dynamics of investments slowed down in 2007, but in 2008 the investment volumes into the Latvian economy were by 13.2% lower than in 2007.

Table 3.2

| Gross Capital Formation | | | | | |
|---------------------------------|------------------|-------------|-------------|-------------|---------------------------------|
| | Average annually | 2006 | 2007 | 2008 | 1 st quarter of 2009 |
| Real growth (%) | | | | | |
| GDP | 10.4 | 12.2 | 10.0 | -4.6 | -18.0 |
| Gross Capital Formation | 15.3 | 18.3 | 11.6 | -13.9 | -62.8 |
| – gross fixed capital formation | 17.6 | 16.4 | 7.5 | -13.2 | -34.1 |
| % of GDP | | | | | |
| Gross Capital Formation | 37.6 | 39.7 | 40.4 | 34.7 | 17.8 |
| – gross fixed capital formation | 31.7 | 32.6 | 33.7 | 30.2 | 20.1 |
| – changes in inventories | 5.9 | 7.1 | 6.7 | 4.5 | -2.3 |

In 2009, the investment processes are negatively influenced by deterioration of investment environment, low domestic and external demand, as well as by the production capacity load level. In the 1st quarter of this year, the investment volumes were almost by three times lower than in the 1st quarter of 2008.

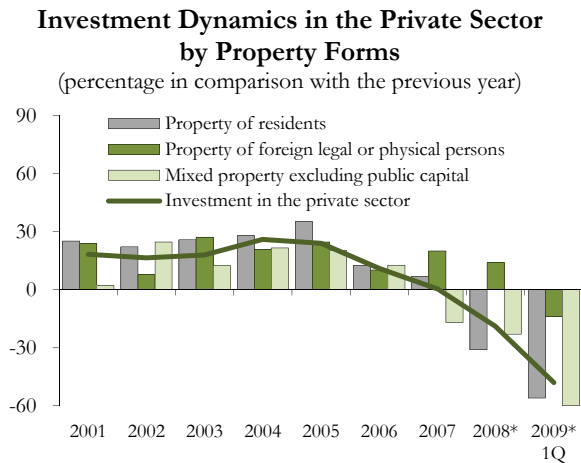
The largest decrease of investment volumes in 2008 and the 1st quarter of 2009 has been observed in

the private sector – by 19% and 48%, respectively. In 2008, the positive dynamics of investment remained in the public¹ sector. In comparison with 2007, the investment volumes increased by 6%. However, in the

¹ The public sector includes enterprises and organisations of the central and local governments, business companies with the share of central or local governments or their enterprises in equity capital in the amount of 50% or more, social, and religious organisations and enterprises owned by them, and budgetary institutions.

1st quarter of 2009, due to the deterioration of budgetary situation, the investment volumes were by 9% lower if compared to the 1st quarter of 2008. Due to substantial decrease of investments in the private sector and rather steady investments in the public sector, the share of both sectors in the total investment structure is equal.

Figure 3.4



* estimated using the quarterly data

Sectoral structure of investments¹. Rapid growth of investments during the period of 2004–2007 was

observed in such sectors as construction, hotels and restaurants, operations with real estate, financial intermediation, health protection and education. Largely it was determined by the financing conditions favourable for investments and rapidly increasing demand.

In general, the investment growth rates in national economy were two times lower in 2007 compared to 2006, which was determined by both, slower investment dynamics in several sectors and also decrease of investment volumes in the trade sector, as well as transport and communications sector by 16.6% and 15.5% respectively, testifying sensitivity of investors against fluctuations of domestic and external demand. According to the provisional data, in 2008 positive investment dynamics remained in the primary sectors and public services sectors. In 2008, investments in education and health care sectors increased almost by 25%. The investment volumes in other sectors compared to 2007 were smaller. A particularly large decrease of investment volumes was in energy sector – by 31.5%, financial services – by 40.4%, operations with real estate – by 23.2% and construction – by 16.8%. Those are mainly real estate market related sectors in which investment process largely depends on accessibility to external financing.

Table 3.3

Dynamics and Structure of Investments by Sectors
(excluding investments in individual construction, %)

| | 2004–2007 (average annually) | 2007 | 2008* | 1 st quarter of 2009* | 2004–2007 (average annually) | 2007 | 2008 | 1 st quarter of 2009* |
|-----------------------------------|---------------------------------|------------|--------------|--|---------------------------------|------------|------------|--|
| Primary sectors | 7.6 | -17.8 | 16.6 | -13.8 | 4.5 | 3.6 | 4.8 | 6.0 |
| Manufacturing | 17.9 | 10.5 | -9.7 | -52.0 | 16.7 | 17.4 | 15.9 | 14.2 |
| Electricity, gas and water supply | 13.2 | 51.6 | -31.5 | -33.9 | 8.0 | 8.8 | 10.0 | 12.0 |
| Construction | 27.0 | 8.8 | -16.8 | -45.0 | 4.3 | 4.7 | 4.2 | 3.7 |
| Trade | 5.0 | -16.6 | -7.1 | 49.5 | 13.6 | 11.0 | 12.4 | 12.2 |
| Transport and communications | 3.0 | -15.6 | -3.4 | -21.3 | 13.6 | 11.5 | 12.8 | 16.2 |
| Other commercial services | 22.8 | 15.5 | -21.5 | -48.9 | 24.2 | 27.3 | 17.5 | 11.5 |
| Public services | 19.5 | 16.5 | 10.5 | 5.9 | 15.2 | 15.8 | 22.5 | 24.1 |
| Total | 17.6 | 7.5 | -13.2 | -34.1 | 100 | 100 | 100 | 100 |

* estimated using the quarterly data

With the deepening of the economic crisis, in 2009 the investment activities continue to decrease in all sectors. During the 1st quarter of 2009 investments in the sector of production of goods have decreased by 29% and in the services sector – by 40%.

Since the accession of Latvia to the EU, the annual investment volumes in manufacturing have almost doubled, however, since 2006 the slowdown of investment dynamics has been observed. In 2006 and 2007, the investments in manufacturing grew by 9.4%

and 10.5% respectively or almost two times slower than in the first years after the accession to the EU.

In 2008, the decrease of investment volumes in manufacturing was comparatively small – by 9.7%, which was largely determined by the increase of investments in production of other non-metallic minerals, which partially compensated the decrease of investments in food industry, wood processing and other manufacturing sub-sectors.

It should be noted that already since 2006 investments have been decreasing in such sectors as food industry, production of electrical and optical equipment and production of transport vehicles. To a

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

certain extent, such trends may indicate to the decrease of competitiveness of these sectors.

At the same time, the investment volumes in the light industry have decreased already since 2003. In 2003, the investments in the light industry amounted to 7.1% of the total investment volume in

manufacturing, in 2007 – only to 2.1%. In 2008, the investments in this sector decreased by 56.5%, but in the 1st quarter of 2009 – by 36.8%. Such dynamics of investments testify substantial decrease of competitiveness of the light industry.

Table 3.4

Dynamics and Structure of Investment in Manufacturing
(%)

| | Growth rates | | | | Structure | | | |
|---|---------------------------------|-------|-------|----------------------------------|---------------------------------|------|-------|----------------------------------|
| | 2004–2007 (average annually) | 2007 | 2008* | 1 st quarter of 2009* | 2004–2007 (average annually) | 2007 | 2008* | 1 st quarter of 2009* |
| Food industry | -1.8 | -37.0 | -9.0 | -50.0 | 21.8 | 13.7 | 17.9 | 22.2 |
| Light industry | -13.3 | -3.5 | -56.5 | -36.8 | 2.7 | 2.1 | 1.5 | 3.5 |
| Wood processing | 18.2 | 19.1 | -22.5 | -82.5 | 26.4 | 28.3 | 19.4 | 7.0 |
| Paper industry and publishing | 20.2 | 4.9 | -46.5 | -81.7 | 7.2 | 7.3 | 4.9 | 1.5 |
| Chemical industry and related industries | 24.3 | 1.1 | -21.7 | -65.1 | 7.6 | 8.2 | 10.3 | 21.9 |
| Production of other non-metallic mineral products | 79.0 | 63.8 | 62.9 | 114.7 | 14.4 | 21.6 | 31.4 | 35.8 |
| Production of metals and metal articles | 20.5 | 46.4 | 9.7 | -79.4 | 7.1 | 7.8 | 6.8 | 3.5 |
| Production of machinery and equipment | 9.0 | 31.0 | -36.4 | -79.4 | 2.1 | 1.8 | 1.9 | 0.8 |
| Production of electrical and optical equipment | 7.1 | -15.7 | -2.6 | -72.3 | 2.5 | 1.9 | 2.2 | 1.1 |
| Production of transport vehicles | 25.0 | 5.9 | -26.0 | -55.6 | 2.3 | 2.0 | 1.5 | 1.1 |
| Other industries | 20.9 | -6.1 | -72.0 | -65.6 | 5.8 | 5.3 | 2.1 | 1.7 |

* estimated using the quarterly data

Since 2004, positive dynamics of investments has remained in the wood processing industry and production of construction materials. Moreover, during the period of 2006–2007, the annual investment growth rates were more rapid as compared to the previous two years. In 2007, the investment volumes in these sectors amounted to 58.1% of the total investment volume. Like in other sectors, the investment volumes in 2008 have decreased also in the wood processing sector, while the investment increased in the sector of production of construction materials.

Most likely, the negative investment dynamics will remain also in the nearest future, by gradually slowing down the decrease rates of the investment volumes. The investment processes in Latvia, like in other countries, which have been affected by the financial crisis, will be largely determined by availability of financial resources, increase of aggregate demand and implementation of state aid measures for facilitation of business activities.

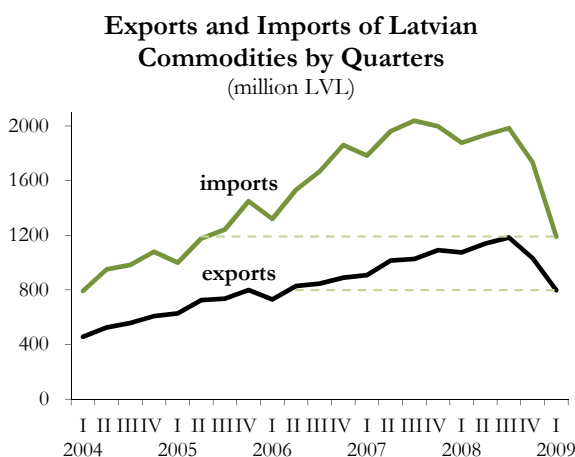
3.1.4. Exports and Imports

Exports and imports of commodities

Exports of Latvian commodities in 2008 was by 9.6% higher than in 2007 in current prices, while in constant prices – only by 1.7%. During the last quarter of the year, the export volumes started to decrease significantly and already in January–May 2009 the

exports of commodities have gone down considerably in comparison with the level of the respective period last year (by 27.7% in current prices).

Figure 3.5



The commodity imports started to decrease at the end of 2007 and in 2008 in total were by 3.2% lower in current prices. Disregarding the price increase of the imported commodities, the reduction of imports is even larger – by 11.1%. At the beginning of 2009, the imports continued to go down dramatically (in January–May 2009 in comparison with respective period of the previous year – the decrease was 39.9%) and in the 1st quarter it was on the level of 2005.

In 2008 and the beginning of 2009, the changes in the trading conditions negatively influenced the **exports of commodities**, and the import prices increased more rapidly than the export prices. Most substantially, the decrease in the exports unit value in the 1st quarter of 2009 (by 5%) was influenced by the decrease of export prices in wood-processing and metal-working products groups.

In 2008, the exports of commodities increased significantly in the agriculture, food products and metal-working product groups while decreased in the groups of wood and wood processing products and light industry goods.

In January–May 2009, the exports decreased in all the groups of goods and like in 2008 the largest decline was observed in wood and its products group, which amounted to one fourth of the whole decrease of exports. Similarly, the exports of metal-working products and machine building industry decreased significantly.

Figure 3.6

Dynamics of Latvian Commodity Exports by Months (million LVL)

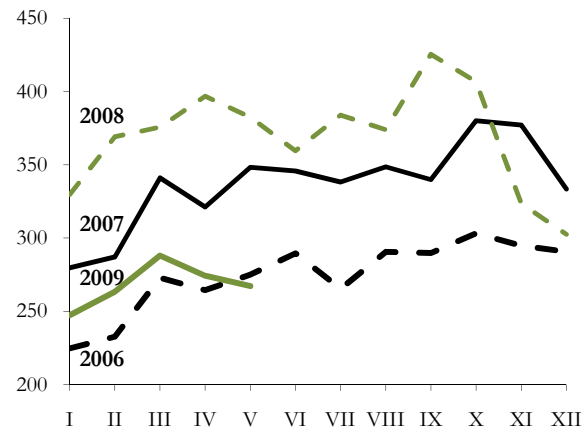


Table 3.5

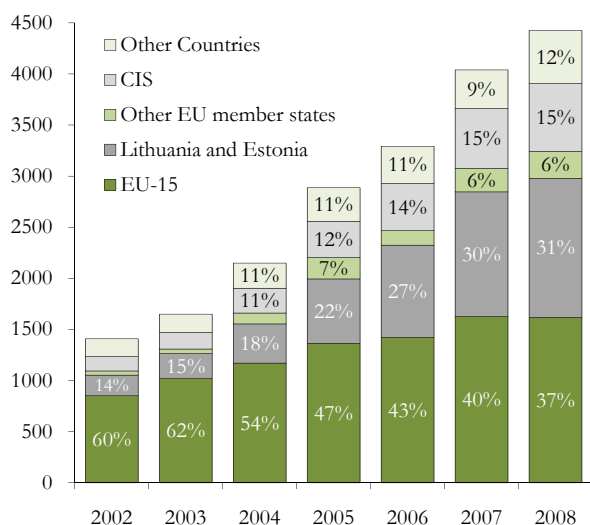
Exports by Main Groups of Commodities (%, in current FOB prices)

| | 2008 | | January–May 2009 | |
|--|------------|--------------------------------------|--|--------------------------------|
| | structure | change compared to the previous year | change compared to the corresponding period of the previous year | contribution to volume changes |
| Total, | 100 | 9.6 | -27.7 | -27.7 |
| including: | | | | |
| wood and wood products (IX) | 16.6 | -19.1 | -39.7 | -7.5 |
| metals and metal articles (XV) | 16.7 | 25.3 | -39.5 | -6.6 |
| light industry products (VIII; XI–XII) | 6.1 | -8.5 | -26.3 | -1.6 |
| agricultural and food products (I–IV) | 16.9 | 29.0 | -10.1 | -1.5 |
| products of chemical industry and allied industries, plastics (VI–VII) | 11.2 | 18.5 | -13.5 | -1.4 |
| machinery (XVI) | 12.5 | 24.7 | -24.6 | -3.0 |
| mineral products (V) | 4.2 | 11.2 | -7.0 | -0.3 |
| transport vehicles (XVII) | 7.4 | 16.0 | -37.6 | -3.1 |
| other commodities (X; XIII–XIV; XVIII–XXII) | 8.4 | 5.2 | -31.3 | -2.7 |

The exports to EU-27 in 2008 have increased by 5.5% in comparison with the previous year. Like the total Latvian exports, also exports to the EU-27 increased mainly in the machinery, metal-working and agriculture and food products groups, but decreased in the wood-processing sector. In January–May 2009, exports to the EU-27 member states decreased considerably in the wood-processing group (almost one third of the total decrease of exports), as well as in metal-working and transport vehicles groups (23% and 11% respectively of the total decrease of exports to the EU-27 member states).

As usual, the exports to the CIS countries in 2008 continued to increase more rapidly than the total exports and accounted for slightly more than one fifth of the total growth of exports. The biggest increases were observed for exports of agriculture and food industry, as well as chemical products. In January–May 2009, exports decreased considerably also to the CIS countries. The largest decrease of exports was in the machinery products group (slightly over 20% of the total exports decreased to the CIS countries), as well as in food products and light industry groups (15.8% and 15.4%, respectively).

Figure 3.7
Structure of Latvian Exports
by Groups of Countries
(million LVL)



Increase of **commodity imports** in 2008 was observed in the groups of mineral products, agricultural and food products, as well as chemical industry products, while the biggest decrease in the volumes was observed in the groups of transport

vehicles, machinery, as well as wood and wood processing products. In January–May 2009, imports decreased in all the groups of goods, the largest of these – machinery and transport vehicles groups, which accounted for almost half of the decline of imports.

Figure 3.8

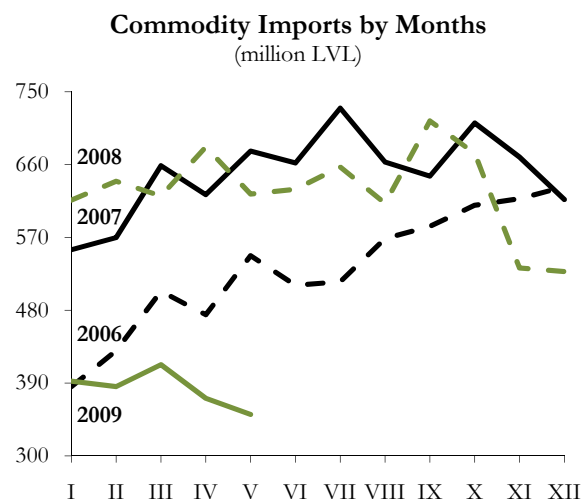


Table 3.6

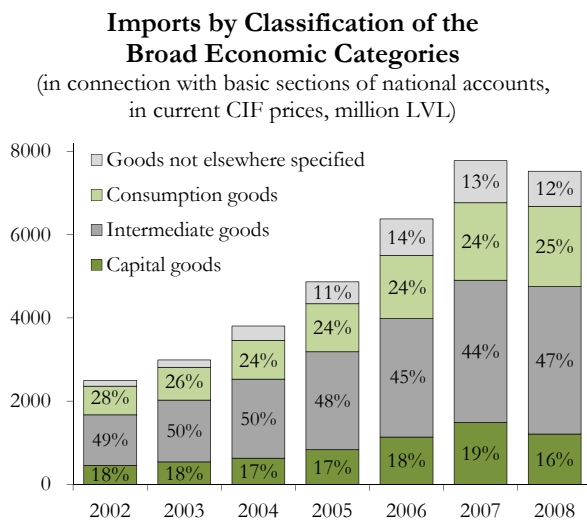
Imports by Main Groups of Commodities
(%, in current CIF prices)

| | 2008 | | January–May 2009 | |
|--|------------|--------------------------------------|--|--------------------------------|
| | structure | change compared to the previous year | change compared to the corresponding period of the previous year | contribution to volume changes |
| Total, including: | 100 | -3.2 | -39.9 | -39.9 |
| wood and wood products (IX) | 1.9 | -46.7 | -63.4 | -1.4 |
| metals and metal articles (XV) | 10.3 | 3.7 | -48.7 | -4.9 |
| light industry products (VIII; XI-XII) | 5.2 | -8.8 | -33.2 | -1.8 |
| agricultural and food products (I-IV) | 13.7 | 18.4 | -16.6 | -2.1 |
| products of chemical industry and allied industries, plastics (VI-VII) | 14.5 | 8.5 | -31.2 | -4.6 |
| machinery (XVI) | 18.3 | -15.1 | -52.4 | -9.8 |
| mineral products (V) | 15.6 | 30.9 | -20.9 | -2.8 |
| transport vehicles (XVII) | 10.7 | -28.9 | -65.3 | -8.3 |
| other commodities (X; XIII-XIV; XVIII-XXII) | 9.8 | -8.5 | -41.5 | -4.1 |

As viewed by classification of the broad economic categories, the imports have changed slightly in the last years – the imports of capital goods have decreased while the imports of intermediate consumption goods have increased (see Figure 3.9).

The biggest **trading partners** of Latvia in the period of January–May 2009 were Lithuania (15.6% of the total foreign trade turnover), Russia (11.5%), Germany (10.2%), Estonia (9.8%), Poland (6.0%), as well as Sweden (5.0%).

Figure 3.9



The highest share of foreign trade of Latvia is mostly with Lithuania and Estonia. During the recent years, the share of these countries in the total share of foreign trade increases continuously. At the same time, the trade balance with both Baltic States has deteriorated during the period of rapid increase of trade. However, at the end of 2008 and especially at the beginning of 2009, the balance has improved and is close to zero.

As Figure 3.11 shows, the foreign trade balance with Estonia is positive in the last quarters, while it remains negative with Lithuania. The imports from Lithuania in January–May 2009 exceeded the exports by 44%, while the exports to Estonia exceeded

imports by 42%, although the total trade with Estonia is slightly lower than with Lithuania. The main goods exported to Estonia and Lithuania are agricultural and food products, chemical industry products, as well as machinery products. The main goods imported from Lithuania and Estonia are agricultural and food products, mineral products, as well as chemical industry products.

Figure 3.10

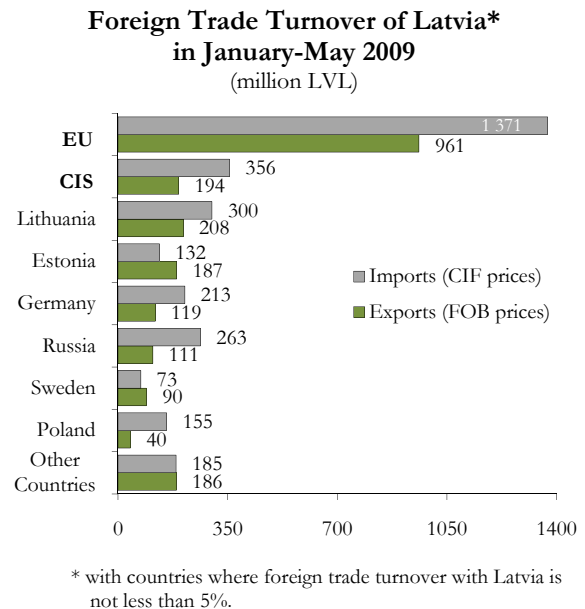
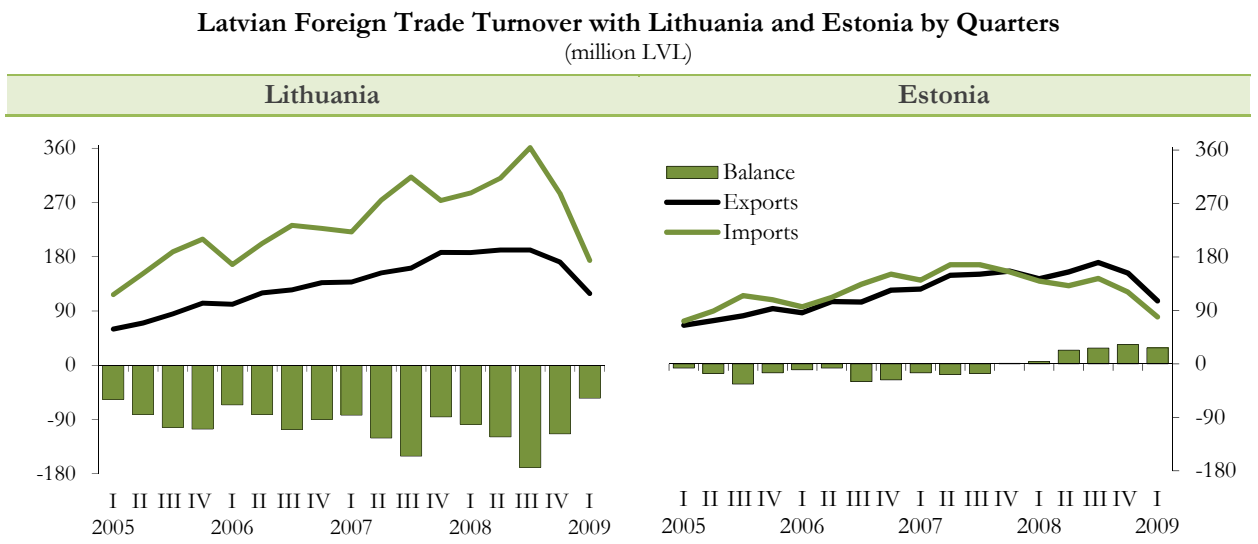


Figure 3.11



Exports and imports of services

Approximately one fourth of the negative trade balance of commodities of Latvia in 2008 was covered by the positive balance of services. The data of the balance of payments for 2008 indicates that the balance of services continues to improve, as

exports of services grow more rapidly than imports. Due to the fact that imports of services have rapidly decreased, the balance of services has improved significantly in the 1st quarter of 2009, thus covering the largest part of the negative trade balance of commodities.

Table 3.7

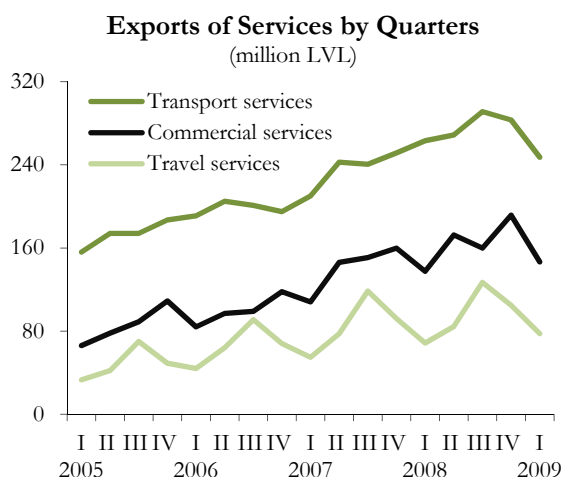
Exports and Imports of Services (%)

| | 2008 | | | | 1 st quarter of 2009 | | | |
|-------------------------|------------|------------|-------------------------------|-------------|---------------------------------|------------|--|--------------|
| | structure | | change over the previous year | | structure | | change compared to the corresponding period of the previous year | |
| | exports | imports | exports | imports | exports | imports | exports | imports |
| Services – total | 100 | 100 | 16.0 | 10.6 | 100 | 100 | 0.3 | -24.8 |
| including: | | | | | | | | |
| Transport services | 50.8 | 25.5 | 17.1 | -3.2 | 55.3 | 26.5 | -6.0 | -31.8 |
| – sea transport | 17.2 | 5.8 | 3.3 | -8.4 | 20.6 | 6.0 | -2.1 | -33.5 |
| – air transport | 8.0 | 8.4 | 25.1 | -4.0 | 7.6 | 8.1 | -13.5 | -28.6 |
| – other transport | 25.6 | 11.4 | 25.9 | 0.2 | 27.1 | 12.4 | -6.8 | -33.0 |
| Travel | 17.6 | 35.7 | 12.1 | 15.1 | 14.4 | 29.7 | 13.3 | -7.4 |
| Commercial services | 30.4 | 36.9 | 17.1 | 17.0 | 28.9 | 41.8 | 6.6 | -32.5 |
| Other services | 1.2 | 1.9 | 4.9 | 24.6 | 1.4 | 1.9 | -12.1 | -29.0 |

Slightly more than a half of the exports of services is made of the revenues from transit services. 2008 was a rather successful year for the transit business, as cargo turnover in ports has increased, along with volumes of other road transport services. However, in the 1st quarter of 2009, the exports of transit services have decreased slightly.

The increase of commercial services has been significant, as well as the increase of revenues from the foreign tourists in Latvia.

Figure 3.12



3.2. Contribution of Sectors

3.2.1. Structure of Economy

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 services sectors, because their growth was considerably more rapid than development of the sectors of production of goods.

In 2008, the share of services sectors in terms of value added has increased to 74.2% compared to 71.8% in 2000. According to the employment rate, the

structure of national economy considerably differs from that, which is shown by the value added, due to the markedly different levels of productivity in different economic sectors.

After the accession to the EU (2004–2007), a half of the growth was provided by the trade sectors (wholesale and retail), as well as growth of other commercial services. Contribution of manufacturing was considerably lower and also lagged behind the contribution of construction, transport and communications sectors to the growth.

Table 3.8

Structure of Economy
(%)

| | By value added | | By number of employed | |
|-----------------------------------|----------------|------------|-----------------------|------------|
| | 2000 | 2008 | 2000 | 2008 |
| Primary sectors | 4.8 | 3.5 | 14.5 | 8.2 |
| Manufacturing | 13.7 | 10.6 | 17.9 | 15.1 |
| Electricity, gas and water supply | 3.6 | 2.8 | 1.9 | 1.4 |
| Construction | 6.1 | 8.9 | 5.9 | 11.3 |
| Trade, hotels and restaurants | 17.9 | 19.0 | 17.7 | 19.9 |
| Transport and communications | 14.0 | 10.8 | 8.3 | 9.3 |
| Other commercial services | 23.0 | 28.7 | 12.4 | 15.5 |
| Public services | 16.9 | 15.7 | 21.4 | 19.4 |
| Total | 100 | 100 | 100 | 100 |

The economy of Latvia has a particularly low share of manufacturing, which considerably lags behind the average EU level in this regard – only such EU member states as Cyprus and Luxembourg, having a high share of export-oriented services in their

economies, have a lower share of manufacturing in GDP. The asymmetry of the structure of economy may not provide stable growth and it is particularly dangerous in the conditions of changing capital flows.

Table 3.9

GDP Growth
(%)

| | Growth rates | | | Contribution to growth | | |
|-----------------------------------|---------------------------------|-------------|---------------------------------------|---------------------------------|-------------|---------------------------------------|
| | 2004–2007 (average annually) | 2008 | 1 st quarter of 2009 | 2004–2007 (average annually) | 2008 | 1 st quarter of 2009 |
| Primary sectors | 5.1 | 0.0 | -10.1 | 0.2 | 0.0 | -0.3 |
| Manufacturing | 4.8 | -6.5 | -25.8 | 0.6 | -1.2 | -3.4 |
| Electricity, gas and water supply | 3.6 | -2.4 | -10.8 | 0.1 | -0.1 | -0.4 |
| Construction | 16.5 | -2.6 | -28.2 | 1.2 | -0.3 | -2.0 |
| Trade, hotels and restaurants | 15.4 | -8.4 | -26.6 | 3.4 | -3.2 | -7.2 |
| Transport and communications | 9.1 | 1.1 | -15.4 | 1.3 | 0.2 | -2.3 |
| Other commercial services | 12.2 | -0.2 | -6.5 | 3.0 | -0.1 | -1.9 |
| Public services | 4.0 | 0.7 | -3.7 | 0.6 | 0.1 | -0.5 |
| GDP | 10.4 | -4.6 | -18.0 | 10.4 | 10.3 | -18.0 |

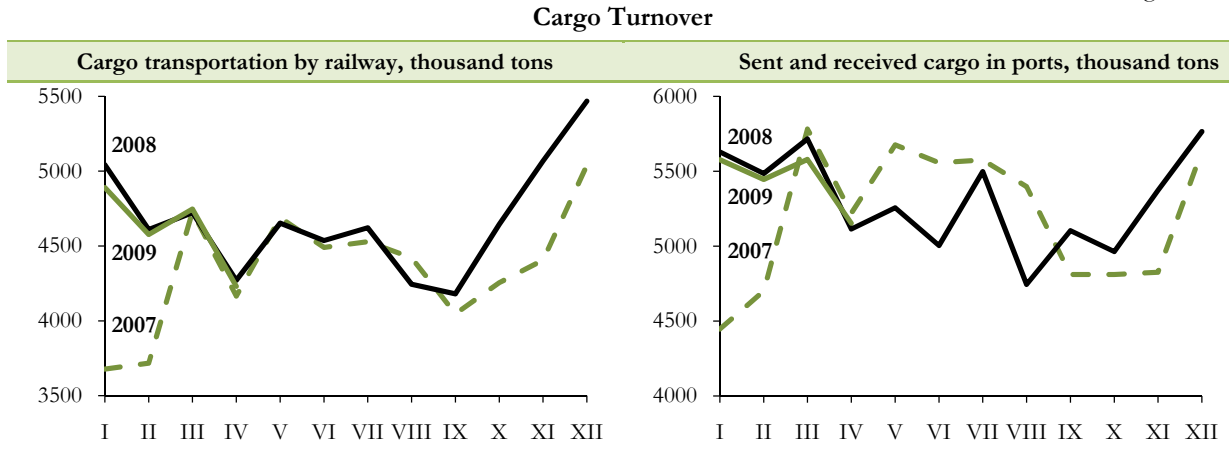
Due to the decline of external financing, a substantial decrease has been observed also in the domestic demand, which affected directly the economic activities of the sectors – retail trade has declined, as well as the growth rates of construction and the activities in the real estate market have decreased.

The total output of the transport and communications sector in 2008 remained positive, but already in the 1st quarter of 2009 the decrease was rather significant. More substantial decrease is observed in services related to the domestic demand, but the transport transit services, for instance, the railway transport, have remained almost on the level of the previous year.

Figure 3.13



Figure 3.14



The decrease of the manufacturing output has started already earlier – in 2007, and this process has been determined by the gradual decrease of the competitiveness of the Latvian industry – due to the high inflation rate and the rapid increase of labour costs. In 2008, the manufacturing industry was negatively influenced by the decline of domestic demand and in the second half of 2008 and in 2009 – also by significant reduction of the external demand, especially in Lithuania and other EU member states.

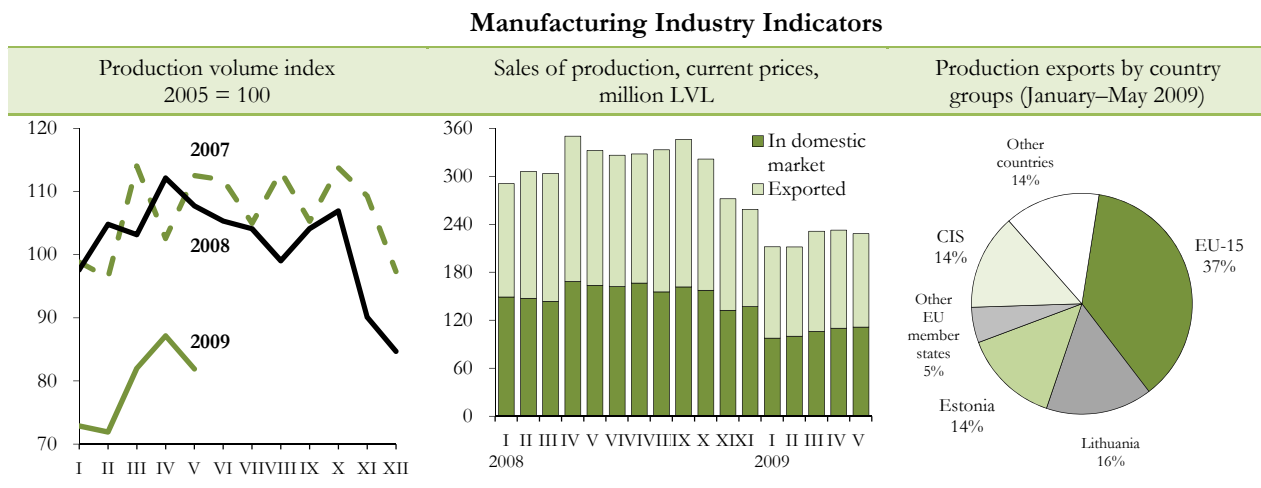
3.2.2. Manufacturing

In 2009, unlike in 2008, manufacturing is influenced by a rapid decrease of external demand. In 2008, the low domestic demand was the main reason

for a decreased output, and also in 2009 domestic demand continued to decline.

The production volumes in January–May 2009 were by 24.7% lower than in the respective period of the previous year. It should be noted that after a rapid decline at the beginning of the year, in March and April the decrease rate of output in comparison with the respective months of the previous year has slowed down and was -20.5% and -22.3%, respectively. However, in May in comparison with April 2009, the output volumes of the sector decreased again (by 6.1%). Since March 2009, the confidence indicator of manufacturing has slightly improved, however, it is still on a very low level. In the 1st quarter of 2009, the volumes of new orders have decreased significantly both, in domestic and export markets.

Figure 3.15



The decrease of output can be observed in all sub-sectors of the manufacturing industry. The most substantial decrease in production volumes is in the light industry, production of electrical and optical equipment, transport vehicles, as well as production of machinery and equipment. The smallest decline is in the food industry and wood-processing sector.

Deterioration of the situation in the sector in 2008 was mainly determined by the rapid decrease of the domestic demand, as a result of which the sales volumes in the domestic market declined by 8.8% if compared with 2007. At the same time, the volumes of exported products exceeded by 0.4% in 2008 the volumes exported in 2007.

Table 3.10

Changes of Production Volumes in Manufacturing*
(percentage change in comparison with the corresponding period of the previous year)

| | 2006 | 2007 | 2008 | 2009 I-V |
|---|------------|------------|-------------|--------------|
| Manufacturing – total | 6.4 | 0.3 | -4.7 | -24.7 |
| Food industry | 6.0 | 1.3 | -5.3 | -17.2 |
| Light industry | 4.2 | 0.3 | -11.0 | -42.0 |
| Wood processing | -2.7 | -6.0 | -12.1 | -18.2 |
| Paper industry and publishing | 7.7 | 0.2 | -4.2 | -25.3 |
| Chemical industry and related industries | 20.3 | 3.1 | -2.6 | -24.8 |
| Production of other non-metallic mineral products | 10.0 | -17.1 | -5.6 | -23.8 |
| Production of metals and metal articles | 11.4 | 11.5 | 1.8 | -27.2 |
| Production of electrical and optical equipment | 16.4 | 3.8 | 4.5 | -31.5 |
| Production of machinery and equipment | 16.2 | 5.0 | 12.2 | -49.9 |
| Production of transport vehicles | 14.9 | 10.7 | 8.1 | -50.3 |
| Other industries | 1.6 | 3.0 | -8.0 | -26.9 |

* according to NACE Rev.2

In 2009, the domestic demand continues to decrease and the sales volumes in the domestic market decrease considerably. In January–May 2009, the sales volumes were by 29.4% lower than in the respective period of the previous year.

The processes in the global financial markets have affected the growth of the main export markets of Latvia – Lithuania, Estonia, the rest of the EU and Russia, therefore in the five months of 2009, the sales

volumes of goods produced in Latvia have decreased considerably (by 22%) also in export markets.

The main factors hindering production are the lack of current assets and accessibility to the traditional financial instruments, devaluation risk of the national currency and devaluation of national currencies in the neighbouring countries (Belarus, Poland, Russia, etc.), the lack of support to exports, high tariffs for energy resources, concentration of retail trade and respective decrease of competition, as well as state tax policy.

Table 3.11

Structure of Manufacturing in 2008*
(%)

| | By value added | By number of employed | Share of exports in sector's sales |
|---|----------------|-----------------------|------------------------------------|
| Manufacturing – total | 100 | 100 | 51.0 |
| Food industry | 21.3 | 21.4 | 24.2 |
| Light industry | 5.5 | 11.4 | 76.8 |
| Wood processing | 13.8 | 17.8 | 65.3 |
| Paper industry and publishing | 7.9 | 7.4 | 39.6 |
| Chemical, rubber and plastic industry | 7.2 | 5.9 | 64.8 |
| Production of other non-metallic mineral products | 7.0 | 4.7 | 23.9 |
| Production of metals and metal articles | 15.4 | 10.0 | 70.2 |
| Production of machinery and equipment | 3.7 | 4.1 | 81.7 |
| Production of electrical and optical equipment | 6.7 | 4.5 | 73.7 |
| Production of transport vehicles | 7.5 | 5.5 | 77.9 |
| Other industries | 3.9 | 7.4 | 46.3 |

* according to NACE Rev.2

When the economic recession started, not all the sectors were able to re-orientate their activities successfully. For example, in 2008 the share of wood processing has considerably decreased in manufacturing both, in terms of the value added and the number of employed persons, because the demand for

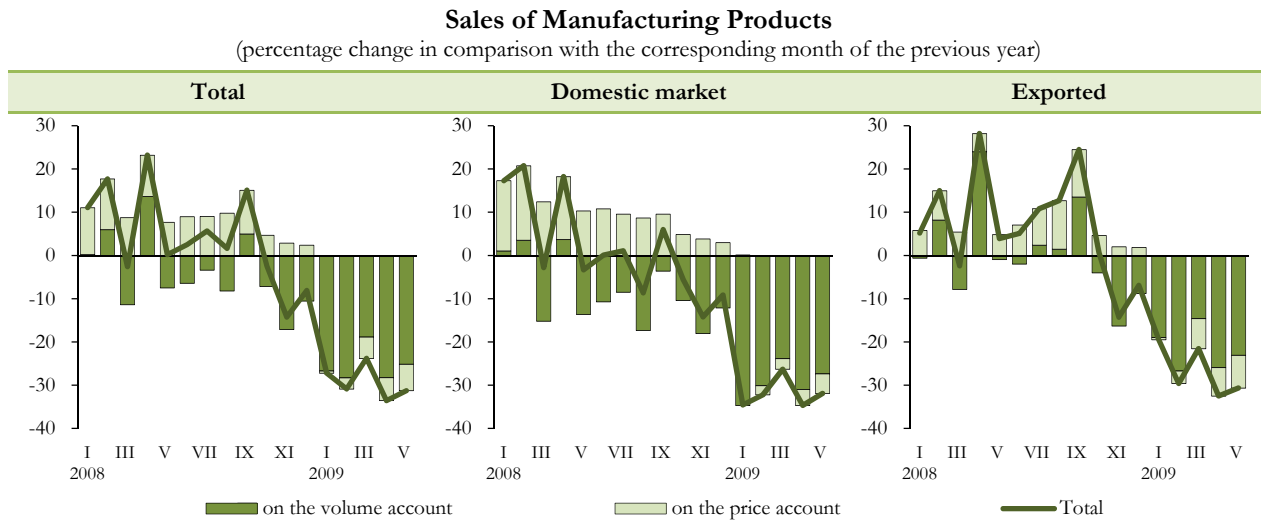
wood processing products in the global markets also decreased. The share of production of metals and metal products increased in the last year due to the increase of export volumes of the sector. However, in the second half of 2008 it has also started to decrease.

Domestic demand decreases more rapidly than the external demand, thus the share of exports has increased by 2 percentage points in the sales of the sector. During five months of 2009 it was 53% of the total sales of the sector.

The export structure of manufacturing remains almost unchangeable in the recent years. Almost 75%

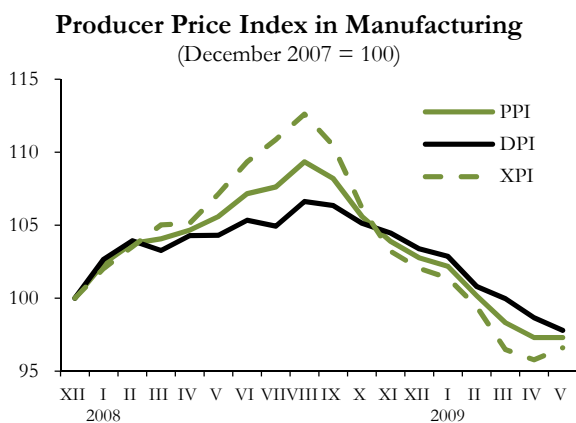
of the exports of products are related to the EU member states, slightly more than a half of which to EU-15 member states and 30% to Lithuania and Estonia. During five months of 2009, exports to the CIS countries amounted to 15% of the produced goods.

Figure 3.16



The decline of producer price growth rates in manufacturing started already in the mid-2007, when the growth rate of economy decreased gradually. The average growth rate of producer prices in manufacturing in 2008 was by 7 percentage points (by 8.3%) slower than in 2007 (15.3%).

Figure 3.17



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

Until the mid-2007, the price dynamics were similar in the domestic market and for the exported products, but in the second half of the year producer prices started to rise more rapidly in the domestic market, while the price dynamics of the exported products became slower. At the beginning of 2008, the price increase continued for both – products sold in the domestic and export markets. However, at the end

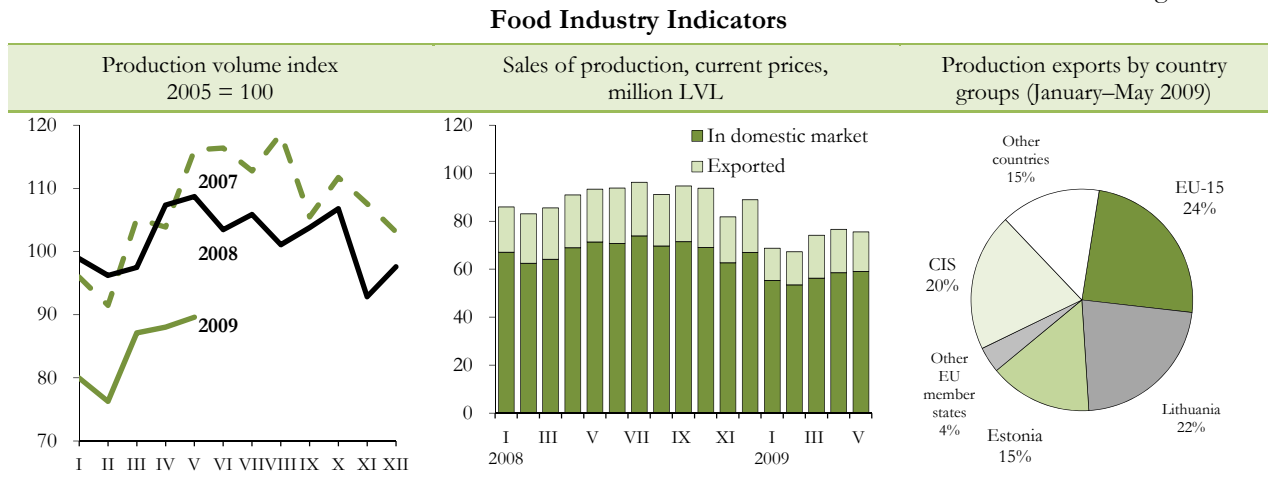
of the year, the growth rate of producer prices slowed down, and at the beginning of 2009 the deflation of producer prices started.

In January–May 2009, the producer price level in manufacturing has decreased by 4.8%. Thus, within one year, in comparison with May 2008, the producer prices have decreased by 7.9%. The total producer price level has decreased mainly due to the fall in prices in metal production, wood-processing and food industry. Although the competitiveness of Latvian producers increases, when prices go down, the current producer price deflation has to be considered negatively, since it does not facilitate an increase of economic activities.

The dynamics of the producer prices in manufacturing in Latvia slightly differs from the total price dynamics within the EU. In autumn 2007, the manufacturing prices within the EU started to rise rapidly, while in Latvia their growth rates started to decrease. The increased producer price indices in the EU remained also in the beginning of 2008. However, the various price change dynamics actually did not improve competitiveness of Latvian producers, since the changes in prices of Latvian producers were more rapid than the average EU prices. At the end of the year, the producer price growth rates decreased substantially also on average in the EU, and in 2009 deflation started.

Food industry is one of the biggest sectors of value added. Latvian manufacturing and constitutes one-fifth of its

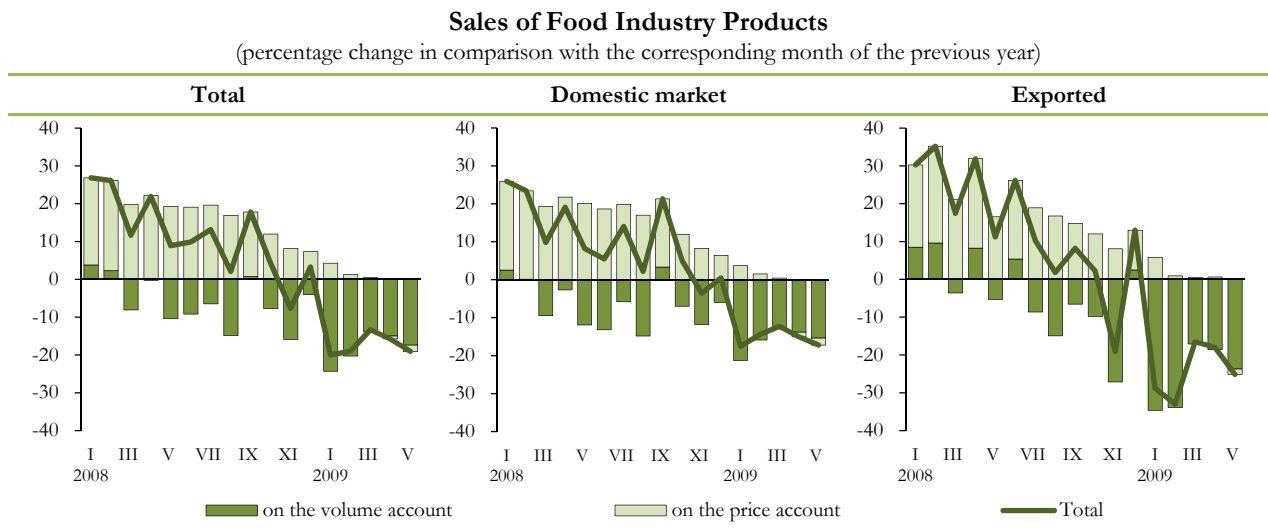
Figure 3.18



In five months of 2009, output of the sector has decreased by 17.2%. The decline in the food processing sector has been observed already since the end of 2007, which was determined by both, decrease

of the domestic and external demand. In January–May 2008, the sales volumes of the products sold in domestic market and the exported products decreased considerably (by 15.9% and by 25.3%, respectively).

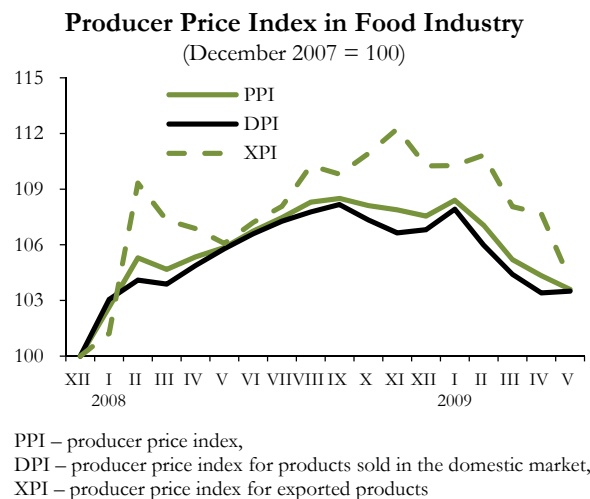
Figure 3.19



Although the production volumes of the sector decreased up to now, they were compensated with the price increase thus the revenues from sales in the food industry were increasing until the end of 2008. However, since the demand considerably decreased, it is not possible to increase the prices anymore, although in January–May 2009 in comparison with the five months of 2008 the producer prices in the sector have increased by 1%, including by 0.7% for the products sold in the domestic market.

Approximately three fourths of the goods produced by the sector are sold in the domestic market, the rest is exported, mainly to Estonia, Lithuania and Russia. Moreover, the exports of food products to Lithuania and Estonia accounts for 70% of Latvian food export to the EU member states.

Figure 3.20

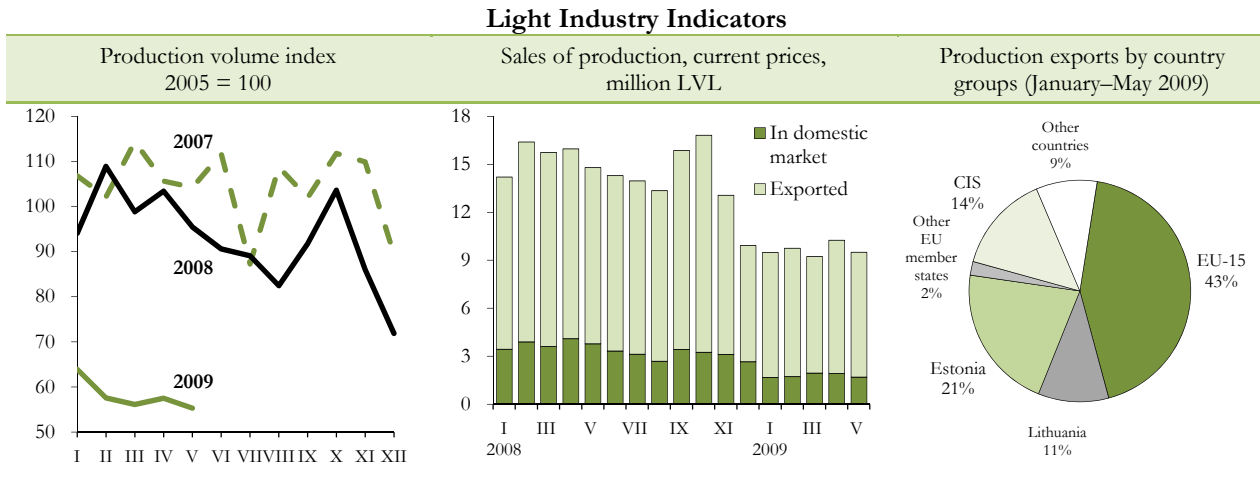


The purchasing power of population decreases, therefore the manufacturers of the food industry have to start to think about producing at lower prices, thus with lower quality. Moreover, as the consumption in the domestic market declines, the possibility of exporting also decreases, because in some sectors other production equipment is needed to produce products with longer period of validity, but such equipment requires considerable investments.

The share of the light industry sector continued to decrease in terms of the value added of manufacturing in 2008 and amounted to 5.5%. The sector is mainly oriented to exports – more than three fourths of the produced output is exported abroad.

The main sales markets of Latvian textile industry are in the old EU member states. Due to the poor demand in the EU member states and high competition in the sector, it is hard for Latvian producers to expand the production volumes.

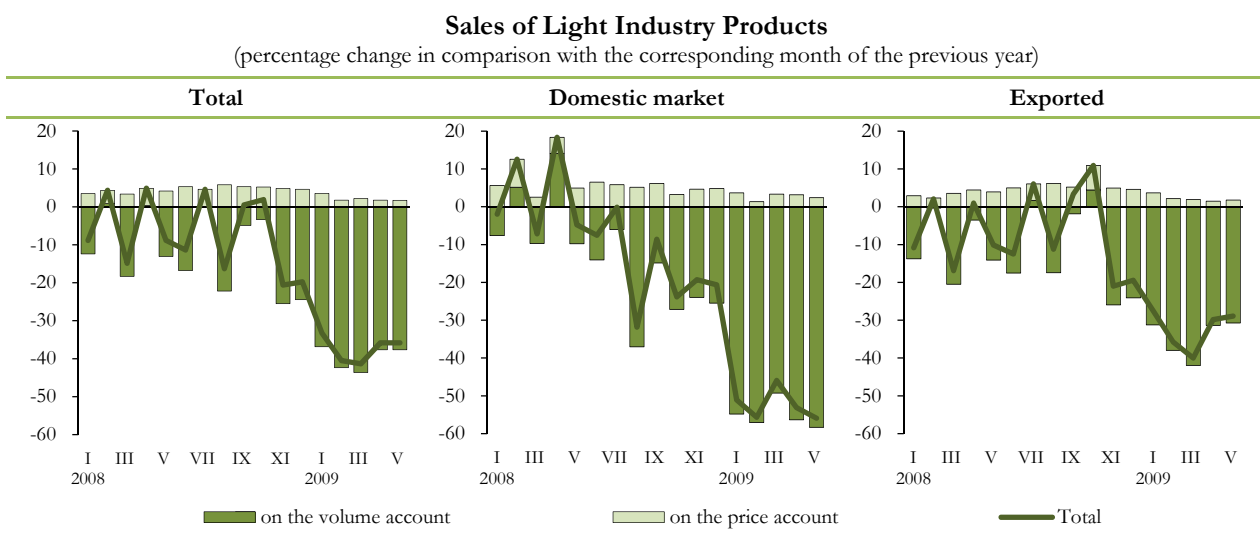
Figure 3.21



The main reason why the domestically produced goods are not in the local stores is the payment term for the delivered products – local supermarkets perform payment for the delivered products within 90–100 days while money from foreign partners can be received within 3–14 days. Therefore, it is more profitable to export products than to sell domestically. In the situation of the economic crisis, the motivation

to export rather than sell domestically has increased by even more substantial factor: domestic demand, which was increasing until now due to the huge consumer crediting volumes, has decreased rapidly and there is no hope that it will increase considerably in the coming years. Therefore, the only possibility for many businessmen to save their businesses is to look for the market of their products outside the country.

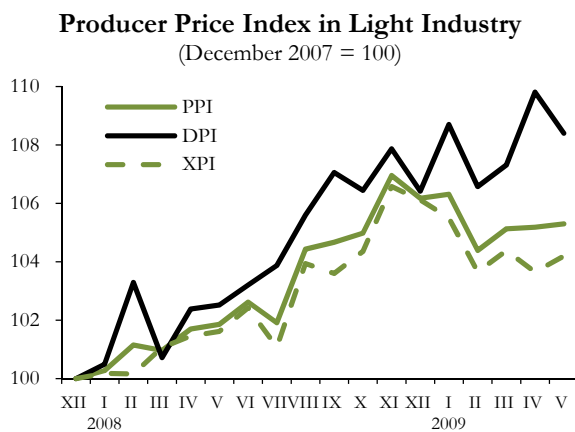
Figure 3.22



In five months of 2009, the output of the sector has decreased by 42% if compared with January–May 2008. The rise of producer prices did not manage to compensate the decline of the production volumes. As a result, the revenues from sales of the sector decreased by 37.5% in 5 months of 2009.

The producer price increase in the light industry in May 2009 was 3.4% if compared to May 2008, thus from the beginning of the year the producer prices in the sector were by 4.1% higher than in January–May 2008. In general, the price increase for the exported products in the light industry sector is considerably lower than for the products sold in the domestic market.

Figure 3.23

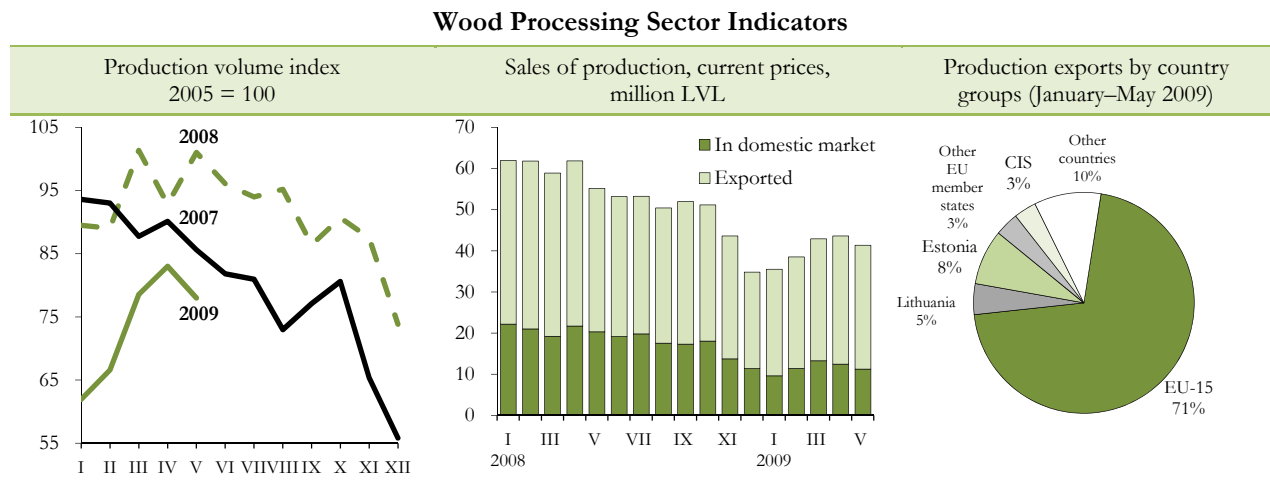


PPI – producer price index,
 DPI – producer price index for products sold in the domestic market,
 XPI – producer price index for exported products

Wood processing is one of the biggest sectors of Latvian industry. Its value added makes up more than 14% of the manufacturing output. Approximately 65% of the output of the sector is exported, out of which more than 70% is sold in the old EU member states.

In the mid-2006, when the demand for the wood-processing products decreased considerably in Europe, the decrease of production volumes of the sector started. From 2006 to 2008, in total the output of the sector has declined by almost 20%. At the end of 2008, the government supported the increase of the maximum permissible cutting volumes in the state forests thus stabilizing the wood supply to the Latvian wood-processing industry, eliminating the reduction of working places and export revenues. The increase of the maximum permissible cutting volumes is not a decree to cut in the state forests by 4 million cubic meters more wood, but rather it allows the sector to plan activities under the circumstances of economic recession and to keep their share in the export markets.

Figure 3.24



In five months of 2009, the wood processing sector's output has decreased by 18.2% in comparison with the respective period of the previous year.

Moreover, the wood-processing sector faces one of the smallest volume decreases out of all the sub-sectors of the manufacturing industry.

Figure 3.25

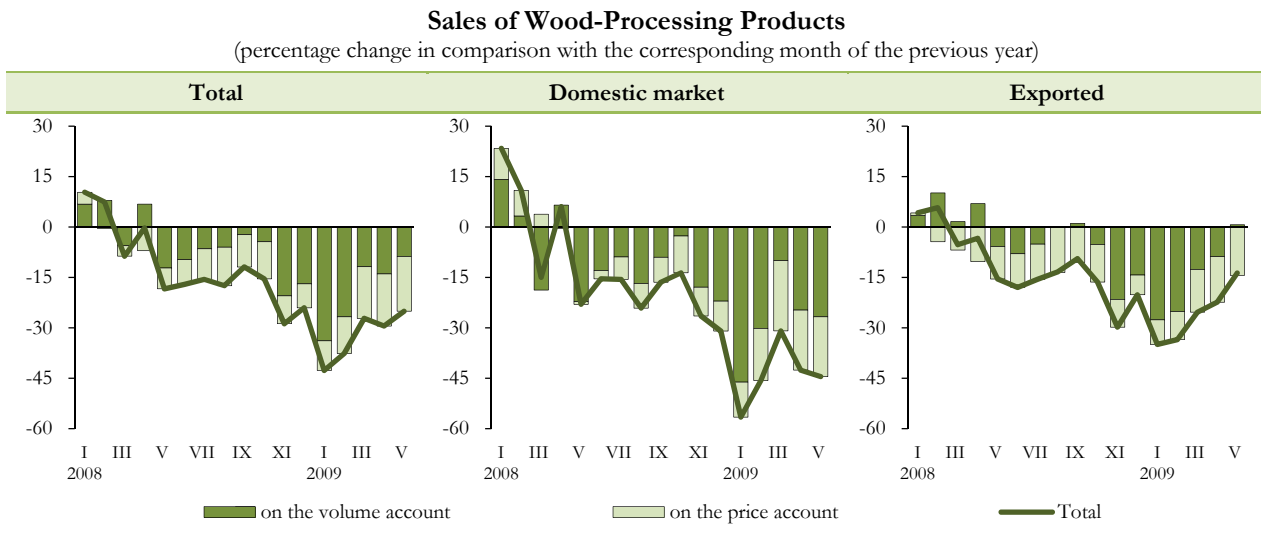
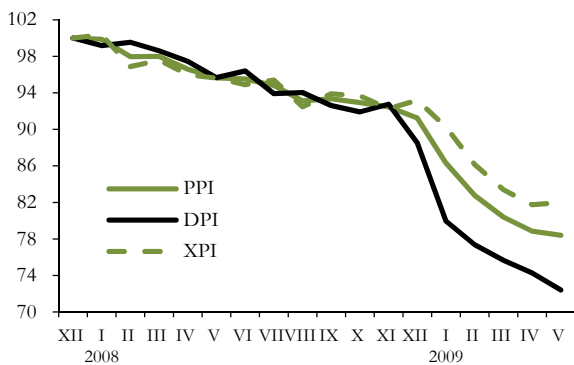


Figure 3.26

Producer Price Index in Wood Processing

(December 2007 = 100)



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

The producer prices in the wood-processing sector have been decreasing since the mid-2007. In 2008 the prices were by 6.9% lower than a year before, while in January–May 2009 the prices decreased on average by

16.7% in comparison with the respective period of 2008. Moreover, the prices of products sold in the domestic market decreased more rapidly – by 22.5%.

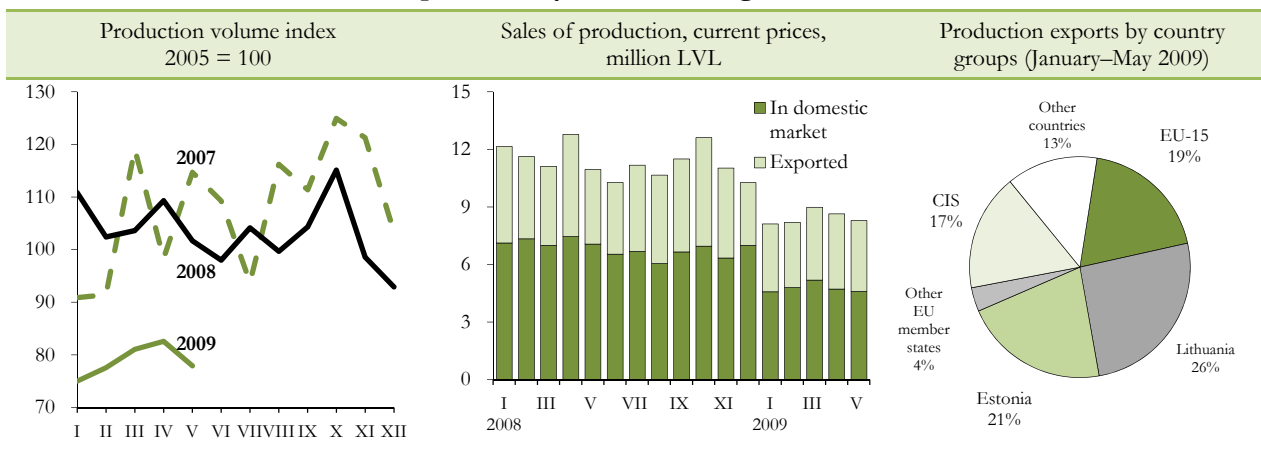
Significant improvement of the economic situation in the sector is not expected in many of the export markets, and it is expected that the prices of products will continue to fall, thus, even with unchanging production volumes, the decrease of turnover is possible.

In 2007, the growth of *paper industry and publishing* remained on the level of the previous year, whereas the output of the sector in 2008 fell by 4.2% as a result of decrease of the domestic demand. During the five months of 2009 the output of the sector is already by 25.3% smaller than in the 5 months of the previous year.

Production sales volumes in the domestic market during the five months of 2009 were by 33.1% lower than in January–May 2008. Whereas the decrease of the sales volumes in export markets during this period has been more moderate (by 11.2%).

Figure 3.27

Paper Industry and Publishing Indicators



In 2009, the overall development of the sector has been most significantly affected by the increase of the VAT rate, especially it has influenced the book industry, which is very price-sensitive, the increase of the tax rate reduces the retail sales volumes of books and thus also the possibility to publish new books. As a result, the solvency of the publishers has decreased, which in its turn directly influences solvency of printing houses and paper suppliers. The printing and publishing sector is negatively affected by the reduction of public procurement.

Approximately 40% of sales of the sector are comprised by exports. In January–May 2009, its share has increased slightly.

Although the sales markets of the sector are not related to the export opportunities to a great extent,

the increase of export volumes is still a substantial incentive for the growth of the sector. Almost half of the exported products are sold in Lithuania and Estonia. Recently, exports to the EU-15 member states have increased slightly.

In 2008 compared to 2007, the producer prices of the sector rose by 3.7%, the price increase of the exported products was lower (by 2.7%). During the five months of 2009, the prices in the sector are by 3.3% lower than in January–May of the previous year. The prices of the products sold on the domestic market in January–May 2009 are by 0.6% lower than during the respective period of the previous year, while the prices of the exported goods during the same period have decreased by 8.8%.

Figure 3.28

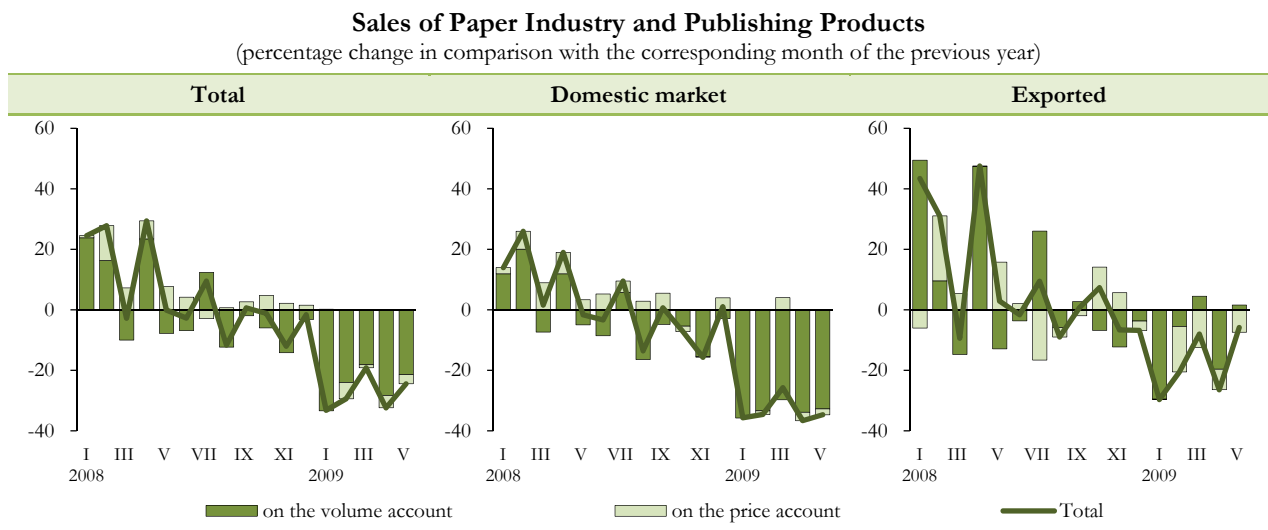
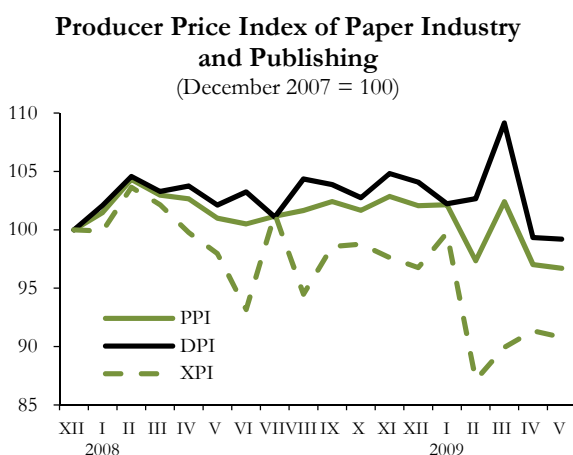


Figure 3.29



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

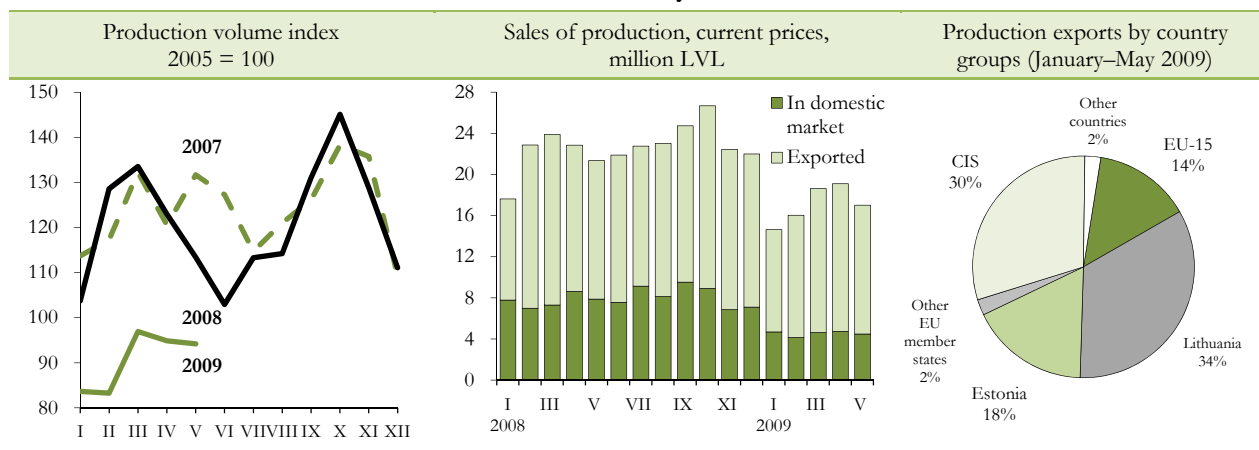
The price changes influence also the exports of the printing materials, because it is directly related with the ability or inability of the publishing houses to invest resources in their development, which accordingly determines the increase of orders from the local publishers. The increase of the VAT rate caused a fall of the production volumes in the local market and undermined significantly the successfully launched exports of books abroad.

The share of the *chemical industry* in 2008 amounted to 7.2% of the total value added of manufacturing. In November 2008, the output of the sector decreased by 2.6% as compared to 2007. Due to the decrease of the domestic demand, the sales volumes had decreased by 17% in the domestic market in 2008, whereas the sales of exported products grew by 22.9%.

A similar trend can be observed in the sector at the beginning of 2009. The sales volumes in the local market are decreasing substantially (in January–May 2009 by 42.5% in comparison with the five months of 2008), while the sales volumes of exported goods during the same period have decreased only by 8.9%.

Figure 3.30

Indicators of Chemical Industry and Its Related Sectors



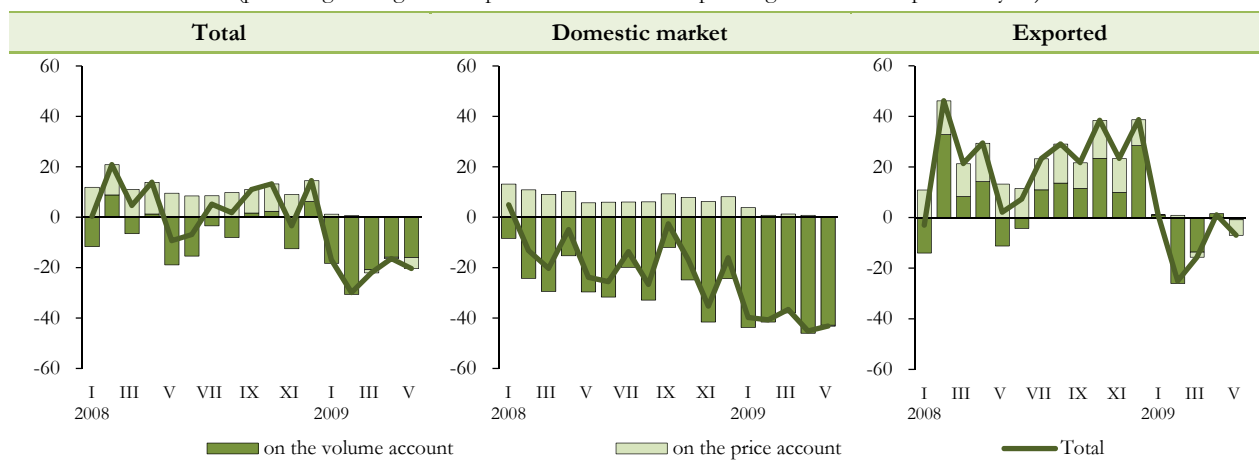
In 2008, 65% of the production output was exported and taking into account the considerable decrease of sales volumes in the domestic market, the export share of the sector has increased up to 74% during 5 months of 2009. In comparison with 2008, at

the beginning of 2009, the share of exports to Lithuania has increased significantly (by 10 percentage points) in the structure of exports, while less is exported to the old EU member states. The share of other export markets has remained unchanged.

Figure 3.31

Output Sales of Chemical Industry and Its Related Sectors

(percentage change in comparison with the corresponding month of the previous year)

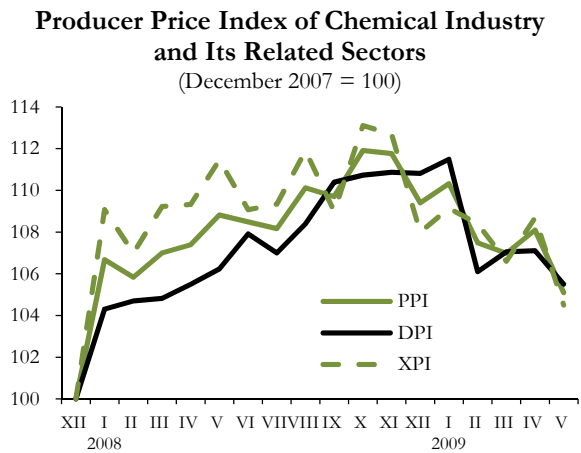


In the nearest future, the main risks for the development of the sector are further devaluation of national currencies and protectionist decisions in target markets, as well as the economic situation in Latvia. To promote the sales, the enterprises of the sector invest considerable resources in marketing campaigns in the existing markets and for acquiring new market shares.

In 2008, the producer prices in the sector continued to grow gradually (by 11.3% in comparison with 2007), whereas the prices for the exported products increased slightly faster (during 2008 – by 11.7%).

During five months of 2009, the total producer price level has still increased (by 0.4% in comparison with January–May 2008). It is related to the price increase of products sold in the domestic market (by 2.2%), while the prices of exported products in January–May are by 1.6% lower than in the respective period of 2008.

Figure 3.32



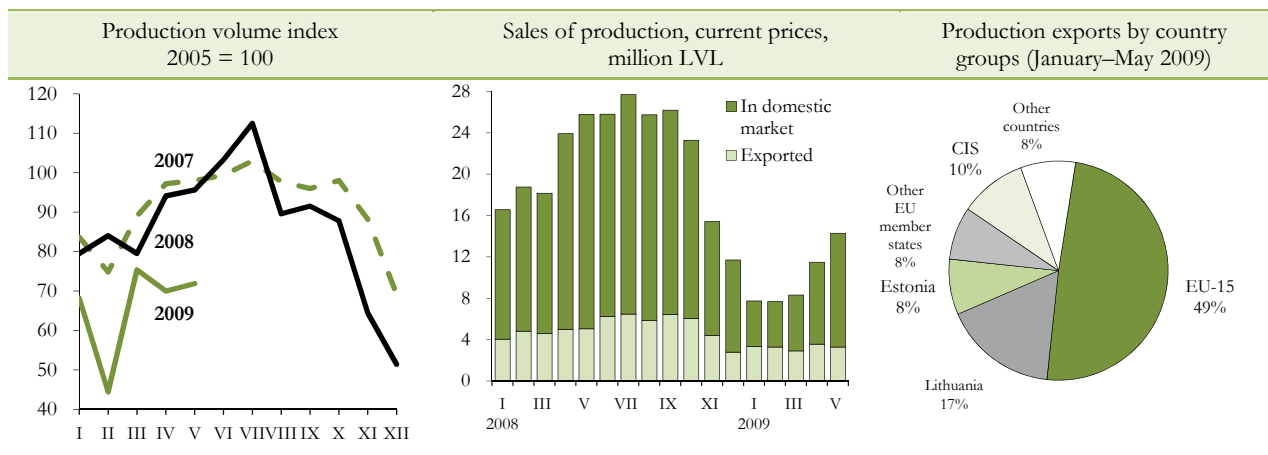
PPI – producer price index,
 DPI – producer price index for products sold in the domestic market,
 XPI – producer price index for exported products

The decrease of the production volumes of *other non-metallic mineral products* is closely related with the situation in the construction sector. The demand for non-metallic mineral products has rapidly decreased and it is expected that a larger fall will follow. In 2008, the output of the sector was by 5.6% lower than in 2007. A particularly rapid decrease in the output volumes was observed at the end of 2008, and also in 5 months of 2009 the output continued to decrease and was by 23.8% lower than in January–May 2008.

The sales volumes during five months of 2009 have decreased even more rapidly – by 47% in comparison with the respective period of 2008. Moreover, the sales volumes of products sold in the domestic market decreased by 55.7%, while the exports sales in January–May decreased by 28%. It should be noted that the sales in the domestic market decreased already at the end of 2008, when exports volumes were still increasing.

Figure 3.33

Indicators of Production of Other Non-Metallic Mineral Products



In 2008, almost one fourth of the production output was exported. In 2009, when the sales in the domestic market have stopped, the exports share in

production output is approaching to 45%. The main export market is EU, where 75% of the exported products are sold.

Figure 3.34

Sales of Other Non-Metallic Mineral Products

(percentage change in comparison with the corresponding month of the previous year)

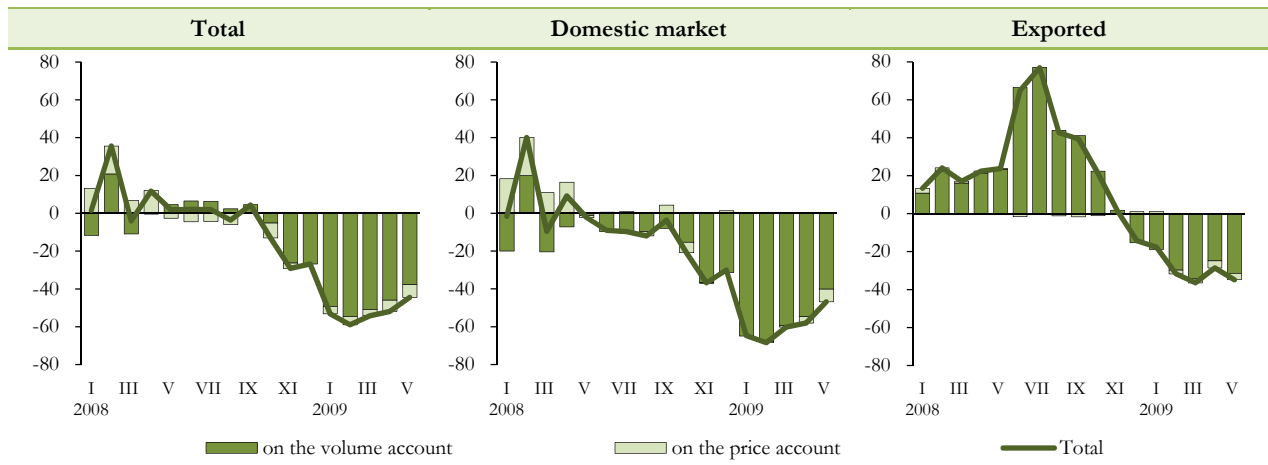
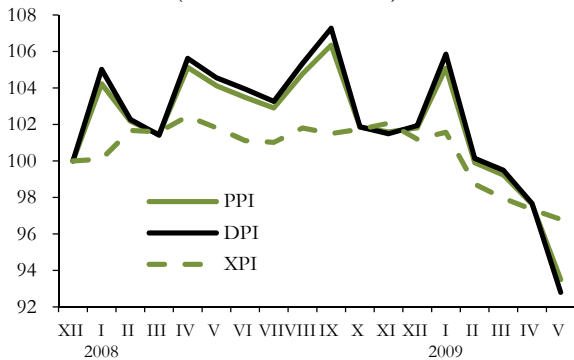


Figure 3.35

Producer Price Index of Other Non-Metallic Mineral Products
(December 2007 = 100)



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

Taking into account the rapid decrease of the demand during the second half of 2008, also the increase of the producer prices has slowed down. In November 2008, the prices increased by 4.2% as compared to 2007. In the first half of 2009, the price decrease continued, and in January–May they are

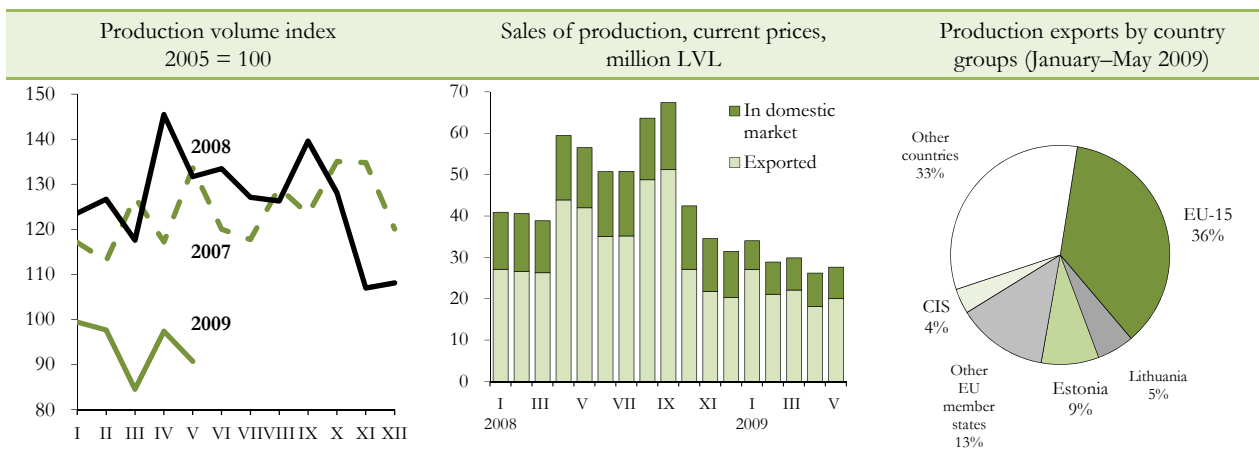
already by 4.2% lower than in five months of 2008. Although during the previous years the price growth rate of the products sold in the domestic market was more rapid than that of exported products, the decrease rates of prices in 2009 in both markets are similar.

During the recent years of rapid growth, the sector of *production of metals and metal articles* has developed under the favourable conditions both in the domestic and foreign markets. In 2008, the sector constituted 15.4% of the value added of manufacturing.

In 2008, the output of the sector increased by 1.8%. Moreover, taking into account the price increase, the total revenues from sales of the output in the sector have increased by 12.5%. As the production of metals and metal articles sector is mainly oriented to exports, the development of the sector is determined by the development trends of the foreign markets, thus at the end of 2008, when the external demand decreased also significantly, the output rate of the sector fell rapidly. During the five months of 2009, the output volumes of the production of metals and metal articles sector is by 27.2% smaller than in January–May 2008.

Figure 3.36

Indicators of Production of Metals and Metal Articles



Metals and metal articles produced in Latvia have a rather high competitiveness around the world. More than 70% of the products are exported to the EU member states. Moreover, a half of them are exported to the old EU member states.

As a result of global price trends, the producer prices of the sector grew rapidly at the beginning of 2008 and increased on average by 14.4%. However, the producer prices of the exported goods increased even by 18.2%. In 2009, the producer price deflation started due to the decreased demand and fall of prices

on the global market. In January–May 2009 the producer prices have decreased on average by 16.2% in comparison with five months of 2008, while the producer prices of the exported goods have undergone an even more rapid decrease – by 22%. Thus, with decreased sales volumes and producer prices, the total sales revenues of the sector during five months of 2009 were by 38% lower than in January–May 2008.

Figure 3.37

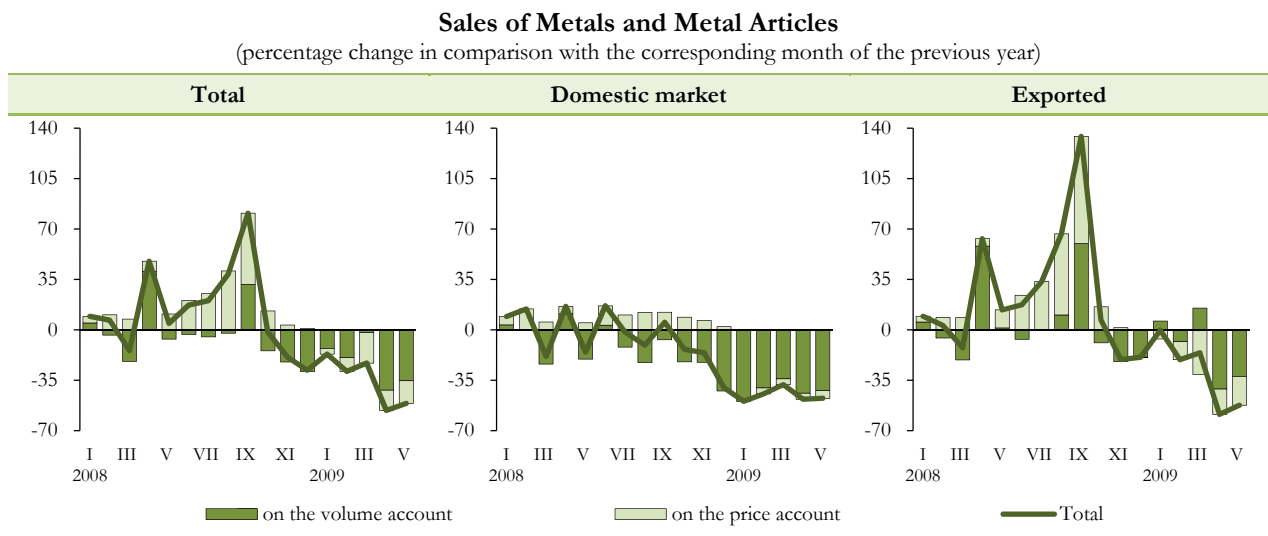
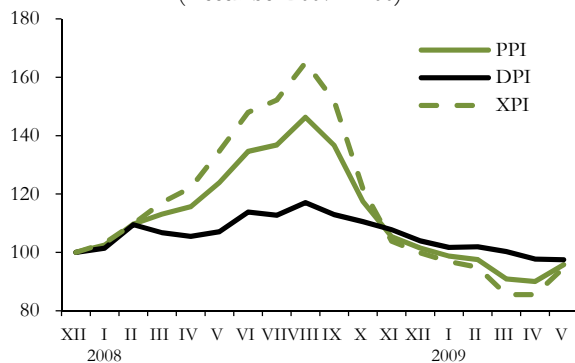


Figure 3.38

Producer Price Index of Metals and Metal Articles

(December 2007 = 100)



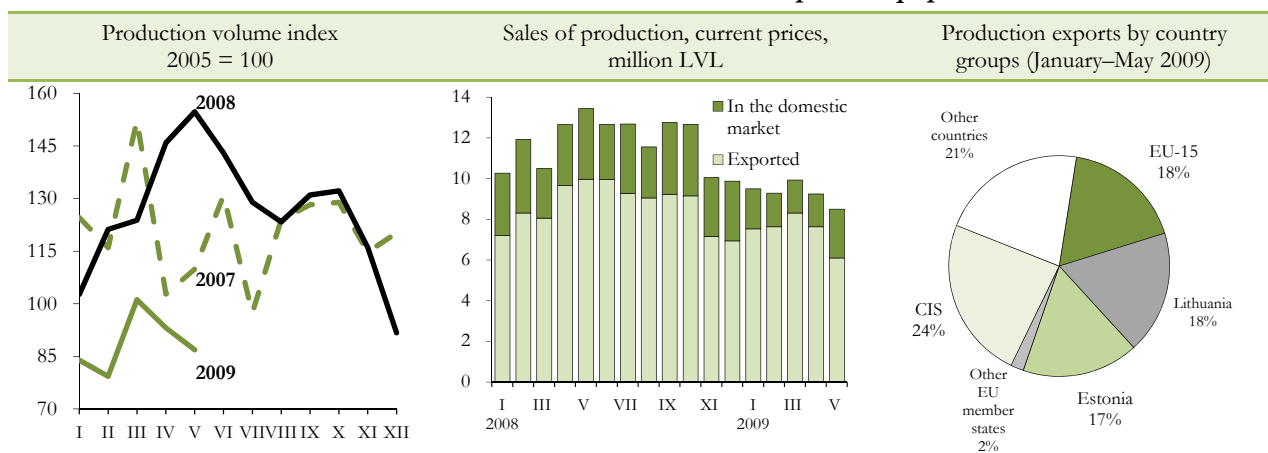
PPI – producer price index,
 DPI – producer price index for products sold in the domestic market,
 XPI – producer price index for exported products

Production of electrical and optical equipment has developed rapidly in the recent years, and output of the sector exceeds the level of 2000 by more than three times. In 2008, the output of the sector exceeded the output of the previous year by 4.5%. However, during the five months of 2009 the output volumes have decreased by 31.5%. Despite the comparatively rapid growth of the sector during the previous years, its share of the total value added of manufacturing is still small (7%).

The total sales volumes in January–May 2009 have decreased by 20.2% in comparison with the respective period of the previous year. The volumes of the products sold in the domestic market have decreased by 37.6%.

Figure 3.39

Indicators of Production of Electrical and Optical Equipment



The sector exports almost three fourths of the output. Moreover, as the sales in the domestic market decrease, its export shares increase. The products of the sector are mainly sold to the partners in the CIS

countries, although since 2008 their share has reduced by more than 10 percentage points. At the same time, the share of products exported to Lithuania and Estonia has increased.

Figure 3.40

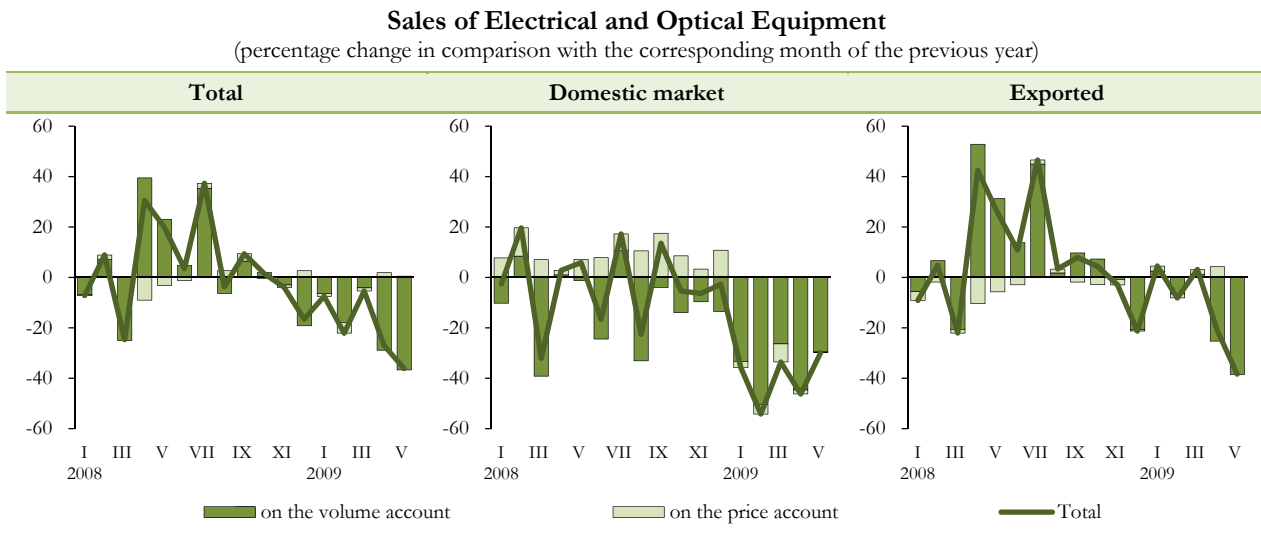
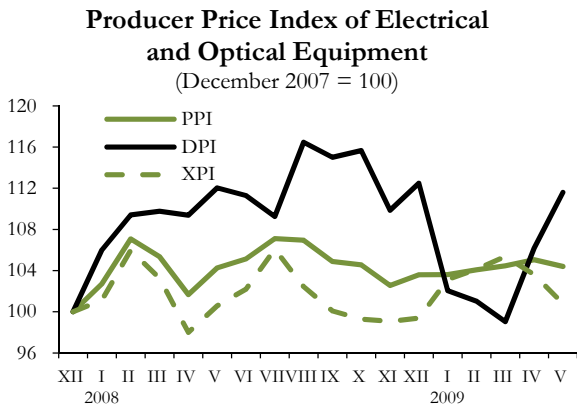


Figure 3.41



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

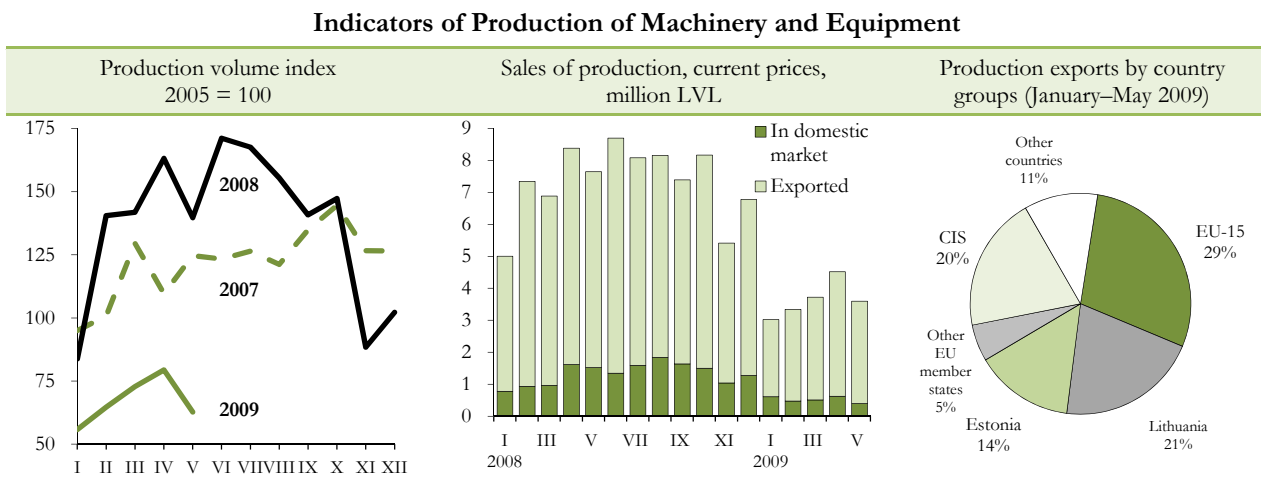
In the beginning of 2008, a small increase of producer prices was observed in the sector, which was determined by the price increase for the products sold in the domestic market, while the prices for the exported products fell. In total, in 2008 the producer

prices increased on average by 1.6% in comparison with 2007, including the prices of the products sold in the domestic market rose by 9.6%, but the prices of exported products fell by 2.1%.

The producer prices fall, due to the decrease of domestic demand. In January–May 2009, the prices of the products sold in the domestic market were by 4.9% lower than in the respective period of the previous year, while the prices of the exported goods increased by 1.6% in the same period.

The *production of machinery and equipment* sector is basically a supplier of the means of production and technologies to other sectors, therefore the economic crisis has influenced this sector especially strongly. In 2008, the output of the sector increased by 12.2% in comparison with 2007, mainly due to the rapid growth at the beginning of 2008. During the last months of 2008 and at the beginning of 2009, the output of the sector has shrunk considerably. In January–May 2009, the production volumes are by 49.9% lower than in the respective period of 2008.

Figure 3.42



The sales volumes have decreased by more than 50% in five months of 2009 as compared to January–May 2008, the decrease in both the domestic and export markets is similar.

The sector exports more than 80% of its products and the main markets are in the EU member states. Moreover, more than a half of the products exported to the EU are sold in Lithuania and Estonia. A relatively big part of the exports of the sector is related to the markets of the CIS and other countries.

During the previous years when the demand grew rapidly, producer prices increased. The average price increase in 2008 by 11.4% as compared to 2007 has to be considered as very rapid. The price increase continued also in 2009. Although there is a trend for the prices to fall during the last months, in January–May 2009 they in general are by 8.2% higher than in five months of 2008. At the same time, the prices for products sold in the domestic market have increased at a slower rate – by 7.3%, while for exported products more rapidly – by 8.2%.

Figure 3.43

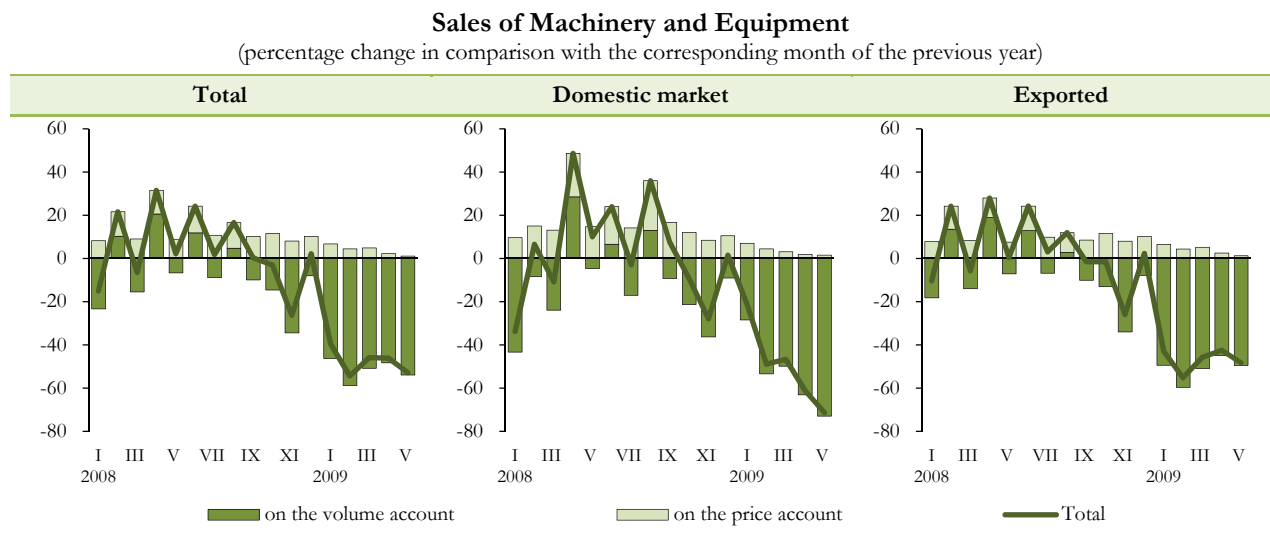
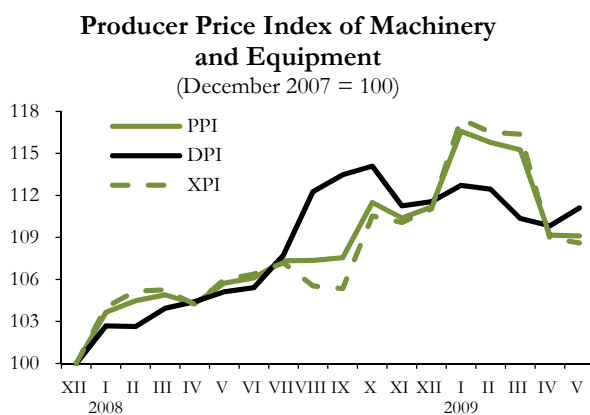


Figure 3.44



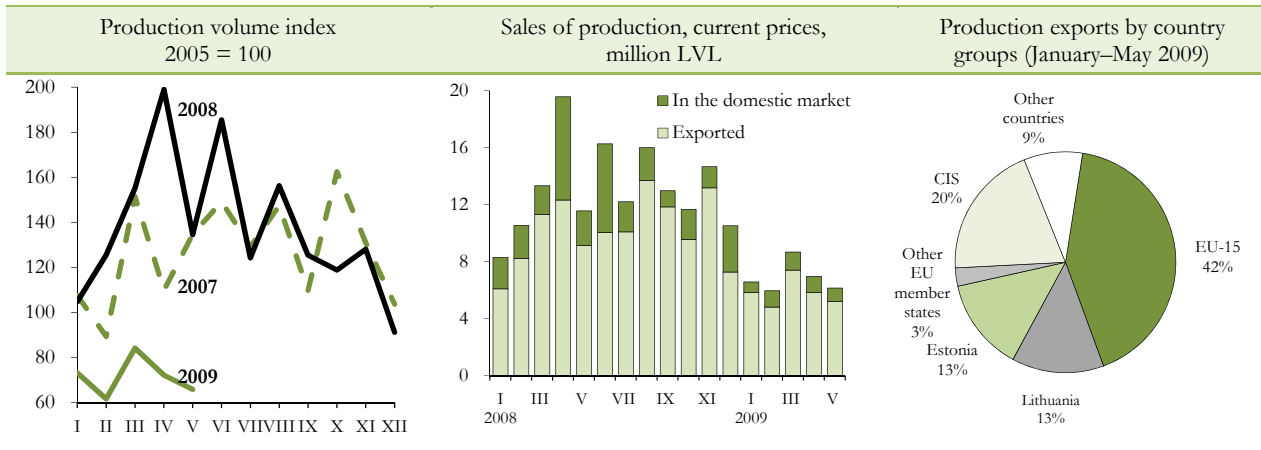
PPI – producer price index,
 DPI – producer price index for products sold in the domestic market,
 XPI – producer price index for exported products

In 2008, the *production of transport vehicles* increased by 8.1% compared to 2007. The rapid growth of production of transport vehicles was determined by the considerable increase of new orders at the beginning of 2008 both, in the domestic and foreign markets. During the five months of 2009 the output of the sector is by 50.3% lower than in January–May 2008.

The sales volumes in the domestic market during five months of 2009 in comparison with respective period of the previous year have decreased more rapidly (by 69.7%) than those of the exported products (by 40.2%).

Figure 3.45

Indicators of Production of Transport Vehicles



Almost 85% of the production of this sector is being exported. The export markets are rather evenly distributed in various directions – both to the EU member states, including Lithuania and Estonia, and to the CIS countries and other countries of the

world. However, it should be noted that the share of the old EU member states in the export structure has increased by 11 percentage points during the year and in five months of 2009 it constituted 42% of the total exports.

Figure 3.46

Sales of Production of Transport Vehicles

(percentage change in comparison with the corresponding month of the previous year)

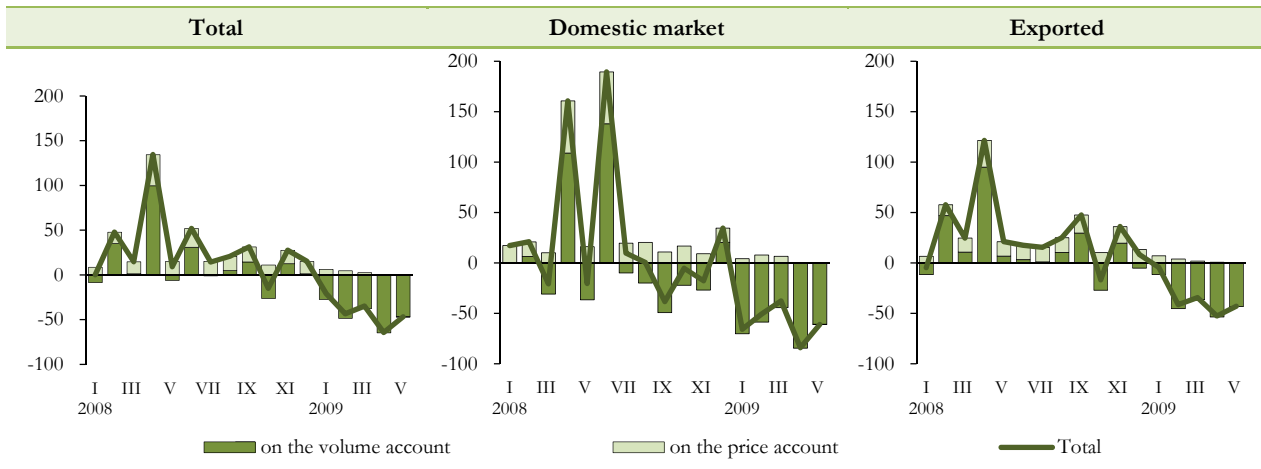
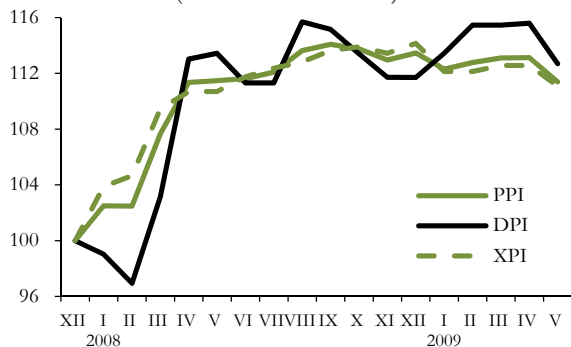


Figure 3.47

Producer Price Index of Transport Vehicles Sector

(December 2007 = 100)



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

The producer prices for the products sold in the domestic market and in the foreign markets increase almost equally. In 2008, the prices for the products sold domestically increased on average by 19.2%, while for exported products – by 12.6% as compared to 2007. Despite the decrease of the demand, the prices continue to increase also in 2009. In January–May, the producer prices are by 5.1% higher than during the respective period of the previous year.

3.2.3. Energy Sector

Both, the imported (natural and liquefied gas, oil gas products, petroleum products, coal) and local energy resources (firewood and peat) are used in Latvia to ensure fuel, electricity and heat to the national economy sectors, commercial consumers and

population. A part of electricity is generated by Latvian HPPs and CHPs, whereas other part is imported.

Mainly the imported fuels (natural gas and oil) and local fuels (firewood) are used in the heat generation.

Table 3.12

Consumption of Energy Resources in Latvia
(thousand tons of equivalent fuel – ktce*)

| Energy resource consumption | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|--|-------------|-------------|-------------|-------------|-------------|-------------|
| Energy resources consumption – total | 6514 | 6648 | 6770 | 7021 | 7206 | 6926 |
| including: | | | | | | |
| natural gas (GCV) | 2138 | 2114 | 2155 | 2233 | 2158 | 2116 |
| light fuel products and other oil products | 1857 | 1950 | 1995 | 2225 | 2442 | 2323 |
| heavy fuel oil, oil shale | 166 | 132 | 113 | 77 | 59 | 40 |
| firewood, peat, coke and other types of fuel | 1655 | 1719 | 1722 | 1725 | 1691 | 1603 |
| coal | 90 | 87 | 107 | 116 | 145 | 145 |
| electricity (HPPs, wind generators and imported from abroad) | 608 | 646 | 678 | 645 | 711 | 699 |

Source: CSB and the Ministry of Economics.

* 1 ktce = 0.02931 PJ.

In 2008, the total energy consumption of Latvia was 203 PJ, and 59.9% of this consumption was ensured by imports of energy resources mostly from Russia: natural gas – 25.1%, heavy fuel oil – 3.3%, other oil products – 32.6%, coal – 2.1%. Among the local energy resources, wood was used the most (firewood, remainders from wood-processing, woodchips, wood briquettes and granules), comprising 22.7% of the total energy consumption. The share of the electricity generated by Latvian HPPs and wind power stations in the total energy consumption was 5.6%.

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

In 2008, the SJSC “Latvenergo” generated 59% of the required electricity, 32% was supplied by other countries and 9% was purchased from small producers of electricity. In comparison with the respective period of the previous year, the electricity consumption has increased by approximately 0.3%.

Table 3.13

Electricity Supply in Latvia
(billion kWh)

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Total electricity supply | 6.608 | 6.786 | 7.053 | 7.399 | 7.771 | 7.794 |
| Electricity generation – total | 3.975 | 4.689 | 4.905 | 4.891 | 4.771 | 5.274 |
| of which: | | | | | | |
| HPPs* | 2.216 | 3.044 | 3.267 | 2.661 | 2.668 | 3.042 |
| CHPs** | 1.363 | 1.225 | 1.278 | 1.740 | 1.452 | 1.524 |
| other CHPs | 0.298 | 0.306 | 0.255 | 0.407 | 0.532 | 0.582 |
| small HPPs | 0.050 | 0.065 | 0.058 | 0.037 | 0.066 | 0.067 |
| wind generators | 0.048 | 0.049 | 0.047 | 0.046 | 0.053 | 0.059 |
| Imports of electricity | 2.633 | 2.097 | 2.148 | 2.508 | 3.000 | 2.520 |

Source: SJSC “Latvenergo”, Ministry of Economics, CSB

* Daugava cascade and Aiviekste HPP (HPP of SJSC “Latvenergo”)

** CHP of SJSC “Latvenergo”

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 making 30–35%. Of the total amount of sold heat energy, 1.6% was sold to industry, 73.8% to households and 24.6% to other consumers.

The biggest consumers of natural gas are CHPs and heat supply enterprises of “Latvenergo” – 57.1%, industry – 19.9% and other consumers ~23%. The

Riga region accounts for 70% of the total natural gas consumption in Latvia. Natural gas is not used at all in Latgale region, with the exception of Daugavpils and Rēzekne cities and Preiļi district. In Kurzeme region, natural gas consumption is the biggest in Liepāja and reaches ~11% (by the JSC “Liepājas siltums” and the JSC “Liepājas metalurģis”), while in Zemgale region it amounts to ~4% (in Jelgava city and Bauska district).

The *oil products* are used both as heating fuel and liquid fuel. The prices in the oil product market are liberalised and competitive with regard to other types of heating fuel. Free market principles function with regard to oil product supply in Latvia.

The share of oil products in the energy resources market is significant – it is slightly higher than 30%, including the share of heavy fuel oil in the oil fuel balance amounting to approximately 1.6%. The biggest consumers of heavy fuel oil are heat supply – 55.6% and industry – 37%. Complying with the requirements of the EU Directive 1999/32/EC, on March 2, 2004, the Cabinet of Ministers adopted the Regulations No. 125 “On the Limitation of Sulphur Content in Certain Liquid Fuels”. It is expected that the heat supply enterprises that used heavy fuel oil for heat

generation will replace this type of fuel with other energy resources.

Solid fuel used in Latvia is coal imported from the CIS and local fuels (firewood and peat). The forecast of firewood consumption depends on the extent to which regions will manage to change from the extensive use of firewood to its rational use. In the total fuel consumption, the share of firewood is already quite substantial and has reached 25%. The biggest consumers of firewood are households – 65.4%, heat supply companies – 15.1%, industry (mainly wood-processing enterprises) and other consumers – 19.5%. Firewood and coal are used evenly across all regions of Latvia. The usage of peat in the energy sector continues to decrease.

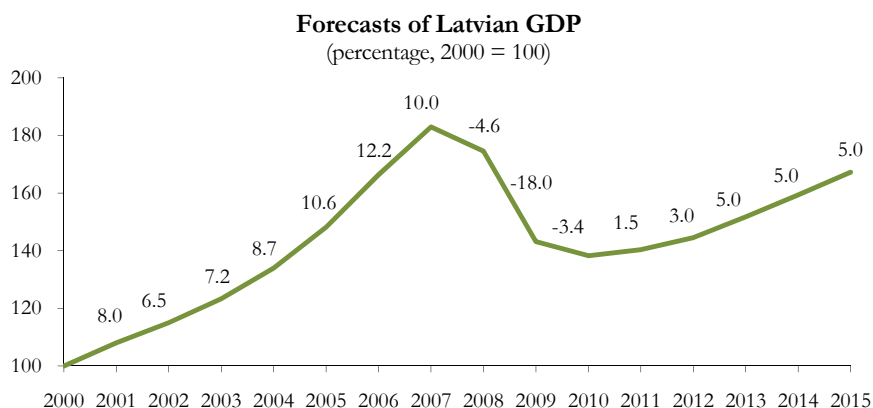
3.3. Forecasts

The Ministry of Economics has developed medium-term economic development forecasts for the period until 2015.

The development scenario of the national economy has been drafted taking into account the future possibilities of economic development determined to a great extent by the reaction of the global economy to the financial crisis and by the possibilities to overcome it. In this respect, there is a rather deep uncertainty among the opinions of the world economic experts, especially with respect to the issue of the depth and duration of the crisis. The growth forecasts are

changing frequently thus changing the growth indicators for 2009 and 2010. Majority of economic experts (IMF, WB and European Commission, etc.) forecast the beginning of recovery from the recession no earlier than in the second half of 2010 if the situation in the financial markets stabilises at least by the end of 2009. This consideration provides the basis of the forecasting scenario, because the recovery possibilities of the Latvian economy are closely related with the renewal of crediting and opportunities to develop exports.

Figure 3.48



Development of national economy in 2009–2010

In 2009, a significant decrease of economic activities and thus decrease of GDP by 18% is being forecasted. Despite the improving situation in the second half of 2010, in general in 2010, negative GDP growth rates will remain. The main basic assumptions for the forecasts of 2009 and 2010 are the poor external and shrinking domestic demand as a consequence of the global financial crisis.

In 2009, unlike in 2008, the economy of Latvia will be influenced by a rapid decrease of external demand.

In 2008, the low domestic demand was the main reason for decreased output, and also in 2009 domestic demand will continue to decline.

Taking into account the vulnerability of the economy of Latvia related to the high current account deficit, the impact of the slowdown of financial flows on the real sector reflected in substantial decline of economic activities and therefore decrease of the total income.

The decrease of private consumption in 2009 is determined by the slowdown of household crediting

process, decrease of wages and increase of unemployment. In 2010, the private consumption may continue to decrease, because employment and wages will not increase.

The decrease of investments in the private sector will be mainly affected by the deterioration of the access to financial resources, as well as by pessimistic future expectations of entrepreneurs. The decrease in the investment will be partially compensated by the public investment in road construction and repair and the policy implemented by the government for improvement of the access to financial resources.

The net exports will improve, i.e. the deficit of export–import will decrease, because as a result of reduction of the domestic demand the imports will continue to decrease. Taking into account the poor demand of the export partners of Latvia, a slight decrease of exports in 2009 is to be expected. In 2010, it can slightly increase, thus stimulating further total growth.

Table 3.14

Forecasts of Latvian GDP by Expenditure Items

| | 2009 | 2010 | 2011–2015* |
|--|--------------|-------------|------------|
| growth rates, % over the previous year | | | |
| Gross domestic product | -18.0 | -3.4 | 4.0 |
| Private consumption | -21.0 | -2.0 | 3.5 |
| Public consumption | -9.5 | -11.0 | 1.0 |
| Gross fixed capital formation | -24.0 | 0.0 | 5.0 |
| Exports | -12.0 | 4.3 | 5.5 |
| Imports | -29.0 | -6.0 | 5.0 |
| Structure, % | | | |
| Gross domestic product | 100 | 100 | 100 |
| Private consumption | 58.3 | 59.4 | 60.4 |
| Public consumption | 21.1 | 17.3 | 14.8 |
| Gross fixed capital formation | 23.9 | 25.1 | 26.9 |
| Changes in inventories | 0.9 | 1.0 | -0.2 |
| Exports | 39.1 | 41.1 | 46.7 |
| Imports | -43.4 | -44.0 | -48.5 |
| Export–import balance | -4.3 | -2.9 | -1.8 |

* annual average growth, structure in 2014

As concerns sectors, in the years of recession (2009 and 2010), the most significant decline will be in the services sector. Considerable decrease is also expected in the construction sector and manufacturing industry. Agriculture, energy sector, gas and water supply sectors, as well as transport and communications services will be influenced by the recession to a smaller extent.

Table 3.15

Forecasts of Latvian GDP by Sectors (real growth in % over the previous year)

| | 2009 | 2010 | 2011–2015 (average annually) |
|-----------------------------------|--------------|-------------|---------------------------------|
| Gross domestic product | -18.0 | -3.4 | 4.0 |
| Primary sectors | -9.0 | -4.0 | 3.0 |
| Manufacturing | -19.5 | 4.0 | 4.5 |
| Electricity, gas and water supply | -11.5 | -3.0 | 1.5 |
| Construction | -20.5 | -3.5 | 5.5 |
| Trade, hotels and restaurants | -23.5 | -3.5 | 4.5 |
| Transport and communications | -7.0 | 2.0 | 5.0 |
| Other commercial services | -12.5 | -5.5 | 3.5 |
| Public services | -7.0 | -12.0 | 1.5 |

Development prospects for 2011–2015

Positive economic growth could start in 2011, if the financial markets would stabilise, thus providing positive incentives to local businesses and a gradual increase of economic activities in countries to which goods and services are exported, especially, the EU member states.

The main growth stimulus for Latvia in the future periods must be related with the expansion of export opportunities. Therefore, competitiveness of our key export-oriented industry sectors both in international and local markets has a determinant role for ensuring growth. It should be taken into account that intensification of the price competition is observed in the global markets for goods and services, expressed in the crisis situation as the correction of national competitiveness with devaluation of national currencies and direct protectionism.

The competitiveness of Latvian industry was largely based on a relatively cheap labour force and low general costs. In 2006 and 2007, due to the increase of labour costs and prices, these advantages were to a great extent lost. The current crisis situation with the low demand and strict budgetary restrictions, when wages are being reduced considerably in the public sector, causes pressure on the total wage level and prices, and that partially improves the competitiveness of Latvian manufacturers. However, it should be taken into account that with the renewal of growth in the other EU countries it will be impossible to retain competitiveness in the economy of Latvia with these methods, therefore the respective increase of productivity and complexity of export products will have a decisive significance, allowing competing more successfully on international markets.

In order to provide the average growth in 2011–2015 by 4%, the production volumes of manufacturing should increase by at least 4.5% plus it is foreseen in the forecasts that the external balance of Latvian services should also improve, where the major contribution has been provided by transport services.

It is forecasted that further development will not be as rapid as it was in 2005–2007 since its driving force will not be voluminous financial inflow stimulating domestic consumption and development of services, as well as operations with real estate. The main growth stimulus will be increase of

competitiveness of the economy in open goods and services markets related for Latvia mainly with development of industry and transit services.

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

Taking into account the rapid recession during the years 2008–2010, the growth in 2011–2015 will not compensate it. Therefore, the GDP level in 2015 will reach the level of the year 2006.

3.4. Regional development

A clear difference exists between Riga and the other regions of Latvia regarding the economic activities. However, such difference is not present among the other regions of Latvia.

In 2006, the largest share of GDP of Latvia (55.3%) was produced in Riga. The second largest region by contribution into GDP is the region around Riga (Pieriga) (13.1%).

In 2006, the GDP per capita level in Riga was 1.7 times higher than on average in the country. In Latgale this indicator reached only 47.7% of the average level in the country.

In 2003–2006, the increase of the GDP per capita was more rapid than the average in the country in the regions around Riga and in the Vidzeme region. In Riga and Zemgale region its increase is almost equivalent.

inhabitants. In Riga and Vidzeme region this indicator is higher than the average in the country. Although, it should be noted that in the Vidzeme region the level of active statistical units is higher than the average due to the large share of farmers' holdings and self-employed persons. It should be noted that the contribution of these units to formation of GDP is smaller than contribution of commercial enterprises.

The rapid economic development of Latvia since the accession to the EU positively influenced the situation in the labour market – employment grew, the share of job seekers decreased and the number of economically active persons increased. During three years, the number of employed increased every year while the share of job seekers decreased. The share of job seekers in Vidzeme, Zemgale and Latgale regions was higher than the average in the country – 6.6%, 6.5% and 8%, respectively.

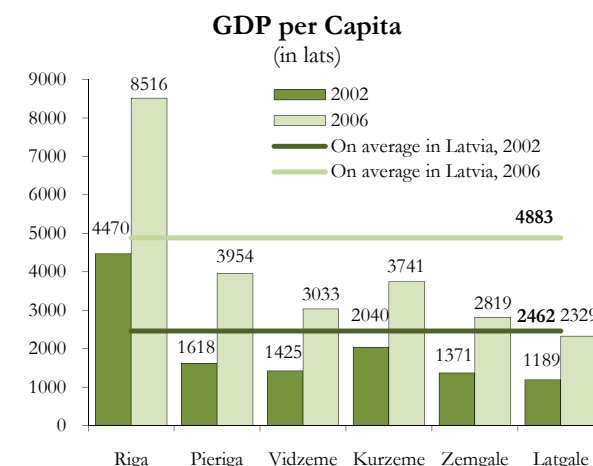
Table 3.16

Area, Population and Density of Population in Statistical Regions of Latvia at the Beginning of 2009

| | Area (% of the state territory) | Population (% of total number) | Number of Inhabitants (per sq. km) |
|--------------------|---------------------------------|--------------------------------|------------------------------------|
| Latvia: | 100 | 100 | 35.0 |
| Riga | 0.5 | 31.5 | 2353.2 |
| Region around Riga | 15.7 | 17.1 | 38.0 |
| Vidzeme | 23.6 | 10.4 | 15.5 |
| Kurzeme | 21.1 | 13.3 | 22.2 |
| Zemgale | 16.6 | 12.5 | 26.3 |
| Latgale | 22.5 | 15.2 | 23.6 |

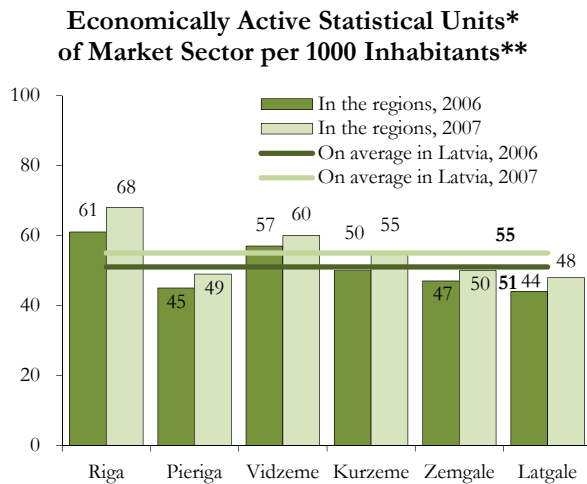
In Latvia the number of the active statistical units (self-employed persons, individual businessmen, commercial companies, farmers and fishermen holdings) gradually increases. In 2007, the number of the active statistical units per 1000 inhabitants on average increased by approximately 4 units. This indicator is approximately equal in all the regions of Latvia, except Riga, where it is 48–55 units per 1000

Figure 3.49



The decrease of economic activities, which started in 2008, was still weakly reflected in the employment indicators in the first quarters, because changes in the employment rate always slightly – by 4–6 months on average – lag behind the changes in economic activities.

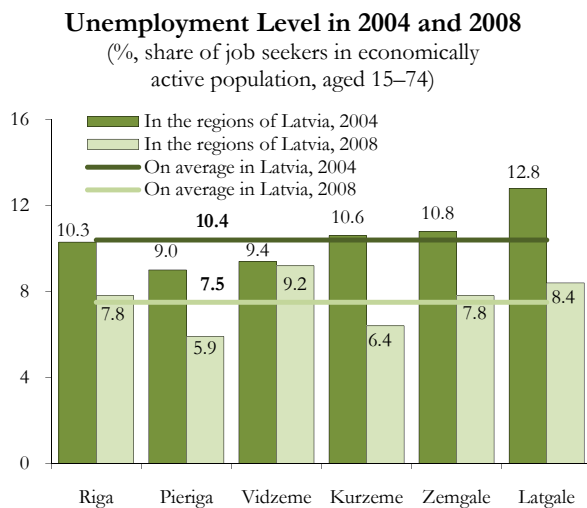
Figure 3.50



* Statistical units of market sector: self-employed persons, individual businessmen, commercial companies, farmers and fishermen holdings
 **Provisional data for 2007

In 2008, the number of job seekers increased rapidly. In comparison with 2007, it increased by approximately 27.2% and the biggest increase of job seekers was during the last quarter of 2008. The average share of job seekers in Latvia in 2008 was 7.5%. The unemployment level in Riga, Vidzeme, Zemgale and Latgale regions was higher than the average in the country – 7.8%, 9.2% and 8.4%, respectively.

Figure 3.51



In 2008, the wages continued to increase in all the regions. In 2008, the average wages in the country were higher than in the previous year.

In the 4th quarter of 2008, high growth rate of wages was still observed in all the regions. Due to the rapid wage increase in 2007, the average gross wage during the last three years has almost doubled.

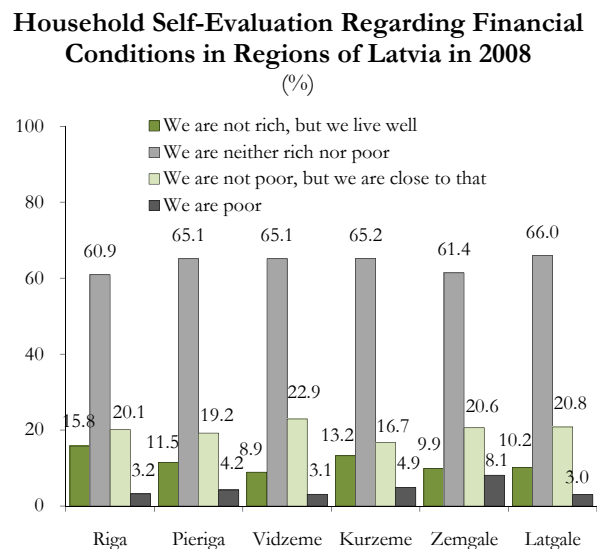
Figure 3.52



The average wage in Latvia in the 4th quarter of 2008 was 500 LVL. The amount of wage exceeded the average wage only in Riga.

The data of the Household Budget Survey provided by the CSB on the self-evaluation of households regarding their financial condition in 2008 show that the self-evaluation of households differs. The results of the survey show that in Riga and Riga suburbs, the share of the households providing an answer “we are not rich, but live well” is 15.2% and 11.5%, respectively. The largest share of households expresses a view that they are poor or that they are on the poverty line, is in Latgale (23.8%). Also in Kurzeme, like in Latgale, the share of households that are of the opinion “we are neither rich, nor poor” is considerably higher.

Figure 3.53



4. MACROECONOMIC STABILITY

4.1. Public Finances

4.1.1. Fiscal Policy and Public Debt

Deterioration of the economic situation has had a significant impact on Latvian fiscal position. As it is

shown in Table 4.1, the general government sector budget deficit¹ in Latvia was LVL 644.1 million or 4% of the gross domestic product (GDP) in 2008.

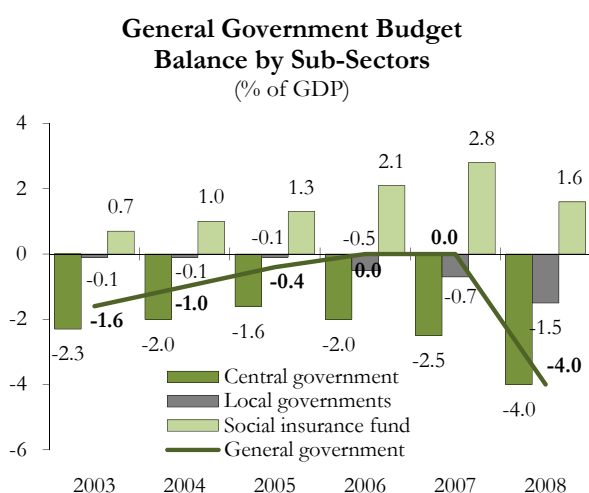
Table 4.1

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|----------------------------|--------|--------|--------|--------|--------|--------|
| Revenues (million LVL) | 2120.2 | 2583.2 | 3185.5 | 4211.7 | 5252.5 | 5764.4 |
| (% of GDP) | 33.2 | 34.7 | 35.2 | 37.7 | 35.5 | 35.5 |
| Expenditures (million LVL) | 2223.6 | 2659.6 | 3223.2 | 4265.4 | 5310.6 | 6408.5 |
| (% of GDP) | 34.8 | 35.8 | 35.6 | 38.2 | 35.9 | 39.5 |
| Balance (million LVL) | -103.5 | -76.5 | -37.8 | -53.7 | -58.2 | -644.1 |
| (% of GDP) | -1.6 | -1.0 | -0.4 | -0.5 | -0.4 | -4.0 |

The general government budget deficit has been determined mainly by the deficit of the central government budget, which has a tendency to increase (see Figure 4.1). The local government budget balance has deteriorated substantially in 2008, which was largely due to the construction of the Southern Bridge in Riga. Social insurance budget has run at a surplus in recent years. However, it has slightly decreased in terms of the percentage of GDP in 2008.

Member States in 2008. In 2008, the highest general government budget deficit as a percentage of GDP was observed in Ireland (-7.1%), United Kingdom (-5.5%), Romania (-5.4%), Greece (-5%). Seven EU Member States had general government budget surplus in 2008, of which the highest surpluses as a percentage of GDP were in Finland (+4.2%), Denmark (+3.6%), Luxembourg (+2.6%) and Sweden (+2.5%).

Figure 4.1



As it is forecasted by the European Commission the budgetary situation in the EU Member States will continue to deteriorate.

One of the basic elements of the *Economic Stabilisation and Growth Revival Programme of Latvia*² is to ensure a strict fiscal policy – balancing of state and local government expenditures with the level of revenues. In order to ensure a further decrease of the consolidated budget deficit, the aim of consolidation measures in 2011 is to decrease the consolidated budget deficit in 2011 by up to 3% of GDP. The abovementioned programme envisages that as of 2013, the consolidated budget, excluding expenditures related to absorption of EU and other foreign financial support, must be balanced or with a surplus.

Similarly, the average level of the budget deficit in the EU Member States has increased in 2008. As it can be seen from the Figure 4.2, the average level of the budget deficit in the EU Member States was 2.3% of GDP in 2008 (0.8% of GDP in 2007, 1.4% of GDP in 2006). Budget position has deteriorated in 21 EU

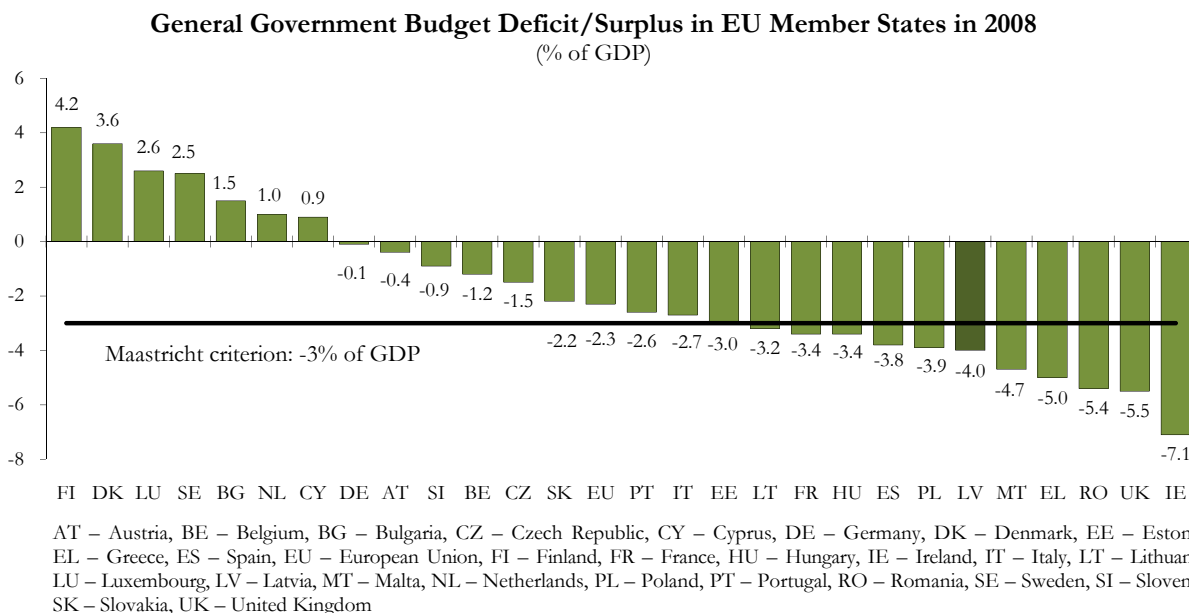
¹ According to the methodology of the European System of Accounts ESA 95. Taking into account that EU Member States follow the Maastricht criteria regarding government budget deficit and debt, their notification results are used according to the methodology of the European System of Accounts ESA 95. The rates calculated by applying such methodology are defined according to the so-called accrual concept. The calculations of the Ministry of Finance regarding the general budget deficit are made by applying the cash principle, that is why there are some differences in the data.

² Approved by the Saeima on 12.12.2008, supplemented on 16.06.2009.

In order to ensure implementation of the strategic goals of the budget, the government has established a *Fiscal Discipline Monitoring Committee* and has extended the competences of the Minister of Finance with the consent of the Saeima. On May 28, 2009, the Saeima

passed the “Amendments to the Law on Budget and Financial Management” allowing the Minister of Finance to effectively reduce the state budget’s actual expenditures, if necessary, to avoid the breach of the annual deficit set by the Law on Budget.

Figure 4.2

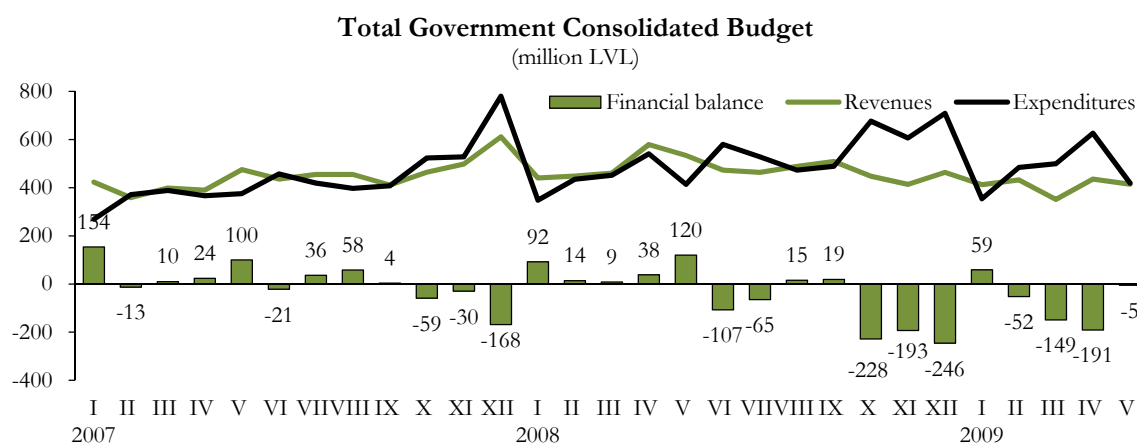


In November 2008, the Saeima approved the **state budget of 2009** with a deficit in the amount of 1.8% of GDP. However, at the beginning of December 2008, the government decreased the forecasts for 2009 related to the growth and revenues due to the deterioration of the economic situation in Latvia and in the world. Taking into account the revised forecasts, the Saeima approved the amendments to the budget of 2009 in December 2008, foreseeing a budget deficit in

the amount of 4.9% of GDP, as well as several reductions of public expenditures.

In the first half of 2009, with the deterioration of economic situation, in the first five months of 2009, the consolidated budget deficit was LVL 337.8 million, which was mainly due to the deficit in the state budget. This budget deficit is unusually large for the first months of the year and could be explained by the significant deterioration of economic situation.

Figure 4.3



On June 16, 2009, the Saeima approved the new amendments to the state budget for 2009, which envisages a reduction of budget deficit by LVL 500 million. The methodology of the International Monetary Fund for calculating the budget deficit prescribes increased costs for social needs, including

local governments to ensure placing of guaranteed income level, as well as it is assumed that the current trends of total expenditures will remain and the capital expenditures will increase. Therefore, the experts of the IMF define the consolidated budget deficit in the amount of 11.6%.

The amendments to the state budget for 2009 by the Saeima in June foresee:

- to increase income from dividends, requiring all state capital companies to deposit 80% of the previous year profit into the state budget, but "Latvenergo" is required to deposit 100% of the previous year profit.
- to increase the excise tax on beer and spirit drinks, as well as tax rates on lotteries and gambling;
- to decrease untaxed minimum of personal income tax from 90 to 35 lats;
- to reduce public administration expenditures by 30% and remuneration by 20%, the number and administrative expenditures of state agencies by 50%, excluding funding from EU funds and other foreign financial support;
- to reduce old-age and retirement pensions by 10%, old-age pensions of employed pensioners by 70%;
- to set family benefits in equal amount for each child, as well as to reduce parental benefit of employed parents by 50%;
- to eliminate the boards of the state capital companies.

In order to ensure further decrease of the consolidated budget deficit, the government and local municipalities observe a strict fiscal policy, by making the functions to be performed more efficiently and thus ensuring the decrease of budgetary expenditures. Being aware about the necessity to optimize the public services sectors and taking as a basis the state administrative territorial structure established in 2009, the government continues to implement reforms of the education and health care systems, by improving the efficiency of provided services and reducing the total expenditures of the sectors.

In order to balance the budgetary expenditures and the shrinking state revenues, the government with the budget modification of 2009 has implemented also the measures to optimize and reduce the state expenditures, by significantly decreasing the administrative expenditures of the ministries (including wages), establishing that the structural reforms are implemented by reducing both, the number of employed and wages.

To ensure the financing of basic state functions, the *Economic Stabilisation and Growth Revival Programme of Latvia* in 2010 prescribes:

- to extend the real estate tax base by including housing, while setting substantial allowances for each person registered in the house;
- to set a differentiated rate on real estate tax (standard rate – 1% and rights of local governments to determine additional rate with total tax rate limited to 3%) improving the procedure of granting tax allowances;
- to extend personal income tax base by means of levying a tax on revenues from capital in taxation periods, as from income generated in 2010 deducting a tax in 2011, but for the deposit interest – in 2010;
- to increase personal income tax rate on income of the self-employed persons to 23%;
- to increase the retirement age gradually.

In preparing the budget of 2010, the government will implement fiscal consolidation measures in the amount of LVL 500 million. In co-operation with the social partners, all possible revenue increase and reduction of expenditures will be evaluated. Preparing the budget of 2011 the opportunity to increase social insurance contributions rate by 4 percentage points in 2011 depending on fiscal situation will be assessed.

Figure 4.4

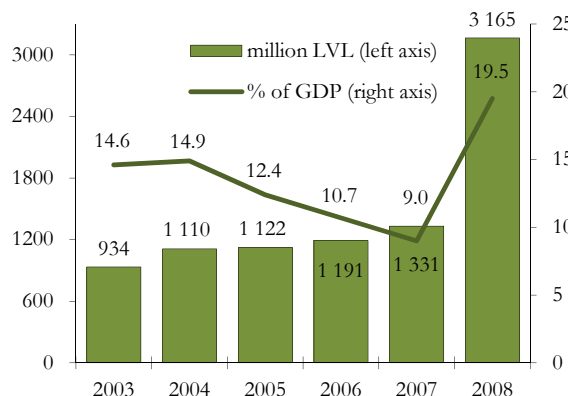


The level of the general government debt¹ in Latvia is one of the lowest in the EU (see Figure 4.4). In 2008, the EU average level of the general government debt was 61.5% of GDP (58.7% of GDP in 2007, 61.3% of GDP in 2006, 62.7% of GDP in 2005). The general government debt exceeded the Maastricht criterion (60% of GDP) in 9 EU member states in 2008. In 2008, the highest general government debt in terms of the percentage of GDP was observed in Italy (105.8%), Greece (97.6%), Belgium (89.6%), while the lowest general government debt in percentage of GDP was registered in Estonia (4.8%), Romania (13.6%), Bulgaria (14.1%) and Luxembourg (14.7%).

The general government debt in Latvia has gradually increased until 2007 – from LVL 933.9 million at the end of 2003 to LVL 1331.1 million at the end of 2007. However, in terms of the percentage of GDP it has even decreased from 14.6% to 9%. However, it increased very rapidly in 2008 to ensure national funding commitments and reached LVL 3164.7 million or 19.5% of GDP at the end of the year (see Figure 4.5).

Figure 4.5

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



Despite the fact, that economic recession in Latvia affects the state budget fulfilment indicators, it is expected that in the medium term the level of the general government debt will still remain below the public debt criterion defined by the Maastricht criteria.

4.1.2. Budget Revenues

The total revenues of the state consolidated budget in 2008 amounted to LVL 5723 million, which was only by 6.4% more than in 2007. For the purposes of comparison – during the years of the rapid growth, the budget revenues grew almost by 30% annually.

Although in the beginning of 2008 the budget revenues increased rapidly, due to the substantial

decrease of the economic activities, especially the domestic demand, the consolidated budget revenues also decreased in the second half of the year, which were even lower in the 4th quarter of 2008 than in the 4th quarter of 2007. It should be noted that the budget revenues grew at a more moderate pace than in current prices of GDP, thus the share of the state consolidated budget revenues in GDP decreased to 35.2%.

Table 4.2

Budget Revenues* (% of GDP)

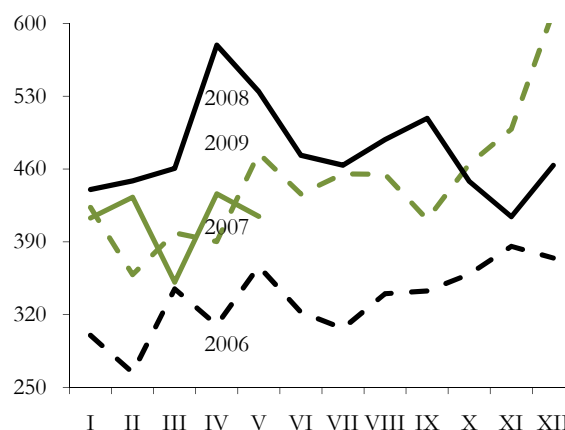
| | 2006 | 2007 | 2008 | 2009 I |
|---|-------------|-------------|-------------|-------------|
| General government sector revenues | 35.9 | 36.4 | 35.2 | 36.4 |
| I Tax revenues | 29.9 | 29.5 | 29.2 | 28.3 |
| 1. Indirect taxes | 11.8 | 11.4 | 10.4 | 10.6 |
| – value added tax | 8.3 | 8.1 | 6.9 | 6.6 |
| – excise tax | 3.3 | 3.0 | 3.3 | 3.8 |
| – customs duties | 0.2 | 0.2 | 0.2 | 0.2 |
| 2. Income taxes and property taxes | 8.7 | 9.2 | 9.9 | 9.2 |
| – corporate income tax | 2.3 | 2.7 | 3.1 | 2.4 |
| – personal income tax | 5.9 | 6.0 | 6.3 | 6.1 |
| – real estate tax | 0.6 | 0.5 | 0.4 | 0.7 |
| 3. Social security contributions | 9.0 | 8.6 | 8.6 | 8.2 |
| 4. Other taxes | 0.4 | 0.4 | 0.3 | 0.3 |
| II Non-tax revenues | 6.0 | 6.9 | 6.1 | 8.1 |

* according to the official data of the Treasury

As the deterioration of economic situation continues, in the first five months of 2009, the total revenues of the state consolidated budget were only LVL 2047.4 million, which was by 16.9% less than in January–May of the previous year.

Figure 4.6

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



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

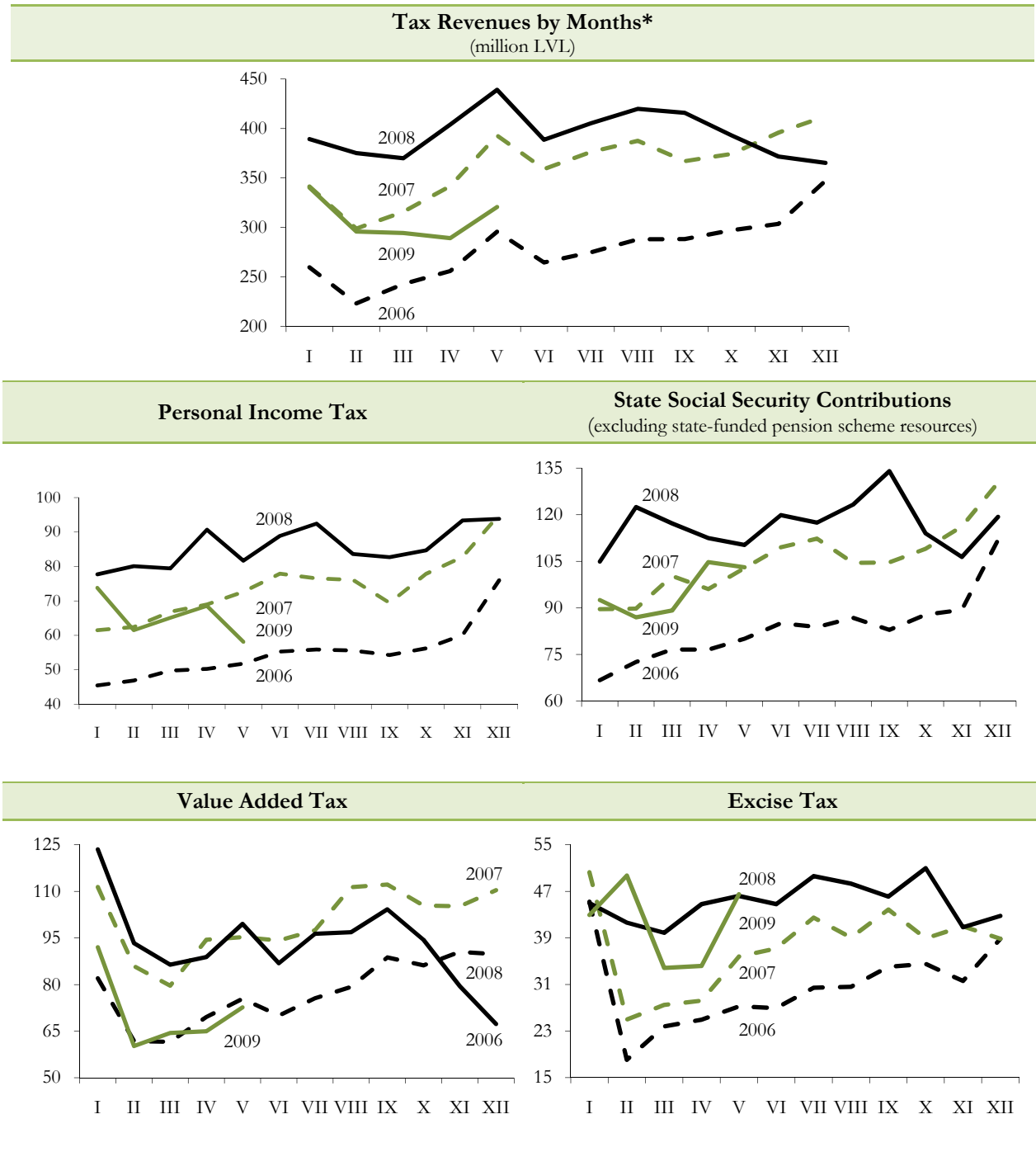
¹ According to the methodology of the ESA 95 European System of National Accounts.

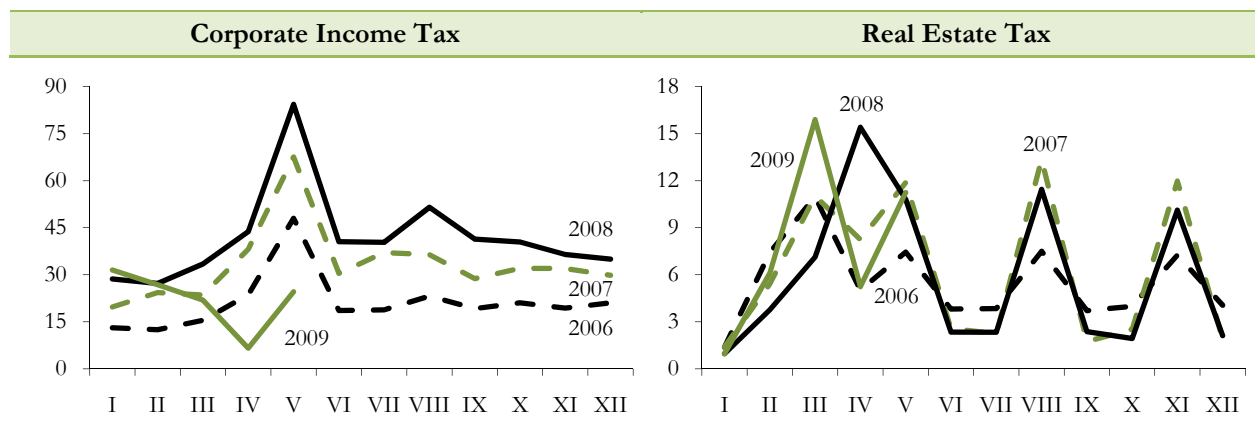
In 2008, the tax revenues constituted LVL 4736.7 million of the state consolidated budget, which exceeded the tax revenues of 2007 by 8.6%. The highest contribution to the tax revenues in recent years was provided by the growth of consumption taxes, and especially the value added tax. In 2008, the increase in taxes was mainly ensured by payroll taxes – the state social insurance contributions and personal income tax. The main factors affecting the increase of

the tax revenues in 2008 were still high inflation and increase in wages. Decrease of economic activities in the second half of 2008 had a direct influence also on the tax revenues.

In the beginning of 2009, despite the increase of certain tax rates, the total tax revenues decreased rapidly and were by 22.1% lower in January–May than in the respective period of the previous year.

Figure 4.7



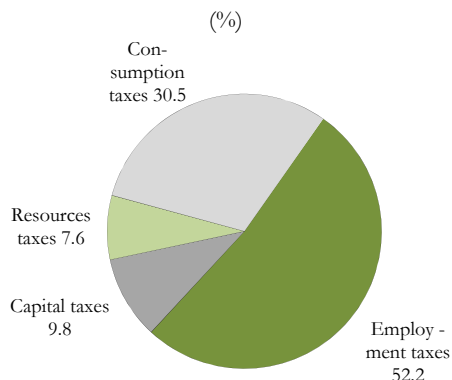


* according to the official data of monthly reports of the Treasury

The share of the employment taxes in the total tax revenues grew and reached 52.2% in the first five months of this year. In 2008, the growing wages and continuously high employment rate determined the growth of the payroll tax revenues (state mandatory social insurance contributions grew by 10.8%, but personal income tax collection increased by 15.9%). The total contribution of these taxes to the total increase of tax revenues constituted 7.3% or more than $\frac{3}{4}$ of the increase in total tax revenues.

Figure 4.8

General Government Consolidated Budget Tax Revenues by Tax Groups in the first five months of 2009



From January 1, 2009 the distribution of personal income tax revenues between the state and municipal budgets has been altered. 83% (previously 80%) from total revenues of the personal income tax are paid in the municipal budget, but 17% – in the state budget (previously 20%). Similarly, as from January 1, the tax rate of personal income tax was reduced from 25% to 23%. The increase of the unemployment level, more moderate increase in wages and reduction of wages in public sector, as well as increasing illegal employment influenced the decrease in payroll taxes. During January–May 2009, personal income tax revenues decreased by 20.2%, but state mandatory social insurance contributions decreased by 16% in comparison with the respective period of the last year.

The share of consumption taxes in the tax structure still decreases compared to 2007. The consumption taxes ensured the most rapidly growing taxes in the previous years, which were fostered by the increasing domestic demand and high inflation. In 2008, the contribution from the consumption taxes decreased due to the shrinking domestic consumption and decreasing inflation in the second half of the year, and was lower by 2.2% comparing to 2007.

The most substantial decrease in 2008 was in the value added tax revenues, which amounted to LVL 1117.2 million or by 7.1% less than in 2007. The increase of the consumption share of excise tax revenues by 32.6% in 2007 was affected by increasing excise tax rates, especially for tobacco products.

In the beginning of 2009, with continued decrease of the domestic demand, the revenues from the consumption taxes have decreased significantly. The value added tax revenues were LVL 354.3 million in the first five months of 2009, which is by 27.9% less in comparison with January–May 2008, even despite the increase of the standard rate of the value added tax from 18% to 21%. The decrease of income from this tax was mainly influenced by a decrease of total turnover of retail sales, a total decrease of transactions value and an increase of repayment of the tax.

The consumption shares of the excise tax revenues were LVL 94.6 million in January–May 2009, which is by 8.6% less than in the respective period of 2008. The decrease of income from the excise tax was mainly influenced by a rapid decrease in volumes of sales of goods in comparison with the indicators from the previous year. The increase of the excise tax rates implemented in the beginning of this year and the global economic recession has caused a rapid decrease in volumes of sales of excise goods, which accordingly decreased also the excise tax revenues in the state budget.

If the forecasts on decrease in domestic consumption are fulfilled, it can be expected that the revenues from the consumption tax will continue to decrease.

In 2008, the growth of the tax revenues continued in the **group of capital taxes** (by 21.1%). Despite the general economic tendencies, the corporate income tax revenues increased at a relatively rapid pace in 2008 (by

25.9%), while the real estate tax revenues amounted to LVL 70.7 million only, which is by 4.7% less than in the previous year despite the high activity in the real estate market in the previous years.

In the first five months of 2009, with a decrease of business activities and an increase in the number of insolvent companies there has been a rapid decrease of the corporate income tax collection, which was by 50% lower in January–May than in the first five months of the previous year. However, the real estate tax is collected in the amount of LVL 39.5 million, which is by 3.6% more than in the first five months of 2008.

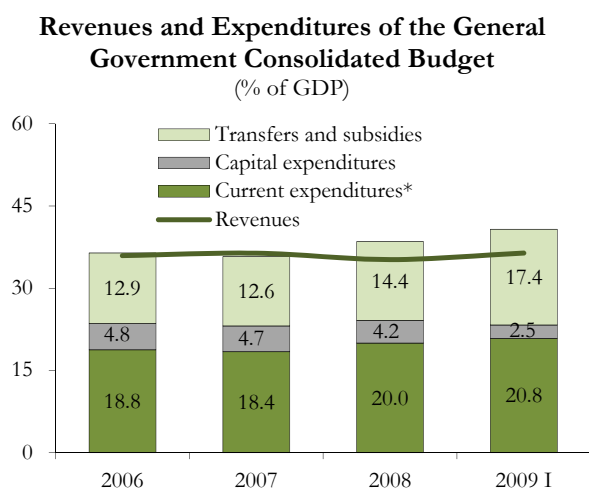
The changes in the group of **resource taxes** are mainly related to the excise tax on oil products, the share of which in this tax group constitutes 97%. In comparison with the previous years, the share of the resource tax group has slightly increased and amounts to 7.6% of the total tax revenues. In 2008, the excise tax on oil products was collected in the amount of LVL 283.4 million exceeding the collection of the previous year by 11.6%, which was largely related both to the increase of the excise tax rate and a high demand for fuel.

In the first five months of 2009, the excise tax on oil products is collected in the amount of LVL 112.6 million, which is by 1.3% lower than in the respective period of 2008.

4.1.3. Budget Expenditures

In 2008, the consolidated budget expenditures comprised LVL 6254.4 million or 38.5% of GDP. Despite strict discipline and reduction of the public administration expenditures the budget expenditures exceeded the level of 2007 by LVL 970.1 million or 18.4% in 2008.

Figure 4.9



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

Expenditures of the state consolidated budget continued to grow in the first five months of 2009 and

exceeded the level of the respective period of the previous year by 8.9%.

According to economic categories, the fastest increase in expenditures was observed in subsidies and grants in 2008 (by 26.9%). The increase of the current expenditures was also rapid (by 21.3%), and at the end of 2008 capital expenditures decreased by 1.7% in comparison with 2007, reducing public investments significantly.

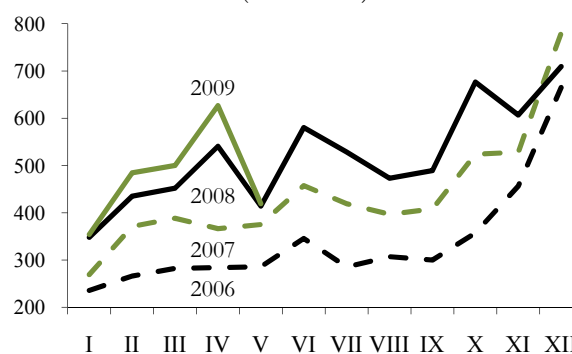
In the first months of 2009, expenditures on subsidies and grants continued to grow more rapidly, exceeding the level of the first five months of 2008 by 30%. It is mainly due to the continued increase in the number of unemployed persons and unemployment benefits paid, increase of dismissal benefits for employees released in the public sector, as well as other social benefits. However, the capital and current expenditures in the first five months of 2009 have decreased equally (slightly more than by 10%) in comparison with January–May 2008.

A rapid growth of expenditures on subsidies and grants in the last months already constitutes almost a half (45.6%) of all expenditures of the state consolidated budget. A high proportion (48.6%) of the current expenditures has remained, while the proportion of capital expenditures has decreased rapidly and constitutes only 5.8% from expenditures of state consolidated budget.

In 2008, there was a rapid growth also in the expenditures in accordance to functional categories: expenditures of social security (by 25.8% in comparison with 2007), economic activity (by 31.2%) and education (by 22.9%).

Figure 4.10

Expenditures of General Government Consolidated Budget by Months* (million LVL)



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

The highest share in the total expenditures regarding government functions in 2008 was made up by social security (21.5%), education (20.2%) and economic activity (18.1%). In general, the growth of expenditures in 2008 was observed in almost all groups of expenditures, except public order and security, where LVL 357 million were spent, which was by 3% lower than in 2007.

In the first five months of 2009, the highest growth is observed on expenditures of social security (by 28.3%), environmental protection (by 24.1%) and economic activity (by 21.6%) in comparison with the

respective period of the previous year. At the same time, the biggest decrease was in management of municipal areas and housing (by 49.2%) and defence (by 17%).

Table 4.3

Expenditures of the General Government Consolidated Budget by Directions*
(%)

| | 2008 | | 1st quarter of 2009 | |
|---|------------|-------------|---------------------|-------------|
| | structure | % of GDP | structure | % of GDP |
| Expenditures – total | 100 | 38.5 | 100 | 40.7 |
| General government services | 13.6 | 5.3 | 18.7 | 7.6 |
| Defence | 3.5 | 1.3 | 2.5 | 1.0 |
| Public order and safety | 5.0 | 1.9 | 4.6 | 1.9 |
| Economic activity | 18.1 | 7.0 | 14.3 | 5.8 |
| Environmental protection | 2.4 | 0.9 | 1.6 | 0.6 |
| Management of municipal areas and housing | 3.6 | 1.4 | 1.9 | 0.8 |
| Health | 8.1 | 3.1 | 7.1 | 2.9 |
| Recreation, culture and religion | 4.0 | 1.5 | 3.6 | 1.5 |
| Education | 20.2 | 7.8 | 18.8 | 7.7 |
| Social security | 21.5 | 8.3 | 26.9 | 11.0 |

* according to the official data of the Treasury

The **public demand** is made up by the public consumption or public services (their value is determined by the volume of the provided public services) and public investment that is the capital

investment using budget resources. The public demand constitutes approximately one fifth of the aggregate domestic demand.

Table 4.4

Public Demand
(%)

| | % of GDP | | | Changes over the previous year | | |
|-------------------------------|-------------|-------------|-------------|--------------------------------|-------------|-------------|
| | 2006 | 2007 | 2008 | 2006 | 2007 | 2008 |
| Public Demand | 21.2 | 23.1 | 24.9 | 13.0 | 10.7 | -2.6 |
| Public consumption | 16.6 | 17.4 | 20.0 | 4.9 | 3.7 | 1.5 |
| – central government | 9.3 | 9.5 | 10.7 | -2.0 | 1.4 | -0.4 |
| – local governments | 7.3 | 7.9 | 9.2 | 15.2 | 6.6 | 3.9 |
| Gross fixed capital formation | 4.6 | 5.7 | 4.9 | 53.1 | 34.5 | -13.5 |
| – central government | 3.1 | 2.8 | 2.0 | 58.7 | 1.3 | -29.7 |
| – local governments | 1.5 | 2.8 | 2.9 | 43.0 | 101.4 | 2.9 |

In 2008, the public demand decreased slower (by 2.6%) than GDP. The decreased demand was mainly determined by a reduction of expenditures by 13.5% on gross fixed capital formation of central government compared to 2007. At the same time, the municipal expenditures on investments increased last year (by

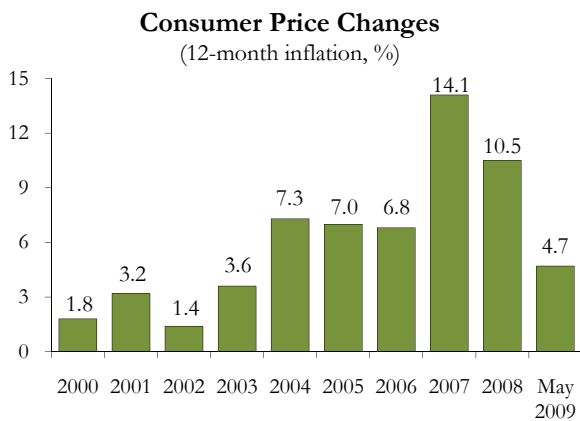
2.9%). However, they were significantly lower than the increase rates in the years of rapid growth. In 2008, public expenditures on the gross fixed capital formation amounted to LVL 795.2 million or 4.9% of GDP.

4.2. Prices

4.2.1. Consumer Prices

In the beginning of 2008, high inflation rate remained on the level of the previous year, but it started to decrease since June.

Figure 4.11



Contrary to 2007, when the demand-pull factors were the key driving forces of inflation, the increase of prices in 2008 was mainly determined by the supply-

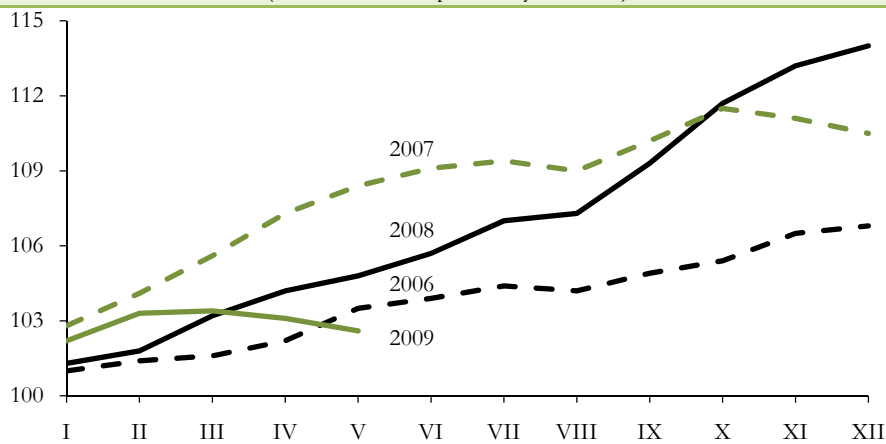
side factors, because the domestic demand started to decrease. In the first half of 2008, the rise of fuel prices had a big influence on the increase of prices. A substantial rise was created by the increase of natural gas tariffs, as well as by the increase in heating tariffs as from October 2008.

Upon continuing decrease of the private consumption, as well as decreasing influence of the supply-side factors, especially with a decrease of fuel prices the growth rate of consumer prices fell in the second half of 2008.

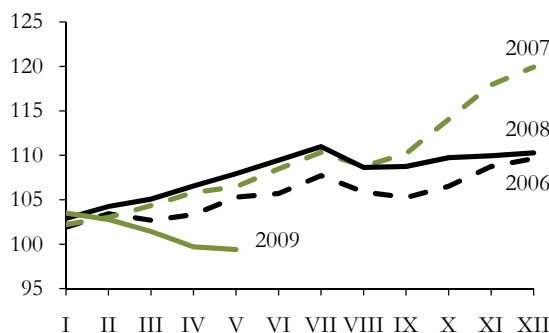
In 2008, the total price level increased by 10.5%, which is by 3.6 percentage points lower than the price increase of the previous year. The rise of prices was mainly determined by the increase of the administratively regulated prices, which increased the total level of consumer prices by 4 percentage points. The increase of prices of food raised the total price level by 2.3 percentage points, but of alcoholic beverages and tobacco – by 2 percentage points. The price changes for fuel, clothing and footwear decreased it by 0.7 percentage points and 0.2 percentage points respectively.

Figure 4.12

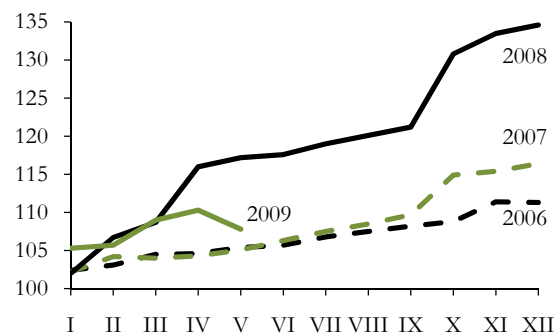
Consumer Price Index by Groups and Subgroups
(December of the previous year = 100)



Food and soft drinks



Administratively regulated prices



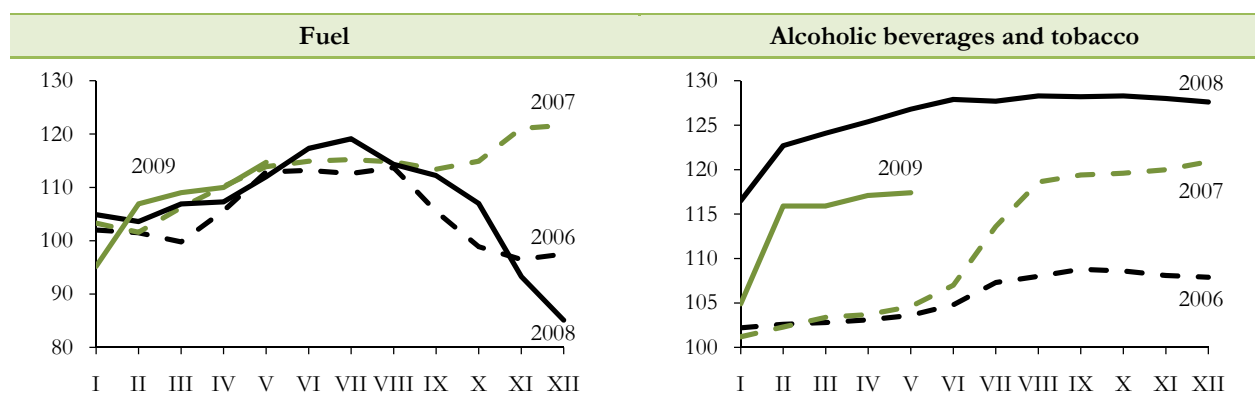


Figure 4.13

In 2009, the total price level increased only during the first two months of the year. It was determined by the supply-side factors, which are related to administratively regulated prices and changes of the tax rate on value added tax and excise tax. In the upcoming months deflation is to be observed:

In January–May 2009, the level of consumer prices has increased by 2.6%, which is by 5.8% less than in the respective period of the previous year.

The total consumer price increase in May 2009 in comparison with May 2008 amounted to 4.7%, which was almost four times lower than a year ago (17.9%). During the year there was a price increase both, on services (by 8.4%) and goods (by 3.3%).

As from March 2007, a substantial rise of prices can be observed within the entire European Union. However, similar to the previous periods, Latvia had the highest consumer price inflation in the EU in 2008, as well. In May 2009, the inflation level was higher only in Romania and Lithuania.

The Impact of Different Consumer Price Groups on 12-Month Inflation
(percentage, May 2008 and 2009)

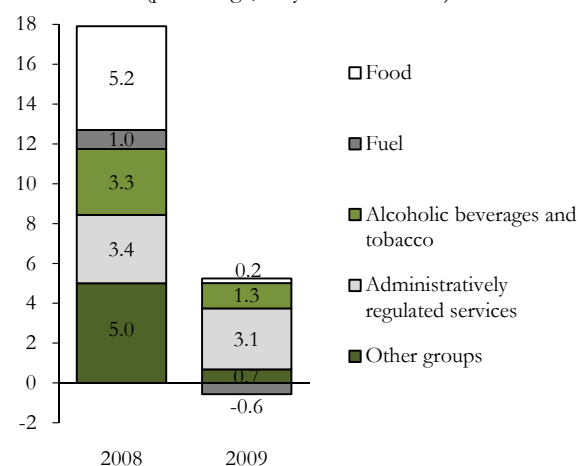
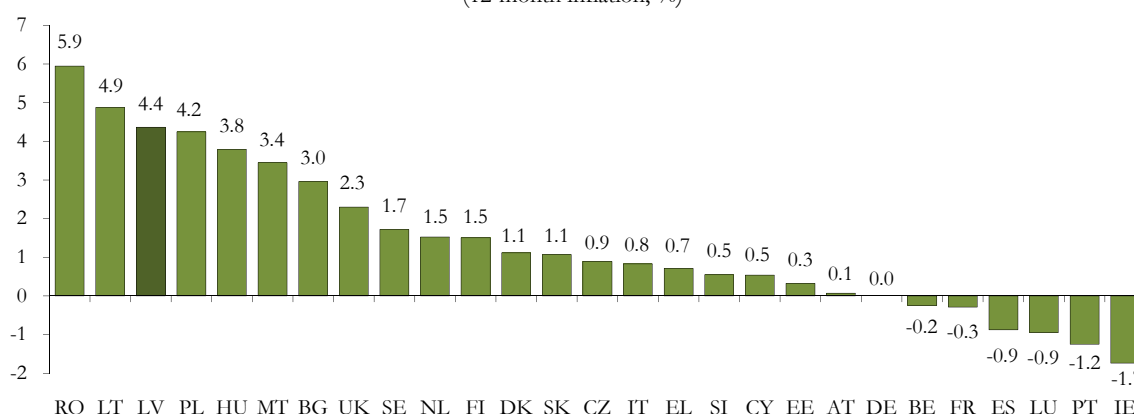


Figure 4.14

Changes of Harmonized Indices of Consumer Prices in the EU Member States in May 2009 as Compared to May 2008*
(12-month inflation, %)



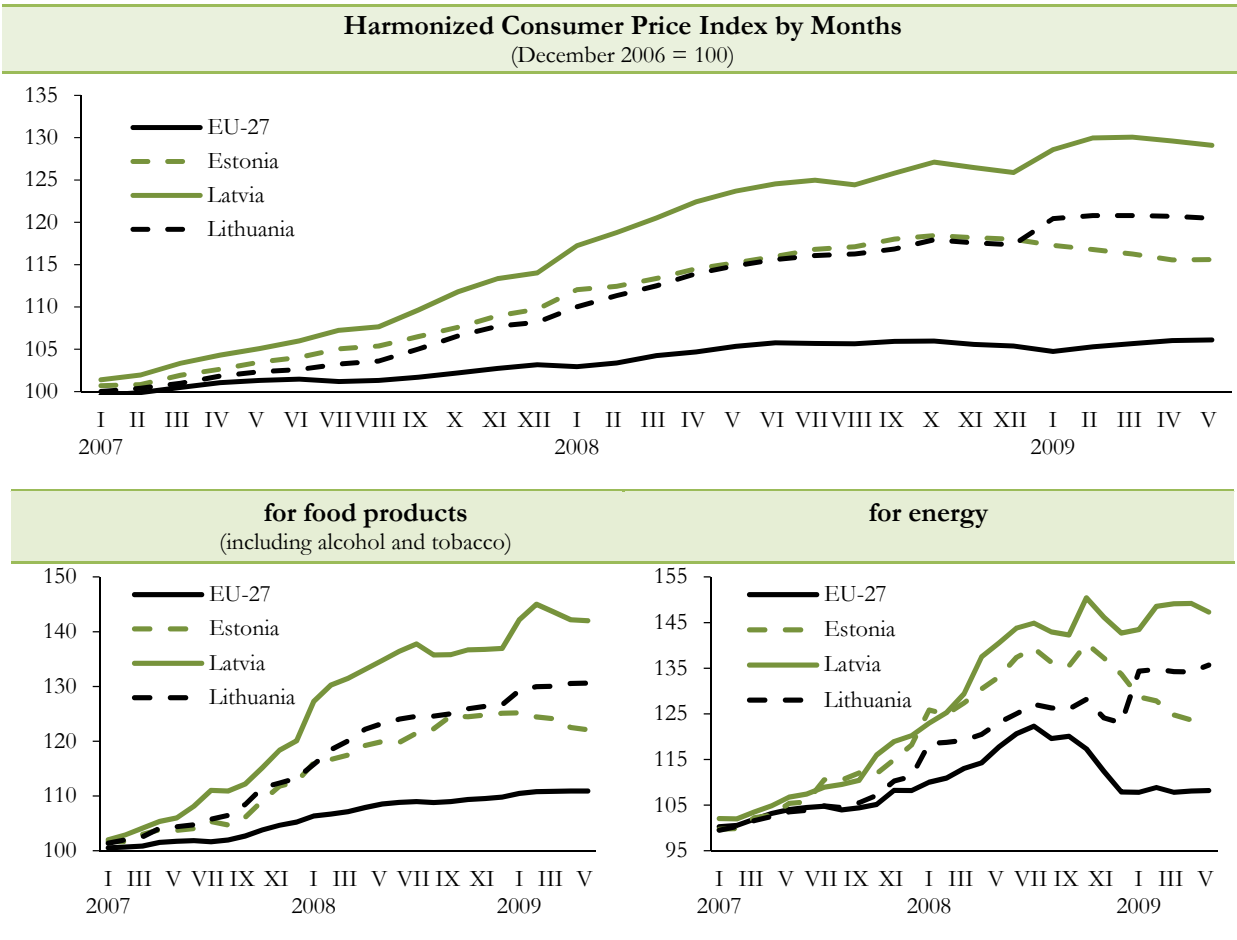
AT – Austria, BE – Belgium, BG – Bulgaria, CZ – Czech Republic, CY – Cyprus, DE – Germany, DK – Denmark, EE – Estonia, EL – Greece, ES – Spain, FI – Finland, FR – France, HU – Hungary, IE – Ireland, IT – Italy, LT – Lithuania, LU – Luxembourg, LV – Latvia, MT – Malta, NL – Netherlands, PL – Poland, PT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

* UK – March 2009 compared to April 2008; Source: Eurostat

The level of inflation in January–May 2009 was higher in Lithuania (2.7%) (in Latvia: 2.5%), but there was a deflation in Estonia (-2%). Thus, the total

12-month inflation in Estonia was 0.3%, in Lithuania – 4.9% and in Latvia – 4.4%.

Figure 4.15



In the beginning of 2009, the situation in Latvia has changed, price changes are mainly influenced by supply-side factors, and as the figure shows, the growth of inflation tends to decrease. The most rapid increase of prices in Latvia was observed for services and food with a price increase by 3.7% (by 3.1% in Lithuania, but the prices decreased by 2.4% in Estonia).

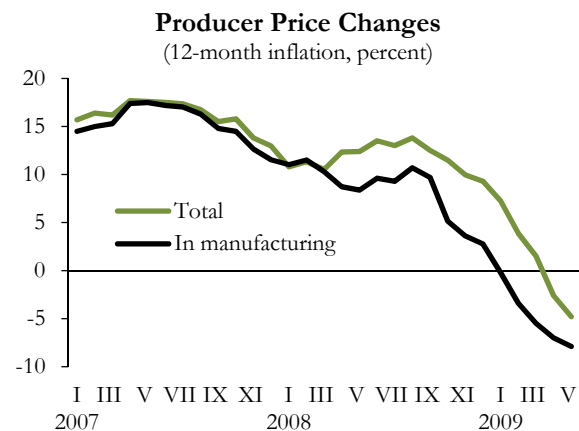
In the beginning of the year, the most rapid increase of prices in Lithuania was observed for energy – by 10.4%. The price for energy in Latvia grew by 3.2%, but it decreased by 7.5% in Estonia (on average the EU-27 energy price in January–May increased by 0.3%).

4.2.2. Producer Prices

The producer prices grew slowly during 2000–2003. Their fluctuations were mainly related to currency exchange rate changes, as changes in export prices determined to a great extent the overall dynamics of producer price changes. Like consumer prices, the increase in producer prices also grew rapidly as from 2004 lagging behind from the consumer price index in the beginning, but exceeding it already in 2006.

The fall in the growth rates of producer prices began already in the mid-2007 upon gradual decrease of the economic growth rates. The rise of the increase rates of producer prices in April 2008 and further months is greatly related to the tariff increase for administratively regulated prices (electricity, gas and heating).

Figure 4.16



The total increase of producer prices in 2008 (by 9.3%) was by 3.7 percentage points slower than in the previous year (by 13%). The increase of the producer prices in manufacturing was observed until August

2008, when it was followed by a substantial decrease in the producer prices.

The total level of producer prices in May 2009 in comparison with May 2008 has decreased by 4.8% (it decreased by 12.4% in 2008). In May 2009, the decrease (by 0.9% compared to April 2009) was related mainly to the decline of tariffs on electricity, gas supply and heat supply. The decline of the producer prices in manufacturing was only 0.1% during the same period.

In 2007 and 2008, the rise of prices for the products sold in the domestic market and exported products was even. In the beginning of 2007, the prices for goods sold in the domestic market began to grow more rapidly, while in the beginning of 2008 the growth became more even and the price increase for the exported products exceeded the price increase for the goods sold in the domestic market.

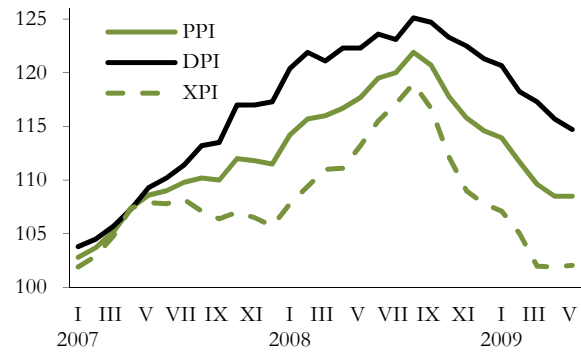
In the beginning of 2009, the increase of prices fell for products sold in the domestic market, but deflation of prices was observed for exported products related to decrease in prices in global markets for Latvian main exported goods, including timber and food products. However, with a rapid decrease in domestic consumption, in May 2009 deflation was observed in domestic market. Price decrease for the total amount

of products sold in the domestic market was smaller (by 1.9%) than for the exported goods (by 9.9%), manufacturing decreased by 6.2% and 9.8% respectively during a year (May 2009 compared to May 2008).

Figure 4.17

Producer Price Dynamics in Manufacturing

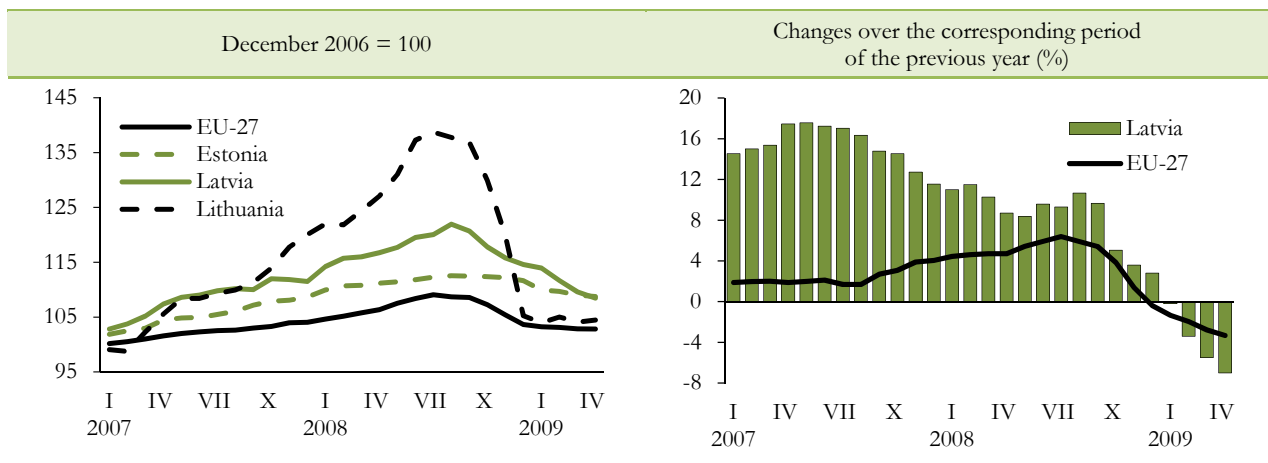
(December 2006 = 100)



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

Figure 4.18

Producer Price Index by Months in Manufacturing



The dynamics of producer price index in manufacturing in Latvia differs a little from the total EU dynamics. The EU manufacturing prices began to grow faster in autumn 2007, when their growth rates in Latvia began to fall. The increase of producer prices

was observed until August 2008, when it was followed by a substantial decrease in producer prices across the European Union. Since December 2008, the deflation of producer prices was observed in the EU.

4.3. Balance of Payments

4.3.1. Current Account

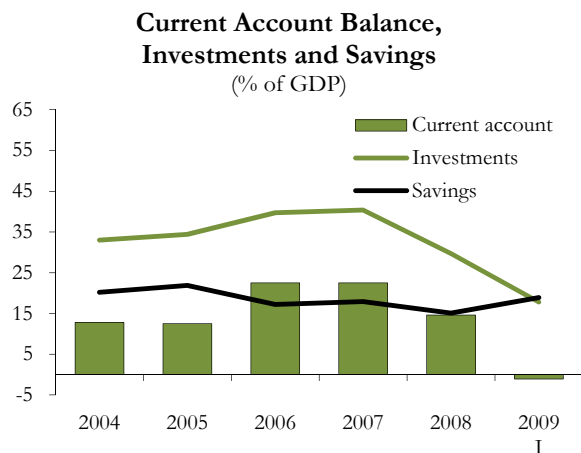
For several years, Latvia typically has had a relatively high current account deficit of the balance of payments with markedly negative trade balance. The

current account increased from 12.5% of GDP in 2005 to 22.5% of GDP in 2007.

Since the second half of 2007, a new tendency has appeared – negative balance of current account of balance of payments was constantly reducing – almost by 3 percentage points each quarter. In the 4th quarter

of 2008, the current account deficit reached already 8.3% of GDP, but in the 1st quarter of 2009 the current account had a surplus in the amount of 1.1% of GDP. Decrease in the current account deficit was largely determined by improvement of the trade balance due to the decline of imports, while at the same time, the exports dynamics remained positive.

Figure 4.19



Improvement of the situation of the current account of the balance of payments is based on the significant decrease in the domestic demand, which was mainly based on the voluminous inflow of foreign capital in Latvian economy during the period of rapid

growth. Under the influence of the global financial crisis, due to decrease of capital inflow, there was a significant decrease of the domestic demand, which resulted in substantial economic adjustments with an improvement of the current account balance.

The rapid inflow of foreign capital until 2007 positively affected investment on the one hand, but on the other hand became a substantial factor for decreasing the level of savings. Private consumption increased rapidly and the level of savings decreased from 20.4% of GDP in 2004 to 17.9% in 2007 respectively, while the investment level in the national economy increased from 27.5% to 40.4%, respectively.

In 2007, the dynamics of investments slowed down, but in 2008 the level of investments was almost by 10 percentage points lower than in 2007. The level of national savings remained relatively stable confirming a substantial adjustment of domestic consumption in the conditions of decreasing income. Such consumers' behaviour may be explained by the low level of savings, substantial burden of debt of households and uncertainty of economic situation. In general, the decrease of the current account deficit was determined by a substantial decline of investments in 2008 with savings remaining on the previous level and even with a slight increase. In the 1st quarter of 2009, the share of investments in terms of GDP was 17.8% or almost two times lower than in the 1st quarter of the previous year, but the level of savings was 19% of GDP.

Table 4.5

Balance of Payments of Latvia
(% of GDP)

| | 2005 | 2006 | 2007 | 2008 | 2008 I | 2009 I |
|------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| A. Current account | -12.5 | -22.5 | -22.5 | -12.6 | -16.8 | 1.1 |
| Trade balance | -18.9 | -25.6 | -23.9 | -17.0 | -18.6 | -10.7 |
| <i>exports</i> | 33.5 | 30.7 | 28.5 | 28.0 | 29.8 | 24.8 |
| <i>imports</i> | -52.4 | -56.3 | -52.4 | -45.0 | -48.4 | -35.5 |
| Balance of services | 3.8 | 3.3 | 3.4 | 4.0 | 3.2 | 6.3 |
| Net income | -1.1 | -2.7 | -3.3 | -1.9 | -3.0 | 3.6 |
| Current transfers, net | 3.7 | 2.4 | 1.3 | 2.2 | 1.7 | 1.9 |
| B. Capital account | 1.3 | 1.2 | 1.9 | 1.5 | 1.1 | 3.0 |
| C. Financial account* | 16.3 | 30.5 | 24.7 | 11.1 | 25.2 | -13.3 |
| Direct investment | 3.6 | 7.5 | 6.7 | 3.3 | 6.9 | 0.8 |
| <i>abroad</i> | -0.8 | -0.9 | -1.1 | -0.6 | -0.1 | 0.3 |
| <i>in Latvia</i> | 4.4 | 8.3 | 7.8 | 4.0 | 7.0 | 0.5 |
| Portfolio investment** | -1.3 | 0.2 | -1.6 | 0.4 | 9.4 | 7.0 |
| <i>assets</i> | -1.3 | -1.3 | -1.0 | 1.4 | 2.5 | 8.7 |
| <i>liabilities</i> | 0.0 | 1.5 | -0.5 | -1.0 | 6.9 | -1.7 |
| Other investments | 14.0 | 22.6 | 19.5 | 7.3 | 9.0 | -21.2 |
| <i>assets</i> | -2.7 | -9.7 | -21.0 | -1.4 | 12.0 | 9.5 |
| <i>liabilities</i> | 16.7 | 32.2 | 40.5 | 8.8 | -3.0 | -30.7 |
| D. Net errors and omissions | -1.9 | 0.6 | -0.7 | -1.9 | -4.1 | -0.9 |
| E. Reserves | -3.2 | -9.9 | -3.4 | -2.0 | -5.4 | 10.1 |

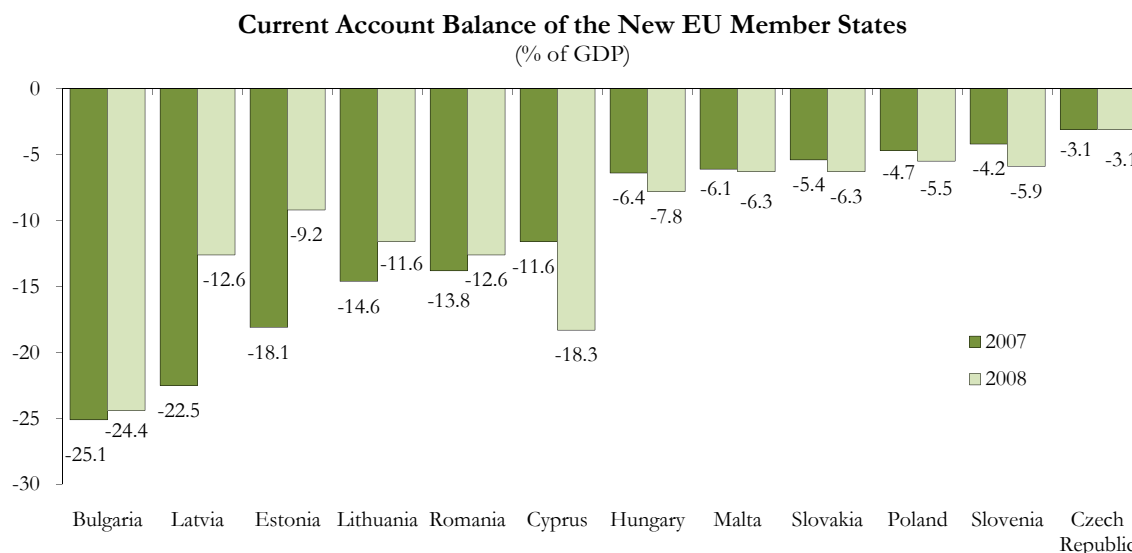
* excluding reserve assets; ** portfolio investment and derived financial instruments

After accession to the EU, all of the new EU member states had a negative savings–investments balance, which was mainly related to the high level of investments stimulated by the intensified inflow of foreign financial resources in the national economy. The influence of the global financial crisis on external

imbalance in 2008 is observed mainly in the Baltic States, where the corrections of the current account deficit have been the highest.

The decrease of the current account deficit in Latvia has been the highest among the Baltic States in 2008 (see Figure 4.20).

Figure 4.20

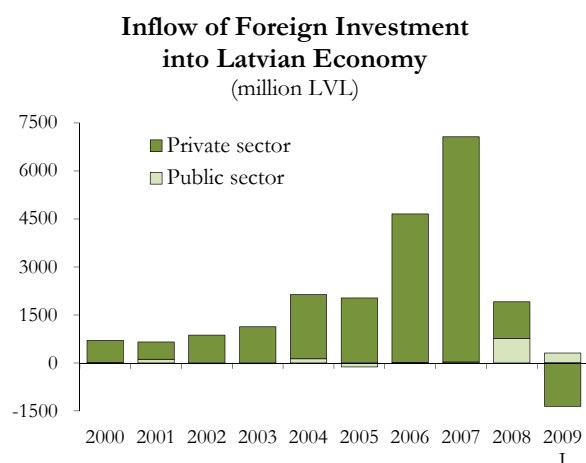


Source: IMF database

4.3.2. Financial Flows

The adjustments of the current account balance were mainly determined by the changes of financial flows' directions and dynamics under the influence of the global financial crisis.

Figure 4.21



Increased inflow of foreign capital started in Latvia at the beginning of the transition, which was fostered by the liberalisation of financial flows. There are no limitations to conversion of the national currency in Latvia. Foreign companies may freely withdraw their investments and profits after paying taxes. Also every resident of Latvia is free to use the financial services of any foreign company. There are no restrictions for

operations with securities. The purchase and sale of real estate is not restricted as well.

Foreign investment was mainly attracted by the private sector. As from 2004, foreign investments increased rapidly and their volume increased by 1.5 times in 2007 as compared to the previous year, but in 2007 compared to 2004 – increased by almost 3.5 times. In 2008, a much slower inflow intensity of the foreign investments has been observed, which is mainly determined by the unfavourable conditions in the global financial markets. The amount of private capital inflow in 2008 compared to 2007 was almost seven times smaller, but in the 1st quarter of 2009, the outflow of foreign capital has been observed. Also, the structure of foreign capital flow is changing. At the end of 2008 and in the 1st quarter of 2009, the public sector ensured the inflow of foreign capital, which partially reduces the negative impact of foreign capital outflow on financial account.

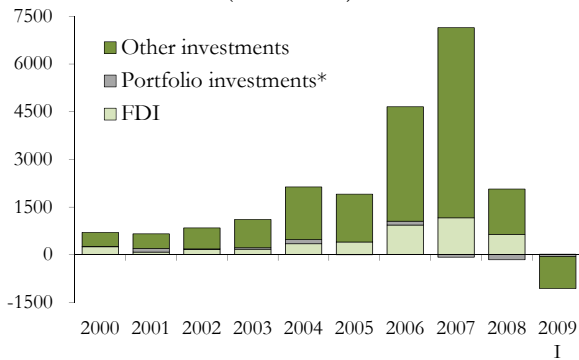
FDI constitutes almost one third of the incoming foreign capital. Within the period of 2005–2007, the volume of investment has tripled and it covered 35–37% of the negative balance of the current account. In 2008, as compared to 2007, FDI stock decreased by almost a half and reached 31.4% of the negative balance of the current account. In the 1st half of 2009, the FDI flows remained positive, however, they are almost 15 times smaller than in the respective period of the previous year.

The share of portfolio investments in the incoming financial flows is small and does not exceed 10% in the last three years. In 2008, the balance of portfolio

investments was positive mainly due to the financing attracted by the Latvian government as bonds and promissory notes.

Figure 4.22

Inflow of Foreign Investment into Latvian Economy by Types of Investment
(million LVL)

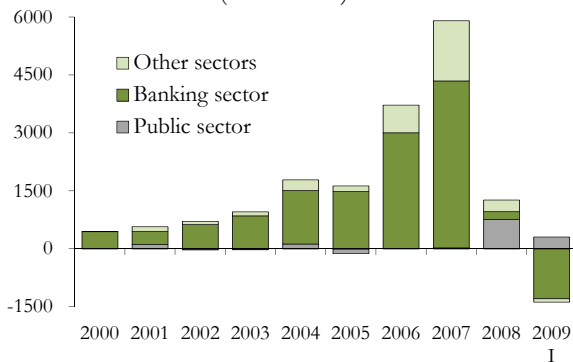


* portfolio investment and derived financial instruments

“Other investments”¹ comprise the majority of total foreign investments. These are trade loans, other credits and borrowings, cash and deposits, etc. Within three years (2005–2007) it grew by 4.4 times. In the 1st quarter of 2008, a negative flow of “other investments” has been observed for the first time within the last four years. It was mainly determined by the decrease of non-resident deposits in monetary financial institutions and decline in the level of borrowings of the private sector. In the 2nd, 3rd and 4th quarter of 2008, the flows of other investments were positive, however, in 2008 they were almost two times smaller than in 2007, which were mainly determined by the decrease in the short-term flows. In the 1st quarter of 2009, due to the rapid fall of liabilities in the banking sector as a result of transactions, the flows of other investments were negative.

Figure 4.23

Net Foreign Investment Flows by Sectors*
(million LVL)



* excluding foreign direct investment

The foreign capital attracted under the influence of the global financial crisis, exceeded the volume of

GDP by 11.8% in 2008. At the end of the 1st quarter of 2009, the debt of Latvia to the rest of the world amounted to 128%, including the government debt of 8.4%. Since the end of 2007, the foreign government debt has almost doubled.

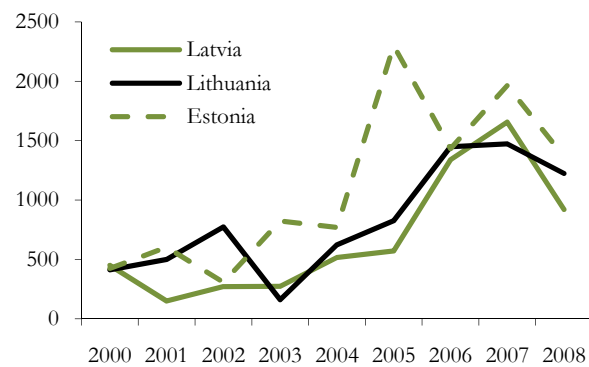
4.3.3. Foreign Direct Investment

Under the influence of the global financial crisis, the foreign capital flow in Latvian economic situation has significantly decreased.

It affected also FDI flows, although it should be noted that the decrease of FDI is relatively smaller among other flows.

Figure 4.24

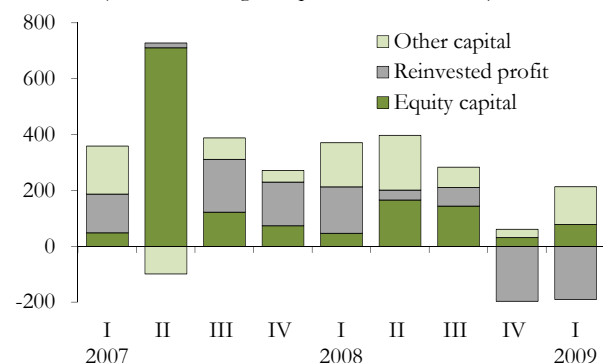
Inflow of FDI in the Baltic States
(million EUR)



There is a certain cycle in the intensity of FDI in Latvian economy. With Latvia’s accession to the EU, the intensity of FDI has increased considerably. In the period of 2004–2007, investments of the foreign entrepreneurs into Latvian economy in the form of direct investments were almost four times higher than in the period of 2000–2003, but in 2008, the volume of FDI was almost two times lower than in 2007. Such tendencies are typical for all Baltic States.

Figure 4.25

FDI in Latvia
(received during the quarter, million EUR)



Since 2008, the activities of Latvian investors have decreased in the rest of the world. In 2007, Latvian entrepreneurs have invested EUR 237 million in the

¹ Financial transactions not included in direct and portfolio investments.

form of direct investments, i.e., almost five times more than before the accession to the EU. In 2008, Latvian investments abroad have decreased to EUR 144 million.

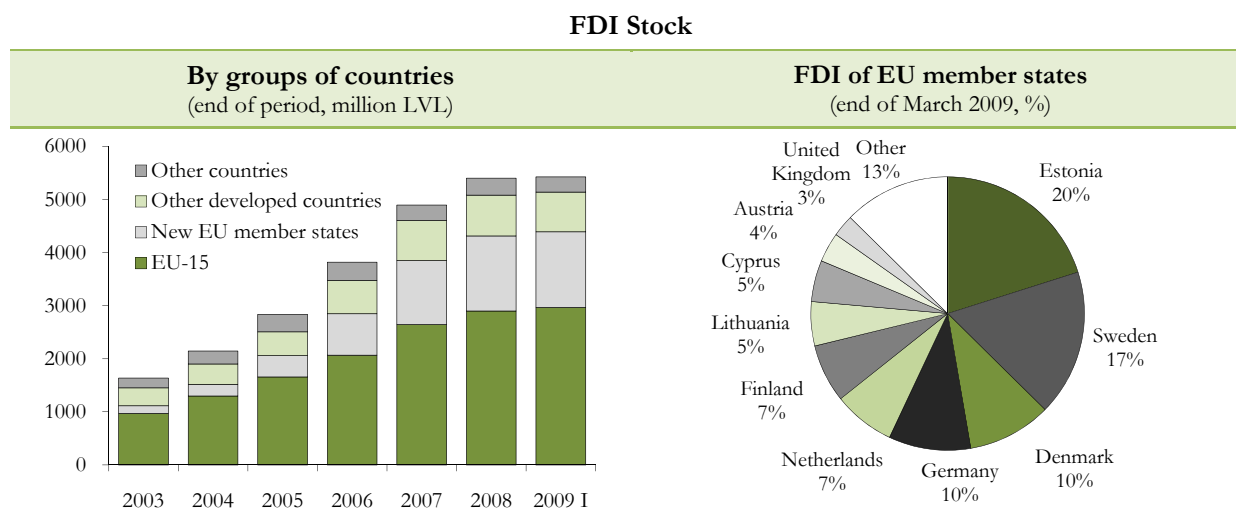
In 2008, the volume of incoming FDI has been by 44% lower and reached LVL 644 million (EUR 916.4 million) comparing to 2007. It was mainly determined by the decrease of reinvested profit, which has been negative in the 4th quarter of 2008 and the 1st quarter of 2009 indicating that the investing enterprises were running at a loss.

According to the international investment balance of Latvia, the FDI stock in Latvian economy at the end of March 2009 reached LVL 5607.8 million or

almost 35% of GDP. The share of FDI in the structure of the accumulated foreign capital has slightly increased and amounted to 23.3% at the end of March 2009, which was mainly determined by more rapid decrease of other investments instead of FDI flow in the inflow of foreign capital.

The geopolitical structure of the FDI stock in Latvia has not changed substantially since 2004: it is mainly investment of the EU member states. At the end of March 2009, investments of the EU Member States amounted to 81% of the total FDI stock, and one-third of it is related to investments of the new EU Member States.

Figure 4.26



The biggest investor countries are Sweden, Estonia, Germany and Denmark. At the end of March 2009, the FDI stock of these four countries comprised almost 46.1% of the total FDI stock in Latvia. Typically dominant sectors exist in all of the abovementioned

countries. Swedish and Estonian FDI are concentrated in the sectors of financial services (respectively 40% and 64% from the FDI stock in Latvian economy). German entrepreneurs have mainly invested in the energy sector and real estate (53.1% of German FDI stock in Latvia).

Table 4.6

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

| | 2004 | 2005 | 2006 | 2007 | 2008 | 1 st quarter of 2009 |
|------------------------------|-------|-------|-------|--------|--------|---------------------------------|
| Primary sectors | 49.8 | 59.5 | 71.6 | 112.9 | 144.8 | 145.9 |
| Manufacturing | 276.1 | 376.0 | 395.3 | 465.2 | 515.2 | 628.5 |
| Energy | 164.7 | 327.6 | 348.1 | 270.7 | 207.1 | 176.0 |
| Construction | 36.5 | 49.7 | 67.6 | 86.0 | 111.3 | 130.3 |
| Trade | 395.7 | 437.8 | 562.3 | 681.9 | 854.9 | 844.2 |
| Transport and communications | 333.3 | 336.4 | 347.0 | 398.0 | 455.7 | 457.6 |
| Financial mediation | 375.9 | 625.4 | 964.6 | 1434.7 | 1612.3 | 1575.9 |
| Other services | 439.2 | 529.0 | 795.3 | 1214.5 | 1277.4 | 1339.3 |

Since Latvia's accession to the EU, the FDI stock more than doubled in both, goods and services. As regards the production of goods, a particularly rapid increase of the FDI has been observed in the energy sector (by almost 5 times), and more than 5 times in the

construction sector. The dynamics of FDI was not so rapid in the manufacturing sector (increased by 1.5 times).

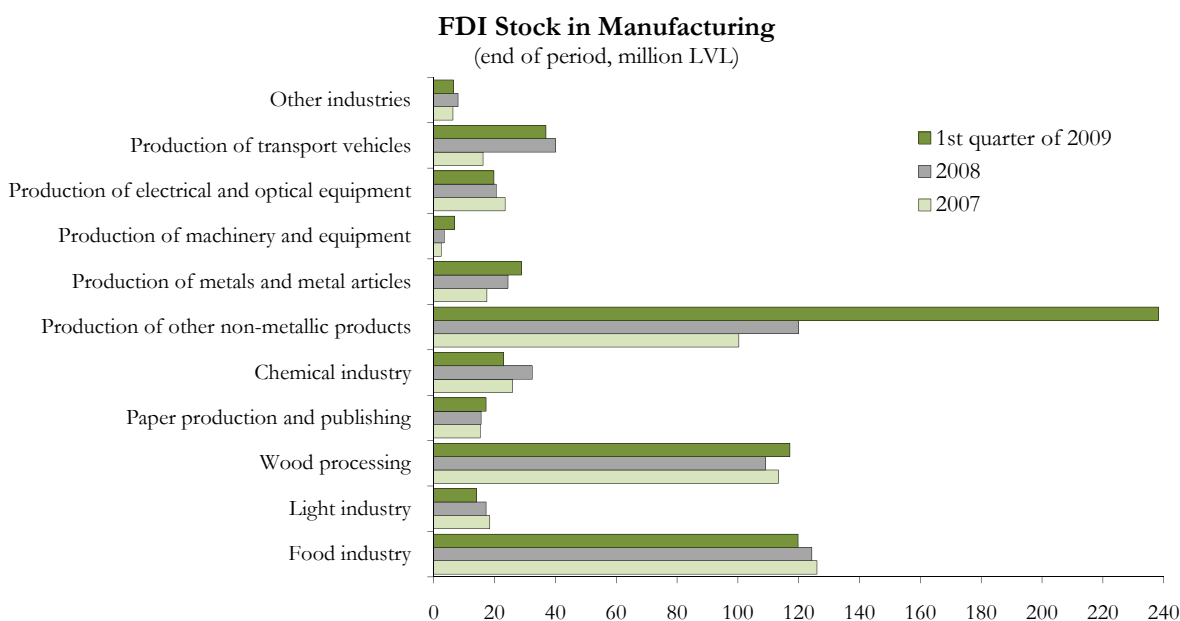
By the end of 2004, the commercial services sector had the biggest share in the sectoral structure of the

FDI stock, but already from 2005, financial services took the leading positions in attraction of FDI. The share of financial services sector in the structure of FDI stock in 2008 remained on the level of the previous year and reached 30% at the end of the year.

The overall level of FDI stock had increased in all sectors in 2008, indicating that the investors have not adjusted their plans substantially regardless of the decrease in the economic activities. However, the growth rates of FDI have slowed down, especially in the services sector. The FDI stock in the services sectors in 2008 increased by 12.7% (including by 12.4% in financial intermediation) and by 3.2% in the sector “operations with real estate”, but in the respective period of 2007 it grew almost three times faster – by 40%. It was largely determined by a much lower investment in the mentioned sectors. The decrease in the growth rates of the FDI stock in the production of goods was small. In the 1st quarter of 2009, the level of FDI stock in services sector remained unchanged, but in production sector it grew by 10.5%, including manufacturing – by 22%.

After Latvia’s accession to the EU, substantial changes are observed in the sub-sectors of manufacturing with regards to the attraction of FDI. In comparison with the end of 2003, the FDI stock decreased by almost a half in light industry and chemical industry, but by more than five times in production of machinery and equipment. However, the FDI has substantially grown in such sectors as production of electrical and optical equipment (by 4 times), production of other non-metallic products (by 4 times). The FDI growth in manufacturing by 10.7% in 2008 and by 22% in the 1st quarter of 2009 indicates that the crisis has not seriously affected the interest of foreign investors about this sector. In 2008, high investments were made in production of transport vehicles. In comparison with the end of 2007, the FDI stock increased by 2.4 times in this sector. There was a rapid increase in the sectors for production of other non-metallic mineral products. In the 1st quarter of 2009, the investments almost doubled.

Figure 4.27



The most attractive manufacturing sectors for foreign investors are food industry, wood processing and production of other non-metallic mineral products. The FDI stock in these sectors made up 74% of the total FDI stock in manufacturing at the end of March 2009. The investors from Denmark, Finland, Germany, Sweden and Ireland have made higher investments in manufacturing within the last four years.

A lot is being done in Latvia in order to improve the investment environment. A big role in this process is played by the Investment and Development Agency of Latvia, which was founded as the non-profit organisation state JSC “Development Agency of Latvia” in 1993 and reorganised as the

state agency “Investment and Development Agency of Latvia” (IDAL) in 2003. One of the most important priorities for operations of the IDAL in the sphere of investment attraction is attraction of such projects that are based on knowledge and technologies. The investment attraction strategy of the IDAL is focused on qualitative maintenance of the projects of incoming investments and proactive 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 FDI dynamics show that foreign investors still consider Latvia’s business environment as a comparatively favourable location for starting business

activity, which is attractive for foreign investments despite the global economic crisis.

The production unit of household objects opened by the Dutch company “Brabantia” (EUR 8 million) in the rural municipality of Ģibuļi parish near Talsi and employing more than 70 persons, second production unit of vehicle spare parts of the Swedish company “Leax” in Latvia, which serves “Volvo” and “Scania”, in Rēzekne (respectively EUR 5 million and 120 job places), which is particularly important for the region, taking into account the recent closure of the “Rebir”,

may be mentioned among the successfully implemented FDI projects in 2008.

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 implementation of projects.

4.4. Financial and Capital Markets

4.4.1. Monetary Policy and the Exchange Rate¹

The Law “On the Bank of Latvia”² stipulates 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 decisions or instructions of the government or public 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 SDR³ currency basket (1 SDR = LVL 0.7997) thus *de facto* implementing the fixed exchange rate policy. As of January 1, 2005, the peg of lat to the SDR basket is replaced with the peg to the euro (1 EUR = LVL 0.702804). The change of the lat's peg was determined by Latvia's plans 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)⁴. *The Economic Stabilisation and Growth Revival Programme of Latvia* contains a commitment that the Cabinet of Ministers and the responsible public administration institutions will take all the necessary measures in order to fulfil the Maastricht Convergence criteria, which would ensure introduction of the euro as soon as possible (in 2013).

As from May 2, 2005, Latvia joined the ERM II with the already existing exchange rate of lats against euro, namely, 1 EUR = LVL 0.702804. The ERM II allows standard fluctuations of the exchange rate within +/-15% around the central or peg rate. However, Latvia commits to maintain the exchange

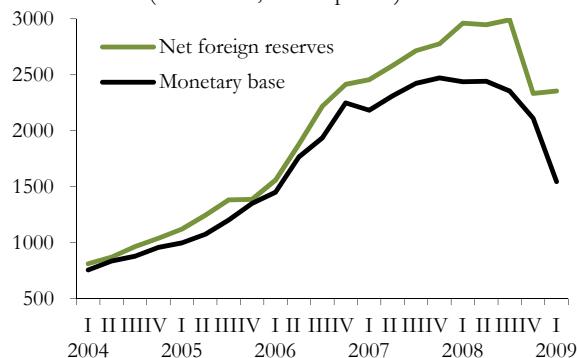
rate fluctuations margin unilaterally within +/-1%, retaining the former width of the corridor of the lats fluctuations, which was habitual to the financial market since 1994, when lats was fixed to the SDR, and was kept when lats was re-pegged to the euro on January 1, 2005.

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 4.28).

Figure 4.28

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



The coverage of monetary base (currency in circulation and deposits in the Bank of Latvia) with net foreign assets was 132.5% at the end of April 2008 (at the end of December 2008 – 110.5%).

¹ Data of the *Financial and Capital Market Commission* and the *Bank of Latvia* is used in this chapter.

² The Bank of Latvia is the central bank of the country.

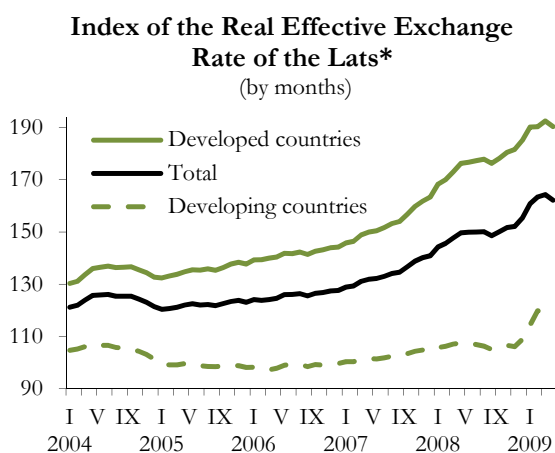
³ Special Drawing Rights – ((SDR) – special currency code in accordance with the international currency classifier ISO 4217 – XDR).

⁴ Participation in EMU has been defined in the EU Accession Treaty, but Latvia is allowed to choose the most appropriate time for introduction of Euro.

The foreign currency reserves are invested in safe and liquid financial instruments, mainly in debt securities issued by the governments of the USA, Eurozone 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 4024 million at the end of April 2009 (USD 5248 million at the end of 2008, USD 5758 million at the end of 2007, USD 1535 million at the end of 2003). The Bank of Latvia calculates the real effective exchange rate of the lats¹ against the currencies of 13 countries, which are the main trading partners of Latvia². It shows the relative export competitiveness of Latvia in global markets (see Figure 4.29).

Since 2005, the real exchange rate of lats has been experiencing a trend of increase with regard to currencies of the developed countries due to the relatively high inflation, however, since the mid-2006 – also with regard to currencies of the developing countries. Especially rapid increase of the rate was in the second half of 2008 and the beginning of 2009. The increase of the real effective exchange rate of the lats is not favourable for Latvian exporters.

Figure 4.29



* Calculated using consumer price index. December 1995 is the base of the real effective exchange rate index (1995 = 100).

4.4.2. Market Structure and Development

In the financial and capital market of Latvia, bank assets form the biggest share (96%) in the total assets.

In the mid-2009, 21 banks and six branches of foreign banks operated in Latvia. Moreover, credit institutions or their branches, which are registered in

the European Economic Area (EEA) countries and which have submitted applications to the *Financial and Capital Market Commission* (hereinafter FCMC)³ may provide banking services in Latvia.

The total amount of bank assets reached LVL 22.1 billion at the end of April 2009 (LVL 23.2 billion at the end of 2008, LVL 21.9 billion at the end of 2007, LVL 15.9 billion at the end of 2006). The share of foreign capital in the sector in the end of 2008, was 77.3% from the total equity capital paid up by banks. Almost all banks are privately owned. Only the *Mortgage Bank of Latvia* is fully owned by the state.

The global financial market turmoil has also affected the Latvian banking system. In order to help the second largest, in terms of the assets, bank to avoid problems created by the global financial crisis, in November 2008, the state, with the mediation of the *Mortgage Bank of Latvia (MBL)*, took over the controlling share of JSC "Parex banka". In February 2009, the government handed over *Parex banka* shares owned by MBL to the professional capital shareholder – *Privatisation Agency*. One of the main tasks of the *Privatisation Agency* as the state representative is to look for strategic investors for *Parex banka*. Partially this goal was reached on April 16, 2009, when an agreement was signed with the *European Bank for Reconstruction and Development* regarding the purchase of *Parex banka* shares (25% + 1 share).

The *Economic Stabilisation and Growth Revival Programme of Latvia*, which was renewed in June 2009 envisages implementation of several measures to stabilise the financial sector. The Programme specifies that:

- the state retains guarantees for all deposits in Latvian banks to EUR 50 000;
- the state will provide guarantees to the syndicated bank loans to be repaid in 2009 by adopting a separate decision in each case;
- in the field of credit risk management, the FCMC will continue improving the credit risk regulation (especially emphasizing the responsibility of the bank leading management) and will strengthen the supervision of this regulation;
- FCMC will work to strengthen the supervision framework for liquidity risk management, to introduce the respective guidelines of the Basel Committee and the Committee of European Banking Supervisors (CEBS), to strengthen stress testing and emergency action planning, including periodical stress testing in accordance with the FCMC scenario;
- on the basis of results of the stress testing performed in the bank sector, the FCMC will

¹ 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.

² 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.

³ 226 applications from the EEA countries about willingness of banks of these countries to start providing financial services in Latvia without opening a branch were received by June 2009.

develop a strategic plan for emergency situation action;

- the FCMC will strengthen stress testing as a role of a supervision instrument.

Taking into account the situation in the international financial markets, which negatively influences the availability of resources and their price, the bank sector liquidity indicator tends to decrease. However, it still exceeds the norm, i.e. 30%. In the end of May 2009, it was 50.2% (in the end of 2008 – 52.8%, in the end of 2007 – 55.7%). Along with the increasing expenditures for establishing reserves, as well as the resources becoming more expensive and decreasing growth rates of crediting, the bank profitability also decreases. In 2008, the bank profits amounted to LVL 60 million, which is by 84% lower than in 2007. As of May 2009, the situation in the bank sector was the following – LVL 146 million losses. The bank losses are mainly due to the accumulated insecure loans.

The average capital adequacy ratio still significantly exceeds the minimum stipulated by the law – 8%. In the end of 2008, this ratio decreased. In the end of December, it was 11.8% (in the end of September – 12.3%). In the end of May 2009, it was 12.8%. Return on assets (ROA)¹ was 0.9% at the end of March 2009, while return on equity (ROE)² amounted to 11.2% (0.3% and 3.6% at the end of 2008, respectively).

In the mid-2009, 15 **insurance companies**, four of which provided life insurance and 11 provided non-life insurance, as well as 11 branches of foreign insurance companies operated in Latvia. In the Latvian financial and capital market, the share of insurance companies in the total assets is slightly below 2%.

The total amount of gross premiums signed in the insurance market reached LVL 337.3 million in 2008, which was by 10% more than in 2007, while the volume of paid gross rewards was LVL 183.1 million or by 40.3% more than in 2007. Whereas in the 1st quarter of 2009, the amount of gross premiums signed by the insurance companies was LVL 75.5 million which was by 18.2% less than in the same period of 2008, and the amount of paid gross rewards was LVL 45.1 million or by 0.6% less, respectively.

The accession to the EU has fostered competition in this sector. Since May 1, 2004, the non-bank financial institutions of the EU Member States no longer need to receive a licence or to open a branch in Latvia in order to offer their services. Foreign companies now are allowed to insure assets of their subsidiaries in Latvia not only with local insurers, thus reducing the growth of real estate insurance volumes in the Latvian market³.

The securities market plays an important role in attraction of investments. At present, the necessary legal base for development of securities market compliant with the requirements of EU directives has been created in Latvia, and necessary institutions required for functioning of this base have been set up. However, the stock market in Latvia is poorly developed, thus its influence on the economic development of the country is insignificant.

The Riga Stock Exchange (RSE) is the only licensed stock exchange in Latvia offering trade with publicly circulated securities, quotation of securities and information services. In February 2008, the US biggest securities exchange *NASDAQ Stock Market, Inc.* completed an acquisition and merger transaction with the former owner of the RSE *OMX AB*, thereby establishing the biggest stock exchange company of the world *NASDAQ OMX Group, Inc.*

The situation in the global financial markets substantially affects the Latvian securities market. At the end of 2008, market capitalisation of Latvian companies at the RSE was LVL 820 million (LVL 1475 million at the end of 2007). At the end of 2008, the RSE index *OMX Riga* (January 1, 2000 = 100) had decreased to 271 points (it was 595 points at the end of 2007). In the first months of 2009, *OMX Riga* index continued to fall reaching the bottom on March 9 – 203 points; at the end of May *OMX Riga* index was 224 points.

As of July 1, 2001, the supervision of the financial sector is being implemented by the **Financial and Capital Market Commission**. The FCMC took over the functions that had been previously performed by the Credit Institutions Supervision Board of the Bank of Latvia, Securities Market Commission and the State Insurance Supervision Inspection. The FCMC was established to promote protection of interests of investors, depositors and insured persons, as well as foster development and stability of the financial and capital market.

4.4.3. Deposits and Loans

In the second half of 2007, a decrease in the growth rate of monetary indicators started, which continued also within the first five months of 2009. It was mainly determined by the situation in the global financial markets, as well as in the economy of Latvia in general.

During 2008, the **share of deposits** of companies and individuals withdrawn by residents decreased by 3.9%. This trend continued in 2009, and at the end of May the total deposits of companies and individuals were LVL 5051.9 million, which was by 4.6% less than a year ago.

In the 1st quarter of 2009, the total amount of deposits decreased by LVL 103 million or by 1.1%, whereas the total amount of resident deposits increased by LVL 135 million or by 2.3%, which is

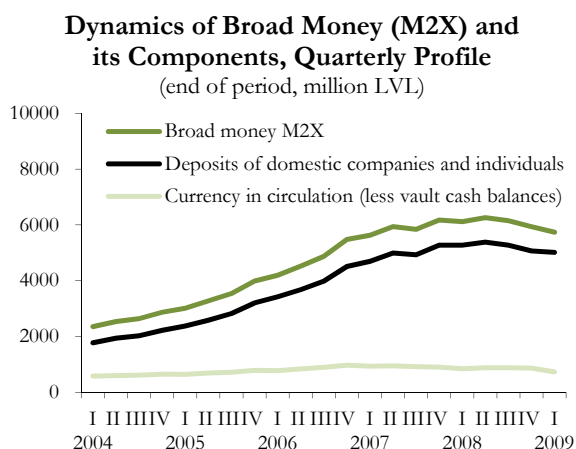
¹ ROA – ratio of profit/losses to assets.

² ROE – ratio of profit/losses to capital and reserves.

³ 3572 applications by insurance supervision bodies of the EEA countries on the intention of insurers licensed in these countries to use the principle of service provision freedom in Latvia were received as of June 2009.

mainly related to the additional funds deposit of the Treasury at JSC "Parex banka". The amount of non-resident deposits decreased by 6.3% in comparison with December 2008.

Figure 4.30



At the beginning of 2009, the changes in deposit term structure continued. In January–May demand deposit surplus decreased by 7.2%, whereas term deposits grew by 5.5% in the first five months of the year as compared to December 2008, and their share in the total deposits reached 42.4% at the end of May.

The share of the resident deposits in the total deposits at the end of March 2009 reached 63.2%, which is by 2 percentage points more than at the end of 2008. The biggest share of all resident deposits was formed by the deposits of households (45.9%) and the deposits of private non-financial companies (22.5%).

In the 1st quarter of 2009, the changes of the resident deposits currency structure continued. As compared with the end of 2008, the amount of deposit in lats decreased by LVL 233 million or by 7.9%, whereas the amount of deposit in euro increased by LVL 370 million or by 13.7%. At the end of March, from the total amount of non-resident deposits, 44.4% were deposits in lats and 50.2% were deposits in euro.

Table 4.7

Monetary Indicators of the Banking System of Latvia
(end of period)

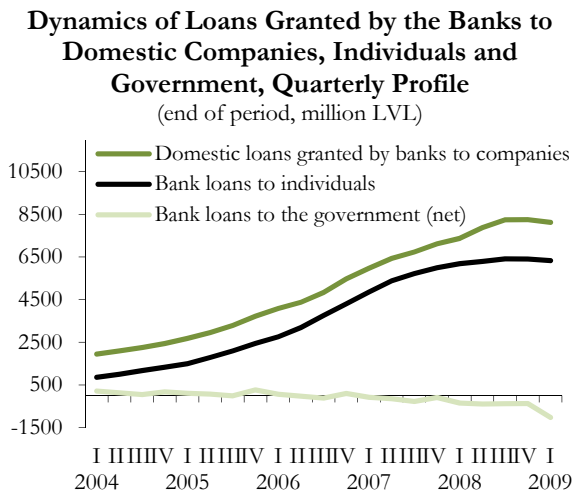
| | 2006 | 2007 | 2008 | 2009 V |
|---|---|-------------|------------|---------------|
| | <i>(million LVL)</i> | | | |
| Net foreign assets | -2634.7 | -4482.8 | -5914.6 | -4976.7 |
| Net domestic assets | 8114.6 | 10654.0 | 11846.1 | 10747.3 |
| Domestic loans | 9877.4 | 13018.2 | 14279.7 | 13576.4 |
| to government (net) | 100.5 | -87.4 | -370.0 | -718.9 |
| to companies and individuals | 9776.9 | 13105.6 | 14649.7 | 14295.3 |
| Other assets (net) | -1762.8 | -2364.2 | -2433.6 | -2829.1 |
| Broad money M2X | 5479.9 | 6171.3 | 5931.4 | 5770.6 |
| Currency in circulation (less vault cash balance) | 969.3 | 900.0 | 866.1 | 718.7 |
| Deposits of individuals and companies, including: | 4510.6 | 5271.3 | 5065.3 | 5051.9 |
| demand deposits | 2974.5 | 2864.9 | 2308.0 | 2142.8 |
| time deposits | 1536.1 | 2406.4 | 2757.3 | 2909.1 |
| | <i>(changes over the respective period of the previous year, %)</i> | | | |
| Domestic loans, including: | 53.3 | 31.8 | 9.7 | 0.6 |
| to companies and individuals | 58.3 | 34.0 | 11.8 | 2.3 |
| Broad money M2X | 37.5 | 12.6 | -3.9 | -6.3 |
| Currency in circulation (less vault cash balance) | 23.3 | -7.1 | -3.8 | -17.0 |
| Deposits of individuals and companies | 41.0 | 16.9 | -3.9 | -4.6 |
| GDP (in current prices) | 23.3 | 32.3 | 9.9 | -12.2* |

* in the 1st quarter of 2008

During the years of the rapid growth (2004–2007), the volume of **loans** granted to companies and individuals increased by 50–60% on average annually. It was facilitated by the foreign capital inflow, increased economic activities, as well as by easy access

to loans. As from the end of 2007, a decrease in the crediting growth rates was observed, which was related to more cautious crediting policy of the biggest Latvian commercial banks affected by deterioration of the situation in the global financial markets.

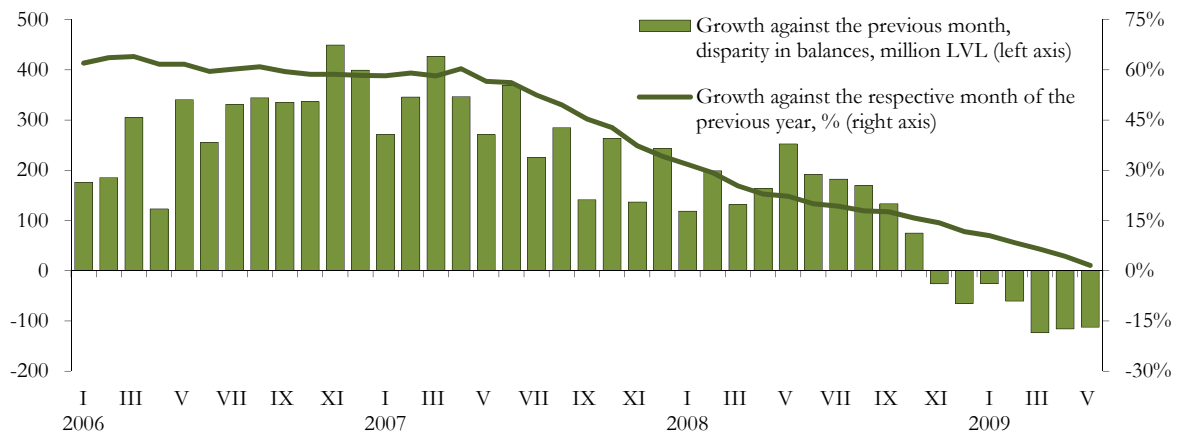
Figure 4.31



The growth rates of loans granted at the end of 2008 in comparison with the respective month of the previous year decreased significantly. The growth rates of loans granted in January 2008 increased by 31.8% and in December by 11.7% in comparison with the respective month of the previous year, whereas the growth rates of loans granted in May 2009 only by 1.6% exceeded the level of the previous year. Besides, since November 2008, the loan surplus margin in comparison with the previous month is decreasing.

Figure 4.32

Loans Granted to Resident Financial Institutions, Non-Financial Companies and Households (total)



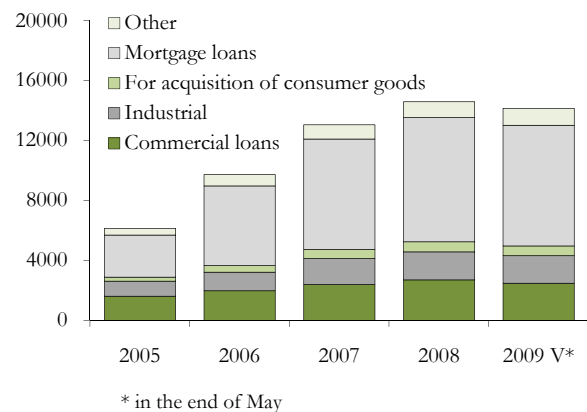
The mortgage loans still have the highest share in the structure of loans granted to domestic companies and individuals, the share of these loans in the bank credit portfolio had increased from 22% in the end of 2002 to 56.8% in December 2008, and, despite the decrease of loan surplus, this share has remained unchanged also in May 2009 (56.9%). At the same time, the share of such essential loans to increase business assets of companies as commercial loans had decreased by LVL 231.5 million in May 2009, when compared with December 2008, thus their share in the total sum of bank loan portfolio has decreased by 17.5% (for the purposes of comparison – in the end of 2008 it was 18.6%). The share of industrial loans (for acquisition of fixed assets and financing of long-term investment projects), as of the end of May, has remained in the amount of 13%.

LVL 78.8 million less than in April. The main factors hindering the mortgage loans are the crediting policy of the commercial banks and the decrease of household income.

The amount of the granted mortgage loans grew very rapidly in the preceding years (by 39% in 2007 and by 13% in 2008). At the end of May 2009, the mortgage crediting stopped (there was a 0.9% increase of the loan surplus, when compared with May 2008). Besides, the mortgage loan surplus in May 2009 is by

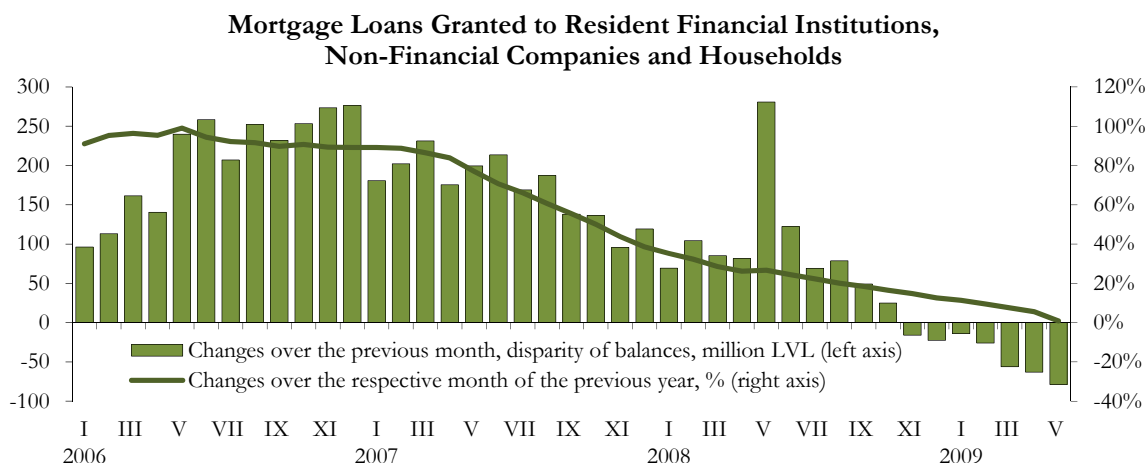
Figure 4.33

Volume and Structure of Loans Granted to Domestic Companies and Individuals
(end of period, million LVL)



* in the end of May

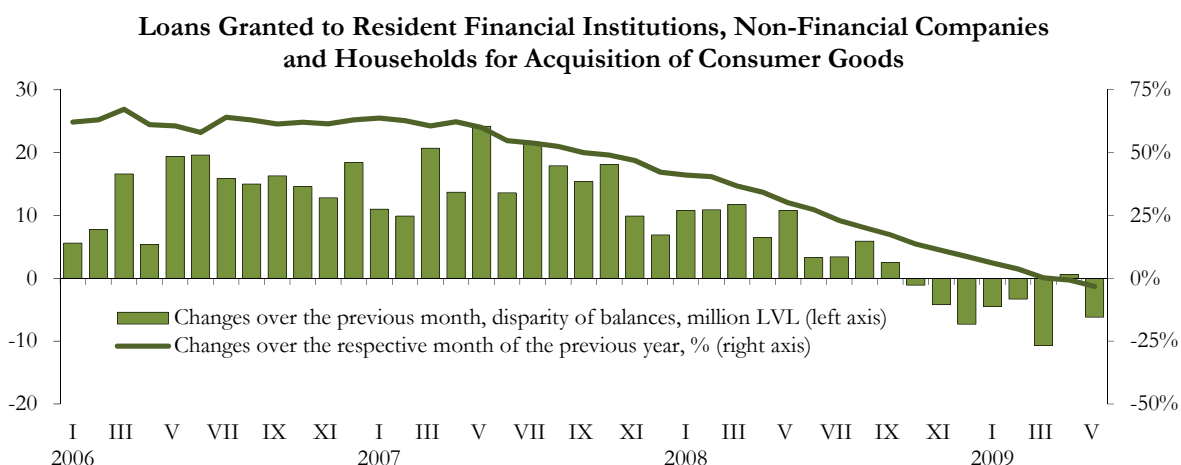
Figure 4.34



Since the mid-2007, a decrease of the growth rate was observed also with respect to the loans for purchase of consumer goods. In May 2007, they still increased by 60% in comparison with the respective month of the previous year, however, in December 2008, only by 8.6%, while in May 2009, a loan surplus

decrease of 3.2% was observed, when compared with May 2008. The loan surpluses have been decreasing every month since October 2008. At the end of May 2009, the share of consumer loans was 4.6% from all loans granted.

Figure 4.35



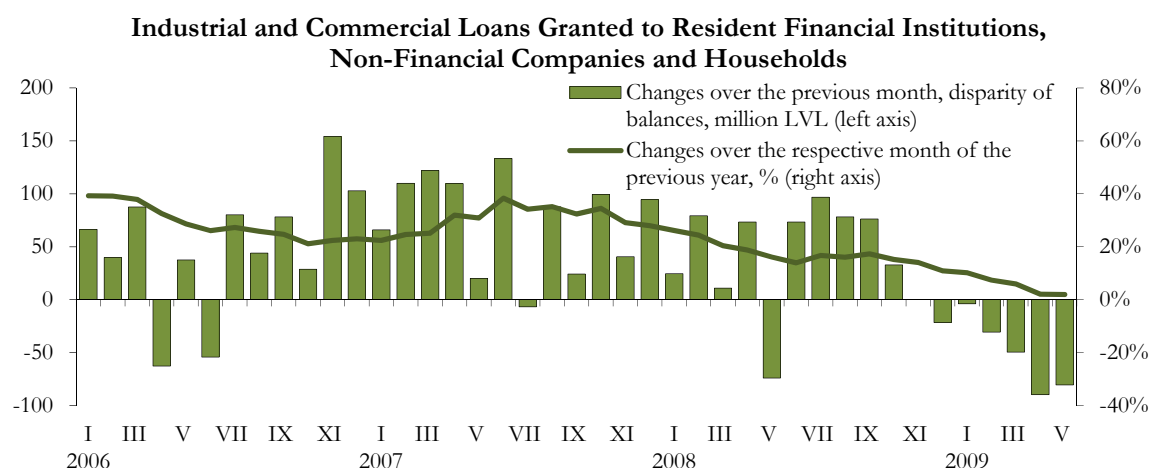
Industrial and commercial loans granted to the resident financial institutions, non-financial companies and households in total, at the end of May 2009 formed 30.6% from the total amount of loans, and surpluses of these loans, when compared with May 2008, increased by 1.9% mainly on the account of industrial loans.

In the total loan term structure before the end of 2008, the number of medium-term loans decreased and accordingly the number of short-term and long-term loans increased. In the first five months of 2009, a decrease of long-term loan surplus has been observed (by LVL 272.2 million when compared with the end of December 2008). As a result, the share of long-term loans in the sum of loan portfolio at the end of May was 60.9% (at the end of December 2008 – 61%). Whereas, the surplus of short-term loans

in the same period decreased less rapidly (by LVL 58.6 million), and their share in the total loan amount at the end of May 2009 was 12.2%.

In the 1st quarter of 2009, due to the rapid increase of unemployment and decrease of the income level of individuals, the paying capacity of borrowers reduced. The share of loans with overdue payments (principal amount, interest) in the sum of loans increased from 15% in the end of 2008 to 20.5% at the end of the 1st quarter of 2009. At the end of March, the share of loans with overdue payments exceeding 90 days in the loan portfolio reached 7.1% (at the end of 2008 – 3.6%). With the decrease of loan portfolio quality, during the 1st quarter of 2009, the volume of bank accruals for insecure debts increased by LVL 190 million and reached LVL 558 million at the end of March.

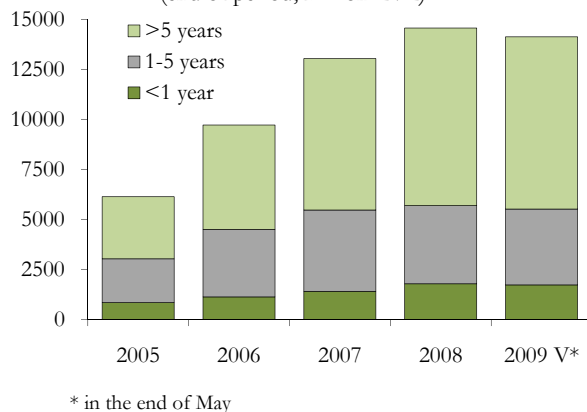
Figure 4.36



The majority of loans with overdue payments exceeding 90 days, at the end of the 1st quarter of 2009, were loans granted to resident households. Their share in the total loans of the bank sector with payment delays exceeding 90 days at the end of March was 45.7%. It must be noted that significant payment delays are observed in such sectors as operations with real estate and construction.

Figure 4.37

**Term Structure of Loans Granted to Domestic
Companies and Individuals**
(end of period, million LVL)



In total, at the end of 2008, the financial institutions and non-financial companies had granted loans in the amount of LVL 8 177.3 million. The largest loan surpluses were for operations with real estate – LVL 2486.9 million forming 30.2% from the total loans granted in this sector of the economy; then followed by manufacturing, financial services and trade sectors, where the share of each sector in the total loan surplus is between 12 and 14%. 11% of all loans granted to the sectors are loans in lats.

The average weighted interest rate of the short-term loans granted to companies and individuals in lats

in the 1st quarter of 2008 was 11.5%, but the long-term loans amounted to 17.2%, where the interest rates of the loans granted in euro were lower – respectively 6.7% and 6.5%. During the year, the interest rates of loans granted in lats have rapidly grown. The interest rate of the short-term loans in the 1st quarter of 2009 was 17.3%, of long-term loans – 17.8%. The growth of the interest rate of the loans granted in euro has been more moderate, and a decrease of interest rates of short-term loans was observed in the last quarter. As a result, in the 1st quarter of 2009, the interest rate of short-term loans in euro was 6.2%, whereas for long-term loans – 7.1%.

Figure 4.38

**Balance of the Long-Term Loans Granted to
Companies in the National Economy**
(at the end of the 4th quarter of 2008, %)

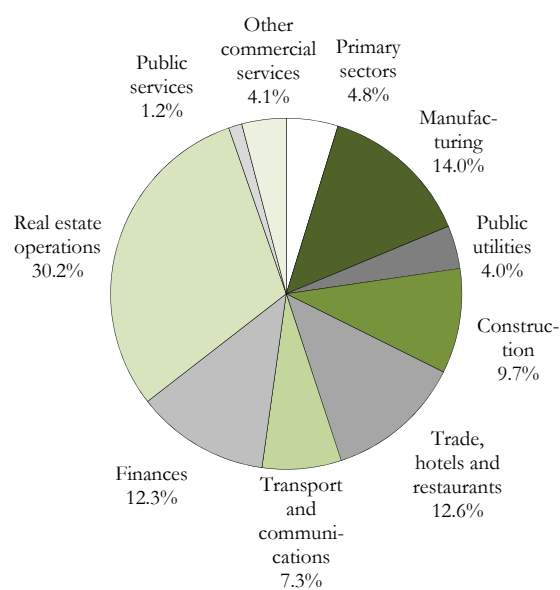
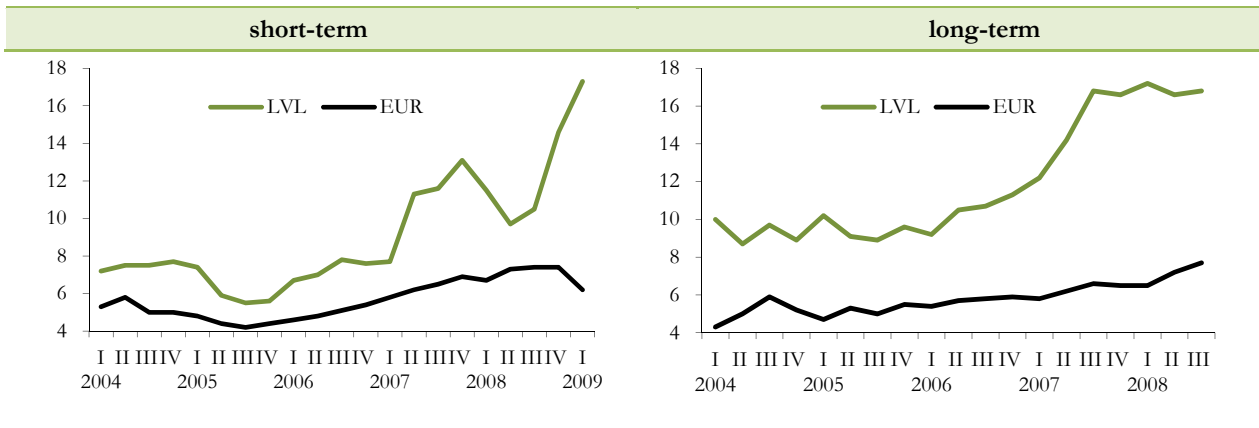


Figure 4.39

Average Weighted Interest Rates on Loans Granted in Credit Institutions, Quarterly Profile
(percentage)

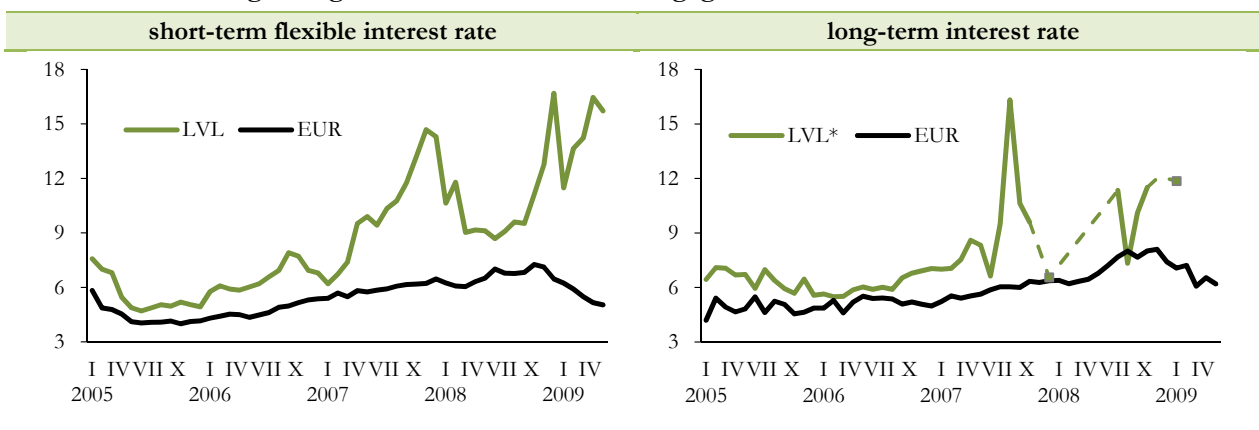


During the year, the average weighted interest rates of long-term deposits in lats in credit institutions have grown from 10.1% in the 1st quarter of 2008 to 10.3% in the 1st quarter of 2009. However, in the same period, the interest rates of short-term loans have decreased from 6.6% to 6.3%, respectively.

Similar trends can be observed with respect to the average weighted annual interest rates for deposits in euro. Short-term rate decreased and in the 1st quarter of 2009 it was 2.8%, while the long-term average weighted annual interest rate increased by 5.4%.

Figure 4.40

Average Weighted Interest Rates on Mortgage Loans Granted to Households



* there is no data for November 2007, January–June and November–December 2008, as well as for February–May 2009

Since 2006, the interest rates for loans granted to households in lats have rapidly grown, which was related to significantly increased demand. Along with the diminishing intensity of activities in the housing market, the rates for loans in euro in the end of 2008 and the first five months of 2009 decreased in relation with reduction of euro base interest rates.

Short-term flexible interest rate for loans in euro reached its highest point in October 2008 (7.3%), while in May 2009 it was already 5%.

Similar trends can be observed with respect to the average weighted interest rates for loans granted for the purchase of housing to households that reached its highest level at the end of 2008 (November – 8.1%), while in May 2009 the rate had fallen to 6.2%.

The interest rate fluctuations of loans granted in lats are related to the activities of commercial banks in the interbank market.

5. LABOUR MARKET

5.1. Employment and Unemployment

The decrease of economic activities, which started at the end of 2007, had been still weakly reflected in the employment indicators of the first half of 2008, because the changes in the employment rate always lag slightly behind the changes in the economic activities.

During the first two quarters of 2008, employment did not decrease and its rate even slightly exceeded the indicators of the respective period of the previous year. Actually, employment started to decrease only in the 4th quarter of the year.

In 2008, the number of the employed persons was 1124.1 thousand which is by 5.1 thousand persons or 0.5% more than in 2007. The employment rate reached 68.6% in 2008, which exceeded the EU-27 average indicator by 2.7 percentage points.

However, it should be noted that changes have been observed in the unemployment rate, which has increased from 6% in 2007 to 7.5% in 2008. The most

significant increase of job seekers was in the last quarter of 2008, when their number reached 118.7 thousand, which is the highest since 2005. Also the number of the unemployed in 2008 exceeded the level of 2007 by 27.2% reaching 91.6 thousand people.

In 2008, there was a high level of economic activity among the citizens (74.5%), which exceeded the indicator of the previous year by 1.6 percentage points (the unemployment rate increased already in the beginning of the year, while the number of the employed did not decrease). It is partly due to the increased motivation to be employed (increase in wages along with inflation), as well as due to the decreased labour demand in Ireland and the United Kingdom.

It can be also expected that in 2009 the employment rate will continue to decrease since the economic recession continues.

Table 5.1

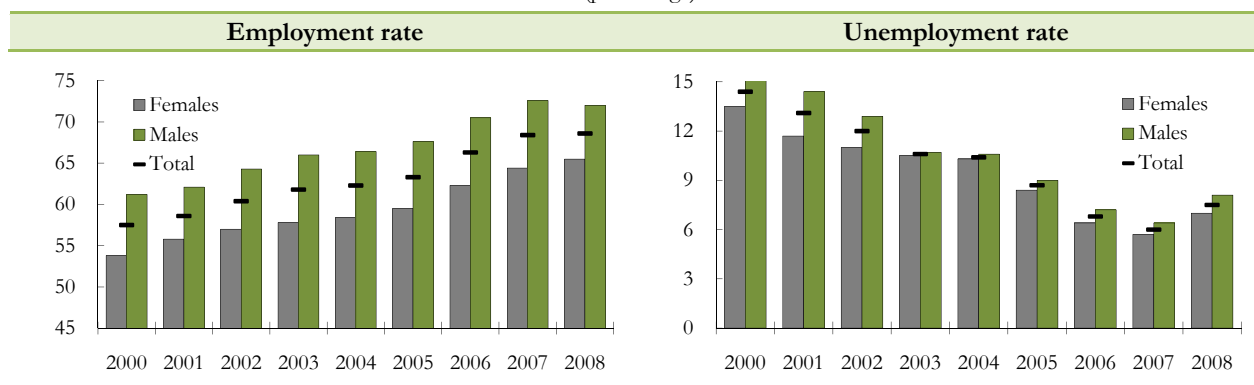
Key Indicators of Employment and Unemployment*

| Indicators | 2000 | 2005 | 2007 | 2008 |
|--|--------|--------|--------|--------|
| Population in the age of 15–64 years (thousand) | 1600.3 | 1583.8 | 1573.4 | 1567.8 |
| Economically active persons in the age of 15–64 years (thousand) | 1074.7 | 1100.8 | 1146.6 | 1167.5 |
| Employed persons (thousand) | 917.6 | 1003.6 | 1075.5 | 1076.2 |
| Participation rate (%) | 67.2 | 69.5 | 72.9 | 74.5 |
| Employment rate (%) | 57.3 | 63.4 | 68.4 | 68.6 |
| Unemployed (job seekers) (thousand) | 158.3 | 99.1 | 72.1 | 91.6 |
| Unemployment rate (%) | 14.4 | 8.7 | 6.0 | 7.5 |
| Registered unemployed persons (end of period, thousand) | 93.3 | 78.5 | 52.3 | 76.4 |
| Registered unemployment (end of period, %)** | 7.8 | 7.4 | 4.9 | 7.0 |

* In the table and further in the text, indicators of employment are given for persons in the age of 15–64 years and indicators of unemployment are given for persons in the age of 15–74 years.

**Share of registered unemployed persons in the economically active population from 2002 according to the new methodology.

Figure 5.1

Employment and Unemployment in Latvia
(percentage)

Upon comparing the employment rate by gender, it may be concluded that female employment in Latvia is higher than the EU average and this difference tends to grow, as the female employment rate exceeded the EU-27 average by 3 percentage points in 2004, in 2007 – by 6.1 percentage points, but in 2008 – by 6.3 percentage points. The male employment rate in 2008 was 72.1%, which was by 0.4 percentage points lower than in 2007, and in 2008 it lagged behind the average EU level by 0.7 percentage points (in 2007 it reached the average EU level).

In 2008, the number of vacancies decreased rapidly (see Figure 5.2). The number of vacancies started to decrease in the second half of 2007. It means that already since the mid-2007 the majority of Latvian

enterprises have not foreseen the increase of production volumes.

Figure 5.2

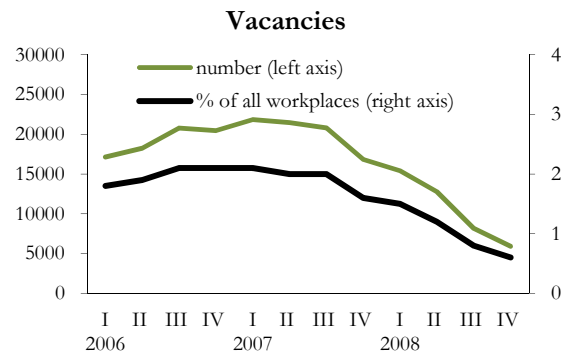
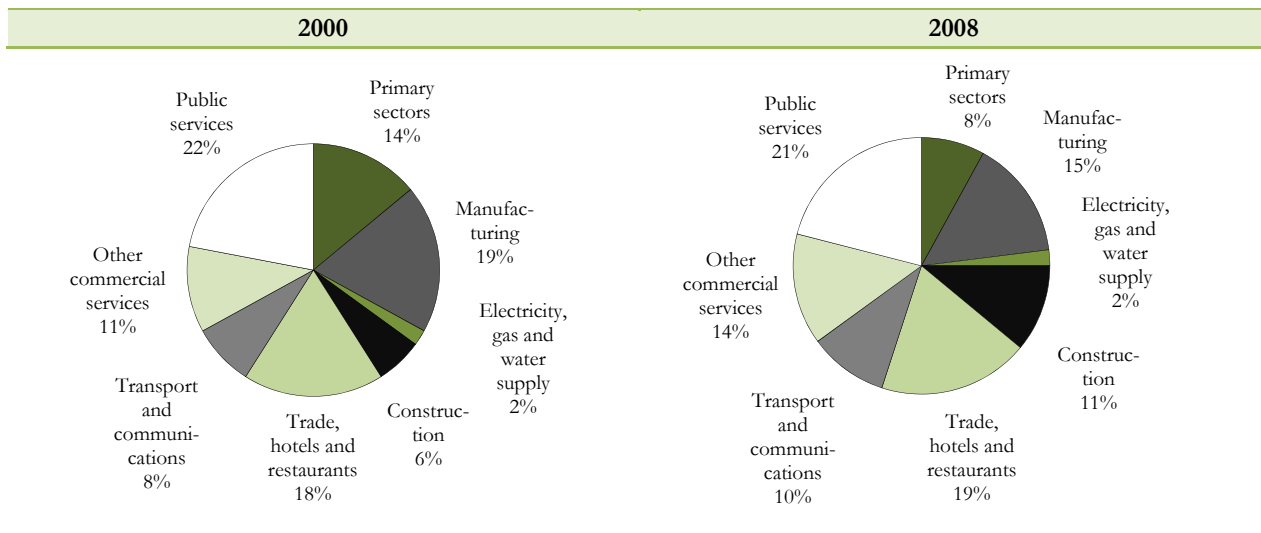


Figure 5.3

Structure of Employed Persons by Sectors (%)



Source: Eurostat

The structure of the employed persons has changed slightly since 2000 (see Figure 5.3). The share of the employed in the construction sector has grown more rapidly, while it has decreased in the primary sectors.

In 2008, a more rapid growth of the share of the employed persons was observed in the public services sector – by 2 percentage points as well as minor growth in transport and communications sector. The decrease can be observed in the primary sectors, mainly in agriculture.

As mentioned above, the number of the employed persons in 2008 increased in comparison with 2007. The labour demand decreased only in the end of 2008.

Except for primary sectors, where the number of employed has decreased by 25 thousand persons (mainly in agriculture) and the construction sector (the number of employed has decreased by 0.1 thousand persons), in the other sectors in 2008, in comparison with 2007, the number of employed has grown.

The largest increase in the number of employed has been observed in the public services sector, where the number of employed has increased by 15.9 thousand in comparison with 2007, reaching 231.7 thousand people, which is slightly more than 1/5 from the total number of the employed persons in the economy. The number of employed grew by 6.2 thousand in manufacturing.

5.2. Employment Policy

The employment policy of Latvia is closely related to the EU employment policy. The Member States and the Community use a coordinated approach to deal with employment issues. The employment policy of

Latvia is being implemented in the framework of the EU employment strategy. The directions of activities of the Member States and the measures for the implementation of the EU employment strategy are

reflected in the national Lisbon programmes (see Chapter 6.1).

In spring 2008, the European Council approved the *Integrated Guidelines for Growth and Jobs for 2008–2010* launching the new Lisbon strategy cycle. In the framework of the employment policy coordination mechanism, the assessment of employment policies is carried out and the European Council forwards recommendations to the Member States. Latvia is recommended, within an integrated flexicurity approach, to intensify efforts to increase labour supply and productivity by: reinforcing activation measures; and by enhancing the responsiveness of education and training systems to labour market needs, including the implementation of a coherent lifelong learning strategy. Thus, the role of training and retraining is emphasized for the development of the labour market.

In the framework of the new Lisbon Strategy cycle, new tasks and measures are set for 2008–2010 in order to implement the Integrated Guidelines and country-specific recommendations. The priorities of the employment policy of Latvia for 2008–2010 are as follows:

- promotion of inclusive labour market;
- promotion of establishment of social dialogue and flexicurity principles, as well as safe work environment harmless for health;
- encouraging regional mobility of labour and economic activities in the least developed regions;
- reduction of undeclared employment.

The economic recession in 2008 was poorly reflected in the employment indicators – the average annual employment indicator was higher than in the previous year. More significant changes have been observed since the last quarter of 2008, when the situation deteriorated substantially in the end of the year. The increase in the number of the unemployed persons led to the rise of the unemployment level from 6% in 2007 to 7.5% in 2008. These trends are intensified by the crisis in 2009 – employment continues to fall and unemployment continues to rise. The crisis also increases the unemployment-related social risks of the unemployed.

Therefore, already at present, new turning points must be faced when the indicators are deteriorating in the labour market. To reduce the negative impact of the growing unemployment, an inclusive labour market policy should be implemented, promoting employment and facilitating access and return to the labour market.

The State Employment Agency (SEA) is the authority, which implements the state policy with regard to the reduction of unemployment and providing support to job seekers. The SEA influences the labour market with **the active labour market policy measures**. Their improvement is carried out in a close cooperation with the local governments and social partners, in order to ensure that these measures

would better respond to the needs of the labour market.

In order to decrease the unemployment, the SEA implements the following employment measures:

- professional training, re-training and improving professional skills;
- paid temporary work;
- measures to improve competitiveness;
- measures for certain groups of persons.

In addition to these active measures, other measures are implemented, such as measures for starting a commercial activity or self-employment, trial work at a work place, training at the employer, as well as complex support measures.

In general, 84.8 thousand unemployed persons were involved in the active employment measures (one unemployed person can participate in several activities) in 2008. The majority of these people (70.8 thousand unemployed persons) were involved in the measures aimed at improvement of competitiveness. The rest of the measures were implemented in the following way: 2.1 thousand unemployed persons were involved in the professional training, re-training and raising skills of the unemployed, 10 thousand in temporary paid employment and 1.1 thousand unemployed persons involved in the measures for certain groups of persons.

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

Career consultation services have been provided to 67.9 thousand persons, 39.1 thousand of whom were unemployed persons and job-seekers.

In the framework of the measures for certain 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 the workplaces established for a specific period. The target group of this measure comprises the unemployed disabled persons and the unemployed persons in unfavourable conditions.

In 2008, the active employment measure “measures for starting commercial activity or self-employment” was launched. With this measure the unemployed persons are motivated to start commercial activity or self-employment. The unemployed persons participating in the measure prepare business plans, and if accepted, the necessary aid in a form of subsidy is granted for the first year of the activity, as well as assessment of the business plan’s implementation during the first 2 years is provided. During the year, 93 unemployed persons were involved in Latgale and Riga region, and 20 business plans were accepted, which are now being implemented.

Attention is paid to the promotion of **youth employment**. The project “Employment Measure during Summer Holidays for Persons Acquiring Education in General, Special or Vocational Education Institutions” has been implemented for several years.

The aim of this measure is to promote summer employment of pupils and create opportunity for them to acquire work experience. In the project, the SEA finances pupils' wages from the state budget resources in the amount of 50% of the minimum monthly wage determined in the country and covers expenses for the manager of the work practice. Expenses of employers were constituted by 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, the SEA will not implement this measure.

In order to provide an opportunity for young people of Latvian origin living abroad to acquaint themselves with the working and living 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 will not be implemented.

Although the **female employment rate** is comparatively high in Latvia, the female and male employment rate 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 the child care leave, women face several problems concerning integration in the labour market. The measure "Raising Motivation and Professional Training of the Unemployed Persons after Child Care Leave" is implemented in order to involve this target group in employment. In 2008, 161 unemployed persons participated in this measure, mainly young mothers.

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 the 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 second half of 2008, and by the end of the year, 18 employed persons by enterprises were involved.

Due to the increasing economic globalisation, rapid development of technology and negative demographic processes, higher attention in the European employment strategy is paid to the issues of **labour market flexibility and employment security or flexicurity**.

Flexicurity comprises 4 fields of activities, which must promote labour market flexibility and employment security by mutual interaction. 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 the case of necessity of the active labour market policies, the transfer from one workplace to another or from the status of an unemployed person to employment must be efficiently

facilitated. The lifelong learning systems should be improved enabling an employee to be employed during the entire period of a person's working age. At the same time, a modern social security system must be established, providing adequate assistance to residents in the case of unemployment, as well as facilitating mobility and faster return to the labour market.

It is important to ensure conditions for safe work environment, friendly for health, by **providing safety at work**. An important measure in the field of labour security is "Labour Security Development Guidelines for 2008-2013" approved in April 2008. The goal of the guidelines envisages improvement of the working conditions in enterprises and reduce the number of fatalities at work by 30% (per 100 000 residents).

For the implementation of the guidelines, in November 2008, "Programme on the Development of Labour Security for 2008-2010" was approved. The goal of the programme is to ensure gradual reduction of the number of fatalities at work, promoting a safe working environment in the enterprises that does not affect health in a negative way. By 2010, reduction of the number of fatalities at work by 10% must be achieved.

Latvia has a relatively high **level of undeclared employment**, particularly in sectors having negative influence on employees and creating conditions of unfair competition. To solve this problem more intensively and to encourage the population to be involved in the formal economy, strengthening of the state audit institutions and activation of cooperation with social partners – trade unions and employers' associations, is taking place.

In the framework of implementation of the illegal employment reduction measures, the administrative capacity of the State Labour Inspectorate is strengthened, co-operation between supervisory institutions is improved, and the measures for informing the society and promoting legal culture are implemented.

An important component from the aspect of the employment policy is development of the **education system** by putting a special emphasis on **the importance of lifelong learning** in development of the labour market. The investments into the education system must provide substantial improvements in capacity of the education system to adapt to the changing requirements of the labour market, to improve availability of education on all levels, to increase participation and responsibility of regional governments and employers in providing availability of vocational education, as well as to create an efficient lifelong learning system.

The Lisbon Strategy envisages that at least 85% of young people in the age of 20-24 years should complete secondary education by 2010. The situation in Latvia in this field is better than the average situation in the EU. It is expected that the goal set for 2010 will be achieved.

A topical task is to reduce the number of student drop outs from education institutions, who do not continue their studies.

It is necessary to activate development of the lifelong learning system. In accordance with the goal of the EU, at least 12.5% of population in the age of 25–64 years must participate in the measures of lifelong learning by 2010. In Latvia in 2008, 6.8% of adult population were involved in lifelong learning, which is below the average EU indicator. In comparison with the previous year, this indicator decreased by 0.3 percentage points.

In order to ensure the implementation of the *Lifelong Learning Policy Guidelines for 2007–2013*, the Cabinet of Ministers approved on April 9, 2008 the *Programme for Implementation of the Lifelong Learning Policy Guidelines for 2007–2013 in 2008-2010*. The main target of the programme is the number of persons involved in the process of lifelong learning in 2010 amounting to 12.5% of the lifelong learning target group.

Changes in the labour market for a timely balancing of the labour demand and supply create the necessity to develop a **labour market forecasting system**. On the EU level, medium and long-term labour market forecasting has been raised as a priority issue.

As from July 1, 2007 the Cabinet of Ministers has assigned the Ministry of Economics as a responsible institution for co-ordination of medium and long-term labour market forecasting in the country. The Ministry of Economics has started work and has established an institutional framework for development of the labour market forecasts.

At the beginning of 2008, the Advisory Council of the Labour Market Forecasting, consisting of the representatives of the concerned institutions and social partners, established by the Ministry of Economics, started its work. The task of the Council is to ensure inter-institutional cooperation by assessing the prepared forecasts and searching solutions for further action. The Council has reviewed the initial medium-term labour market forecasts developed until 2013, as well as other documentation prepared for the implementation of the Top-Priority Work Plan of the Cabinet of Ministers and related to the labour market. The short-term labour market forecasts developed by the Ministry of Welfare were reviewed in the meetings, as well as the analysis on the issues of migration made by the Ministry of Interior in comparison with both Baltic States. In order to obtain complete data characterising the actual labour market situation, the Central Statistical Bureau made proposals for solution of the problems.

In June 2008, the Cabinet of Ministers reviewed the initial medium-term labour market forecasts until 2013 drafted by the Ministry of Economics.

Taking into account the global economic crisis and its impact on Latvia, in 2009, the Ministry of Economics has updated the forecasts.

The updated medium-term labour market forecasts have been developed for the period until 2015.

The key factors influencing the situation in the labour market within a medium-term period until 2015 are as follows:

- economic growth – impact of recession on labour demand and the slow changes in the post-crisis period;
- unfavourable demographic development;
- changes in the population participation level.

The forecasts are developed in the framework of 15 sectors of economy and 35 groups of aggregated professions. They are based on 3 economic development scenarios – basis scenario with the highest probability, as well as more rapid and slow growth scenarios. The obtained results reflect the situation, which may develop in the labour market, if no changes are provided to the structure of the education system.

The forecasts emphasize several aspects in the future labour market, which should be taken into account, when implementing corrections in the education, social and employment policies.

In 2009 and 2010, significant decrease of labour demand is expected, which will lead to a sharp increase of unemployment, and in 2009, the unemployment rate may reach 13–15%. Stabilisation of the labour market can be expected in 2012.

The increase of employment will start in 2013. However, it should be noted, that the future growth will mainly be based on increased productivity and less on increased employment, which will be determined by the high competition on the goods and services markets.

While the demand will in general decrease evenly in all groups of professions, supply will decrease unevenly leading to significant disproportions of the labour demand and supply in certain groups of professions. The share of highly qualified unemployed will increase.

It is possible that emigration of Latvia's population may increase not only to other EU Member States, but also to third countries, if their post-crisis recovery will start faster and at a more rapid pace.

The sharp slowdown of the economy may cause social problems in the next years, which may last for the next 3–4 years.

In order to prevent the potential labour market problems revealed by the forecasts, the main directions of activity must focus on the improvement of the labour supply:

- by improving the quality of the educational system, as well as by improving the competencies and skills of the persons trained;
- by ensuring close cooperation of education institutions and employers;
- by improving the attraction of secondary vocational education and by ensuring an optimal distribution of pupils among general secondary and secondary vocational education;
- By promoting the professional mobility of the employed, including the improvement of lifelong learning.

6. ECONOMIC POLICY AND PRIORITIES OF STRUCTURAL POLICY

6.1. National Lisbon Programme of Latvia

On October 19, 2005 the Cabinet of Ministers approved the *National Lisbon Programme of Latvia for 2005–2008* (hereinafter – Programme) aimed at promotion of growth and employment. The Programme is a policy-planning document that shows how Latvia will achieve the Lisbon Strategy goals in 2005–2008 on the basis of the *Integrated Guidelines* approved by the European Council in July 2005 (see Box 6.1).

The Programme is based on the policy-planning documents approved in Latvia and reflects the most essential problems of Latvia with regard to the achievement of the Lisbon Strategy goals, indicates main lines of action and measures to solve the problems, as well as performance indicators for achievement of the goals.

The Programme points out five main economic policy directions to reach the Lisbon Strategy goals in Latvia, namely:

- Securing macroeconomic stability;
- Stimulating knowledge and innovation;
- Developing a favourable and attractive environment for investment and work;
- Fostering employment;
- Improving education and skills.

For each of the mentioned economic policy directions, main tasks (priorities) are defined and specific measures with implementation terms are determined and, if the government has decided, also financing is set. The Programme takes into account the EU approach regarding the necessity to separate the economic growth from the resource use so that the economic and social progress is not achieved at the expense of excessive use of natural resources and deteriorated environmental quality.

Progress Reports on the Implementation of the National Lisbon Programme of Latvia for 2005–2008 were developed in 2006 and 2007, as well as approved by the Cabinet of Ministers respectively on October 10, 2006 and October 9, 2007. The abovementioned reports contained assessment of the progress in achieving the goals of the Lisbon Strategy.

On March 13–14, 2008, upon approving the *Integrated Guidelines for Growth and Jobs for 2008–2010* and country-specific recommendations, the European Council marked the beginning of a new Lisbon Strategy cycle for 2008–2010.

According to the call of the European Council of March 2008, Latvia prepared the *Progress Report on the*

Implementation of the National Lisbon Programme of Latvia (hereinafter – Progress Report), which was approved by the Cabinet of Ministers on October 14, 2008. The Progress Report contains the assessment of the measures implemented during the previous Lisbon Strategy cycle (2005–2008), as well as sets new tasks and measures for 2008–2010 on the basis of the updated *Integrated Guidelines* and country-specific recommendations by the Council. The Progress Report also contains a reflection of the measures for implementation of the four priority areas¹ approved by the Spring European Council in 2006.

The Progress Report is based on the policy planning documents adopted in Latvia and is in line with the three key priorities for development of the country during 2007–2013 period, identified by the government – an educated and creative person, technological excellence and flexibility of enterprises, development of science and research (*National Development Plan of Latvia for 2007–2013*).

The use of the European Union structural funds (see Chapter 6.2.1) promotes the achievement of the defined Lisbon Strategy goals in Latvia. Approximately 60% of financial resources from structural funds in the programming period of 2004–2006 were channelled for the implementation of the Lisbon Strategy priorities. Likewise, in the programming period of 2007–2013 for the structural funds and the Cohesion Fund, it is planned to channel approximately 56% of the total granted financing for implementation of the Lisbon Strategy priorities.

In order to ensure co-ordination and supervision of implementation of the Lisbon Strategy in Latvia, the government has developed a mechanism for monitoring of the Lisbon Strategy's implementation in Latvia, and has established:

- *Supervisory Board of the Lisbon Strategy* in order to ensure the fulfilment and supervision of tasks set in the Lisbon Strategy in Latvia. The Board is chaired by the Minister of Economics, who is approved by the Cabinet of Ministers as the national Lisbon Strategy co-ordinator. Ministers and representatives of the Saeima, municipal governments and social partners, who are involved in the Lisbon Strategy process, are

¹ The four priority areas of the Lisbon Strategy are the following: investments in human capital and innovations; unlocking the business potential, especially of SMEs; increasing employment and implementation of flexicurity principles; common EU energy and climate change policy.

included in the Board. Tasks of the Board are to co-ordinate the development of the *National Lisbon Programme of Latvia* and involve public institutions, the Saeima, municipal governments and social partners in the development of the Programme as well as supervise fulfilment of the Programme and inform the society about the fulfilment of its tasks. It should be noted that the Supervisory Board of the Lisbon Strategy was

- expanded in 2007, including a representative of the European Affairs Committee of the Saeima;
- *Advisory Working Group of the Lisbon Strategy* in order to ensure the development of the *National Lisbon Programme of Latvia* and its implementation on the inter-institutional level. The Working Group is chaired by the State Secretary of the Ministry of Economics. Senior officials of the ministries involved in the Lisbon Strategy process are included in the Working Group.

Box 6.1

Lisbon Strategy and its legal framework

The Lisbon Strategy was approved during the meeting of the Spring European Council on March 23–24, 2000 in Lisbon, where the leaders of the EU Member States came together. The strategic goal of the Lisbon Strategy was, *within the next ten years, to make the EU the most competitive knowledge-based economy in the world*, capable of sustainable economic growth with more and better jobs and greater social cohesion.

The legal framework for the implementation of the Lisbon Strategy is defined in the Articles 98, 99 and 128 of the Treaty Establishing the European Community (hereinafter – EC Treaty). According to the Article 98 of the EC Treaty, the EU Member States shall conduct their economic policies with a view to contributing to the achievement of the objectives, as defined in the Article 2, (e.g., promoting harmonious, balanced and sustainable development of economic activity, high level of employment and social security, and high degree of competitiveness, etc.) and in the context of the broad guidelines that the Council, acting on a recommendation from the European Commission, shall prepare in accordance with Article 99(2). It must be emphasised that the European Council shall discuss the broad guidelines, acting on the basis of the report from the Council. The European Council shall prepare conclusions on these guidelines, and on the basis of these conclusions, the Council shall adopt the broad guidelines and inform the European Parliament accordingly. In the framework of the Article 99 of the EC Treaty, the Council shall, on the basis of reports submitted by the European Commission, monitor economic development in each EU Member State, as well as the consistency of economic policies with the broad guidelines. For the purposes of this economic policy coordination and surveillance, the EU Member States shall forward information to the Commission about measures taken by them in the field of economic policy. It is also important to note that Article 99 of the EC Treaty prescribes that the Council may, acting upon a recommendation from the European Commission, give the necessary recommendations to the Member State concerning its economic policy.

Article 128 of the EC Treaty is related to the coordination of the EU Member States' employment policies, and this coordination in principle is similar to the coordination defined in the Articles 98 and 99. In accordance with the Article 128 of the EC Treaty, the European Council shall each year consider the employment situation in the Community on the basis of a joint annual report by the Council and the Commission. On the basis of the conclusions made by the European Council, the Council shall prepare annual guidelines which the Member States shall take into account in their employment policies. These guidelines shall be consistent with the broad guidelines adopted pursuant to Article 99(2). In accordance with Article 128 of the EC Treaty, each Member State shall provide the Council and the Commission with an annual report on the principal measures taken in order to implement its employment policy taking into account the employment policy guidelines. The Council, on the basis of the EU Member States' reports, shall perform an annual examination of implementation of the employment policies taking into account the employment policy guidelines. The Council, acting on a recommendation from the Commission, may make recommendations to the Member States regarding the employment policies implemented. The Council and the Commission shall prepare a joint annual report to the European Council on the employment situation in the Community and on the implementation of the employment policy guidelines.

The essence of the described legal framework is included in the Lisbon Strategy's implementation framework approved by the Spring European Council of March 23–24, 2000 in Lisbon, known as the *open method of coordination* (hereinafter – OMC). This method is considered to be an innovative supranational governance mechanism and it concerns the EU Member States' national policies (e.g., employment policy, social security and inclusion, education and training policy, etc.) which help to achieve common EU goals. The OMC consists of five stages:

1. The European Council approves the broad guidelines and goals;
2. The broad guidelines and goals are defined more clearly in the Council; the EU Member States agree on short-term, medium-term and long-term measures, as well as future actions;
3. Development of quantitative indicators to allow the assessment of whether the defined goals have been achieved;
4. EU Member States develop specific measures and implement reforms;
5. Each EU Member State annually submits a national progress report to the European Commission. The European Commission prepares annual progress report, which consists of the evaluation of the progress in the EU as a whole and each Member State, including the recommendations for the EU Member States.

Renewal of the Lisbon Strategy in 2005

During the Spring European Council of March 22–23, 2005 in Brussels, the Lisbon Strategy was renewed, due to the fact that, as recognised in the assessment of November 2004 on Lisbon Strategy implementation in the EU prepared by High Level Group under the leadership of Wim Kok, the Member States were lacking the political will to introduce the necessary structural reforms. Therefore the Member States were called to implement the strategy more actively. In the Wim Kok's report, it was recognised that the goals of the Lisbon Strategy were too general and the report emphasised that in the future it is necessary to concentrate on growth and employment. It was decided that each Member State must develop national reform programmes for 2005–2008 and submit them to the European Commission by October 15, 2005. In July 2005, the European Council approved the *Integrated Guidelines for Growth and Jobs* that combine the Broad Economic Policy Guidelines and the Employment Policy Guidelines, as well as constitute a base for development of national reform programmes. It was also decided that the EU Member States have to prepare and submit to the European Commission annual progress reports on the implementation of the national Lisbon programmes.

Meetings of the *Supervisory Board of the Lisbon Strategy* and of the *Advisory Working Group of the Lisbon Strategy* are held at least once per quarter.

The issues related to the Lisbon Strategy are discussed at the committees of the Saeima, the National Economy Council, the Advisory Council of the Small and Medium-Sized Enterprises and Crafts of Latvia, the Free Trade Union Confederation of Latvia, different seminars, conferences, etc.

Recommendations of the European Commission to Latvia

In accordance with the legal framework of the Lisbon Strategy described in the Box 6.1, the European Commission carries out an annual assessment regarding the implementation of the national Lisbon programmes of the EU Member States and develops its recommendations that are approved by the Spring European Council. Recommendations of the European Commission to Latvia (see Box 6.2) serve as an important contribution in defining the national economic policy priorities and formulating the necessary reforms.

It should be noted that the European Commission's assessment on the implementation of the national Lisbon programme of Latvia, as well as recommendations (see Box 6.2) were discussed at the meetings of the Supervisory Board of the Lisbon Strategy and at the meetings of the Advisory Working Group of the Lisbon

Strategy. Proposals for implementation of the European Commission's recommendations were discussed during these meetings. The European Commission's recommendations are included in the Letter of Intent concluded with the IMF and in the Memorandum of Understanding concluded with the European Commission. In accordance with the decision taken by the Supervisory Board of the Lisbon Strategy during its meeting on January 9, 2009, the Advisory Working Group of the Lisbon Strategy has developed proposals for the implementation of the European Commission's recommendations, which were included in the Action Plan for the Implementation of the Economic Stabilisation and Growth Revival Programme of Latvia (hereinafter – Action Plan) approved by the Cabinet of Ministers on February 3, 2009. Paragraph 33 of the Action Plan sets a task to strengthen the implementation of the National Lisbon Programme of Latvia and:

- to implement the R&D policy, as well as to promote innovations;
- to implement active labour market policy;
- to ensure the conformity of educational and training system to the labour market requirements by implementing the life-long learning policy;
- to strengthen the flexicurity approach.

Box 6.2

European Commission's assessment on the implementation of the national Lisbon programme of Latvia and recommendations

According to the European Commission's assessment presented on January 28, 2009 the immediate economic policy challenge for Latvia is to secure macro-financial stability as there is a risk of a pronounced and prolonged downturn. In the medium-term, productivity enhancing investment in R&D, innovation and education has to facilitate a shift from domestic-demand-driven sectors towards tradeables. Structural reforms are urgently needed to further labour market flexibility and support transition, primarily through more efficient activation and training. Public wage policy should give the right signal for wage moderation in the private sector, helping to contain inflation, and to maintain the cost-competitiveness of exports. A timely and determined implementation of the Structural Fund programmes will have a positive effect on strengthening the supply potential of the economy, support employment and safeguard access to finance for businesses. It is essential to maintain administrative capacity to implement the programmes. The implementation of the energy and climate change package, agreed by the European Council, will require close attention.

Taking into account the European Commission's assessment regarding the progress achieved, the **Council recommendations for Latvia** were adopted during the meeting of the European Council on March 19–20, 2009, which are as follows:

- To pursue a restrictive fiscal policy, within which expenditures are carefully prioritised and both tax and expenditure measures are focused on strengthening the supply potential of the economy; this should be facilitated by adopting a strong, medium-term fiscal framework with tight expenditure ceilings;
- In order to reduce inflation and improve competitiveness, Latvia should promote wage moderation in the public and private sector;
- Within an integrated flexicurity approach, Latvia should intensify efforts to increase labour supply and productivity by: reinforcing activation measures; and by enhancing the responsiveness of education and training systems to labour market needs, including the implementation of a coherent lifelong learning strategy;
- To integrate more closely R&D and innovation policies, especially through partnerships amongst key private and public actors, and through additional incentives for investment by the private sector.

Paragraph 33 of the Action Plan includes specific measures for each of the mentioned tasks.

At the moment, the Ministry of Economics in cooperation with other ministries involved in the Lisbon Strategy's implementation process has started the preparation of the Progress Report for 2009. In accordance with the roadmap developed during the previous years, it is planned to approve the Progress

Report at the Supervisory Board of the Lisbon Strategy in the end of September 2009, to submit it for approval to the Cabinet of Ministers in the beginning of October 2009 and to submit it to the European Commission by October 15, 2009.

Future of the Lisbon Strategy after 2010

Taking into account the fact that the Lisbon Strategy's implementation cycle is for the medium-term

(3 year cycle and 5 year mid-term assessment) with long-term vision (10 years), the current Lisbon Strategy cycle will end in 2010. According to the Spring European Council conclusions of March 13–14, 2008, the European Commission, the

Council and the national Lisbon Strategy coordinators of the EU Member States (in Latvia's case it is the Minister of Economics) were invited to launch a discussion regarding the future of the Lisbon Strategy after 2010 (see Box 6.3).

Box 6.3

Discussion regarding the future of the Lisbon Strategy after 2010

The meetings of the national Lisbon Strategy coordinators took place on May 26, 2008 in Brussels, on December 5, 2008 in Paris and on April 22, 2009 in Prague. During the discussions, the European Commission and the national Lisbon Strategy coordinators of the EU Member States spoke about the possible future challenges, which the EU will face after 2010, as well as discussed the improvement of the governance of the new strategy, closer involvement of social partners and communication with the society about the implementation of the new strategy.

In general, the EU Member States expressed positive support for the continued implementation of the Lisbon Strategy after 2010. The Member States are of the opinion that the governance mechanism of the Lisbon Strategy should be improved, it should become more efficient, the country-specifics of the EU Member States should be taken into account and the reporting burden of the EU Member States to the European Commission should be decreased. The EU Member States also understand that the involvement of the social partners in the implementation of the Lisbon Strategy plays a significant role. As the Lisbon Strategy is linked with the implementation of structural reforms, its successful implementation depends also on efficient communication with the society, the support of which is needed for the implementation of structural reforms. It is planned that such discussion will continue also in the second half of 2009 and in 2010.

In autumn 2009, the European Commission plans to publish an assessment on the implementation of the Lisbon Strategy in 2005–2010 and present its view regarding the future of the Lisbon Strategy after 2010.

The Swedish EU Presidency (June–December 2009) and Spanish EU Presidency (January–June 2010) will provide their contributions regarding the development of the Lisbon Strategy after 2010.

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

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

As an EU Member State, Latvia has access to financial support from the EU Structural Funds (hereinafter – SF), which is an instrument for implementation of the EU regional cohesion policy.

Planning period of 2004–2006

In the period of 2004–2006, the total accessible financing for Latvia in the framework of SF programmes was EUR 625 million.

In the first quarter of 2009, the payments to the funding beneficiaries have been finished. The SF repayments to the funding beneficiaries are LVL 463.2 million or 105.4% from the EU allocation. LVL 394.2 million or 89.7% from the EU allocation have been declared with the European Commission, and payments in the amount of LVL 328.7 million or 74.8% from the EU allocation have been received from the EC, which together with the received EC advance payments make 95% from the total EU allocation being the maximally available amount before the conclusion of the programme.

Figure 6.1 shows the progress of EU SF absorption as of March 31, 2009.

On February 18, 2009, EC adopted a decision on the extension of the deadline for eligibility of costs until June 30, 2009. This decision allows Latvia to minimise SF 100% absorption risks and better prepare

the conclusion documents. Accordingly, the Ministry of Finances has drafted amendments in the Cabinet of Ministers regulations¹ that were approved on March 31, 2009 and that allow the submission of the final cost declaration in the Treasury by July 10, 2009 and the submission of the conclusion documents to the EC by September 30, 2010. Currently, the conclusion procedure of the programme is taking place, including the preparation of the conclusion documents, verifications, revisions, solving of specific cost eligibility problematic issues.

In order to level out the differences between the EU Member States after accession to the EU, access to resources from the Cohesion Fund (hereinafter – CF) replaces the ISPA funds, which were available for Latvia before accession. Assistance from the Cohesion Fund is available for those EU Member States where GDP per capita is below 90% of the EU average. The main goals of the CF are to provide support to environmental protection measures and improvement of transport infrastructure.

Similarly as in the case of the SF, resources from the CF are only granted as co-financing for measures supported financially by the Member State. The EU

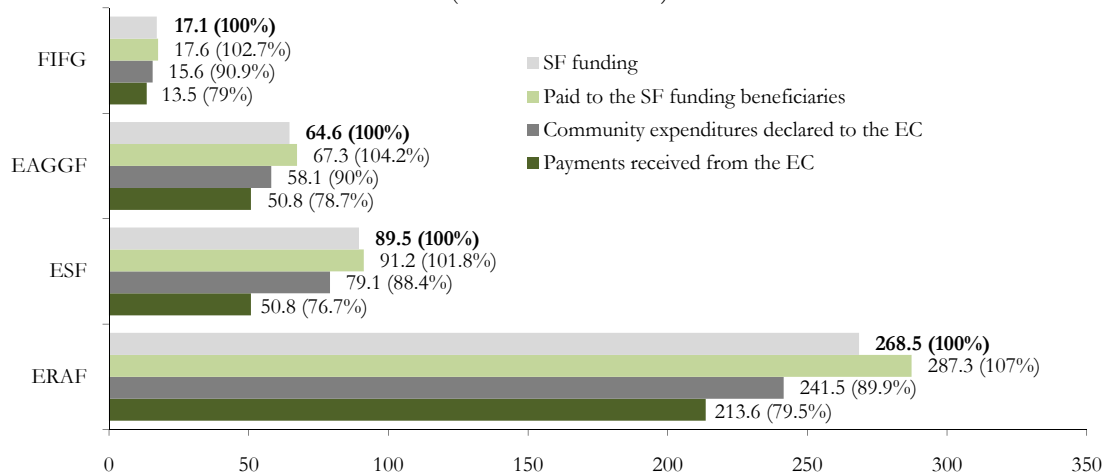
¹ Cabinet of Ministers Regulations No.494 of June 20, 2006 “Procedure of the Financial Management of European Union Structural Funds”, Cabinet of Ministers Regulations No.538 of June 27, 2006 “Procedure regarding the Financial Control and Audit Ensured by Institutions Involved in the Management of the European Union Structural Funds”.

co-financing from this fund was set at 80–85%. Furthermore, the contribution from the EU may even reach up to 90% of the total project costs if financing

is also received from the SF. The project costs have to reach at least LVL 7 million (EUR 10 million).

Figure 6.1

Absorption of the EU Structural Funds in the Planning Period of 2004–2006 (Full Financial Flow) as of March 31, 2009*
(million LVL and in %)



* In the calculations, the EUR exchange rate defined by the Bank of Latvia has been used (EUR 1 = LVL 0.702804)

Expenditures of the CF resources are regulated by the *Reference Framework Document*, coordinated with the EC in December 2003. Unlike the *Single Programming Document*, which sets only the priority support areas, particular projects are prescribed in the *Reference Framework Document*, to which financing will be allocated. The CF has a broader range of financing in comparison with the ISPA:

- transport sector – roads, railways, ports, airports, public transport;
- environmental sector – management of household waste (regional waste landfill sites), sewage treatment, drinking water supply.

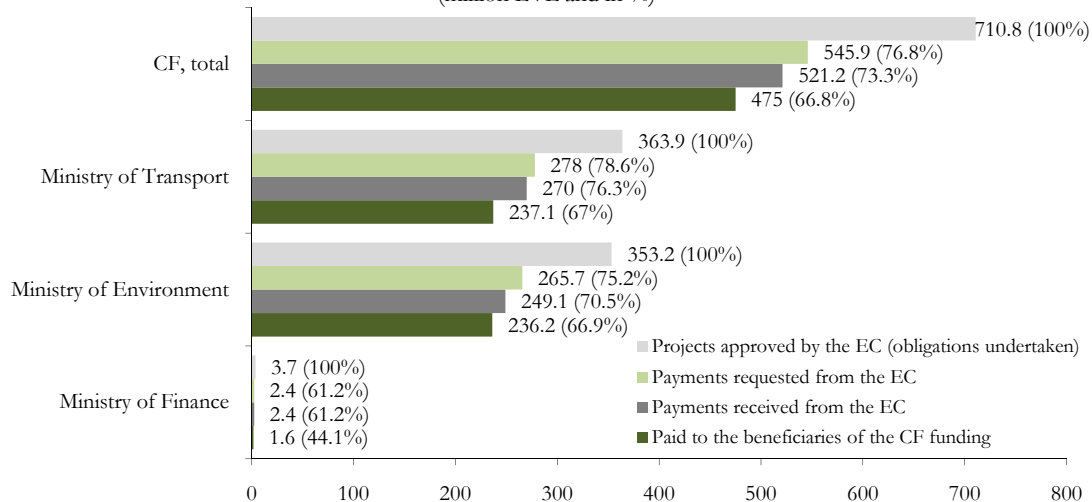
The total CF funding available to Latvia in the period of 2000–2006 is EUR 710 million.

By March 31, 2009, EUR 474.9 million or 66.8% from the CF funding have been paid to the beneficiaries. The EC has been declared EUR 545.9 million or 76.8% from the CF funding and EUR 521.2 million or 69.7% has been received.

The CF absorption since January 2000 till March 31, 2009 is shown in the Figure 6.2.

Figure 6.2

Absorption of the EU Cohesion Fund in the Planning Period of 2004–2006 (Full Financial Flow) as of March 31, 2009*
(million LVL and in %)



Since a large part of the CF projects will be implemented by the end of 2010, the absorption rates given right now can be considered satisfactory.

Planning period of 2007–2013

In the planning period of 2007–2013, the SF support is mainly directed towards the education of inhabitants, technological excellence and flexibility of enterprises, as well as towards the development of science and research in order to promote a knowledge-based economy in the country and to strengthen other necessary preconditions for sustainable economic development and life of people in Latvia in general (in order to reach the average EU development level, Latvia should implement its national development strategy with the support of the funds, which has been defined by the government in the *National Development Plan*. At the front of the national development strategy, there is an educated and creative person. The main goal of the strategy is education, science and economy based on competitive enterprises).

For efficient absorption of SF and CF resources in accordance with the SF and CF general regulation, the programming is implemented in 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 (hereinafter – OP).

Hence, the *National Strategic Framework Document* for the programming period of 2007–2013 (hereinafter – 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 OP and other financial instruments.

NSFD, on which the distribution of the SF and CF financing in the amount of EUR 4.53 billion available for Latvia within the period of 2007–2013 is based, was approved by the Cabinet of Ministers on June 19,

2007. On September 20, 2007 it was also approved by the EC, so that absorption of the programme, as well as the resources could be started.

In accordance with the decision of the Council regarding the multiannual financial framework for the programming period of 2007–2013, Latvia has received EUR 4.53 billion for the implementation of cohesion policy goals with mediation of EU funds (European Regional Development Fund (hereinafter – ERDF), European Social Fund (hereinafter – ESF) and CF).

Breakdown of the funding among OP from the total EU funding of EUR 4.53 billion in the programming period of 2007–2013 is as follows:

- 1. OP “Human Resources and Employment” (ESF) – EUR 551 million;
- 2. OP “Entrepreneurship and Innovations” (ERDF) – EUR 737 million;
- 3. OP “Infrastructure and Services” (ERDF+CF) – EUR 3.2 billion.

By March 31, 2009, in the framework of all three OPs from evaluation criteria of 146 project applications, a set of 142 criteria has been approved in the Monitoring Committee. By March 31, 2009, in total, in the framework of all three OPs, 95 Cabinet of Ministers regulations have been approved, which is 65% from the necessary number of the Cabinet of Ministers regulations.

By March 31, 2009, 514 contracts have been concluded on LVL 629.2 million or 19.8% from the SF funding. Also the payments in the amount of LVL 70.6 million (EUR 100.7 million) or 2.2% from SF funding have been made to the funding beneficiaries. The EC has been declared LVL 50.1 million, which equals to 1.6% from the SF funding.

The EU funds’ financial progress as of March 31, 2009 is reflected in the Table 6.1.

Table 6.1

EU Funds’ Absorption in the 2007–2013 Planning Period as of March 31, 2009

| Fund* | Financing of EU funds** | | Contracts concluded | | | Paid to the funding beneficiaries | | |
|--------------|-------------------------|----------------|---------------------|--------------|---------------|-----------------------------------|--------------|--------------|
| | million LVL | million EUR | million LVL | million EUR | % | million LVL | million EUR | % |
| ESF | 387.0 | 550.7 | 76.1 | 108.2 | 19.65% | 0.9 | 1.2 | 0.22% |
| ERDF | 1 714.8 | 2 440.0 | 383.6 | 545.8 | 22.37% | 63.6 | 90.5 | 3.71% |
| CF | 1 082.2 | 1 539.8 | 169.5 | 241.2 | 15.66% | 6.1 | 8.6 | 0.56% |
| Total | 3 184.0 | 4 530.5 | 629.2 | 895.2 | 19.76% | 70.6 | 100.3 | 2.21% |

In accordance with the fulfilment of the objective set in the agreement concluded with the government, International Monetary Fund and the EC on the loan (hereinafter – *Memorandum of Understanding*), by the end

of 2009, Latvia should be able to demonstrate an effective use of resources (expenditure of the intermediate bodies) in the amount of at least EUR 60 million from the ESF, EUR 170 million from

the CF and EUR 270 million from the ERDF. Thus, as of March 31, 2009 the payments were made to the SF beneficiaries in the amount of 20.2% from the amount payable in 2009, including:

- from the ESF – LVL 0.8 million (EUR 1.2 million) which is 2% from the 2009 objective;

- from the ERDF – LVL 63.6 million (EUR 90.4 million) which is 33.5% from the 2009 objective;
- from the CF – LVL 6.1 million (EUR 8.6 million) which is 5% from the 2009 objective.

Table 6.2

Funding Requested and Received from the European Commission in the EU Fund Planning Period of 2007–2013 as of March 31, 2009

| | Payments requested from the EC | | | Advance payments received from the EC | | |
|--------------|--------------------------------|-------------|--------------|---------------------------------------|--------------|--------------|
| | million LVL | million EUR | % | million LVL | million EUR | % |
| 1. OP | 0.2 | 0.2 | 0.04% | 27.1 | 38.5 | 7.00% |
| 2. OP | 49.9 | 71.1 | 9.65% | 36.3 | 51.6 | 7.00% |
| 3. OP | 0 | 0 | 0.00% | 197.4 | 280.9 | 8.66% |
| Total | 50.1 | 71.3 | 1.57% | 260.8 | 371.0 | 8.19% |

The closest goal in order to fulfil the *Memorandum of Understanding* is, by June 30, 2009, in accordance with the objective of the *Action Plan on the Implementation of the Economic Stabilisation and Growth Revival Programme of Latvia* (50% from the year’s objective) to make payments in the following amounts (EU fund’s share): LVL 21.1 million (EUR 31 million) from the ESF, LVL 95 million (EUR 135 million) from the ERDF and LVL 59.7 million (EUR 85 million) from the CF.

Taking into account the economic situation in the country, in December 2008 the Cabinet of Ministers adopted a decision regarding the postponing of 62 activities until a relevant conceptual decision of the government is taken.

On April 7, 2009 the Cabinet of Ministers decided to allocate additional funding to 3 EU fund activities in the framework of the OP “Infrastructure and Services”, and on March 31, 2009 the government approved the launching of 20 activities the implementation of which was postponed at the end of 2008.

On April 21, 2009 the Cabinet of Ministers adopted a decision to allocate additional funding in the framework of the OP “Infrastructure and Services” in the amount of LVL 15 million for high value added

investments in enterprises; additional funding in the amount of LVL 20 million for guarantees to improve the competitiveness of enterprises; in the amount of LVL 5 million for the development of science infrastructure; and in the amount of LVL 4.4 million for acquisition of international trade markets and for external marketing.

Besides, in the framework of the OP “Human Resources and Employment” additional funding in the amount of LVL 94.9 million is allocated to four fields – professional education, fostering of teaching personnel’s competitiveness, employment measures and social inclusion measures. Funding has been removed from 6 EU fund activities and decreased for 2 activities in the framework of the OP “Entrepreneurship and Innovations” in the amount of LVL 44 million. With respect to the OP “Human Resources and Employment”, funding has been removed from 12 activities and decreased for 18 EU fund activities in the amount of abovementioned LVL 94.9 million.

Information regarding activities for 2007–2013 that are under the responsibility of the Ministry of Economics has been summarized in the Box 6.4.

Box 6.4

Activities under the responsibility of the Ministry of Economics

In total, LVL 600.9 million is available for the activities of the Ministry of Economics in the programming period of 2007–2013 broken down as follows:

1. OP “Human Resources and Employment” – LVL 56.24 million;
2. OP “Entrepreneurship and Innovations” – LVL 391.33 million;
3. OP “Infrastructure and Services” – LVL 153.30 million.

By May 2009, the Cabinet of Ministers had approved 22 Cabinet of Ministers regulations in the framework of the OPs regarding the implementation of activities.

Contracts signed within the activities under the responsibility of the Ministry of Economics as of July 6, 2009

- Within the Activity 1.3.1.1.1 “Support to Training for Employed in Partnership”, 13 contracts have been signed with the total contracted amount of LVL 1 890 398.3.

Box 6.4 continued

- Within the Activity 1.3.1.1.4 “Support to Training for Employed for Enhancing Competitiveness of Enterprises – Support to Individually Organized Training by Enterprises”, 109 contracts have been signed with the total contracted amount of LVL 3 320 535.19.
- Within the Activity 1.3.1.9 “Attraction of Highly Qualified Employees”, 5 contracts have been signed with the total contracted amount of LVL 165 408.67.
- Within the Activity 2.1.2.1.2 “Technology Transfer Contact Points”, 8 contracts have been signed with the total contracted amount of LVL 1 649 771.81.
- Within the Activity 2.1.2.2.2 “Development of New Products and Technologies – Support for Introduction of New Products and Technologies in Production”, 50 contracts have been signed with the total contracted amount of LVL 9 301 153.97.
- Within the Activity 2.3.1.1.1 “Access to International Trade Markets – External Marketing”, 98 contracts have been signed with the total contracted amount of LVL 1 248 507.76.
- Within the Activity 2.3.2.2 “Co-financing to the Investments in Micro, Small and Medium-Sized Enterprises Operating in the Specially Assisted Areas”, 90 contracts have been signed with the total contracted amount of LVL 4 261 564.18.
- Within the Activity 3.4.2.1.1 “Maintenance and Renewal of Town Planning Monuments of National Importance and Infrastructure Adjustment to Develop a Tourism Product”, 8 contracts have been signed with the total contracted amount of LVL 5 219 195.73.
- Within the Sub-Activity 3.4.2.1.2 “Development of Cycling Tourism Product of National Importance”, 7 contracts have been signed with the total contracted amount of LVL 4 699 533.35.
- Within the Activity 3.4.4.2 “Improvement of Heat Insulation of Social Residential Buildings”, 19 contracts have been signed with the total contracted amount of LVL 2 378 282.17.
- Within the Activity 2.2.1.1 “Holding Fund for the Investment in Guarantee, High-Risk Loans, and Venture Capital Funds and Other Financial Instruments” – EUR 91 500 000.
- Within the Activity 2.2.1.3 “Guarantees for the Improvement of Enterprise Competitiveness” – LVL 20 000 000.
- Within the Activity 2.2.1.4 “Loans for the Improvement of Enterprise Competitiveness” – EUR 64 668 446.

Responding to the changes in the economic situation, on April 21, 2009 the Cabinet of Ministers in the Ministry of Economics decided:

In the framework of the Supplement to the 1st Operational Programme:

- to decrease funding for Activity 1.3.1.9 “Attraction of Highly Qualified Employees”, public financing in the amount of LVL 191 259 (EU fund co-financing – LVL 191 259), channelling this amount for the contracts already concluded in the framework of this activity;
- to allocate additional funding to Sub-Activity 1.3.1.1.4 “Support to Training for Employed for Enhancing Competitiveness of Enterprises – Support to Individually Organized Training by Enterprise” in the amount of LVL 16 000 000 (EU fund co-financing – LVL 16 000 000);

In the framework of the Supplement to the 2nd Operational Programme:

- to postpone sub-activities: “Technology Transfer Contact Points”, “Development of Riga Science and Technology Park”, “Business Angel Network”, “SME’s Securities Exchange”, “Access to International Trade Markets – Strengthening of International Competitiveness of Industry Sector”;
- to allocate additional funding to the Activity 2.1.2.4 “High Value Added Investments” in the amount of LVL 15 000 000 (EU fund co-financing – LVL 12 519 515), providing an opportunity also for the timber industry enterprises to apply for the funding; Activity 2.2.1.3 “Guarantees for the Improvement of Enterprise Competitiveness” in the amount of LVL 20 000 000 (EU fund co-financing – LVL 16 668 907), assessing the possibility to provide guarantees also to municipal government capital companies; Sub-Activity 2.3.1.1.1 “Access to International Trade Markets – External Marketing” in the amount of LVL 4 408 276 (EU fund co-financing – LVL 4 298 271).

Holding Fund

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

Due to the economic situation in the beginning of 2009, the Ministry of Economics called for amendments in the OP “Entrepreneurship and Innovations”, by introducing new activities – “Guarantees for the Improvement of Enterprise Competitiveness” (implemented by the LLC “Latvian Guarantee Agency”) and “Loans for the Improvement of Enterprise Competitiveness” (implemented by the SJSC “Mortgage Bank of Latvia”), as well as to decrease the funding of the activity “Holding Fund for the Investment in Guarantees, High-Risk Loans, and Venture Capital Funds and Other Financial Instruments” by EUR 91.68 million (50%).

In the framework of the activity “Guarantees for the Improvement of Enterprise Competitiveness”, the enterprises started receiving guarantees from April 20, 2009.

In the framework of the activity “Loans for the Improvement of Enterprise Competitiveness”, the enterprises started receiving loans from April 30, 2009.

In the framework of the activity “Holding Fund for the Investment in Guarantees, High-Risk Loans, and Venture Capital Funds and Other Financial Instruments”, on May 6, 2009 the EIF published a selection of financial mediators for the activity “High Risk Loans”, and for activities “Venture Capital” and “Technology Transfer”. On May 8, 2009 the EIF held interviews with financial mediators selected in the second round of the tender.

In the framework of the described activities, the enterprises will be allocated an investment in the equity capital (in the case of the venture capital programme), a loan (in the case of a loan programme) and a guarantee (in the case of a guarantee programme), not a grant, and thus the funding will be gradually repaid to the funds (loan fund, guarantee fund, holding fund) and will be accessible for repeated support to the enterprises. In this way, the abovementioned instruments will operate as long-term support instruments.

Box 6.4 continued**Export credit guarantees**

As of June 1, 2009, the guarantees about 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 1 million EUR 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, Island, 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 formulated 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 the sectors, including, wood-processing, milk processing companies, as well as enterprises of services sectors, for instance transports or logistics, etc.

The guarantees for the business activities to countries except EU member states and Australia, Canada, Island, Japan, New Zealand, Norway, Switzerland, and the United states of America will be issued to an enterprise or corporative company of agriculture services, if their export volume in the preceding year was at least 500 thousand EUR, which exports for at least two years and the export turnover is at least 20% of the total turnover and the certificate of origin of products to be exported states that the exporting country is Latvia.

The guarantees for the business activities to the EU member states and Australia, Canada, Island, Japan, New Zealand, Norway, Switzerland, and the United states of America are issued to an enterprise or corporative company of agriculture services, if their export volume in the preceding year was at least 500 thousand EUR but was not exceeding 2 million EUR, the number of employees does not exceed 250 or there is a 50 million EUR turnover, which exports for at least two years and the export turnover is at least 20% of the total turnover and the certificate of origin of products to be exported states that the exporting country is Latvia. The guarantee to business activities to these countries will be issued after receiving an approval for the European Commission.

Heat insulation of apartment houses

On February 10, 2009 the Cabinet of Ministers adopted the Cabinet of Ministers Regulation prepared by the Ministry of Economics No.138 “Regulation on Operational Programme “Infrastructure and services” complement’s activity 3.4.4.1 “Improvement of heat insulation of multi-apartment residential buildings””.

Support can be received by those apartment houses which are put into operation from 1944 until 1993 (including), are divided into the apartment properties and one owner owns not more than 20% of the total number of apartment properties. Savings of the heat energy after implementation of the renovation must be at least 20% per year from the standardized total consumption of the heat energy.

The available financing is LVL 16 634 796.16, of which LVL 14 139 549.12 is the financing of European Regional Development Fund (hereinafter – ERDF) and LVL 2 495 214.24 – the state budget financing.

On March 10, 2009 the Building, Energy and Housing State Agency announced the first four rounds for project application selection, providing that the financing available for 1st round of project application selection is LVL 4 000 000, for the 2nd selection round – LVL 4 000 000, for the 3rd selection round – LVL 4 000 000, and for the 4th selection round – LVL 4 634 764.16.

Terms for submitting project applications:

1st selection round – April 14, 2009 – May 14, 2009 (including), – 17 projects were submitted, out of which 16 were approved for the financing from ERDF and the state budget for the sum total LVL 643 853.00;

2nd selection round – May 15, 2009 – June 15, 2009 (including) – 13 projects were submitted;

3rd selection round – June 16, 2009 – July 16, 2009 (including);

4th selection round – July 17, 2009 – August 17, 2009 (including).

Information on financial instruments

In the framework of the **Risk capital** programme, it is planned to establish risk capital funds managed by skilled and qualified industry professionals within which private financing is also attracted along with the public financing, thereby providing availability of the risk capital financing for rapidly developing enterprises in the early development and growth stages of business activity, as well as promoting development of the risk capital sector in Latvia in general.

With the help of the **Guarantee** programme, the availability of financing to enterprises will be improved in situations, when an enterprise lacks guarantee and experience or the business risk is excessively high by ensuring improvement of the guarantee support mechanism and raising capacity in accordance with the dynamics and rates of economic development of Latvia.

In the framework of the **Technology transfer** programme the new enterprises in the high and medium technology sectors will be provided with financing in the initial stage of starting and developing business activity.

With the help of the **Loan** programme, enterprises will receive investment and liquid assets loans. The liquid assets loans are intended for improvement of the liquid assets of the enterprise. The investment loans are intended for initial investments of the enterprises to make productive investments. The goal of the Loan programme is to provide the enterprises with access to funding for the development of commercial activities and for the implementation of EU projects via ensuring loans in situations when the guarantee at the disposal of the enterprise is not sufficient to attract credit resources in the necessary amount and when the banks evaluate the enterprise as too risky.

6.2.2. Foreign Trade Policy

Multilateral relations

Strengthening of the Multilateral Trading System in the framework of the World Trade Organisation (WTO) has to be considered as the cornerstone of sustainable development of the current global economy and is the main priority of the EU common trade policy.

The administration of multilateral contracts and settling of its member states' mutual disputes, as well as systematic trade liberalisation and the coordination of the global economic policies with such international institutions as the International Monetary Fund and the World Bank are among the most important the WTO's functions.

The main activity directions of the WTO are the following: successful conclusion of the discussion round on trade liberalisation launched in 2001, in Doha, Qatar (hereinafter – DDR); monitoring of trading policies of the WTO member states, which receives greater attention during the global economic recession; supervision of regional trade agreements concluded by the WTO member states, etc.

Recognizing the role of the international trade in the overcoming of the global economic recession, on April 2, 2009 at the G-20¹ country summit, a political agreement was reached for the allocation of USD 250 billion for the financing of the international

trade, restriction of general protectionism measures, as well as for the need in the near future, to achieve an ambitious and balanced result in the DDR discussions. A successful conclusion of DDR could annually provide an approximate USD 150 billion contribution in the development of the world economy.

At the moment, the **DDR discussions** have relaxed, taking into account the fact that, in the end of 2008, the WTO member states could not harmonise their position with respect to the main themes of the discussion: agriculture with respect to the special protection mechanisms for developing countries and the liberalisation of the cotton market, as well as the accessibility of the industrial goods market with regard to the so-called industry issue.

At the same time, an acknowledgeable progress has been observed in the trade promotion talks about the administration of regulations, freedom of transit, procedural issues of imports and exports, as well as technical assistance to the developing countries and increasing of their trade capacity, in which regard, in the upcoming months, drafting of multilateral agreements could start. Similarly, also with respect to the so-called trade and environment issues in the light of the global warming and climate change linked to that, the WTO member states have not managed to reach a substantial convergence of opinions by now (see Box 6.5).

Box 6.5

Coordination of trade and environment policies – WTO contribution in sustainable development of the world

Sustainable development and environmental conservation/protection is one of the basic objectives of the Multilateral Trading System that is defined in the so-called Marrakesh Agreement or Agreement establishing the WTO, and this objective is implemented by fostering the value of the global trade. Thus, even though there are no special agreements within the organisation with respect to the environmental issues, the WTO member states, following the WTO's principles, are entitled to implement such trade policy measures that would promote protection of the environment, if needed.

A significant role is attributed to the solving of environmental issues in the DDR discussions launched in 2001. In accordance with the elements of the Doha Declaration concerning trade and environmental issues, in the framework of the round discussions are on:

- Mutual compliance of the WTO rules and specific trade obligations provided for in the multilateral environmental agreements;
- Information exchange procedures amongst the secretariats of the multilateral environmental agreements and the WTO;
- Decreasing/removing the trade barriers (tariffs and non-tariffs) for environmentally friendly goods and services.

Therefore, as a result of a successful conclusion of the DDR discussions, there will be the following benefits: development of international trade of environmentally friendly goods and services together with the development and deployment of environmentally friendly technologies, which would contribute to the management of climate change, as well as the multilateral regulatory framework of environmental and trade issues would be improved.

Since the WTO member states must reach a political compromise with respect to the core elements of the discussion, a certain DDR progress is possible in the second half of 2009, when the results of the general elections in several influential states of the organisation, including USA, EU, China and India, and the trade policy priorities and directions of their new administrations will be known.

A significant role in the future development of the DDR is also attributed to the 7th WTO Conference of Ministers, taking place on November 30–December 2, 2009 in Geneva (Switzerland), in the framework of which, together with the issues on strengthening the international trade relations in the global economic recession, it is planned to work on reaching an agreement with respect to the core themes of the DDR discussion.

¹ Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Spain, Turkey, United Kingdom and USA.

In relation with the threats of protectionism created by the global economic recession in the world and the possible deterioration of the international trade conditions, the WTO Secretariat and the EC (independently from each other) are **monitoring the trade policy instruments** of the world countries since the beginning of 2009. Although several countries, including Russia, Belarus and China, have introduced or are planning to introduce internal market protection measures that primarily concern the trade of agricultural, steel, car industry, textile industry products, as well as toys and electronics, escalation of protectionism measures currently cannot be seen in the world. Besides, many countries, including USA and EU, give preference to the use of instruments more favourable to the development of the international trade, providing the necessary trade funding to the exporters, as well as aid to the financial institutions.

On April 6 and 8, 2009 the WTO Trade Policy Review Institution carried out **evaluation of the EU trade policy** implemented since 2007. In the framework of this evaluation, a particular attention has been paid on the development trends of the EU common trade policy in the context of the internal market and business environment, as well as on such specific trade policy issues as sanitary and phytosanitary measures and application of technical barriers for trade, etc. The main conclusions drawn during the evaluation concern the need to intensify the harmonisation of legislative acts regulating the business environment in the EU Member States and the decreasing of barriers in both, the EU internal market and in the trading relations with the third countries.

In the WTO accession process there are 29 candidate states, including Belarus, Kazakhstan and Russia. From these, the closest to joining is Russia, the accession time of which still mainly depends on its readiness to solve economically and politically sensitive issues within the framework of the multilateral talks, including issues that are very important to the EU – export duties on untrimmed timber, freight rail transport tariffs, as well as restrictions on foreign investments and sanitary and phytosanitary measures.

Accession talks of Belarus to the WTO are currently in a rather early stage, taking into account the political situation in the country until now, as well as the creation of Customs Union with Russia, and, at the moment, a renewal of the multilateral talks is taking place. Similarly, the multilateral talks of the accession of Kazakhstan have been neglected, however, the country, despite the economic and political hardships, wants to activate these talks. In this process, the main issues to be solved for the EU are related to the export duties, energy, etc.

Bilateral relations within the framework of the EU common trade policy

The trade relations of Latvia with third countries are regulated under agreements concluded by the European Union.

The EU has concluded several preferential agreements with third countries:

- European Economic Area Agreement with Iceland, Liechtenstein and Norway;
- Free Trade Agreements with the Faeroe Islands, Switzerland and Mexico;
- Association Agreements with Chile, Mediterranean countries¹ and several overseas countries and territories;
- Customs Unions with Turkey and Andorra;
- Stabilisation and Association Agreements with Macedonia, Croatia, Serbia, Montenegro, Albania, Bosnia and Herzegovina;
- Trade, Development and Co-operation Agreement with South Africa.

The EU, in addition to already previously initiated negotiations on the Free Trade Agreements (FTA) with the Mediterranean countries, Gulf Co-operation Council countries² (hereinafter – GCC), negotiations on Association Agreements with Mercosur countries³ (hereinafter – Mercosur) and negotiations on Economic Partnership Agreements (hereinafter – EPA) with the African, Caribbean and Pacific Group of States (hereinafter – ACP), as well as negotiations on Association Agreements incorporating FTA with the countries of Central America⁴ and the Andean Community⁵, continues negotiations on conclusion of extended FTA of new generation with the Republic of Korea, Republic of India, Association of Southeast Asian Nations⁶ (hereinafter – ASEAN), as well as the negotiations with Ukraine and Libya have been started.

The European Community Member States have agreed on starting negotiations concerning conclusion of an extended FTA with the Russian Federation after its accession to the WTO.

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

² Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates

³ Argentina, Brazil, Paraguay and Uruguay

⁴ Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua, as well as Panama after its involvement in the Central American economic integration process

⁵ Bolivia, Columbia, Ecuador and Peru

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

Box 6.6

Bilateral relations of the EU with third countries

The EU–Russia economic co-operation is regulated by the Partnership and Cooperation Agreement (PCA), for which the parties agreed on extending the term of its validity on October 26, 2007 in Mafra, Portugal during the meeting of EU and Russian leaders. FTA talks with Russia fully depend on the process of Russia's entry in the WTO. EU member states, including Latvia, support Russia's access to the WTO as soon as possible, but the results of the talks are more important than the speed of the entry. Taking into account, that position of the Community envisages the start of the process of FTA talks with Russia only after the admission of Russia to the WTO, on May 26, 2008 the Council approved a mandate for starting talks with Russia on conclusion of a new framework agreement. After the adoption of the directives for the talks at May 2008 meeting of the Council, on June 26–27, 2008 during the EU–Russia summit, the leaders of both parties agreed to launch talks on a new framework agreement that would be the basis for the future bilateral relations of the EU with Russia and would replace the current PCA concluded in 1997. The new framework agreement will provide solutions to the issue of trade barriers between the EU and Russia by concentrating on normative regulations. On March 20–April 3, 2009 the 4th round of negotiations took place. The 5th round of negotiations between EU and Russia is planned to take place on June 2–19, 2009. The EU–Russia economic cooperation is also regulated by the *EU–Russian Federation Agreement on Four Cooperation Areas* (economic area, area of freedom, security and justice, cooperation with respect to external security and cooperation with respect to research and science, including culture) that was concluded in 2004 and one of the principal tasks of which is to establish the common economic area. In the economic part of the agreement, such issues as energy security, cross-border cooperation, investments, security etc. are dealt with.

Along with the accession of **Ukraine** to the WTO, the precondition to initiate talks between the EU and Ukraine on conclusion of an Enhanced Agreement was fulfilled, which will replace the PCA. Official negotiations on conclusion of the EU-Ukraine Enhanced Agreement, in the framework of which it is also planned to conclude the FTA, were started on February 18, 2008 in Kiev (Ukraine). On March 30–April 3, 2009 the 6th round of EU-Ukraine FTA negotiations took place in Brussels. Progress has been achieved with respect to the sections concerning the protection of intellectual property rights, state aid, as well as customs and trade promotion. Negotiations have been started with respect to tariff offers and energy aspects in the context of transport, transit and pricing issues. There have been no discussions yet about the transparency and approximation of provisions, as well as settling of disputes in the energy sector. The next round of EU-Ukraine FTA negotiations is planned to take place on June 30–July 3, 2009.

Latvia has particular economic interests regarding conclusion of the FTA between the Community and Ukraine, considering that such an agreement with Ukraine had existed before Latvia's accession to the EU and it fostered the development of transit and trade. Latvia is especially interested in substantial reduction of bureaucratic requirements and elimination of other non-tariff barriers for the entry into the Ukrainian market.

Economic cooperation between the EU and USA takes place within the framework of the Transatlantic Economic Council Initiative. The EU and USA together are the world's largest trading partners, as well as the world's largest economies, comprising 57% of the world's GDP. In order to extend the transatlantic economic relations, the EU and USA initiative for promotion of economic integration and growth was adopted on June 20, 2005 during the EU-USA summit talks. On April 30, 2007 a new document "Strengthening the Transatlantic Economy between the EU and USA" was adopted at the EU-USA summit in Washington. The document envisages promotion of co-operation within such fields as intellectual property, trade security, financial markets, innovations and technologies, as well as investments. A Transatlantic Economic Council supervising and promoting implementation of economic cooperation between the EU and the USA was established during the summit. The aim of this Council is to achieve harmonisation of EU and USA regulations and to promote development of mutual trade and dialogue between entrepreneurs.

The 3rd EU-USA Transatlantic Economic Council Meeting took place on December 12, 2008 in Washington. The agenda of the meeting included the regulatory cooperation issues, import security, 100% container scanning rules in the USA, issues of investment dialogue, as well as financial, energy, issues concerning EU-USA economic co-operation, etc. The Progress Report of the 3rd Transatlantic Economic Council meeting confirms the close economic dialogue between the EU and USA, including the issues of investments, standardisation, finances, intellectual property, regulation, trade, import security, etc.

The European Commission has summarised the priorities of the EU Member States in the context of the Transatlantic Economic Council in 2009. These are trade security, including 100% container scanning rules, financial markets, trade and investment barriers, consumer protection, regulatory work and new cooperation areas.

Latvia will continue supporting implementation of the initiative while paying attention to the promotion of foreign trade, investment, and cooperation between entrepreneurs.

In the framework of implementation of the political strategy for the economic relations with **China** adopted by the Commission in 2006, negotiations were launched regarding a drafting of a comprehensive Partnership and Cooperation Agreement in 2007. The aim of this agreement is to improve the bilateral trade and investment framework, as well as to renew the EU–China Trade and Economic Cooperation Agreement, which was concluded in 1985.

On September 25, 2008 a meeting of the Joint Trade Committee took place in Beijing (China), during which the issues on EU-China relations, cooperation in development and trade dialogues (trade in goods and services, trade protection instruments, public procurement, intellectual property, geographical indications and investment regimes) were reviewed. On May 7–8, 2009 in Brussels, the second meeting of the EU–China High Level Economic and Trade Dialogue took place which was mainly dedicated to the revision of improvement of business opportunities in the times of economic recession.

On May 20, 2009 the 11th EU-China Summit took place in Prague.

In 2007, the EU started negotiations on concluding FTAs with **South Korea, the ASEAN countries and India**. On March 23–24, 2009 in Seoul (South Korea), the 8th and final EU–South Korea round of talks took place, however, to conclude the talks fully, the parties still must agree on certain issues to be solved. Significant progress has been achieved with respect to FTA negotiations with India. Until now, 6 rounds of negotiations have taken place. The next round is planned to take place in summer of 2009, in Brussels.

Box 6.6 continued

Negotiations with the **Mediterranean countries** on conclusion of FTAs were started in 1995, in order to establish the free trade area of the Community and Mediterranean countries by 2010. It is planned that FTA will be asymmetric, namely, the Mediterranean countries will have to undertake a lower level of obligations. On July 2, 2008 the 7th EUROMED Conference of Trade Ministers took place in Marseille (France), in which the ministers and business representatives of European countries discussed the issues related to EUROMED trade relations. Exchange of opinions manifested powerful support to the business environment for extended establishment of EUROMED free trade area.

Talks with **GCC countries** on conclusion of FTAs were resumed in 2002, comprising also the conditions on trade in services and investment. The aim of this FTA is asymmetrical and development-orientated opening of goods and services trade in compliance with the WTO norms, taking into account the development level of GCC countries. In December 2008, the talks were terminated since the parties were not able to agree on issues to be solved. After the 19th EU–Gulf Cooperation Joint Council and Ministerial Meeting in Muscat (Sultanate of Oman) on April 29, 2009 the parties agreed to renew the talks.

Negotiations regarding conclusion of the **EU-Libya** FTA have been started. On November 12–13, 2008 the 1st round of EU–Libya FTA negotiations took place in Brussels. In general, the negotiations can be assessed as positive. In relation to the connection of FTA negotiations with the entry process to the WTO, Libya supports inclusion of general WTO principles in the FTA, however without including a specific reference to it. On May 12–13, 2009 the 3rd round of EU–Libya framework agreement negotiations took place in Brussels, and during this round, such issues as tariffs and non-tariffs, technical trade barriers, as well as customs, intellectual property rights, public procurement, trade in services and energy were discussed.

The goal of the Economic Partnership Agreement between the **African, Caribbean and Pacific Group of States (ACP)** and the EU Member States is to establish new trade agreements compliant with the WTO regulations after the expiry of the existing Cotonou Trade Agreement on December 31, 2007, as well as to support the regional integration of the ACP states and facilitate easier and gradual integration of the ACP states in the global economy, especially promoting sustainable development and decrease in poverty. The primary goal of the European Commission is to ensure conclusion of EPA with all 6 ACP regions – Western Africa, Central Africa, Southern part of Eastern Africa and Africa, Southern African Development Community (SADC), as well as Caribbean and Pacific Group of States. If the overall agreement may not be obtained with some ACP regions during the process of negotiations, the EPA are concluded also with separate countries. In 2008, an Economic Partnership Agreement was signed between the European Communities and its Member States and the **Caribbean Group of States**¹, as well as an Interim Economic Partnership Agreement between **Côte d'Ivoire** and the European Community and its Member States. In 2009, an Interim Economic Partnership Agreement was signed between the European Communities and its Member States and **Central Africa**. Interim EPAs with 5 SADC states (Botswana, Lesotho, Namibia, Swaziland and Mozambique) are planned to be signed in June 2009. The interim EPAs are concluded in order to ensure application of the favourable trade regulations until complete conclusion of trade and development EPAs. The EPAs include conditions on trading with goods, including trading tariffs, non-tariff barriers, trade protection instruments, regulations on customs regime, trade promotion measures, sanitary and phytosanitary measures, as well as forest management measures and measures with respect to trade of forestry products.

In October 2008, the EU launched consultations with **Mongolia** on the conclusion of PCA in order to replace the current EU–Mongolia Trade and Cooperation Agreement concluded in 1993. Initially, the agreement was concluded for five years, but it is being renewed every year.

Strategic partnership of the EU and Latin American states continues to develop, in the framework of which negotiations take place concerning the conclusion of the FTA with the **Andean Community** countries, **Mercosur** states, as well as **Central American** countries.

Association agreement negotiations with the countries of the **Andean Community** were terminated after 3 negotiation rounds due to domestic disputes within the Andean Community with respect to the objectives and content of the trade section of the agreement. In January 2009, the Council authorised the Commission to carry out negotiations on multilateral trade agreement with those countries of the Andean Community which were ready for it, as well as to carry out negotiations regarding the renewal of the 2003 political dialogue and cooperation agreement with all countries of the Andean Community. Taking into account the progress of the negotiations that have taken place so far (there have been 3 negotiation rounds, the next one is planned to take place on June 15–19, 2009), it is known, that an early agreement with respect to the trade agreement is possible at least with Colombia and Peru, if the parties take appropriate political decisions in such fields as market accessibility for sensitive products, conditions with regard to origin of goods, IPR and sustainable development.

After 7 rounds of negotiations with the **Central American countries**, it can be considered that the talks overall have progressed successfully with respect to all 3 pillars to be included in the future association agreement, including the political dialogue, cooperation and trade. Despite the fact that the 7th negotiation round on April 1, 2009 was suddenly suspended, the disagreement is currently being solved and the talks are continuing. If an agreement will be reached with respect to issues to be solved, the final agreement by the parties could be achieved this year – the final negotiation round is planned to take place on July 6–10, 2009.

In November 1999, the talks were started and are still taking place between the EU and **Mercosur** states on conclusion of the EU–Mercosur Association Agreement. The goal of the agreement envisages promotion of co-operation between the EU and Mercosur countries on trade, economics, customs, statistics, intellectual property, inter-institutional co-operation, as well as education and science, and also envisages establishment of a Free Trade Area of EU-Mercosur countries. The talks were not concluded on October 31, 2004 as it was planned, and, at the moment, they have been suspended.

¹ Antigua and Barbuda, the Commonwealth of the Bahamas, Barbados, Belize, the Commonwealth of Dominica, Dominican Republic, Grenada, Republic of Guyana, Jamaica, Federation of Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Republic of Suriname and Republic of Trinidad and Tobago.

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

In order to activate the bilateral economic cooperation after the accession to the EU, Latvia has concluded bilateral economic cooperation agreements with the Russian Federation, People's Republic of China, Republic of Belarus, Ukraine, Republic of Kazakhstan, Republic of Azerbaijan, Georgia, Republic of Moldova, Republic of Uzbekistan and the Kyrgyz Republic.

At the moment, economic cooperation agreements are prepared with Armenia and Tajikistan.

These agreements are the most important umbrella agreements regulating bilateral economic co-operation

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 third countries require the establishment of an Intergovernmental Commission and/or Joint Committee, which ensures supervision of the validity of these agreements and opportunities to analyse how to improve further cooperation (see Box 6.7).

Box 6.7

Activities of intergovernmental commissions of Latvia and third countries

- In the second half of 2009, in Riga, the **3rd meeting of the Latvia–Russia Intergovernmental Commission** in the areas of economic, scientific and technical, humanitarian and cultural cooperation is planned to take place.
- On June 3–4, 2009 in Kiev (Ukraine), the **2nd meeting of the Latvia–Ukraine Intergovernmental Commission in the areas of economic, industrial, scientific and technical co-operation** is planned to take place during which it is planned to discuss the cooperation of the states in the field of transport, fuel–energy package, industry, agriculture, tourism, education, scientific and technical activity, as well as other fields of mutual interest for the development of future trade and economic cooperation. At the same time, as the Intergovernmental Commission's meeting will be taking place, there will be Latvia–Ukraine Business Forum, which will be represented by companies from construction, food production, finance consulting, environmental protection and waste treatment, information technologies and communications, energy and other sectors.
- In the second half of 2009 in Riga, it is planned to organise the **7th meeting of Latvia–China Joint Committee**.
- In the second half of 2009 in Latvia, the 5th meeting of the Intergovernmental Commission that was established in the framework of the Economic Cooperation Agreement with **Belarus** is planned to take place.

Although Latvia and Russia have concluded an agreement on economic cooperation, there is active cooperation also with the regions of the Russian Federation.

In April 9, 2008 the Ministry of Economics concluded an agreement on economic cooperation with the government of Vologda Oblast (Russian Federation), and also negotiations with the governments of the Russian Federation, Ivanovo and Yaroslavl Oblast, the administration of Pskov Oblast and the government of Bashkortostan Republic regarding a conclusion of agreement in the field of economic cooperation.

EU sectoral agreements

Steel

Metals are almost completely recyclable for unlimited number of times, therefore they are very important in relation to sustainable development. Competitiveness of metal industry sector is particularly important, because it forms a part of the overall European competitiveness within all links of the value chain.

Taking into consideration the current economic recession, decrease in production, as well as consumption was observed in 2008, which falls even more rapidly in 2009. For example, in the 1st quarter of 2009, consumption in the European Union has decreased by 22%, while production has decreased by 23.5% in comparison with the respective period last year.

The EU is currently applying quantitative restrictions on import of particular steel products from Russia and Kazakhstan. In October 2007, the EU and Russia concluded an agreement on trade in steel for 2007 and 2008, under which annual increases in quotas are prescribed. As concerns Kazakhstan, autonomous measures are currently being applied. 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 imports of particular steel products from all third countries for the purpose of steel flow monitoring.

Textiles

The textile sector is a socially sensitive economic sector characterised by intensive use of labour, and it is of a big importance both, in regional development and in international trade. The protective textile products are mentioned as one of the promising progressive markets in the communication of the European Commission "Lead Market Initiative for Europe", which is highly innovative, as well as meets the needs of customers, it has a strong technological and industrial base in Europe and it is affected by favourable basic conditions of operation more than other markets which is provided by public political measures. Within the next years, the exports of such textile products from the EU to some regions of the world within which rapid growth is expected could increase by approximately 50%. More rapid drafting

and application of the European standards in the global market along with appropriate measures in the sphere of protection of intellectual property, for example, in the form of support services for SMEs would create additional demand.

Since January 1, 2005 no quantitative restrictions have been applied between the WTO member states regarding the trade of textiles. The EU is currently applying quantitative restrictions to the import of the textiles from Belarus and North Korea, while the double-checking system (licensing) without quantitative restrictions applies to the import of particular textiles of Uzbek origin. As of January 1, 2009 licensing for the imports of textiles of Chinese origin was lifted.

Trade Defence Instruments

Trade Defence Instruments of the European Community

The system of trade defence instruments (hereinafter TDI – anti-dumping, anti-subsidy measures and domestic market defence measures) operates in the European Union, as well as in most other countries, which import goods.

The goal of anti-dumping and anti-subsidy measures is to protect the local producers in the EU from losses caused by unfair competition from the enterprises of third countries or subsidies granted by governments. The decisive base of application of domestic market protection measures is an increase of imports causing losses to local producers, which are not indications of a fair competition.

In Latvia, the producers and consumers of goods alike are affected by the TDI procedures, but the most essential interests of Latvia involve import and industrial usage of the goods subjected to TDI. The following trade defence issues were the most important for Latvia from the standpoint of import and user interests in the first half of 2009:

- Anti-dumping inspection with respect to import of certain candles from the People's Republic of China. Latvia is against a dishonest practice of Chinese candle producers, and supports perspective and development directed growth and competitiveness of Latvian candle producers in domestic as well as foreign markets.
- Anti-dumping and anti-subsidy inspection with respect to import of biodiesel from the United States of America. It is in the interests of Latvia to promote the development of the rapidly growing biodiesel sector of Latvia, protecting it from American subsidy programmes, which distort the market and promote the entry of imported biodiesel in Latvia for dumping prices.

Trade Defence Instruments applied by third countries

If the EU applies trade defence measures, other third countries may also apply defence mechanisms,

either against all exporters of the respective EU product (e.g. safeguard measures) or against exporters of the specific product of a particular EU member state (e.g. anti-dumping measures).

The most substantial loss incurred by a Latvian company in the market of a third country, e.g. USA, originates from the anti-dumping measures against imports of steel bars from Latvia. Upon request of the EU, a panel of the WTO Dispute Settlement Body was formed on June 4, 2007, which reviews the compliance with the WTO norms of the practice used by the US in the conduct of anti-dumping inspections, which *inter alia* also affects a Latvian company. According to the WTO panel's decision of November 6, 2008, the panel found that when applying the zeroing method in the anti-dumping inspections, the USA does not observe the WTO norms. On February 19, 2009, the Appellation Body confirmed that the application of the zeroing method is banned. The US used the so-called "zeroing" method in its decisions adopted for determination of the dumping difference. If the US had not used this method against the Latvian company, the established dumping difference would be minor or non-existent. At the moment, there are negotiations about when the US has to implement the recommendations of the WTO.

6.2.3. EU Internal Market

The EU internal market – a cornerstone of the European integration – is acknowledged to be one of the most significant and successful EU projects. The EU internal market currently comprises 30 states (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 has been 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 work places 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 found, 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 the EU citizens.

In Latvia, implementation of the internal market directives is taking place successfully and sufficiently high results have been reached regarding the transposition efficiency of the directives. Latvia is only lagging behind from Germany, Romania, Slovakia and Bulgaria in this regard. The latter currently is the only

Member State, which has achieved transposition deficit in the amount of 0%. 99.45% of internal market directives were transposed into national legislation by November 10, 2008 (no directive implementation measures have been notified on 8 directives), ensuring that the Lisbon strategy goal to transpose 99% of the requirements of directives or to allow the deficit of transposition of directives in the amount of 1% by 2009 is reached.

In Latvia, the process of implementing the principles of the 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 the European Community, is supervised and coordinated by the Ministry of Economics, 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 submitting draft technical regulations (Directives 98/34/EC and 98/48/EC), which prescribes the obligation of the EU Member States to submit draft technical regulations to the European Commission and other EU Member States, as well as European Economic Area countries for further assessment, which serves 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 the free movement of goods, as well as to the freedom to provide information society services. Any business may take part in this process in order to provide its comments and objections concerning the projects prepared by other EU Member States, which may potentially influence exports of goods of a company or the cross-border provision of information society services. Information on draft technical regulations of the Member States is freely accessible on *Technical Regulations Information System (TRIS)* database. The TRIS database is a free service and is accessible on www.europa.eu portal. The majority of the notified draft technical regulations are available in all EU languages.

From May, 2004 until July 1, 2009 Latvia informed the European Commission about 72 draft technical regulations and received detailed opinions from the European Commission in 13 cases. In most cases, the detailed opinions of the EC 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 Treaty, should be granted free access to the Latvian market by the national authorities concerned.

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 EU Member States, the European Parliament and Council Regulation (EC) No. 764/2008 establishing the 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, which was enforced on September 2, 2008. Thereby, a substantial step was taken towards introduction of a new legal instrument on the EU level. The application of the requirements under the Regulation in Latvia and other Member States is ensured as of May 13, 2009.

The Regulation prescribes establishing the procedures, whereby the principle of mutual recognition must be observed in the work of public authorities by applying the national technical regulations to the goods 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 services sector, as well as gradual modernisation and simplification of public administration, one of the 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 initiatives of the recent years of EU legal acts, which must be implemented by the state before the end of 2009. The directive is aimed at creation of the legal regulations necessary to promote implementation of the right of establishment and free movement of services within the EU internal market. Correct and timely implementation of this directive may give a positive contribution in relation to promotion of cross-border economic activities in the services sector, as well as improvement of business environment, particularly in decreasing the administrative burden for businesses.

In order to fulfil 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 the provisions of December 12, 2006 Directive 2006/123/EC of the European Parliament and of the Council on services in the internal market”, which foresees the establishment of one-stop-shop by the public institutions, allowing service providers to carry out administrative procedures remotely using electronic means. By implementing the principle of one-stop-shop, performers of economic activity will be able to reduce the administrative procedure costs and increase the quality of the services provided. By using the advantages of one-stop-shop, service providers and customers will receive information on requirements and procedures established by the state faster and easier. The model comprised in the concept is planned to be implemented by the end of 2009.

In order to facilitate starting and performing business activity, the existing administrative barriers and procedures are continuously reviewed by accordingly liquidating and simplifying requirements for the issue of permits (licences, certificates, certifications and other documents), as well as creating an opportunity to settle all the required procedures electronically. The permits terminated in certain spheres are planned to be replaced by indefinite licenses and the permit extension 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 opportunities of the public administration institutions of the European Communities, since November 2007, in Latvia an **Internal Market Information Network (IMIN)** has been established, which has been introduced and is operating in a pilot project mode. It ensures secure and fast data exchange among the European institutions allowing effective communication in spite of the barriers created by

language and administrative structure differences. 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 IMIN, which means that the entrepreneur does not need to go back to the country of origin to receive an additional notice and to certify it at a notary, etc. At the moment, IMIN in a pilot project mode is available in the professional qualifications field for certain professions, as well as in the field of certain service provision, however, in the future, it is planned to extend the scope of IMIN.

In 2008, the **SOLVIT Coordination Centre of Latvia** received 33 cases for review, of which 79% have been successfully solved (in 2007 it was 80% and in 2008 it was 83%). In the first five months of 2009, already 23 complaints have been received. There has been an increase with respect to the traditionally popular issues – issuance of residence permits for family members and recognition of professional qualifications, and also, for the first time and due to the crisis, the issue of unemployment benefits has emerged. The number of company complaints has slightly decreased. Bearing in mind the fact that many complainants have admitted that they had not heard of SOLVIT services before, SOLVIT Centre continues society awareness campaigns about SOLVIT Coordination network in different cities of Latvia that were started last year, and the network operates as an alternative mechanism for solving internal market problems in the European Economic Area. The basis of the SOLVIT idea is to find a quick and real solution for the internal market problems emerging as a result of operations of public institutions by incorrect transposition of the EU legal norms. The SOLVIT centres solve problems of both, the 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, at the same time identifying and solving issues that are urgent for local industrial enterprises in co-operation with organisations that represent industrial enterprises. Industrial policy is closely connected with innovations, business activity, education and other policies.

On June 28, 2007 the Cabinet of Ministers approved *Programme on Promotion of Entrepreneurship Competitiveness and Innovation for 2007–2013* developed by the Ministry of Economics. The Programme includes measures for promotion of development of

innovation, business, small and medium-sized enterprises and industries (see Chapters 6.4, 6.5, 6.7).

In June 2009, a joint research of the Ministry of Economics and the Ministry of Defence on development of the military sector and related sectors in Latvia will be completed. The capacity of enterprises to handle deliveries for the needs of the armed forces is being assessed within its framework, and military industry delivery chains, as well as policy recommendations provided for promotion of competitiveness, *inter alia* **offset (compensation deals)** recommendations for arrangement of the policy in Latvia. The military industry in Latvia is practically not represented directly. At the same time, several enterprises have already been involved or may potentially be involved in deliveries to the armed

forces and supply chains of the military industry. Such enterprises operate in textile and clothing manufacturing, engineering industry and metal working, electronics and electrical engineering, as well as other sectors. Information about the enterprises identified within the framework of the research will be published in the catalogue of enterprises. On September 10–12, 2009 the Ministry of Defence in cooperation with the Ministry of Economics and the Institute of Economics of Latvian Academy of Science organizes an international conference “Development prospects of defence industry and related sectors in the Baltic States” in which the results of the research “Development prospects of military industry in Latvia” will be discussed. The conference will be held in Riga, in the Latvian War Museum.

Implementation of the international co-operation project BSR InnoNet (Baltic Sea Region Innovation Network) is approaching its end. The project BSR InnoNet was launched in 2006 and until now is the largest cross-border cooperation project in the field of **cluster policy**. The results of the project were presented in an international conference in Copenhagen, on May 7–8. The project is oriented towards co-operation in the sphere of creation of cluster policy, promotion of contacts, exchange of experience and co-operation among clusters, as well as analysis of clusters within a region. The Nordic Innovation Centre is proposed as the institution co-ordinating the project, the Latvian Investment and Development Agency and the Ministry of Economics represent Latvia in the project, involving also representatives of other public institutions and the private sector into various activities of the project.

In 2008, within the framework of the project, implementation of four pilot programmes have been launched in order to develop practical cooperation among related clusters in the Baltic Sea region. This co-operation may be both, horizontal co-operation (which includes formation of co-operation and contacts between similar clusters) and inter-sectoral co-operation that involves clusters on different value added chain levels or clusters from different spheres, which may potentially supplement each other and promote formation of synergies. Pilot programmes include clusters from food, bio-energy, IT, wood-processing and furniture sectors. As concerns Latvia, the information technologies cluster has ensured an active participation in the pilot programmes. Several seminars and meetings for context formation have been held in each pilot programme in order to get acquainted better with the clusters of other countries and to identify the development spheres of future cooperation. The pilot programmes will be implemented until September 2009.

Another important project sphere is related to capacity building. The target audience is co-ordinators and personnel of clusters as well as the public agencies

and institutions that carry out the cluster promotion policy. A number of training modules have been developed and their implementation has been launched.

On the basis of experience obtained from BSR InnoNet and the current cooperation, the government of Sweden has put forward an initiative to launch a big cross-border clusters and innovations promotion programme in 2010 as one of the components in the new EU strategy for the Baltic Sea region. It is the first strategy of such type for a separate macro-region in the European Union. It is planned to approve the strategy at the end of 2009 during the Swedish Presidency in the European Union. It is expected that the cross-border clusters and innovations programme will deal with the following issues:

- Cooperation of global innovation systems;
- Transnational cluster cooperation;
- Cooperation of innovative SME networks;
- Capacity building activities;
- Attraction of direct foreign investment and development of the Baltic Sea region brand.

Contrary to the BSR InnoNet, which basically is meant for cooperation in the sphere of cluster politics, the suggested programme would be directed towards involvement of specific clusters and implementation of joint research and cooperation projects. This year, a transnational forum has been made with a task to develop a detailed mechanism for programme implementation and financing, and to define precise activities and conditions thereof.

Due to the global financial crisis and economic recession **the issues of industrial competitiveness** are topical also on the EU level. On May 28, 2009 the EU Competitiveness Council of Ministers approved Council conclusions regarding the integrated approach to a competitive and sustainable industrial policy in the European Union. The Council conclusions provide evaluation on the recent European Commission initiatives in the sphere of industrial policy and put forward the most essential tasks for further implementation of industrial policy under the circumstances of global economic recession. The most essential settings expressed are as follows:

- The key role of industry for the development of European economy is emphasized, as well as the need to have a coordinated set of short-, medium- and long-term initiatives to react towards the current economic recession and to ensure sustainable development;
- The significance of favourable, stable and predictable business environment, necessity to develop dialogue with stakeholders in industrial sectors as well as to respect better-regulation and internal market principles is underlined;
- Necessity to speed up the process of simplifying legislation and reducing administrative burdens is emphasized;

- Support to urgent measures to improve energy efficiency in compliance with the European Economic Recovery Plan is expressed;
- The need of enterprises, especially SMEs, to have financial resources, is emphasised, especially taking into account the complicated situation in the financial markets; an invitation is expressed to apply guarantees and other economic policy instruments;
- The Council supports the Commission's intention to launch an integrated strategy aimed at ensuring better and undistorted access to raw materials in third countries, to improve framework conditions for extracting raw materials within the European Union and to lower consumption of primary raw materials by increasing resource efficiency and promoting recycling.

The political determination expressed in the Council conclusions to ensure the necessary framework conditions to avoid possible delocalisation of industrial production to other regions of the world is of crucial importance.

For the energy-intensive sectors especially important are the amendments in the EU Emission trading system directive adopted on December 17, 2008. One of the key issues is to identify those energy-intensive sectors that are subject to increased carbon leakage risk or risk to delocalise production outside the EU due to additional costs and loss of competitiveness caused by direct or indirect emission trading system. The directive includes quantified criteria for determining sectors subjected to the carbon leakage risk, taking into account their involvement in the international trade and expected increase of expenses. The list of the sectors to be classified as subjected to the carbon leakage risk is being prepared. These sectors will be able to apply to free allocation of CO₂ emission quotas. The list will be drafted and approved by the end of 2009.

6.3.2. Energy Policy

Main directions of the energy policy (See also Chapters 3.3.3 and 6.9) are aimed at improving the security of energy supply of the country by encouraging diversification of supplies of primary energy resources and creating conditions for increasing self-provision of electricity generation, as well as preventing isolation of the regional electricity 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, within the medium-term and long-term period.

In **electricity supply**, more than 90% of all electricity generated in Latvia is generated by the JSC “Latvenergo”, which also ensures import of electricity and its supply to consumers. As of September 1, 2005 all functions of electricity transmission system operator are performed by the JSC “Augstsprieguma tīkls”. As of July 1, 2007 all functions of electricity distribution system operator are taken over by the JSC “Sadales tīkls”: the sole owner of both joint-stock companies is the JSC “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 state (see Box 6.8). In the sphere of electricity supply, it means that the electricity sector in Latvia operates in compliance with the provisions of EU directives concerning promotion of utilisation of renewable energy resources for production of electricity, joint electricity market regulations, cogeneration based on the useful heat demand, as well as safety of electricity supply and investments in infrastructure.

At present, the JSC “Latvijas Gāze” is the only enterprise in the **natural gas market** in Latvia, which carries out transmission, distribution, storage and sale of natural gas in compliance with the licences issued by the Public Utilities Commission.

Amendments to the “*Energy Law*” made on May 26, 2005 prescribe the main conditions for opening the natural gas market and were developed, taking into account the Directive 2003/55/EC of the European Parliament and of the Council concerning common rules for the internal market in natural gas. The law includes issues concerning operation of systems, duties and rights of market participants, as well as competition opportunities in the natural gas market. The Saeima has passed a special law prescribing that these amendments will become effective on January 1, 2010.

By choosing a regulated procedure of access, the Member States implement the necessary measures to confer rights for accessing the system to natural gas companies and qualified users inside or outside the area, which contains an interconnected system, on the basis of published tariffs and other conditions and obligations that are to be complied with, when the system is used.

In order to update the regulation in **heat supply**, on October 21, 2008 the Cabinet of Ministers adopted “Regulations for Supply and Use of Thermal Energy”, which establish the procedure according to which an energy supply enterprise supplies thermal energy and a thermal energy user uses it, and the procedure according to which a supplier is authorised to stop the supply of thermal energy to a user, who has not paid for the received thermal energy or has not fulfilled other obligations to the supplier.

Box 6.8**Harmonisation of normative acts with EU directives**

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

- **Security of supply and oil and oil product reserves.** The Concept of the State Oil Product Reserve was approved on June 27, 2006. On June 27, 2006 the Cabinet of Ministers adopted its Regulations No. 541 “Procedure for the Establishment and Storage of Petroleum Product Reserve”, which regulates the procedure for oil product reserves to be established by entrepreneurs.
- **Electricity sector.** The legal regulation for efficiently functioning electricity market, within which all the electricity users are supplied with electricity in a safe and qualitative way and for reasonable prices, entitled to freely choose the electricity supplier, as well as production of electricity is promoted by utilising renewable energy resources and preconditions created for raising safety of electricity supply is formed by the Electricity Market Law and the Regulations of the Cabinet of Ministers issued in compliance with the law. In compliance with the Cabinet of Ministers Regulations No. 503 of July 24, 2007 “Regulations on Generation of Electric Energy through Renewable Energy Resources” in 2008 decisions have been passed on assigning the right to sell electric energy generated from renewable energy resources in the form of mandatory procurable electric energy volume – to 3 biogas power stations with total installed power of 1.535 MW, by providing the annual procurement volume of electric energy up to 7370 MWh, to 7 wind power stations with power 1.503 MW, by providing the annual procurement volume of electric energy up to 4507.2 MWh and to 50 hydroelectric power stations with total installed power of 11.312 MW, by providing the annual procurement volume of electric energy up to 43138.947 MWh. In total in 2008 the decisions to grant the right to sell electric energy generated from renewable energy resources in the form of mandatory procurable electric energy volume have been issued to 60 electric power stations with the total installed capacity of electric energy production 14.35 MW, by providing the annual procurement volume of electric energy up to 55016.147 MWh.
- On May 15, 2008 the “Law on Amendments to the Electricity Market Law” came into force. The amendments prescribe that in case if the safety of the state electricity supply is threatened by insufficiency of production capacities and there has not been a possibility to compensate it by submitting permits for production of electricity, which results from the report of the electricity transmission system operator, the government shall announce a competition on establishment of new production capacities or reconstruction of the existing equipment. The winner of the competition will obtain the right to receive payments for the new electricity capacities. At the same time, the respective producer of the electricity will be entitled to participate in the electric energy market and sell the produced electricity for the agreed price to any participant of the electric energy market.
- **Gas sector.** On May 26, 2005 the Saeima passed the “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 harmonise regulatory normative acts with requirements of EU legislation. Transitional provisions of the law prescribe that the time and procedure for coming into force of the legal norms, which regulate principles for operation of the natural gas market, are determined by a special law. Concerning the procedure for coming into effect of particular sections of the Energy Law, the law prescribes that these provisions of the Energy Law will become effective as of January 1, 2010. Delivery and utilisation of natural gas are regulated by the Regulations No. 99 of February 12, 2008 “Regulations Regarding Delivery and Utilisation of Natural Gas”.

In compliance with the provisions of Directive 2003/30/EC of the European Parliament and of the Council of May 8, 2003 regarding promotion of the use of bio-fuels and other renewable fuels for transport (hereinafter – Directive) and the requirements prescribed in the Biofuel Law (15.07.2005), the share of biofuel in Latvia has to amount to at least 5.75% of the total amount of fuel used for transport until December 31, 2010.

In order to reach the objectives set in the Directive and *Biofuel Law* (15.07.2005) with regard to the use of biofuel for transport, the Ministry of Economics is working on amendments in the normative acts on providing the compulsory admixture of 5% of biofuel to the fossil fuel (by volume).

Investments in energy sector

In order to increase the efficiency of thermal energy production, decrease the loss of thermal energy in transmission and distribution systems and foster replacement of the imported types of fossil fuels with renewable fuels or domestic fuels of other types, the Ministry of Economics has drafted regulations which took effect on February 17, 2009 as the Cabinet of Ministers Regulations “Regulations on

Activity 3.5.2.1 “Measures Regarding the Increase of Efficiency of Centralised Heat Supply Systems” of Supplement to the Operational Programme “Infrastructure and Services” in the framework of the use of the Cohesion Fund establishing the procedure, by which a funding is allocated in the framework of Activity 3.5.2.1 “Measures Regarding the Increase of Efficiency of Centralised Heat Supply Systems” 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”.

In order to increase electricity and thermal energy production volumes of renewable resources substantially, diversify supply of primary energy resources and increase self-provision of electricity, thereby decreasing dependence of Latvia on the imports of primary energy resources, the Ministry of Economics has developed regulations, which came into force on February 17, 2009 as the Cabinet of Ministers “Regulations on Activity 3.5.2.2 “Development of Cogeneration Power Plants Utilising Renewable Energy Sources” of Supplement to the

Operational Programme “Infrastructure and Services” prescribing the procedure, by which funding is allocated in the framework of Activity 3.5.2.2 “Development of Cogeneration Power Plants Utilising Renewable Energy Sources” 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”.

The co-financing is foreseen from the EU Cohesion Fund resources in the amount of EUR 127.4 in 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).

87 project applications were submitted and evaluated 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 both on the Production and Distribution Side, as well as the End Consumer Side of the Heat Supply System” of SPD Sub-Activity 1.1.4.2. Co-financing from the European Regional Development Fund (ERDF) was granted to 29 project

applications. The projects foresee modernisation of heat supply systems according to environmental requirements and rise of energy efficiency both on the production and distribution side, as well as the end consumer side of the heat supply system. 6 project applications are approved and are being implemented in the framework of the national programme “Improvement of Heat Supply Systems by Reducing the Content of Sulphur in Fuel” of SPD Sub-Activity 1.1.4.1.

6.3.3. Construction Policy

The goal of the state construction policy is to create conditions to build environmentally friendly, healthy and modern buildings, while saving energy and resources. The main objective of the construction policy is the development of a competitive construction sector, promoting qualitative and energy-efficient construction, developing the efficient information circulation system, and ensuring efficient elaboration of construction law and regulations in accordance with EU requirements and market interests.

Box 6.9

Development trends of Latvian construction sector

In the recent years, construction has been one of the most rapidly developing economic sectors. The annual construction volumes nearly tripled from 2000 to 2007, however, starting with the year 2008, the construction rate has decreased. The construction volumes continue to decrease also in 2009.

Construction volumes during the 1st quarter of 2009 have decreased by 29.8% compared to the same period of the previous year, and by 8.3% if compared to the 4th quarter of 2008. Particular decrease in construction volumes in comparison with the 1st quarter of 2008 is observed in residential buildings (-64.6%), industrial production buildings and storehouses (-59%) as well as hotels and similar buildings (-54.7%).

The growth of construction costs has slowed down in 2008 and in 2009 the costs are even decreasing. The growth of construction costs was facilitated by levelling of prices among the EU member states, as well as growth of prices for energy resources and production costs.

According to the data of CSB for the 1st quarter of 2009 in comparison with the 1st quarter of 2008, the construction costs in Latvia have decreased on average by 3.5%. Compared by basic groups of resources, the most rapid decrease was in the wages of workers – reduction by 13%. While the costs for maintenance and operation of machinery and mechanisms increased by 6.3%, mainly in road construction enterprises.

The most essential problems in the sector are related to the decrease of construction volumes and market slowdown, respectively, causing insolvency of many construction enterprises. In the 1st quarter of 2009, 255 construction companies are registered in Construction Company Register, which is by 47% less than in the 1st quarter of 2008. While the common register of certified specialists contains information about 9431 certificates of builder’s practices and architect’s practices, 254 have been issued in the 1st quarter of 2009.

Quality of construction services and illegal employment remain essential problems of the sector. In 2008, the State Construction Inspection together with the State Labour Inspectorate and the State Revenue Service performed 76 inspections, inspecting existence of illegal employment, ‘envelope wages’ and violations of tax payments.

The following tasks are set up for developing the construction sector:

- improvement of the business environment by reducing administrative obstacles in construction;
- optimising the institutional structure of construction;
- promoting energy-efficient construction.

With the aim to develop the sector further and improve the business environment, a policy document

of the sector *Guidelines of Construction Sector Development for 2009–2013* has been prepared, as well as the restructurization of public administration is in process.

By optimizing the institutional structure of the construction, the State Construction Inspection is reorganized as of July 1, 2009.

Pursuant to Section 15 (14) of the law “On Local Municipalities” from now on it is a completely autonomous function of the local municipality to ensure the rule of law regarding the construction process in its administrative territory.

Recently, much attention is paid to efficient use of energy resources in buildings and the increase of energy efficiency in buildings. In compliance with the *Energy Efficiency Law for Buildings*, the Regulations of the Cabinet of Ministers were adopted on January 13, 2009 regulating the implementation of energy audits of buildings, procedure of energy certification of buildings and requirements towards energy auditors: “Regulations on Energy Auditors”, “Regulations on Energy Efficiency Calculation Method of Buildings” and “Regulations on Energy Certification of Buildings”.

Currently, two certification institutions have been accredited, which have the right to issue certificates to energy auditors. 4 energy auditors have been certified in May 2009.

In 2009, to implement measures for increasing energy efficiency of apartment houses, financing has been allocated from the European Regional Development Fund and the state budget in the amount of LVL 16.6 million.

To improve the existing normative base of the construction sector and business environment, amendments have been made in several normative acts regulating construction sector (see Box 6.10).

Box 6.10

Improvement of the normative base of construction

Normative acts adopted in 2008–2009:

1. The Cabinet of Ministers Regulations No. 238 of March 3, 2008 “Amendments to the Cabinet of Ministers Regulations No. 238 of April 29, 2003 “Statutes of the Ministry of Economics””;
2. The Cabinet of Ministers Regulations No. 475 of June 30, 2008 “Amendments to the Cabinet of Ministers Regulations No. 485 of October 29, 2002 “On Latvian construction standard LBN 242-02 “Gas distribution and users’ external networks””;
3. The Cabinet of Ministers Regulations No. 567 of June 30, 2008 “Regulations on Latvian Construction Norm LBN 208-08 “Public buildings and structures””;
4. The Cabinet of Ministers Regulations No. 589 of July 28, 2008 “Amendments to the Cabinet of Ministers Regulations No. 451 of December 23, 1997 “Regulations on Latvian Construction Norm LBN 203-97 “Design standards for concrete and reinforced concrete structures””;
5. The Cabinet of Ministers Regulations No. 588 of July 28, 2008 “Amendments to the Cabinet of Ministers Regulations No. 139 of April 21, 1998 “Regulations on Latvian Construction Norm LBN 205-97 “Design standards for brick-wall and reinforced brick-wall structures””;
6. The Cabinet of Ministers Regulations No. 499 of July 7, 2008 “Amendments to the Cabinet of Ministers Regulations No. 453 of June 28, 2005 “Regulations on Registration of Construction Companies””;
7. The Cabinet of Ministers Regulations No. 587 of July 28, 2008 “Amendments to the Cabinet of Ministers Regulations No. 140 of April 13, 1999 “Regulations on Latvian Construction Norm LBN 206-99 “Design standards for timber structures””;
8. The Cabinet of Ministers Regulations No. 660 of August 18, 2008 on “Procedure of providing information about the issued construction permits and accepting structures for service, as well as procedure of access to this information”;
9. The Cabinet of Ministers Regulations No. 1070 of December 22, 2008 “Amendments to the Cabinet of Ministers Regulations No. 256 of July 21, 1998 “Regulations on Latvian Construction Norm LBN 221-98 “Internal water-supply and sewerage system of the buildings””;
10. Decree of the Cabinet of Ministers No. 455 of July 28, 2008 “On the National Implementation Plan for Eurocode Standards for 2008-2011”;
11. Decree of the Cabinet of Ministers No. 593 of October 7, 2008 “Amendments to the National Construction Programme”;
12. The Cabinet of Ministers Regulation No. 102 of February 3, 2009 “Regulation on the Latvian Construction Norm LBN 211-98 “Multi-storey apartment houses””;
13. The Cabinet of Ministers Regulations No. 131 of February 10, 2009 “Regulations on state fee for receiving in state and local municipality institutions the technical and specific regulations necessary for construction designing”;
14. The Cabinet of Ministers Regulations No. 142 of February 17, 2009 “Amendments to the Cabinet of Ministers Regulations No. 181 of April 30, 2001 “Procedure of assessing conformity of construction products””;
15. The Cabinet of Ministers Regulations No. 299 of April 7, 2009 “Amendments to the Cabinet of Ministers Regulations No. 112 of April 1, 1997 “General Construction Regulations””;
16. The Cabinet of Ministers Regulations No. 350 of April 28, 2009 “Amendments to the Cabinet of Ministers Regulations No. 299 of April 13, 2004 “Regulations on accepting buildings for service””;
17. Amendments to the Latvian Administrative Violations Code.

6.3.4. Tourism Policy

The main goals of Latvian tourism policy are to improve competitiveness of the tourism sector and, through promotion of sustainable growth of tourism, create new workplaces, encourage balanced

development of regions, preserve cultural and natural heritage and foster social integration of the society.

In order to determine and implement state tourism development policy, a system of tourism policy planning documents and normative acts (see Box 6.11) has been created and is being improved on a regular basis in Latvia.

Box 6.11**Latvian tourism development policy planning documents**

Guidelines on Tourism Development Policy of Latvia for 2009–2015 (project) is a mid-term policy planning document establishing the basic principles of tourism development policy and the main objective of Latvian tourism development policy – sustainable and qualitative development of tourism products and services in Latvia by promoting the growth of the state export capacity and positioning of Latvia as one of the leading travel destinations in the Baltic Sea Region, as well as the development of local tourism.

In order to achieve the goal, the following directions of action are set:

- quality increase in the tourism sector;
- development of Latvian tourism product;
- marketing of Latvian tourism;
- promotion of cooperation.

Specific activities promoting tourism development in the framework of the allocated state budget are determined in action plans set for two years (and 1 for one-year plan). The *Action Plan of Latvian Tourism Development for 2009–2010 (project)* is developed in accordance with the directions of activity set in the guidelines and includes particular measures for promotion of tourism development, as well as prescribes responsible institutions, expected financing, performance deadlines and performance assessment indicators.

Horizontal tourism development measures are included in the plan, implemented by the Ministry of Economics, Latvian Tourism Development Agency, other ministries and public institutions in co-operation with local governments, the private sector and non-governmental organisations.

In the first half of 2009, several meetings of the officials of the Ministry of Economics and other ministries with social partners representing the tourism sector took place in order to discuss and find solutions

to different topical issues regarding tourism development, including the quality of taxi services, simplification of the foreign tourist declaration and visa issuing systems.

Box 6.12**Latvian tourism development indicators**

In 2008, the CSB has performed the first satellite account calculations of Latvian tourism, according to which the share of tourism specific sectors in GDP in 2004 and 2005 constitutes 3% and 4% respectively. In 2008, the share of the tourism sector was 1.5% of GDP in Latvia (1.6% in 2007) (according to the CSB data on hotels and restaurants).

Total exports of goods and services from Latvia in 2008 reached LVL 6.7 billion, 17.6% of which are tourism related services.

In 2008, the number of border crossings made by foreign tourists reached 5.5 million, which is by 5% more than in 2007 (5.2 million). Expenditures of foreign tourists in Latvia also increased by reaching LVL 403 million, which is by 19% (LVL 338 million) more in comparison with 2007. The number of persons employed directly in the tourism sector in 2008 is 34 648 – the number has remained almost unchanged in comparison with 2007.

Growth of the tourism sector in 2008 was mainly facilitated by the following factors:

- measures of Latvian tourism marketing implemented in high-priority, priority and perspective countries;
- strengthening of Latvia as a new tourist destination after accession to the European Union;
- accessibility to EU financial resources;
- development of Riga international airport, facilitating the increase of the number of transported passengers.

The data of the tourism balance of payments are still negative – expenditures of the residents of Latvia abroad exceeded the expenditures of foreign tourists in Latvia by LVL 182.1 million in 2008. In 2008, the average duration of visits of foreign tourists in this country has remained unchanging – 1.4 days, not reaching the planned annual growth to 2.5 days, which may be explained by the global tendencies – development of air traffic, changes of tourist travel habits and shortening of the travel duration thereof.

In accordance with the data provided by the Central Statistical Bureau, there were about 491 tourist campsites in 2008 in Latvia, which is by 22% more than in 2007. The number of the served guests in 2008 increased by 4%, amounting to 1555.9 thousands.

The economic situation in the country and in the world in general, as well as the increase of the VAT rate (especially for accommodation) has negatively influenced the overall development of the sector in 2009.

A considerable contribution to development of Latvian economy is made by the European Union Structural Funds, providing an opportunity to attract additional financial resources also for the development of the tourism sector. In the planning period of 2007–2013, the financial resources of the European Regional Development Fund managed by the Ministry of Economics are accessible for development of the tourism sector for the Measure 3.4.2 “Tourism” of Priority 3.4 “Quality Environment for Life and Economic

Activity” of Supplement to the Programme “Infrastructure and Services”. The goal of the measure is to promote consolidation of Latvia as a tourist destination and increase of competitiveness by creating favourable conditions for complex development of the tourism products of national importance. Two activities are planned in the framework of the measure: 3.4.2.1 “Development of Tourism Product of National Importance” and 3.4.2.2 “Development of Tourism Information System” (see Box 6.13).

Box 6.13**Utilisation of the European Regional Development Fund resources****Measure 3.4.2 “Tourism”****Activity 3.4.2.1 “Development of Tourism Product of National Importance”****Sub-Activity 3.4.2.1.1 “Maintenance and Renewal of Town Planning Monuments of National Importance and Infrastructure Adjustment to Develop a Tourism Product”**

- The goal – promoting development of cultural tourism products of national importance by ensuring internationally recognised improvement of tourism infrastructure regarding Latvian cultural and historical values;
- Amount of ERDF financing – LVL 10 542 060;
- Type of implementation – open selection of project applications;
- Potential investment locations – town planning monuments of national importance in compliance with the list of the State Inspection for Heritage Protection as of January 1, 2007;
- Beneficiaries of financing – local governments.
- First selection of project applications was organized from May 19 until July 18, 2008 and during the first selection 8 project applications were approved. Projects will be implemented during the time period from 2009 until 2011.

Sub-Activity 3.4.2.1.2 “Development of Cycling Tourism Product of National Importance”:

- The goal – facilitating development of a cycling tourism product by establishing a bikeway infrastructure and observing requirements for ensuring tourist safety and tourism resource sustainability;
- Amount of ERDF financing – LVL 4919 628;
- Type of implementation – open selection of project applications;
- Beneficiaries of financing – local governments.
- First selection of project applications was organized from July 7 until October 6, 2008 and during the first selection, 7 project applications were approved. Projects will be implemented during the time period from 2009 until 2011.

Sub-Activity 3.4.2.1.3 “Development of Cultural, Active, Health and Recreational Tourism Product of National Importance” (implementation in compliance with the Cabinet of Ministers meeting of May 7, 2009 minutes No. 23 (§ 47) *has been suspended, by removing financing from it*).

Activity 3.4.2.2 “Development of Tourism Information System” (*implementation in compliance with the Cabinet of Ministers meeting of May 7, 2009 minutes No. 23 (§ 47) has been suspended, by removing financing from it*). In compliance with the Cabinet of Ministers meeting of April 7, 2009 minutes No. 32 (§ 47) implementation of one activity (3.4.2.2) and one sub-activity (3.4.2.1.3) has been suspended, by removing financing from them.

The state policy for tourism development is implemented by the **Latvian Tourism Development Agency** (see Box 6.14).

Box 6.14**Activities of the Latvian Tourism Development Agency in the first half of 2009**

By implementing action plan for 2009, Latvian Tourism Development Agency:

- organized participation in 6 international tourism exhibitions in high priority markets (in Lithuania, Estonia, Latvia, Finland, Norway, Germany), in one of them – in the fair “ITB 2009” in Berlin, by participating in a joint Baltic stand together with state tourism organisations from Lithuania and Estonia;
- organized 3 work seminars for tourism professionals in Russia and Belarus, involving in total 250 participants;
- published informative materials on tourism: regional map of Latvia (in Latvian, Russian, English, German, Lithuanian and Estonian), brochures about top tourism objects in Latvia (in English and French) and the Baltic tourism map (in English and German);
- organized 3 visits of foreign journalists with participation of 12 representatives of mass media, as well as started planning and organizing several other visits;
- launched the new tourism portal of Latvia www.latviatourism.lv in a test mode to check the administrative system, contents and functionality of the new portal;
- jointly with the Lithuanian and Estonian national tourism organisations organises the campaign of promoting the Baltic tourism products “Great Baltic Travel 2009”, including in it 10 objects from Latvia and organizing a wide marketing campaign;
- organized already the third international work seminar for tourism professionals “Buy Latvia, buy the Baltics 2009”, by attracting 147 foreign and local tourism companies, which participated in 24 introductory tours during which an opportunity was provided to visit and acquaint with different services and products offered by the Latvian tourism sector companies;
- launched a foreign tourist inquiry in which 3000 respondents will be interviewed to know their opinion about the service quality of Latvian tourism, sources of information, motivation, satisfaction with travel to Latvia;
- continued implementation of Latvian tourism services quality system “Q-Latvia”;
- ensured publishing of professional tourism magazine “Tūrisms” (*Tourism*);
- in cooperation with Latvia Countryside tourism association “Lauku ceļotājs” (Countryside traveller) organised Latvian countryside tourism conference;
- in cooperation with the Ministry of Economics launched implementation of the European Commission project “European Destination of Excellence 2009” (EDEN), the theme of 2009 is “Development of tourism in protected nature territories”;

Box 6.14 continued

- supplemented the contents of the portal www.visitEurope.com and together with experts from other European countries participated in the development of the portal strategy, which will determine its future informative content, design, marketing activities and technical solutions. Launched the organisation of the annual e-Business Academy, a conference of European Travel Commission which will be held in Riga on October 20–25;
- ensured activity of the Baltic Tourism bureau in Berlin which is active in German market by popularizing tourism offers of Latvia and the Baltic: provides services to individual tourists, maintains homepage www.baltikuminfo.de, regularly sends news briefings to tourism professionals, ensures informative support to journalists and German tourism operators and agencies selling Baltic tourism products.

In order to ensure further international integration of Latvian tourism sector, representation of state interests, and adoption of better practice, international

co-operation is being developed, e.g., taking part in the UNWTO and the European Travel Commission, and in the work of the Tourism Advisory Committee.

6.4. Business Environment

Latvia takes the 29th position among 181 countries in the report *Doing Business 2009* published by the World Bank in 2008 (the 26th position among 178 countries in the report *Doing Business 2008*). Business environment is assessed according to 10 aspects and assessment of Latvia is reflected in the Table 6.3.

Table 6.3

Assessment of business environment of Latvia

| Sphere | 2009 | 2008 | Changes in rank |
|--------------------------------------|-----------|-----------|-----------------|
| 1. Starting a business | 35 | 30 | -5 |
| 2. Dealing with construction permits | 78 | 83 | +5 |
| 3. Employing workers | 103 | 99 | -4 |
| 4. Registering property | 77 | 91 | +14 |
| 5. Getting credit | 12 | 13 | +1 |
| 6. Protecting investors | 53 | 49 | -4 |
| 7. Paying taxes | 36 | 30 | -6 |
| 8. Trading across borders | 25 | 18 | -7 |
| 9. Enforcing contracts | 4 | 5 | +1 |
| 10. Closing a business | 86 | 67 | -19 |
| Total ranking | 29 | 26 | -3 |

Relative place of Latvia in the *Doing Business* index has increased from 2004 to 2007, reaching in 2007 the highest ranking – the 22nd position in the world. During the last years, the position of Latvia has improved in separate spheres, for instance, starting a business, paying taxes and import/export procedures. However, the position of Latvia is low in several aspects, like, dealing with construction permits, employing workers, registering property and closing a business, which has led to a small decline of the total position – to the 26th position in 2008 and the 29th position at the beginning of 2009.

To improve the ranking of Latvia in *Doing Business*, recommendations have been developed regarding construction coordination, property registration, and the regulation of labour legal relations and termination of business activities, as well as included as measures

in the Action Plan on Improvement of the Business Environment for 2009.

Taking into consideration the rapid decrease of growth in the Latvian economy, the entrepreneurs suggested to draft and adopt the *Action Plan on Improvement of the Business Environment for 2009* (hereinafter – Action Plan) timely – at the end of 2008 and launch its implementation already during the first days of this year. Therefore, the abovementioned Action Plan was adopted by the Cabinet of Ministers already on January 16. The Plan comprises 46 measures split into ten sections, such as, construction, real estate, insolvency procedure, employment, taxes, electronic communication, forestry, tourism, etc.

Taking into account the Action Plan on the Implementation of the Economic Stabilisation and Growth Revival Programme of Latvia, the deadlines for submitting the Action Plan reports and additional proposals were specified (further once per quarter – 30 days after the end of the quarter).

Thus the implementation of the already included measures is under control as well as new proposals for supplementing the Action Plan are identified in cooperation with organizations representing businesses in order to create favourable conditions for business activities by reducing administrative burdens.

Implementation of all the measures included in the Action Plan has been launched and already in the nearest future it is planned to open a discussion regarding the following measures:

- new *Construction Law*;
- draft law “Amendments to the Law on Local Municipalities”, which provides cases of pre-emptive rights to be exercised by local municipalities;
- setting standards of hygiene – for specific types of buildings by including technical regulations into the Cabinet of Ministers Regulations, the necessity to receive technical regulations in the Public Health Agency will be withdrawn and thus the costs for coordination of construction will be reduced.

Together with the report on the implementation phase of the measures included in the Action Plan for the 1st quarter, 23 additional measures were approved (the Action Plan includes 69 measures including the new measures). These measures are based on proposals to improve the situation in separate spheres submitted by organisations representing these businesses, like improvement of insolvency procedure (specifying the way of informing the debtor, prolonging the due term of debtor's liabilities, revision of the amount of resources to be arrested during insolvency process, etc.), ensuring flexibility of legal

employment relations (revision of amount of different additional payments, simplified dismissal procedure, etc.), improvement of tax administration (simplified accounting in a limited liability company with one owner, simplified procedure of transit customs declarations, simplified calculation of maximum guarantee amount for excise tax, simplified procedure for storage of oil products, etc.) and others (reduction of the number of documents to be submitted in public procurement processes, alignment of the normative base of "green" market and trade on the streets, abolishing trade restrictions in summer cafés, etc.).

Box 6.15

Implementation of the Action Plan during the first quarter of 2009

Measures of the Action Plan implemented during the 1st quarter, which will improve Latvia's ranking in comparison with other countries in the *Doing Business* report, are as follows:

In the sphere of real estate:

- speeding up the real estate registration procedure;

On March 26, the Saeima supported proposals for the Draft Law "Amendments to the Law on Land Register", which stipulate that the Land Register reviews an application for registration of an estate within 10 days (up to now – 15 days);

- reduction of the number of procedures to be implemented and documents to be submitted during the registration process of real estate;

Doing Business ranking will improve, if:

- as planned, POS terminals will be introduced in all the Land Registry offices; that would ensure collecting state and stamp duties by using payment cards and the clients will not be forced to perform payments in credit institutions. Implementation of this measure will reduce 1 procedure to be performed, when registering real estate and which according to the ranking takes one day;
- on-line data exchange will be developed and introduced between the State Unified Computerised Land Register and Local Governments' Unified Information System, which will allow the Land Register judges to access electronically information about the payment of the real estate tax. Implementation of this measure will reduce 1 procedure to be performed when registering real estate and which according to the *Doing Business* report takes 7–14 days.

The position of Latvia regarding the length of real estate registration process will be improved also by amendments to the Law on Local Municipalities drafted by the Ministry of Regional Development and Local Governments, which will stipulate the cases of pre-emptive rights to be exercised by local municipalities, since according to *Doing Business* report, 20 days are needed to receive from the municipality the refusal to exercise pre-emptive rights.

In the sphere of the legal labour relations:

On April 24, a draft law "Amendments to Labour Law" (reg./No. 1181/Lp9) was submitted to the Saeima, which prescribes that in case of the staff reduction the employer has an obligation to inform the State Employment Agency about the number of employees to be dismissed and their occupation only in cases when the labour legal relations will be terminated with at least three employees within 30-day period (currently it should be reported about 1 employee).

On May 20, during the National Tripartite Cooperation Council meeting, additional proposals to the amendments in Labour Law were examined, including issues regarding dismissal benefits as well as revision of additional payments (overtime work, work at night, and work on holidays).

An agreement was reached during the discussion organized by the Ministry of Welfare with Employers' Confederation of Latvia and Free Trade Union Confederation of Latvia on the following issues:

- changes in procedure of granting holidays to donors;
- deadline for timely notification about the planned collective layoff.

Both these amendments to the *Labour Law* will be submitted to the *Saeima* to the 2nd reading of the draft law.

In the construction sphere:

Improvement of the normative base regulating the construction process prescribes drafting a new *Draft Construction Law* that would considerably shorten the time spent to receive a construction permit and will reduce the number of procedures to be performed.

The Cabinet of Ministers Regulations of April 7, 2009 "Amendments to the Cabinet of Ministers Regulations No. 299 of April 13, 2004 "Regulations on Accepting Buildings for Service" reduces the number of procedures, necessary time and costs for passing the buildings for service, changes are to be introduced in the regulations by excluding from it the requirement to have a cadastral measurement of the building performed by the regional office of the State Land Service. While the draft regulations supported in the Cabinet of Ministers meeting on April 28 "Amendments to the Cabinet of Ministers Regulations No. 112 of April 1, 1997 "General Construction Regulations"" in order to reduce the number of technical and specific regulations to be received from state and municipal institutions for starting construction designing, provides in which cases the technical and specific regulations are to be received.

Box 6.15 continued

Setting the hygiene standards for buildings depending on their type, and including these requirements in the Cabinet of Ministers regulations would also improve the position of Latvia in *Doing Business* report, since it will reduce the number of the procedures to be performed as well as the necessary time for receiving the permit (according to the *Doing Business* in case of a production unit to be designed, drafting of technical regulations in the Public Health Agency costs around LVL 13 and takes 28 days). By including the technical regulations into the Cabinet of Ministers regulations, the necessity to receive the technical regulations in the Public Health Agency will be withdrawn and thus the costs for coordination of construction will be reduced.

By adopting the abovementioned amendments to the normative acts, the number of procedures, the necessary time and total number of days for construction coordination and accepting the buildings for service will be reduced.

For improvement of insolvency procedures:

In the sphere of insolvency, regardless of the outcome, time is important – the sooner the company is announced bankrupt or its activities are renewed, the sooner the frozen resources can be put back into business circulation. For this reason, it is equally important both, to stimulate recovery process and to prescribe a fast liquidation in cases when the company has no creditors.

When reviewing the draft law “Amendments to the Insolvency Law” in the Saeima, it is planned to exclude from the law the requirement for the administrator to submit for approval in the court the decision of creditors’ meeting on launching bankruptcy procedure, thus the insolvency process would be shortened.

Since *Doing Business* evaluates procedures on closing a business and restructuring, essential is also the task set forth to the Ministry of Justice within the framework of the Measures for Stabilisation of Macroeconomic Situation for 2008–2009 to draft a simplified liquidation procedure – for the Enterprise Register to have the right as soon as possible after receiving the application of the company, to exclude it from the Enterprise Register without announcing insolvency procedure in cases when the company has no creditors.

It should be taken into account that the *Insolvency Law* came into force in Latvia on January 1, 2008, therefore the data of *Doing Business* are based on the obsolete law. To a great extent, they reflect the outdated situation, therefore it is expected that the results regarding Latvia in *Doing Business 2010* will be substantially better.

The government of Latvia and the **Foreign Investors Council in Latvia** (FICIL) organize high level meetings to discuss the most topical issues regarding the Latvian economy and business activities. On May 22, the thirteenth meeting took place.

Traditionally on the first day FICIL visits public institutions to discuss specific problems in detail. Separate panel discussions were held with the representatives of the responsible public administration institutions on May 21. The issues put forward to FICIL discussion were as follows:

- vocational education issues (meeting with the representatives of the Ministry of Economics and the Ministry of Education and Science);
- transport issues (meeting with the representatives of the Ministry of Transport);
- taxation and macroeconomics issues (meeting with the representatives of the Ministry of Finance).

On May 22, a representative of the FICIL and the Prime Minister in the Cabinet of Ministers provided high level vision regarding these issues, followed by the FICIL presentation of its vision regarding the necessary amendments in the public administration and strategic planning. Upon the closure of the meeting, a communiqué of the government of Latvia and the Foreign Investors Council in Latvia was

adopted, in which the following development goals were included:

- to improve response to the changes in the economy, by acting timely and adequately, ensuring fulfilment of obligations undertaken by the government in order to obtain financing from external lenders;
- to concentrate available resources for economic research and in a medium-term facilitate establishment of an independent economic research capacity, thus helping to evaluate the government policies and their effect on national economy, while the forecasting models could be a good tool for knowledgeable decision making and qualitative alternative voice to the different policy makers;
- the dual-system vocational education training in Latvia could solve the problems with the quality of vocational education in Latvia, thus eliminating certain labour market mismatches. The labour market in general and employers in particular would gain access to highly qualified and motivated professionals, who have acquired most up to date practical skills as demanded by industries;
- to continue improving the tax system in order to encourage the business activities during the economic slowdown and promote the recovery of Latvian economy.

6.5. Innovations and New Technologies

In the study “European Innovation Scoreboard 2008” published in 2009, Latvia takes the 30th position among 32 countries included in the study (the 35th

position in 2008 among 37 countries, and the 29th position in 2006 among 34 countries); lower indicators in the innovation sphere are those of Bulgaria and Turkey.

According to the data of the Central Statistical Bureau of Latvia, during time period from 2004 to 2006, on average only 16.2% of enterprises were innovative.

The key factors hindering development of innovative business activities are insufficient cooperation of the science and businesses, and insufficient financing for the innovative business activities on their early stage. The main directions of activity set in the *Programme for Promotion of Business Competitiveness and Innovation in 2007–2013* for innovation development prescribes to shape public awareness about innovations, facilitate knowledge and technology transfer, promote cooperation of science, education and private sector, as well as to support development of new products and technologies.

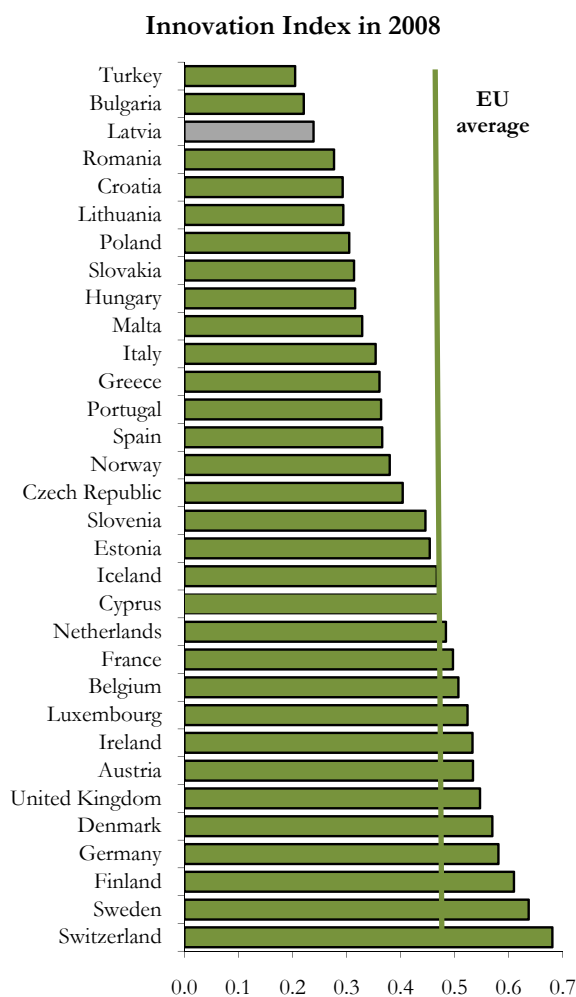
Implementation of the EU Structural Fund programme activity “Activities to encourage motivation for innovations and starting business” has been launched in 2009 to inform the society and raise awareness about innovations. The goal of the programme is to inform and to encourage the society as widely as possible, especially the youth, to start business activities, increase the prestige of business, as well as to foster understanding of the society about the role of innovations for promoting competitiveness, inform the society about events in relation to innovations and their potential, thus encouraging as large as possible part of society and businessmen to turn to development and use of innovative solutions. Particular attention is paid to motivate the youth to implement their business ideas. The Latvian innovative business idea competition “Cup of Ideas 2008” has facilitated activity of more than 400 participants, who have prepared and submitted innovative business ideas individually or in teams. It is planned to continue this competition in 2009. Annual informative seminars – Regional Innovation Days – for popularizing innovation are organised since 2006. During the seminars information is provided about financial support accessible for innovative business, including state support programmes, financial instruments, possibilities to apply for the 7th Framework Programme financing, etc., as well as about support to introduce and produce new products.

In 2009, the Investment and Development Agency of Latvia continued to implement the pilot project for the support to authors of innovative business ideas. Within the framework of the project the authors of business ideas had an opportunity to establish co-operation with mentors and potential investors, partners willing to co-operate within the idea implementation process, as well as there was an opportunity for the most successful authors to receive financing in the amount of up to LVL 5 thousand for development of the business idea. In the framework of the competition, 55 business idea applications were received, of which 16 were supported.

The Enterprise Europe Network in Latvia continues its activities in 2009. The Enterprise Europe Network is the entrepreneurship and innovation support network of EU scale consisting of nearly 600

different partner organisations within more than 40 countries and its goal is to provide informative and advisory support to entrepreneurs in order to facilitate their competitiveness and development in the framework of the European Union, as well as beyond it. Within the framework of the network the entrepreneurs can receive information and practical advice concerning trade, EU legislation, innovation development and technology transfer issues, as well as to receive consultations on involvement in the 7th Framework programme for development of science and technologies.

Figure 6.3



Source: European Commission, European Innovation Scoreboard 2008.

Inefficient technology transfer and poor cooperation of research institutions and the private sector is considered a significant problem not only in Latvia but across the European Union. To improve these spheres, several support programmes have been drafted and their implementation launched in the EU Structural Funds planning period for 2007–2013.

In 2009, implementation of the EU Structural Funds Technology transfer programme is continued. The goal of the programme is to facilitate commercializing of research results both in Latvia and abroad, as well as to gather information systematically about the existing

research competence in higher education institutions and scientific institutes. The main directions of the activity of technology transfer contact points are: providing information concerning competence of a scientific institution and knowledge and technology transfer, preparation of commercialization offers of research results, organization of co-operation seminars, conferences and contact exchanges of entrepreneurs and scientists. The Programme will be financed from resources of the European Regional Development Fund. The total public financing available in the framework of the activity amounts to LVL 1.6 million, and 8 technology transfer contact point projects will receive support until 2013. Within the framework of these projects, it is planned to prepare 424 commercialization offers, 164 Latvian patent applications and 40 international patent applications.

In 2008, the implementation of the EU Structural Funds programme **“Support for the Introduction of New Products and Technologies into Production”** was launched. In the framework of the programme, businesses have an opportunity to receive support for such initial investment in the fixed assets (acquisition and mounting of equipment, acquisition of patents and licences), which directly ensure introduction of new products or technologies into production. The maximum admissible amount of financing is LVL 350 thousand and the support intensity may be up to 35% of the referable costs of the project. The projects for the 1st selection round were to be submitted to the Investment and Development Agency of Latvia from September 29 until November 7, 2008. In the 1st selection round, 91 projects were submitted in the first project selection round, out of which 57 were approved and 50 agreements have been signed for the sum total of LVL 9.3 million until July 6, 2009.

In 2008, the implementation of the EU Structural Funds programme **“Development of New Products and Technologies”** was launched. In the framework of the programme, the businesses will have an opportunity to receive support for industrial research and experimental development, *inter alia* development of prototypes. The maximum permissible amount of financing is LVL 350 thousand, and the support intensity may constitute 25–60% for experimental development and 50–80% for industrial research of the costs referable to the project implementation. The projects for the 1st selection round were to be submitted to the Investment and Development Agency of Latvia from December 15, 2008 until January 23, 2009. In the 1st selection round, 291 projects were received, out of which 134 projects were approved.

In 2009, within the framework of the EU Structural Funds planning period for 2007–2013, development of the state support programme **“Competence Centres”** is continued with the main goal to implement cooperation of scientists and businesses and increase competitiveness of businesses by promoting cooperation of research and industry sectors for implementing industrial research, new product manufacturing and technology development projects. It is planned to launch the programme implementation in 2009.

Since 2007, **Business Incubator Support Programme** is being implemented with the goal to promote establishment and operation of new, viable and competitive enterprises in Latvian regions, by ensuring the necessary business environment, including infrastructure and advisory services. From 2007 until 2008, in the framework of the programme, a total of 178 new businesses have received support for developing their business ideas in the incubators, as well as 460 workplaces have been established and LVL 1.22 million are paid in taxes. The programme is continued in 2009 by attracting the EU Structural Funds financing, and the total amount of financing for business incubators within the period of 2009–2013 is planned in the amount of LVL 20.2 million. Within the framework of this financing the administration of at least 10 business incubators and service providing to business start-ups will be supported.

In order to facilitate synergy of new and existing innovation support instruments with support activities organized by other countries and ensure more efficient support access to businesses, the Investment and Development Agency of Latvia has engaged in several **projects of the Baltic Sea region programme**.

Activity is launched within the Baltic Sea region programme project “Joint SME Finance for Innovation” (JOSEFIN), the goal of which is to develop and provide services to SMEs in order to facilitate international cooperation of SMEs, to support efforts of SMEs to receive financing for implementation of different projects, develop and introduce easy-access financial instruments for innovative SMEs cooperation projects.

In 2009, the Baltic Sea region programme project “BSR InnoReg – Strengthening Regional Innovation Governance through Transnational Cooperation” has been launched, in which one of the main goals is to form joint instruments for facilitating innovative entrepreneurship in the Baltic Sea region outside the metropolis. The project in Latvia will be implemented through cooperation of the Latvian Technological Centre, the State Regional Development Agency and the Investment and Development Agency of Latvia.

6.6. Information Society

Information society is a social development phase based on free mutual exchange of information and

developing a knowledge-based economy. Information society consists of the technological base (infra-

structure, 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, information and knowledge are more and more widely used in work and labour relations, education and everyday life.

One of the main tasks mentioned in the National Lisbon Programme of Latvia for 2008–2010 is to facilitate expanding of ICT and its efficient use in order to develop a fully integrated information society. Two main directions can be distinguished for implementing this task – to improve accessibility to

the internet and to develop and ensure efficient e-government.

According to the CSB data, the share of ICT¹ sector within GDP reached 5.5% in 2007. In 2007, 3077 companies operated in the ICT sector in Latvia, which employed 25 562 persons, company turnover reached LVL 2.7 billion, staff costs – LVL 167 million. The value added of ICT production reached LVL 29 million, provision of ICT services – LVL 644 million. The external trade balance of ICT was negative: LVL -360.9 million, because the imports exceeded the exports considerably, which were LVL 508.1 million and LVL 147.2 million, respectively.

Box 6.16

Use of computers and Internet in Latvia

According to the data of the CSB survey “Computer and Internet Usage in Households”, 57% of all households (households with at least one person in the age group of 16–74 years) had computers and 53% of households had Internet connection in 2008. The best situation with accessibility to Internet was for households in Riga region (computers – 65%, internet – 60%) and Riga region (computers – 63%, internet – 58%), while in the other regions the situation was worse – in Kurzeme region (computers – 53%, internet – 53%), Zemgale region (computers – 52%, internet – 50%), Vidzeme region (computers – 47%, internet – 44%), and Latgale region (computers – 45%, internet – 40%). 59% of inhabitants used a computer on a regular basis (at least once in a week) and internet – 57% of inhabitants. 40% of all households had broadband internet connection.

In January 2008, 93% of all enterprises having 10 and more employees had computers, 86% of such enterprises had an internet connection and 41% of enterprises had their own internet website. 54% of enterprises having 10 and more employees used internet for communications with the public and local government institutions. 31% of all employees of enterprises used computer on a regular basis, while computer connected to the internet was used regularly by 27% of employees.

At the beginning of 2007/2008 academic year, the number of computers per 100 full-time students at higher education institutions and colleges was 13.5, 9.7 per 100 students at professional education institutions, but 8.2 computers at comprehensive schools. 100% of higher education institutions and colleges, 89% of professional education institutions and 99.6% of comprehensive schools had internet connection.

Along with accession to the EU, the EU initiatives refer to development of the information society. have become binding to Latvia (see Box 6.17), which

Box 6.17

European Union initiatives in building the information society

In order to support development of 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 establishment of work places within 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 EU investment in research on information and communication technologies by 80%;
- to achieve an inclusive European information society.

On April 25, 2006 the European Commission communicated the action plan “*i2010. E-government Action Plan: Accelerating eGovernment in Europe for the Benefit of All*” that corresponds to the initiative “*i2010*” and is focused on such important eGovernment goals for the period by 2010 as inclusion of all EU population in the use of information, provision of access to a wide range of information services, creation of an electronic public procurement system, achieving conclusion of 50% of transactions electronically and ensuring availability of all information about all public procurements, etc.

In April 2008, the European Commission published a medium-term report for establishment of *i2010*, which includes a comparison of the progress of the EU member states in the implementation of the initiative. The rapid progress of Latvia in establishment of broadband internet in 2007 is noted in the report, as well as the good knowledge level of ICT specialists. Latvia lagged behind considerably from the EU average indicators in such areas as e-government, e-business and e-health in 2007. The main reason was the small investment volume of both, the public and private sector into the ICT sector.

¹ ICT sector is set in accordance with the OECD definition, envisaging inclusion of the following types of economic activity (NACE): production of ICT (production of office equipment; production of computers and other information processing equipment; production of isolated wires and cables; production of electrons and electron-beam tubes, as well as other electronic components; production of television and radio transmitters and equipment for telephone and telegraph communications; production of television and radio receivers, sound or video cassette or playback equipment and similar goods; production of instruments and equipment for measuring, check, testing, navigation and other purposes; designing and mounting of industrial process control and supervision equipment) and provision of ICT services, including wholesale trade (wholesale trade of household electrical appliances, equipment and electric appliances; wholesale trade of computers, peripheral equipment and software, as well as wholesale trade of other office equipment and devices; wholesale trade of other electrical and electronic equipment and hardware, wholesale trade of other equipment and devices to be used in industry, trade and navigation), telecommunications (telecommunications) and services (computer and office equipment lease; consulting on the issues related to computer equipment; development and distribution of the standard software, programming upon order, consulting on the issues related to software; data processing; maintenance and operation of data bases and Internet portals; repair and maintenance of computers and office equipment; other actions related to computers).

On July 18, 2006, the Cabinet of Ministers approved the *Development Guidelines of the Information Society for 2006–2013*, which set the directions of action for development of the information society in Latvia.

The short-term priority tasks are as follows:

- to develop territorial coverage of ICT access infrastructure;
- to make ICT more accessible financially for households and SMEs;
- to provide basic skills of ICT usage to individuals and motivate them to use ICT;
- to create electronic services of public administration and use ICT in order to optimise administrative functions; ensure access to public information for local governments and entrepreneurs for provision of services and develop centres for provision of public administration services;
- to introduce e-signature and develop infrastructure for its usage.
- to support creation of online services and innovative, knowledge-intensive, and environmentally friendly products.

The directions of long-term action for development of information society are as follows:

- to expand the access infrastructure and promote ICT accessibility;
- to develop knowledge and skills of users;
- to develop services and content;
- to develop ICT usage in commercial companies and innovation;
- to develop ICT science and research;
- to promote creation of export-capable ICT products and services.

The financing from the EU structural funds and resources from the state and local government budgets will be used for implementation of the development programme.

On December 11, 2007, the Cabinet of Ministers approved “*Concept on Establishment of the Electronic Election System*”. The goal of the Concept is establishment of the electronic election system by ensuring introduction of electronic registration of voter participation and electronic voting in the local government elections and European Parliament elections. The solution envisaging previous and secret e-voting with an opportunity of repeated voting was supported in the Concept which ensures complete secrecy of voting on the highest level.

On July 21, 2008, the Cabinet of Ministers approved the “*Regulations on Sub-Activity 3.2.2.1.1 “Development of Information Systems and Electronic Services” of Supplement to the Operational Programme “Infrastructure and Services”*”. The Regulations prescribe that the total financing available for establishment, integration and development of information systems, establishment and development of e-services and digitalisation of information resources amounts to LVL 116.4 million,

of which LVL 98.9 million is ERDF co-financing and state budget financing amounts to LVL 17.5 million.

Pursuant to the Decree of the Cabinet of Ministers of April 1, 2009 No. 220 “On reorganization of the Secretariat of Special Assignments Minister for Electronic Government Affairs”, since June 1, 2009 the functions of the Secretariat of Special Assignments Minister for Electronic Government Affairs are taken over by the Ministry of Regional Development and Local Government.

Electronic services

The Cabinet of Ministers Decree No. 689 of November 10, 2008 stipulated that the Electronic Procurement State Agency shall be merged with the Secretariat of Special Assignments Minister for Electronic Government Affairs as of January 1, 2009. Pursuant to the Decree of the Cabinet of Ministers of April 1, 2009 No. 220 “On reorganization of the Secretariat of Special Assignments Minister for Electronic Government Affairs” as of June 1, 2009 the functions of the secretariat of the Special Assignments Minister for Electronic Government Affairs are taken over by the Ministry of Regional Development and Local Government. Information on e-procurement and development of e-services now is available in the home page 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.rapl.m.gov.lv).

According to the data of the State Regional Development Agency, the total sum of general agreements on procurement in 2008 reached LVL 6.296 million (incl. VAT). The largest part was made up by the procurement of antimicrobial medicines (35.7% out of the total procurement), computer equipment and printing equipment. The number of items in the e-catalogue reached 25 thousand, while the number of buyer organizations – 1358.

In September 2006, the SJSC “Latvijas Pasts” introduced the e-signature service and started the issue of e-signature smart cards. To facilitate introduction of e-signature, a competition was organised for procurement of 50 000 e-signature smart cards for the employees of public institutions. 28 657 e-signature smart cards were issued until the end of 2008. The validity term of the issued smart cards was 2 years that for 47% of the smart cards will expire in 2009, but for the rest – in 2010. Since the further purchase of smart cards will be performed by institutions at their own budget expenses, the number of smart card holders will reduce significantly.

Taking into account the small amount of available electronic services and financial loss caused by introduction and maintenance of e-signature, on May 28, 2008, the Ministry of Transport informed the Cabinet of Ministers about the proposal of the SJSC “Latvijas Pasts” not to continue provision of

certification services. The Cabinet of Ministers assigned the task to the Ministry of Transport in co-operation with Secretariat of Special Assignments Minister for Electronic Government Affairs to work on the transfer of the functions of providing certification services to another institution. The SJSC “Latvia State Radio and Television Centre” was appointed to be such an institution, which took over the abovementioned function in June of 2009.

According to the *Eurostat* data, Latvia had introduced 6 basic services or 30% (average in the EU – 58%) of the 20 basic electronic services in 2007. Introduction of new e-services took place in 2008, some of which are basic services. The internet portal www.latvija.lv contains the list of currently accessible e-services.

Broadband Internet

According to the *Eurostat* data, the share of broadband internet connections reached 15% at the beginning of 2008 in Latvia (EU-27 average – 20%) of all internet connections. Due to the project “Development of broadband communication infrastructure in rural areas” implemented with the support of EU structural funds in the period of 2006–2007, access to internet was improved for inhabitants of rural areas by providing the data transmission speed of 256 Kbit/s. However, the overall goal to provide a broadband internet connection to at least 75% of households with the download speed of at least 8 Mbit/s, as well as to provide broadband networks of appropriate quality in remote areas for the subscription price which is maximally approximated to the subscription price in the densely populated areas is set in the EU for 2010 in compliance with the initiative “i2010 – European Information Society for Growth and Jobs”.

Combating computer piracy

According to the data of the international computer program copyright protection organisation “Business Software Alliance”, the level of computer piracy in Latvia amounted to 56% in 2008, while the

losses to Latvian economy caused by piracy have reached LVL 15 million.

E-Commerce¹

17.5% of all companies in 2007 having 10 and more employees had made purchases over the internet, but 6.9% of companies had sold services and goods over the internet. The turnover of the goods and services purchased over the internet in Latvia constituted 5% of the total purchases in 2007, but the turnover of the goods sold over the internet amounted to 5.2% of the total net turnover. According to the *Eurostat*, the total turnover of e-commerce of EU companies amounted to 12% in 2007.

In the 1st quarter of 2008, 22% of all the population or 33% 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 users in the age group from 25 to 34 years (43% of internet users).

On June 28, 2007, the Cabinet of Ministers approved the *Programme on Promotion of Enterprise Competitiveness and Innovations for 2007–2013* developed by the Ministry of Economics. The key sub-objectives of the Programme are as follows:

- to provide favourable conditions for development of business activity;
- to facilitate increase of capacity and efficiency of the national innovation system;
- to achieve substantial increase of competitiveness and productivity in industry by facilitating the growth of production volumes of high value added products.

In 2008, several e-commerce development promotion measures were implemented within the framework of the programme: e-commerce information day, regional seminars, competition “*The Best E-Commerce Enterprise*”, information day on innovative e-services for small and medium-sized enterprises within the framework of the international forum “Baltic IT&T 2008: eBaltics” and other activities.

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 and Box 6.17).

Assistance to SMEs in Latvia is regulated by the *Law on Control of Aid to Commercial Activity*, which came into force on January 1, 2003.

The Cabinet of Ministers approved the “**Basic Guidelines for Development Policy of the Small and Medium-Sized Enterprises in Latvia**” on January 27, 2004. These guidelines lay down the basic principles for action of the government, long-term objectives and tasks, as well as the main directions of the SME development policy. The goal of these *guidelines* is to ensure promotion of favourable business

environment, spur initiative of entrepreneurs and lessen the total 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 Policy 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, at the same time taking also into account the specifics of SME development problems in Latvia.

¹ Data source on Latvia: CSB; data source on EU: *Eurostat*

Box 6.18**The number of small and medium-sized enterprises in Latvia**

There were 66 810 economically active individual enterprises and commercial companies in Latvia in 2007 (excluding agricultural and fishing farms and self-employed persons, who perform economic activities), of which 99.7% belong to the category of SMEs. The distribution of economically active SMEs in Latvia according to their size is similar to that in the EU member states: micro enterprises – 87.8%, small enterprises – 9.9%, medium-sized enterprises – 2%, large enterprises – 0.3%. 69.9% of the private sector employees in the country are employed in SMEs, which create 63.2% of GDP.

Important indicator characterising 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 29 in 2007.

However, it is equally important to emphasize the number of performers of individual work (self-employed persons), which amounted to 47 990 in 2007 (21 per 1000 inhabitants), and the number of agricultural and fishing farms, which equalled to 14 184 in 2007 (6 enterprises per 1000 inhabitants). Taking into account the fact that there is no single methodological practice among the EU member states for calculating such indicator characterising 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 analogous practice accordingly, Latvia had 57 performers of economic activity per 1000 inhabitants in 2007, which is close to the EU average.

According to the statistical data calculated by “Lursoft” in co-operation with the Register of Enterprises of the Republic of Latvia, 11 361 individual enterprises and commercial companies were registered in 2008. 3749 individual enterprises and commercial companies were registered in the first 5 months in 2009.

In order to promote SME development, on June 28, 2007 the Cabinet of Ministers approved the **Programme on Promotion of Entrepreneurship**

Competitiveness and Innovation for 2007–2013 worked out by the Ministry of Economics.

Box 6.19**Definition of SMEs**

Law on Control of Aid to Commercial Activity establishes the definition of SMEs (according to the EC Regulation No. 70/2001 and amendments to the EC Regulation No. 364/2004, as well as pursuant to the EC 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.

The programme includes policy actions for promotion of business competitiveness, innovative activities and industrial development, describing the vision of competitiveness promotion and of the development of innovation and industry for the next 7 years. The main goals of the programme are to provide favourable conditions for business development, to promote increase of capacity and efficiency of the National Innovation System, to achieve substantial growth of industrial competitiveness and productivity, thus fostering increased volumes of high value added manufacturing products.

The programme defines specific measures to be implemented for the improvement of the business environment, promotion of the availability of finances, development of new entrepreneurship initiatives and fostering their competitiveness, promoting awareness of society on the role of innovation in the promotion of competitiveness, for contribution to co-operation of industrial, educational and scientific sectors, transfer

and commercialization of knowledge, as well as for promotion of industrial development and improving their productivity.

Mortgage Bank of Latvia (hereinafter – Mortgage Bank) has a substantial role in the provision of support instruments¹. The most significant support programme implemented by the Mortgage Bank is a ***Support Programme on Improvement of Competitiveness of Enterprises*** adopted by the Cabinet of Ministers on May 13, 2008. By approving this programme, the government intended to support enterprises oriented on international market, production of products or providing services with high value added, technologically intensive manufacturing

¹ The Cabinet of Ministers adopted the concept “On Development of the State Joint Stock Company “Mortgage Bank of Latvia” for 2007–2013” in October 2006, prescribing a gradual transformation of the Mortgage Bank to a full-spectrum development bank. The concept determines that establishment and development of SMEs remains one of the Mortgage Bank’s priorities.

enterprises, as well as establishment of new enterprises by investment and liquid asset loans. The Mortgage Bank of Latvia started implementing the programme in July 2008 and by the end of the year, 32 loans were allocated within the programme in the amount of LVL 9.9 million, including LVL 7.2 million – investment loans, LVL 2.7 million – liquid asset loans. The spectrum of the supported enterprises is quite extensive – wood processing, logging, production of biodiesel, food production, polygraphy, production of glass fibre, provision of services, etc.

Along with the standstill in the global financial markets, at the end of 2008 the business environment deteriorated and credit risk increased. This situation had a negative impact also on implementation of the programme. On the one hand, many potential support receivers were cautious in taking decision on investment in some certain industry. On the other hand, the bank required risk compensation measures for further successful implementation of the programme.

On February 17, 2009, the Cabinet of Ministers adopted Regulations “*On the Loans for the Improvement of Enterprise Competitiveness*”, prescribing that the Mortgage Bank will grant loans for improvement of enterprise competitiveness in the amount of LVL 210 million. In the framework of these regulations, the range of enterprises was extended – now, along with the small and medium-sized enterprises, also large enterprises with economically justified action plans and without an access to credit institutions financing due to increased risk, may receive a support. The regulations specify the total budget of LVL 210 millions, and in the framework of the programme by December 2013, investment and liquid asset loans will be granted, and the total amount of a loan to one enterprise will not exceed LVL 6 million. Loans are mostly intended for projects of processing enterprises and enterprises attracting financing from EU Structural Funds grant programmes. The Mortgage Bank will make a decision on granting loans on the basis of a business plan and loan application submitted by an enterprise, and in accordance with the principles of banking business. The programme plans to grant liquid assets and investment loans to 430 enterprises.

Decree No. 752 of the Cabinet of Ministers of December 2, 2008 supported ***Micro Crediting Programme of Latvian Small and Medium-Sized Enterprises*** assigning its implementation to the Mortgage Bank. The Programme is aimed at introducing a mechanism of micro crediting for small and medium-sized enterprises and self-employed persons, as well as to promote an access to micro credits for starting a business activity or its development. The micro loans are intended for the implementation of business projects – investments and liquid asset loans – for enterprises with up to 10 employees, as well as for self-employed persons working outside Riga. The Mortgage Bank grants micro loans in the amount of up to LVL 3000

attracting cooperative credit unions, established in accordance with the territorial principle and operating outside Riga city territory, in granting and monitoring micro loans, if necessary. The total budget of the programme amounts to LVL 565 thousand, including a contribution from the Ministry of Finance in the amount of LVL 452 thousand¹ and LVL 113 thousand – financing from the Mortgage Bank. It is expected that the programme will be fully absorbed in 2009, supporting up to 300 enterprises. In the framework of the programme, 35 micro loans in the amount of LVL 92.6 thousand were granted by May 2009.

Together with the Mortgage Bank and its branches also the ***Support Programme Department ALTUM*** (ALTUM) provides support to entrepreneurs. It implements support programmes financed by the state and the EU, granting high-risk loans to sustainable and perspective projects of SMEs and business beginners, which are not financed by commercial banks due to insufficient collaterals and other risks of the project.

Since the establishment of the department in 2005, the following support programmes have been implemented:

- *ERDF Crediting Programme for Business Starters* (2006–2008) – 291 loans granted to business starters in the amount of LVL 22.76 million resulting in about 1500 new work places;
- *ESF Programme of Training and Consultations and Financial Support* (2006–2008) – in the framework of the programme almost a thousand of potential business beginners have been trained, loans for implementation of 327 projects of business beginners have been granted in the amount of LVL 5.84 million, in addition, the beginners received also grants (for company establishment, payment of consulting services, providing subsistence) in the amount of about LVL 2.2 million;
- *Crediting Programme of Rapidly Developing SMEs* – 229 loans in the amount of LVL 16.2 million have been granted to rapidly developing SMEs (unlike the previous two programmes, this one is financed by the Mortgage Bank on its own account);
- *Housing guarantee programme* (2006–2008) – in the framework of the programme, co-operation agreements with two commercial banks (*Nordea, DnB NOR*) have been concluded and guarantees to 231 bank clients in the amount of LVL 2.48 million have been allocated for acquisition of housing; this amount of guarantee allows partner banks to allocate loans in the amount of LVL 11.6 million to such groups of population as tenants of denationalized houses, families with children,

¹ The contribution from the Ministry of Finance is made by funding from the EU PHARE programme LE9201 “First SME Financing Programme”, which by the means of a letter from the European Commission dated on May 21, 2007, is referred to the government of the Republic of Latvia for SME crediting.

inhabitants of apartment blocks (mainly the owners of privatised flats).

On March 31, 2009 the Cabinet of Ministers has approved Regulations establishing the procedure of implementation of a programme *Support to Starting Self-Employment and Entrepreneurship* co-financed by the European Social Fund (ESF). The programme's implementer is the Mortgage Bank (ALTUM). The programme is aimed at increasing economic activity in the country, developing business knowledge and skills of beginners, as well as providing financial support. The target group of the programme comprises working-age persons willing to start business, as well as new businesses registered with the Commercial Register not earlier than one year before submission of an application. According to the programme, the Mortgage Bank (ALTUM) shall:

- provide training on basic economic activities and preparation of a business plan for persons, who are willing to start business and require such training;
- give consultations about support available, evaluate business plans;
- grant loans for implementing economic activities envisaged in the business plan created by economic activity beginners (up to LVL 54 thousand), as well as grants for economic activity (35% from the amount of a loan granted, not exceeding LVL 3.6 thousand) and loan repayment (20% from the amount of the loan, not exceeding LVL 2 thousand).

Supportable projects for business beginners may not exceed LVL 60 thousand and the beginners must provide a co-financing of 10%. The total financing of the programme is LVL 23 million, including LVL 14 million from the ESF and state budget, as well as LVL 9 million co-financing from the Mortgage Bank. In the framework of the total funding of the programme, LVL 17.5 million are planned for loans, LVL 4 million – for grants, training and consultations. It is planned to start a complete implementation of the programme in July 2009 with training of 1200 beginners by the end of 2013 and granting funds (loans and grants) to 600 beginners.

The “**Latvian Guarantee Agency**” (hereinafter – LGA) is a state-supported institution with a goal to support accessibility of financing for small and medium-sized enterprises of Latvia, **by issuing:**

- **loan guarantees** as the necessary additional security for receiving the loan in a commercial bank;
- **financial leasing guarantees** as an additional security for receipt of industrial leasing;
- **export credit guarantees;**
- **co-financing investments in Latvian small and medium-sized enterprises by specially established risk capital funds.**

In 2005, the Support Programme for Development of the Guarantee System drafted by the Ministry of Economics was approved by the European Commission. Since the programme has been launched, the LGA has developed and introduced guarantee products of investment loans, current asset loans and financial leasing. The LGA has also carried out wide-scale information measures, in order to inform the entrepreneurs and credit institutions about the guarantee products and procedure for their receipt. The results of the programme are summarized in the Table 6.4.

Table 6.4

LGA Guarantee Programme Results

| | 2005 | 2006 | 2007 | 2008 |
|--|------|------|------|------|
| Number of the issued guarantees | 20 | 31 | 129 | 192 |
| Amount of the issued guarantees (million LVL) | 0.9 | 2.3 | 11.0 | 20.6 |
| Amount of the guaranteed credits (million LVL) | 1.8 | 6.0 | 21.1 | 35.3 |

In 2005, the State Support Programme for Development of the Risk Capital System was approved by the European Commission in order to develop a risk capital system. In the framework of the Programme, LGA announced a tender in 2005 for selection of the managing companies of the risk capital funds. Eight applications for establishment of risk capital fund management companies were received, of which the companies LLC “Zaļās gaismas investīcijas”, JSC “Eko Investors” and LLC “TechVentures Fondu Vadības Kompānija” were chosen as the winners of the tender, and contracts were concluded with them, establishing 3 risk capital funds – limited partnerships respectively: “ZGI fonds”, “Otrais Eko fonds” and “INVENTO”. By the end of 2006, the risk capital funds attracted private investors, among them such several institutional investors of Latvia as the JSC “Atklātais pensiju fonds SEB Unipensija” and the JSC “Pirmais Slēgtais Pensiju Fonds”. The risk capital funds started their investment activity at the beginning of 2007, by ending the year with investments in 15 companies with the total amount of LVL 3.5 million. After the conclusion of the programme in 2008, the number of companies having received support has increased to 28 and the total amount of investments – to LVL 11.7 million.

The LGA provides a mechanism according to which the businesses may receive a real financial support for implementation of innovative business ideas by means of a guarantee for the receipt of credit or leasing in Latvian commercial banks.

On March 10, 2009 the Cabinet of Ministers adopted Regulations “*On the Activity 2.2.1.3. “Guarantees for the Improvement of Enterprise Competitiveness” of the Operational Programme “Entrepreneurship and Innovations”*”. The goal of the regulations is to provide the enterprises with

access to funding for the development of commercial activities and for the implementation of EU projects via ensuring guarantees in situations when the guarantee at the disposal of the enterprise is not sufficient to attract credit resources for 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 of the existing ones. The LGA guarantees are provided for such financial services as investment loans, liquid asset loans, financial leasing and local factoring. The guarantees cover up to 80% of the basic amount of financial service, but not more than EUR 3 million to one enterprise. The maximum term of a guarantee to loan investments and financial leasing is ten years, and three years for liquid asset loans and local factoring.

On April 20, 2009, the LGA and the Ministry of Economics signed an agreement on the implementation of the OP “Project “Guarantees for the Improvement of Enterprise Competitiveness” of the Activity 2.2.1.3 “Guarantees for the Improvement of Enterprise Competitiveness” of the Measure 2.2.1 “Access to Financial Resources” of the Priority 2.2. “Access to Finances” of the Supplement

“Entrepreneurship and Innovations.” The ERDF financing accessible in the framework of the activity is LVL 20 million.

Since the programme has been launched, there has been a considerable activity of businesses. As of May 15, 2009, the LGA has received applications for guarantees from 41 companies – 16 of them have been approved and 4 are already issued.

The guarantees issued by May 15, 2009 and their amount is shown in Table 6.5.

Table 6.5

Guarantees Issued by the LGA in the framework of the Activity 2.2.1.3 “Guarantees for the Improvement of Enterprise Competitiveness” (02.04.2009 – 15.05.2009)

| | May 15, 2009 |
|--|--------------|
| Number of applications (enterprises) | 41 |
| Amount of applications (million) | 14.0 |
| Number of the issued guarantees | 4 |
| Amount of the issued guarantees (million LVL) | 0.2 |
| Amount of the guaranteed credits (million LVL) | 0.4 |

6.8. Competition Policy

The Competition Council (hereinafter – CC) is responsible for development and implementation of the competition policy in Latvia. Its goal is to promote the opportunity for market participants to perform economic activities under conditions of a free and fair competition, as well as to facilitate development of competition for the public interests in all economic sectors.

The CC acts in accordance with the *Competition Law* and three directions of activity defined in the Operational Strategy of the CC for 2007–2009 are as follows:

- Protection of competition;
- Promotion of competition;

- Strengthening the role of the CC in development and implementation of EU legal acts and in international organisations and networks.

Protection of Competition

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 the mergers of enterprises. From the beginning of 2009, the competence of the CC in relation to prohibition of unfair competition and handling of violations of the *Advertising Law* has been changed (see Box 6.20).

Box 6.20

Changes in competence of the CC

The amendments to the *Competition Law* of January 1, 2009 and to the *Advertising Law* of November 28, 2008 prescribe that as from January 1, 2009 the CC does not control unfair competition and misleading and comparative advertisements without a significant impact on competition in general. After enforcement of the abovementioned amendments, the cases of unfair competition and misleading and comparative advertisement, a violation of which has not caused or cannot cause a significant damage to competition, are subject to ordinary courts, freeing state resources from examining the case and collecting evidence in cases without a significant damage to competition and public interests.

The Amendments to the *Competition law* also prescribe that as from January 1, 2009 the participants of merger are exempted from a responsibility to submit a merger report in cases, when a turnover of one participant of merger in previous financial year does not exceed LVL 1.5 million.

In the first half of 2009, the CC has adopted 8 final decisions, four of which are related to the abuse of dominant position, three – to merger of enterprises and one – concerning unfair competition. In the framework of one decision, the CC established an

abuse of dominant position (see Box 6.21). The violation clearly shows that the market participant may cause major damage to competing commercial companies by abusing its dominant position in the market and violating the *Competition law*.

Box 6.21**The CC imposes a penalty on the Freeport of Riga Authority for the abuse of dominant position**

The CC made a decision on penalty in the amount of LVL 45 000 and application of legal obligations to the Freeport of Riga Authority for abuse of dominant position, which has manifested itself as a hindrance of competition in tugboat services market in the Freeport of Riga.

After acquisition of tugboats and together with the beginning of economic operations in services market in the Freeport of Riga, the Freeport of Riga Authority has abused its dominant position against another participant of the market – tugboats service provider LLC “PKL flote”. The violation expressed itself as an amendment of existing transaction without an objective reason resulting in distorting and influencing competition in tugboats services market. Thus, upon beginning of operations in the tugboats services market, the Freeport of Riga Authority created unjustified advantages for itself compared to other tugboat services providers.

In order to terminate the existing violations and monitor unfavourable consequences to competition, as well as to prevent violations from repeating in the future, in the framework of the CC’s decision, legal obligations were imposed on the Freeport of Riga Authority.

In order to ensure immediate and voluntary termination of the violations and prevention of damage to the competition, the CC has a right to make a decision on termination of case investigation, if a member of the market provides a written determination to fulfil certain legal obligations eliminating limitation of competition. Such a decision at the beginning of 2009 was made in two cases. For example, upon receipt of written determination of the LLC “Preses Serviss”, a case on violation of the

Competition Law in operations of the LLC “Preses Serviss” was terminated (see Box 6.22). As the Amendments of March 13, 2008 to the *Competition Law* allow termination of investigation upon a written determination of a market participant to eliminate limitations to competition provided that market participants assume their legal obligations, the decisions by the CC on termination are essential for the market participants to understand practical application of new legal norms.

Box 6.22**The CC comes to an agreement with the LLC “Preses Serviss” on violation of the *Competition law* established in operations of the LLC “Preses Serviss”**

Upon a written determination of the LLC “Preses Serviss” to assume legal obligations eliminating negative consequences of illegal operations on competition, the CC took a decision to terminate investigation of the case on abuse of dominating position in operations of the LLC “Preses Serviss”.

In the result of the competition, the LLC “Preses Serviss” has received trading rights of Riga public transport single tickets – the LLC “Preses Serviss” performs both, wholesale and retail trade of the tickets. The LLC “Preses Serviss” has a dominant position in the wholesale of the tickets in the territory of Riga city – as may be seen from an agreement concluded between Riga municipality enterprise – LLC “Rīgas Satiksme” and LLC “Preses Serviss”.

The violation in operations of the LLC “Preses Serviss” manifested itself as discriminating and unfair discounts to retailers (price reductions to different retailers ranged from 3% to 6%. However, they were not proportional to the amount of tickets ordered – frequently higher price reduction is applied to retailers, whose turnover had been smaller), similarly different payment terms were applied to retailers (ranging from immediate payment up to 45 days).

The CC has also established that the price reductions granted by the LLC “Preses Serviss” are not proportional to the price reductions granted by the LLC “Rīgas Satiksme” to the LLC “Preses Serviss” itself – after an increase of price reductions from the LLC “Rīgas Satiksme” received on the basis of increase in the costs of retailers, the LLC “Preses Serviss” has not increased price reductions to retailers.

On January 21, 2009 the CC received a written determination from the LLC “Preses Serviss” including a determination to assume the legal obligation to eliminate application of disproportional price reductions and payment terms for ticket retailers, thus eliminating and excluding further hindrance, limitation or deformation of competition in ticket retail market in Riga. In the framework of the abovementioned document, the LLC “Preses Serviss” determines to change applicability of the payment terms, and advance payments, as well as price reduction interest rates, basing further operations on the number of tickets ordered in a month.

The decision of the CC (except for decisions, which are not subject to appeal – on bringing an action, beginning of additional investigation in events of merger control of market participants and prolongation of decision making) may be appealed in the Administrative Court of Appeal within one month from the date of the entry into force of this decision. In the first half of 2009, the Court adopted five final decisions by which the decisions of the CC under appeal remain in force. The decision of the Administrative Court of Appeal to maintain the

decision of the CC on violation of the *Advertising Law* by the JSC “Parex Asset Management” (see Box 6.23) effective is significant to understand the interpretation of prohibition set by the *Advertising Law* – since the cases on violations of the *Advertising Law*, which cannot cause significant damage to competition, are not investigated by the CC from January 1, 2009, when the amendments to the *Advertising Law* have come into force, the unfairly implicated market participants may defend their interests in court bringing a civil claim by themselves.

Box 6.23**The court maintains the decision of the CC on violation of the Advertising Law in operations of the “Parex Asset Management” effective**

The Administrative Court of Appeal passed a judgement maintaining decisions of July 17, 2006 and August 14, 2006 on violations of the *Advertising Law* by the JSC “Parex Asset Management” advertising its pension plans, effective. The judgement of the court has entered into force and is not reversible.

The decision of the CC supported by judgement provides clear frameworks for surveillance practice of the *Advertising Law*. The court has recognized that the advertisement may mislead a consumer, if it contains general statements without a clear reduction (limitation) to current situation. Similarly, an advertisement is considered to be misleading if it lacks (withholds) information, which might have a significant impact and change the statements in the advertisement. It has been stressed by the court that the text of advertisement must contain information, which itself is true and unchangeable by additional information – the text of advertisement must be true despite any additional information obtained by the consumer himself/herself or elsewhere, e.g., from a shop assistant.

It was established by the decision of the CC that in the advertisements of pension plans the JSC “Parex Asset Management” has used misleading comparative data and withheld information essential for consumer – namely, the statement included in the advertisement: “Parex pension plans – the highest long-term profitability!”, the growth of 26% from the beginning of its operations was acknowledged to be misleading since all pension plans offered by the JSC “Parex asset Management” have not had the highest profitability. Moreover, it withheld the information necessary for a consumer to make an objective choice on starting point of advertised pension plans from which the growth by 26% of the advertised pension plans is achieved. “Parex Asset Management” was obliged to cancel the advertisement in the framework of the case communicating it in the same way and amount as the misleading advertisement (this legal obligation has been fulfilled). At the same time, the CC adopted a decision to impose a penalty on the JSC “Parex Asset Management” in the amount of LVL 3000 (also the penalty has been paid by “Parex Asset Management”).

Promotion of competition

This direction of activity comprises supervision and investigation of market sectors, as well as formation of a competition culture in society.

Using information gained on deliberately chosen markets in the framework of market supervision, the

Competition Council performs a competition situation analysis, if necessary, drafts and submits proposals for improvement of the competition situation to competent institutions and verifies, whether there are no violations of the *Competition Law* in the respective market.

Box 6.24**Proposals drafted for improvement of competition situation in motorway construction and engineering construction market**

There are three studies carried out for the CC about the competition situation in the public and municipal procurements from 2004 until 2007 in motorway construction and engineering construction market. In the framework of the study, a situation analysis and proposals for its improvement have been made.

It has been found out that high barriers for market entry for new market members are characteristic for the above industries – in order to start a business, there is a need for large investments and for acquisition of expensive, specific technology that may not serve for other purposes, as well as for previous experience in similar works which has to be certified in case of participation in a procurement procedure. Similarly, a lack of qualified staff is also a significant limiting factor.

The studies conclude that a client had a comparatively large influence in the sector of the motorway and engineering construction, since it is easy to change the contractors. However, in order to retain competition and motivation of the contractors to offer lower prices, the client – mostly in the public sector – is interested in competition of the market participants.

Since a significant part of the abovementioned sectors – motorway and engineering construction – in the whole industry is formed by public sector procurement, a large part of the proposals relate directly to improvement of the procurement procedure. Although a decrease of administrative limitations to participate in procurements is established, there are still possibilities to reduce barriers without a negative impact on efficiency of procurement procedure. Such improvements might include electronic access to procurement documentation imposing minimal or no charge, standardisation of the requirements for qualification documents for projects of similar profile, development of a list of tenders.

For a procurement procedure to be as favourable to the client as possible, it is recommended to develop unified cost estimate standards establishing electronic procurement system and to arrive at electronic submission of tenders, as well as to introduce mechanisms enabling the client to control the actual costs of construction comparing their compliance with the real market prices.

In order to develop a competition-friendly policy to encourage competition in the abovementioned sectors, the authors of the study suggest to develop clients also in the private sector (e.g. transferring specific areas of infrastructure to private management and thus creating new potential clients interested in efficiency), improve the procurement winner selection criteria on the basis of future life cycle costs of infrastructure object, not only construction (the emphasis on a price as the only winner selection criterion does not facilitate the quality of work and might raise long-term costs). Similarly, clients' competence on preparing labour contracts should be improved and predictability of construction policy and at least credible mid-term investment planning should be encouraged, thus enabling the entrepreneurs to plan their investments in technologies improving productivity of work.

In the first half of 2009, the CC continued supervision of the initiated in 2008 and started additional supervision of mail and courier services market, book retail market and retail market of daily consumer goods. The CC finished supervision of the payment card market and veterinary and

breeding services market. As a result of information gained in the supervision, the CC made proposals to state institutions and market participants, as well as made decisions on further proceedings. At the same time, continuing supervision cases and inspection measures in retail market, the CC brought two

actions on abuse of dominant position in retail trade.

At the beginning of 2009, the CC has published the results of several studies performed by independent experts:

- “Study of competition situation in pharmacy market, vertical and horizontal integration, price formation system.” Within the framework of the study, the competition situation has been characterised on the level of producers, wholesalers and pharmacy. Similarly, price formation mechanism, administrative regulations, access to medical products, distribution aspects of original and generic medicines have been examined. In the framework of the study, proposals to improve competition situation are made;
- “General study on competition conditions and situation in non-specialized stores of retail sector.” This study has been carried out to analyze the state of competition environment in non-specialized stores of retail sector and its perspectives, as well as to evaluate the influence of suppliers and consumers on competition in food retail.
- “Competition situation study on motorway construction works completely financed from the state and municipal budget,” “Competition situation study on motorway construction works co-financed by the EU Structural Funds” and “Competition situation study on engineering works (in the framework of public and municipal procurement).” In the framework of the study, a situation analysis was carried out, as well as proposals on its improvement were drafted.

Strengthening the role of the Competition Council in development and implementation of EU legal acts and in international organisations and networks

With gradual removal of national boundaries in European and world economy, it is essential to acknowledge and take over in a timely and effective manner the best practice of other countries in application of legal regulations, establishing equal conditions for entrepreneurs sharing the space in the EU, therefore, the representatives of the CC participate in international organisations and competition networks.

The CC participates in the work of the European Competition Network (ECN), **the goal** of which is to ensure the opportunity **for the competition**

authorities of the EU member states to discuss the application of the Article 81 (prohibited agreements) and Article 82 (abuse of dominant position) of the EC Treaty, as well as to facilitate cooperation among them.

In the first half of 2009, the members of the CC have participated in the ECN plenary sessions on matters of relevance for competition authorities, as well as several meetings of expert working groups on banks and bank payments, horizontal co-operation agreements and questions related to co-operation aspects of competition authorities.

In April 2009, the CC was represented at the annual meeting of the European Competition Authorities (ECA) discussing issues on competition policy and current events of competition authorities. Similarly, a representative of the CC participated in a meeting of working groups organized by the ECA discussing issues on legal obligations in relation with termination of a case without establishing a breach of formal rules.

In 2009, the representatives of the CC have participated also in such important international events as the OECD Global Forum on Competition during which a representative of the CC provided information on Latvian experience in merger cases, a seminar organised by the International Competition Network (ICN) on efficiency of competition authorities, a seminar organised by the Energy Community Secretariat on competition and energy, a symposium organised by German Research Institute about competition and innovations, and a meeting organised by Advisory Committee to European Commission about restrictive practices and dominant position.

In 2009, in co-operation with German Federal Ministry of Economics and Technology and Federal Competition Institution *Bundeskartellamt*, the Competition Council implements Transition Facility *Twinning Light* project No. LV/2006/EC-01TL “Further economic research and analysis capacity strengthening of the Competition Council.” The main objective of this project is to improve the Competition Council’s capacity for economic analysis as a tool to increase competitiveness of national economy within the framework of the Lisbon Strategy goals. In 2009, several missions of German experts took place, in the framework of which seminars and trainings were organised for the CC staff concerning application of economic analysis in investigation and market surveillance activities of the Competition Council.

6.9. Regulation of Public Utilities

In accordance with the Law on Regulators of Public Utilities, a two-level regulation system of public utilities is established in Latvia on the state and local government level.

The Public Utilities Commission (hereinafter – Commission) regulates the public utilities on the state level, while the local government regulators regulate the sector of services in the respective municipal territories supervising heat supply (except combined heat and power), water supply and sewage, municipal waste management (with the exception of municipal waste recycling) sectors. Since the regulator functions independently, the Commission does not supervise the local government regulators and is not authorised to influence their operations.

The Public Utilities Commission is a multi-sector regulator performing regulatory functions in the sectors of energy, electronic communications, postal services and railway transport. The task of the Commission is to ensure the opportunity to receive uninterrupted and safe services to all users for economically reasonable prices and for businesses providing public services – to ensure the possibility to develop 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. Members of the Commission's Board are appointed by the Saeima and only a court may declare decisions taken by the Commission unlawful and repeal them. Activities of the Commission are financed from the state duty paid by businesses 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 businesses that operate therein, protecting the interests of users and fostering development of public utility providers, setting tariff calculation methodologies and approving tariffs in accordance with the laws of each sector, issuing licenses and registering general authorisations, promoting competition in the regulated sectors, settling disputes extra-judicially and supervising compliance of the provided services with license and general authorisation conditions and specified quality requirements.

On November 20, 2007 a delegation agreement on regulation of public utilities in the Riga City administrative territory has been concluded, and since January 1, 2008 the Commission has been regulating the provision of public services as business in the municipal regulated sectors (heat supply, water supply and sewage, waste management) in the administrative territory of Riga City.

On December 16, 2008 the Cabinet of Ministers adopted amendments to the Regulations No. 1068 of December 28, 2004 “Regulations on the Rate of the

State Fee for the Regulations of Public Utilities and Payments Procedures thereof” reducing the annual rate of the state fee for each type of public services within the state-regulated sectors to 0.17% of the net turnover of respective service provided in the previous calendar year and within the municipality-regulated sectors – to 0.35% of the net turnover of the respective service provided in the previous calendar year, if the municipality in accordance with the Law on Regulators of Public Utilities has concluded an agreement with the Public Utilities Commission on regulation of public utilities in municipality-regulated sectors in administrative territory of the respective municipality.

In March, April and May 2009, the Saeima reviewed Amendments to the Law on Regulators of Public Utilities prescribing the establishment of a joint regulator adding municipal regulators to Commission and creating regional structural units.

Situation and policies of the regulated sectors

Energy sector

In the energy sector (see also Chapters 3.3.3 and 6.3.2), electricity supply and gas supply are regulated by the state. The dominant role in electricity supply is held by the JSC “Latvenergo”, which generates more than 90% of the electricity produced in Latvia and ensures supply of electricity, as well as delivery to those users, who have not chosen another supplier. As from September 1, 2005 all functions of electricity transmission system operator are carried out by the JSC “Augstsprieguma tīkls” fully owned by the JSC “Latvenergo”, but as of July 1, 2007 the functions of distribution system operator are carried out by the JSC “Sadales tīkls” fully owned by the JSC “Latvenergo”.

Electricity is also generated by about 150 small hydropower stations with the total capacity of 25 MW, 14 wind power stations with the total capacity of 25 MW and 39 cogeneration plants with the total capacity of 137 MW. In addition, 12 other enterprises have received licences to carry out distribution and sale of electricity.

Latvian electricity market is completely open to competition starting from July 1, 2007 and since the second half of 2008, the largest electricity users buy electric energy for the agreed price, several electricity users have changed their electricity supplier.

In compliance with the Commission's decision of December 12, 2007, starting from January 1, 2009 it is allowed for the JSC “Latvenergo” to set the differentiated electricity tariffs for the captive users. Transmission and distribution network service tariffs proposals submitted by the JSC “Augstsprieguma tīkls” and JSC “Sadales tīkls” at the end of 2008 were rejected by the Commission in March 2009.

Supply of natural gas in Latvia is ensured by the vertically integrated enterprise – JSC “Latvijas Gāze”.

In order to prevent an increase of the gas price, the Commission adopted a decision on January 28, 2009 appointing JSC “Latvijas Gāze” to apply the natural gas trade price set for January 2009 also in February, March and April 2009 to the large users for which the gas price is set each month.

From May 1, 2009 the tariffs of natural gas decreased by 13–17% for large users depending on consumer groups. In general, the JSC “Latvijas Gāze” forecasts that the tariffs for large users in August 2009 might be by 25–32% lower than in April 2009. Tariffs for households in their turn will change on July 1, 2009 and it is expected that users, who use gas stoves and water heaters will receive a decrease by 16%, but the users who use gas heating – by 25%.

On April 22, 2009 the European Parliament approved a draft legislative package aimed at contributing to more competition and consequently to wider choice, energy efficiency and energy security and lower prices in the energy market.

It is planned to increase the competition in electricity and gas companies separating production and supply operations from networks management. The Member States have a chance to choose one of the three models: full ownership unbundling, independent system operator or independent transmission operator.

The draft legislative package also imposes restrictions on third country operators: Regulatory Authorities of the Member States will have to reject applications by management operators controlled by third countries, if they do not observe EU requirements on ownership unbundling, as well as, if the potential market participant endangers the security of supply. However, exceptions concern small and isolated energy markets: Latvia, Estonia, Lithuania and Finland will not have restrictions against third countries in gas market, if there are no pipeline connections with other EU Member States.

The draft legislative package – two regulations and three directives – contains regulations on establishment of co-operation agency of energy regulators, development of network access codes and emergency procedures, as well as envisages requirements for strengthening powers of national regulators. The EU Member States must guarantee legal and financial independence of regulatory institutions – performing functions set in the directive, the regulator does not take instructions from the

government or other public or private structures, the budget of the regulator must be independent and separate.

Electronic communications and postal services

420 companies were registered and actively operated in the sector of electronic communications as of May 14, 2009. In the postal sector, the state JSC “Latvijas Pasts” provides general postal services, while approximately 40 service providers operate actively in the sector of express mail.

On May 7, 2009 the European Commission adopted recommendations concerning termination rates. EC specifies that the termination rate on national level should be set only on the basis of actual costs incurred for termination when a certain operator is making a connection. Aligning the tariffs with actual costs and eliminating the price differences between the EU telephone operators will reduce the consumer prices on voice calls within one Member State and between them, thus in the period from 2009–2012 resulting to savings for companies and households in the amount of approximately EUR 2 billion, as well as providing support to investments and innovations in the entire communications sector. This approach to the termination tariffs will have to be applied for all EU national regulators starting with the end of 2012. However, the national regulators with limited resources will be allowed to use different approach for a certain period after this date, provided that equivalent result in competition has been achieved.

The Commission plans to publish a *Consultation document* with proposals on solutions applied for tariff reduction on calls in fixed and mobile public electronic networks in Latvia.

Railway

In the railway sector, the state JSC “Latvijas Dzelzceļš” ensures maintenance of public railway infrastructure. Domestic passenger transportation is carried out by the JSC “Pasažieru vilciens” and the LLC “Gulbenes-Alūksnes bānītis”. In the sector of cargo transportation, there are also several operators, such as the LLC “LDz Cargo”, the JSC “Baltijas ekspresis” and the JSC “Baltijas tranzīta serviss”.

On November 29, 2008 the Commission fixed a fee for the usage of public railway infrastructure for transportation in 2009. The fee set for 2009 on average is by 13.6% higher on cargo trains and by 17.7% higher on passenger trains in comparison with the previously applied one (within the train schedule of the period for 2007/2008).

6.10. Export Promotion Policy

The Ministry of Economics develops and implements Latvian foreign economic policy, with the aim of stimulating a favourable trade balance and promoting competitiveness of Latvian companies in

the markets of foreign countries. This goal is achieved by implementing three policy directions: promotion of exports and investment attraction, state support instruments and contractual provision.

These directions are included and implemented within the framework of the *Latvian Export Promotion Programme for 2005–2009* (EPP), setting the goals and main tasks of export promotion policy and the results to be achieved. The EPP has been implemented within the framework of annual action plans, comprising work co-ordinated by several public institutions. Implementation of the EPP is supervised by the Export Promotion Council, consisting of representatives of public institutions, industry associations and social partners.

Promotion of exports and investments is implemented by introducing the **direct export promotion measures** in the framework of the EPP Action Plan by 2009. A wide range of support services is available to Latvian exporters in order to increase export capacities and promote exports of Latvian goods and services. In 2008, different export support services have been provided, including 1578 consultations to enterprises concerning issues related to exports, including about foreign markets, 23 seminars on export skills and informative seminars on foreign markets, specific trading requirements, 21 missions of Latvian enterprises, also in the framework of the visits of Latvian officials to foreign countries in which about 370 entrepreneurs participated, as well as 81 individual business visits to the potential co-operation partners in the foreign countries. Active identification and implementation of export and investment projects has continued.

10 foreign economic representative offices of Latvia – in Germany, United Kingdom, Sweden, France, Russia, 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 making and maintaining business contacts, providing information about the requirements of the respective foreign market, implementing the marketing measures of export promotion and attracting investment in foreign countries, as well as the measures of finding co-operation partners by identifying the potential investors and business partners.

Implementation of Activity 2.3.1.1 “Access to International Trade Markets” and operation of the export credit guarantee system are prescribed in the framework of the measure “Business Support Activities” of the EU Structural funds operational programme of 2008–2013 “Entrepreneurship and Innovations”.

In the framework of this Activity, wide support is planned for the enterprises **in implementation of external marketing measures** – participation in exhibitions, contact exchanges, trade missions, organisation of seminars and conferences. **In**

December 2008, the Investment and Development Agency of Latvia started to accept project applications for the sub-activity “External Marketing” in order to support external marketing in foreign countries, as well as the measures promoting integration of enterprises in the international supply chains, facilitate participation of Latvian entrepreneurs in the international exhibitions and trade missions, including single national stands. 358 projects were submitted for a total amount of LVL 5.9 million and by May 2009 – 156 projects have been approved for a total amount of LVL 2.7 million.

The financing available in the framework of the Sub-Activity “Access to International Trade Markets – External Marketing” is LVL 5.27 million.

Short-term export credit guarantees (for up to two years) are provided to improve competitiveness of Latvian enterprises in export markets. Implementation of this system will allow increasing the export volumes (particularly to countries with high degrees of risk), extending export markets (the CIS region, economies showing rapid economic growth, etc.), as well as strengthening in the existing markets. Export credit guaranties are available for all companies representing all sectors of the economy.

Regulations No. 436 of the Cabinet of Ministers of May 12, 2009 “Regulations on Short-Term Export Credit Guarantees” have been adopted, forming the normative base for short-term insurance of export transactions. Regulations determine coverage for short-term export credit guarantees, receivers, procedure of granting guarantees and procedure of recovering losses by the guarantor. In accordance with the regulations, short-term export credit guarantees are issued by the LLC “Latvian Guarantee Agency” (hereinafter – LGA). The programme has been co-financed by the EU Structural Funds in the amount of LVL 20 million. As of June of 2009, the Latvian Guarantee Agency has started to accept the applications of enterprises and 14 guarantee applications were received until July 15.

Guidelines on Promotion of Exports of Latvian Goods and Services and Attraction of Foreign Investments for 2010–2016 were approved by the Decree No. 413 of the Cabinet of Ministers of June 19, 2009 developed by the Ministry of Economics, sectoral associations and social partners.

The guidelines cover all economic sectors and determine basic principles of export promotion and attraction of foreign investments, aims and main directions for the further seven years.

The main directions of action include an increase of competitiveness, contractual provision and support instruments for enterprises.

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 supervision of consumer rights.

On January 15, 2008 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. In March 2009, the Ministry of Economics submitted to the Cabinet of Ministers *Progress Report on the Implementation of the Consumer Rights Protection and Market Surveillance Programme for 2008–2010* during its first year of operation, providing information on measures implemented in

accordance with the main directions of action of the programme:

- improvement of the normative base of consumer rights protection;
- establishment of favourable business environment, implementing adequate and efficient market surveillance and supervision of normative acts of consumer rights protection;
- informing consumers and entrepreneurs on issues of consumer rights protection and promoting education of consumers;
- improving the procedures for settlement of domestic and cross-border extrajudicial disputes;
- promotion of operations of consumer rights protection institutions.

Box 6.25

Changes in the normative acts regulating consumer rights

In order to improve the normative base of consumer rights protection, to ensure efficient consumer rights protection, taking into account the particular economic situation, and to improve the consumer rights protection measures, in 2009 drafting of amendments in the *Law on Consumer Rights Protection* and the *Latvian Administrative Violations Code* continued.

The main goal of the draft **amendments to the Law on Consumer Rights Protection** is to improve the applicable procedure for examination of consumer complaints in order to ensure their faster and more efficient examination, as well as to eliminate certain shortcomings in the regulation of the law in the framework of implementation of *Directive 1999/44/EC of the European Parliament and of the Council of May 25, 1999 on certain aspects of the sale of consumer goods and associated guarantees*. The draft law foresees to improve the situation of borrowers in the future, for example by restricting the rights of banks to request the revaluation of property, additional collateral for the granted loan or early repayment of the loan, if no substantial breach of agreement has been made, as well as by obliging the creditor to examine the consumer's request to extend the repayment term of the loan or to change the currency of the loan. Additionally, the draft law foresees to introduce changes in the procedure for examination of consumer complaints granting rights to the Consumer Rights Protection Centre (CRPC) to assess the relevance of consumer complaints with respect to protection of collective interests of consumers. CRPC has also been granted the right to make a decision on temporary regulation if there are grounds to believe that a breach of consumer rights has been or can be made and it could lead to immediate and substantial damage to the economic interests of a certain consumer group. To ensure a faster and more effective settlement of consumer disputes, the amendments prescribe to establish that the decisions adopted by the CRPC after July 1, 2009 will not be litigated in a higher institution – the Ministry of Economics, but are appealed against in a Regional Administrative Court.

With the amendments in the **Administrative Violations Code** it is foreseen to solve problems with regard to time-limit of the application of administrative penalty for violation of consumer rights, as well as to separate fines and differentiate them according to the seriousness of the violation. The draft law also lays down liability for the use of uncalibrated measuring devices, for placing on the market, offering or selling of goods or services noncompliant with safety requirements, or goods that exceed the allowed quantity of hazardous substances, or goods noncompliant with essential requirements or technical parameters, for failing to submit written information stipulated in the normative acts when concluding agreements with consumers regarding granting of temporary rights with respect to residential buildings or parts of buildings, as well as specifies certain sanctions.

As concerns safety of goods, on March 17, 2009 the European Commission's General Product Safety Directive Committee adopted the **Commission Decision 2009/251/EC requiring Member States to ensure that products containing the biocide dimethylfumarate are not placed or made available on the market**, which, as of May 1, 2009 defines the restrictions with respect to import of goods containing dimethylfumarate (DMF) from third countries and their availability to consumers in the European Union. DMF is a fungicide that is added to goods or inserted in their packaging in little bags and, during transportation, protects leather and textile products from influence of moisture preventing them growing mouldy and deforming. However, consumers in direct contact with DMF-treated goods, e.g. furniture, footwear or clothing, can develop allergic reactions of different severity (dermatitis, redness, irritation, burning, eczema, and in some cases heavy breathing difficulties) the treatment of which can be time-consuming and difficult, thus there is a high risk to consumer health. Since the beginning of 2007, in the EU, several thousand people have suffered due to handling DMF-treated goods (especially in France, Spain, Great Britain and Finland). The goods involved (leather furniture, footwear, textile products) were mainly produced in China. In Latvia, goods containing DMF have not been found.

The work on the proposal for a **Directive on Consumer Rights of the European Parliament and of the Council**, approved in the European Commission on October 30, 2008. The proposal was drafted after the review of consumer *acquis* that was

started in 2004, in order to simplify and upgrade the effective regulations by establishing a real and functional EU internal market for business deals among entrepreneurs and consumers and by finding the appropriate balance between high level consumer

protection and competitiveness of entrepreneurs. Within the proposal, four directives in the field of consumer contractual rights are reviewed:

- Council Directive 85/577/EEC of December 20, 1985 to protect the consumer in respect of contracts negotiated away from business premises;
- Council Directive 93/13/EEC of April 5, 1993 on unfair terms in consumer contracts;
- Directive 97/7/EC of the European Parliament and of the Council of May 20, 1997 on the protection of consumers in respect of distance contracts;
- Directive 1999/44/EC of the European Parliament and of the Council of May 25, 1999 on certain aspects of the sale of consumer goods and associated guarantees.

The draft directive prescribes uniform definitions, as well as uniform requirements for the information provided to consumers before conclusion of the agreement and the information to be included in the agreement, right of withdrawal (duration of its validity, application procedures and consequences), regulates the seller's responsibility for goods noncompliant with the provisions of the agreement, new regulations of unfair provisions of the agreement is stipulated. At the moment, ongoing discussions are held regarding the application of the principle of complete harmonisation to all provisions of the directive.

Supervision of consumer rights

The Consumer Rights Protection Centre (hereinafter – CRPC) operating under supervision of the Ministry of Economics is the main co-ordinating institution that supervises compliance with the normative acts of consumer rights protection. The CRPC reviews applications and complaints of consumers about noncompliance of purchased goods or services with agreement terms, gives practical help to consumers in cases of solving conflict situations, protects consumer rights in legal proceedings, represents interests of consumers in the process of drafting normative acts, gives consultations on consumer rights protection legislation and compliance of goods, and co-operates with international consumer rights protection bodies and national institutions of consumer rights protection of other countries.

Information about consumer rights is available on the CRPC website www.ptac.gov.lv, as well as on the website of non-governmental organisations for protection of consumer interests www.pateretaja-celvedis.lv. These websites contain information on the valid legislation of consumer rights protection, different goods and services, as well as possibilities to protect lawful rights of consumers. In accordance with the Regulations No. 631 of August 1, 2006 of the Cabinet of Ministers on “Procedure for Submission and Review of Consumer Claims Concerning Goods or Services Noncompliant with Agreement Terms”,

in August, the CRPC created and posted a database of examiners on its website, where 17 examiners are registered. However, a larger diversity for examination of various goods and services would be desirable.

The activity results of the *Consumer Rights Protection Centre* in 2008 and in the 1st quarter of 2009 are as follows:

- In 2008, 32 850 consultations have been provided. In the 1st quarter of 2009, 14 077 consultations have been provided which is twice as many as in the same period of 2008. The significant increase is due to the fact the Daugavpils Regional Administration was reorganised into a Consumer Call Centre, i.e. consultations on the phone are provided by three people instead of one as it was before, and this allows ensuring higher quality and more accessible consultations.
- In 2008, 3486 consultations were provided to entrepreneurs.
- In 2008, 2631 complaints were examined, which is by 23% more than in 2007, but in the 1st quarter of 2009, 770 complaints were examined, which is by almost 15% more than in the same time period of 2008. The number of complaints tends to grow considerably in the recent years, which could be explained by both, the economic activity of residents and the greater consumer awareness about their rights. In 2009, due to the recession of the country's economy, the subjects and contents of the complaints have essentially changed. Hundreds of people turn to CRPC who, due to different reasons, have encountered problems with respect to their relations with their creditor (often the interest rate for mortgage loans, as well as for credit lines and credit cards) and also the number of consumers searching for help because they can not cover their credit payments, is increasing rapidly.

Since 2008, 2631 complaints have been examined and in 773 cases the result has been in favour to consumers, while from 770 complaints that have been examined in 2009 only 13% had a solution favourable to consumers.

Out of 2008 complaints, received in 2008, regarding the goods noncompliant with provisions of the agreement, most complaints were received about electric appliances, mobile phones and footwear. In 2009, trends have changed, and 20% from the received complaints (207 complaints in the 1st quarter of 2009) regarding goods noncompliant with provisions of the agreement have been about purchased apartments and houses.

The majority of all complaints (in 2008 – 718) are complaints regarding services noncompliant with the agreement terms – on construction, travel services, air traffic services, rent and public utilities, individual

orders of furniture, as well as electronic communications services. In the 1st quarter of 2009 in comparison with the 1st quarter of 2008, number of complaints on services has decreased by 37%.

While examining the consumer complaints, the CRPC employees actively co-operate with the employees of different institutions in Latvia and other EU Member States. The complaints are examined in compliance with the legal regulations set in the normative acts.

Monitoring of advertisements and unfair commercial practice

In 2008, the CRPC assessed 4956 advertisements, of them 63 – upon individual applications. Examination of cases was started on 221 occasions. In 2008, administrative penalty was imposed in 26 cases. The largest number of violations was established in advertisements of special promotions.

In the 1st quarter of 2009, the CRPC started examining cases in 49 instances, including 17 cases upon individual application. In the 1st quarter of 2009, in 16 cases the violation has been eliminated upon CRPC request.

The supervision sphere of the CRPC has considerably expanded from January 1, 2008, because the *Unfair Commercial Practice Prohibition Law* has come

into force, which means that the CRPC supervises not only advertisements, but also commercial practices of any kind – activities (behaviour, statement, commercial communication, marketing) or inaction (default), which directly relate to trade promotion, sale of goods (tangible or intangible goods) or provision of services to a consumer.

In 2008, investigations of 86 cases on unfair commercial practices have been examined, including launching of proceedings on misleading commercial practice in 86 cases and on aggressive commercial practice – in 4 cases.

In the 1st quarter of 2009, investigations of 28 cases concerning unfair commercial practices have been initiated.

Due to the amendments made to the *Advertising Law* and due to enforcement of the *Unfair Commercial Practice Prohibition Law*, the CRPC has introduced a new practice – requesting the performers of commercial practices and advertisers to undertake in writing to eliminate violations within a particular term. In 2008, out of 56 requests to eliminate violations of advertising regulations, the entrepreneurs have undertaken to fulfil it in 25 cases; out of 23 requests to eliminate unfair commercial practices, a written consent to fulfil these requests has been provided in 3 cases.

Box 6.26

Misleading commercial practice via chat services

In several printed publications, advertisements about Photo Chat were published, that included photos encouraging people to meet other people by sending text messages at high price. When examining this advertisement it was found that no price was indicated or that it was indicated unclearly in the advertisement, and the procedure for terminating the service was not indicated as well, therefore it presents a breach of the *Unfair Commercial Practice Prohibition Law*. After examination, it was concluded that LVL 1.5 has to be paid not only for a text message sent, but also for every text message received from the chosen Photo Chat partner. The consumers also were not informed, how to terminate this service, since the website www.fotochat.lv only had information on how to terminate the sending of advertisements, due to which consumers suffered substantial financial losses. After the CRPC's request, publishing of these advertisements in printed publications was stopped, and the mobile telephone operators also agreed to terminate the operation of these phone numbers used for sending and receiving the text messages till the compliance of the commercial practice with the requirements of the normative acts will be ensured. At the moment, administrative proceedings are conducted against the distributor of these advertisements.

Supervision of agreements

In 2008, the CRPC has examined 576 applications regarding unfair and unequal terms of agreements; from these 157 applications were about unfair and unequal terms of real estate purchase agreements, and 106 applications were about consumer crediting agreements. Upon the CRPC's own initiative, in 2008 the centre has examined 48 agreements. In comparison with the previous year, the number of cases of unfair agreement terms that have been found has increased, which is due to the CRPC's activity in this field, as well as due to the growing level of consumer awareness when they undertake contractual liabilities.

In the 1st quarter of 2009, the CRPC examined 173 agreements due to applications received, which is by 12 times more than in the 1st quarter of 2008. From the applications received, 112 were regarding consumer crediting agreements. This reflects the

current trends and consequences related to the economic situation in the country in general – consumer problems with repaying their loans and creditor activity increasing interest rates and proposing agreement amendments.

The most frequent unfair terms in agreements with the consumers are as follows:

- prescribing settlement of disputes only by the court of arbitration or by the court of arbitration at claimant's choice;
- prescribing disproportionately large penalty to be paid by a consumer in case of non-fulfilment or inadequate fulfilment of contractual obligations;
- infringement of legitimate rights of a consumer;
- prescribing rights to the service provider to alter terms of agreement unilaterally;
- prescribing rights to the service provider or vendor to unilaterally keep the advance

payment paid by a consumer, while not providing such opportunity for the consumer.

In 2008, publishing of decisions regarding collective consumer interests continued on the CRPC's website (www.ptac.gov.lv) in the section "Decisions of the CRPC".

Box 6.27

Example of unfair agreement terms

Decision on automatic activation of services

The CRPC, examining the website of the JSC "Air Baltic Corporation", found that, when booking tickets, the consumer was able to cancel the flight due to illness only in the booking system on the website by deactivating the respective option and not by the consumer activating it. Likewise, on the website, it was automatically accepted that the consumer agrees to pay for one baggage item, as well as to receive commercial notices.

The CRPC with Decision No. 66-pt of July 30, 2008 requested the JSC "Air Baltic Corporation" to implement changes in the ticket booking system on the website, in the future offering the consumers a possibility to activate the respective options related to receipt of services and other offers on the website of the company by themselves.

Unfortunately, the airline company has not implemented the decision and the CRPC has initiated a compulsory infringement procedure.

Also in the 1st quarter of 2009, as it was in 2007 and 2008, the CRPC dedicated a lot of work to informing the entrepreneurs about different issues of consumer rights protection, providing entrepreneurs, before adoption of decisions, with a broadened

assessment of terms of agreement or of other information offered by them in order to enable entrepreneurs to prevent violations of consumer rights voluntarily.

Box 6.28

The projects implemented by the CRPC with respect to supervision of agreements at the end of 2008 and the 1st quarter of 2009

Inspections of Internet Websites

In 2008, examination of 21 cases has been started in relation with violations of Law on Information Society Services, including the examination of 6 cases upon individual applications. The violations mainly concern failure to provide information on services, as well as indication of prices for goods and services and supply.

In 2008, the CRPC inspected 11 websites of airline companies flying to the Riga airport. Violations were discovered on two websites. The main violations concerned automatic choice of a service, as well as provision of incomplete (delayed) information on the price of service. In one case, due to the fact that the airline company is not registered in Latvia, a request to implement measures for violation elimination was sent to the competent authority in Ireland. In the second case, a binding decision was made, as well as negotiations organised on implementation of changes to indicate a final price on the website that is easier for consumers to understand. At the moment, the way of indicating the price on the website has improved, however, the CRPC's decision regarding the automatic choice of a service still has not been implemented.

Supervision of KASKO agreements

By June 2008, the CRPC implemented a project on assessment of KASKO insurance agreements and of information provided before the conclusion of agreements. In the framework of the project, 10 KASKO insurance agreements were inspected. On March 7, 2008 a discussion was organised with participation of the CRPC and the insurance company, as well as representatives of the Latvian Insurers Association and the Financial and Capital Market Commission in relation to the study carried out regarding the information provided before conclusion of an agreement and regarding the assessment of insurance agreements and its results.

As a result of the CRPC's activities, the insurance providers undertook to eliminate the majority of non-compliances found by the CRPC, as well as to pay higher attention to problematic issues that could significantly improve the situation in the field of KASKO insurance. Several of the insurance companies have already eliminated some of the non-compliances. As a result of individual discussions, several insurance companies undertook to create descriptions of products that would help consumers to understand the specifics of a certain service easier.

Cross-border trade

As the number of population emigrating from Latvia and the number 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 (ECC Latvia) was established as a separate department of the CRPC, co-financed by the European Commission.

In 2008, consumers addressed the ECC Latvia 548 times, out of which 418 were consultations and

130 – complaints. 58% of the received complaints concerned air traffic services, 3% – tourism, 1% – clothing and footwear, 3% – to low quality household appliances, 8% – to e-commerce, 27% – accessories, as well as other issues.

31% of the provided consultations were related to air traffic services, 15% – to low quality household appliances, 9% – to clothing and footwear, 21% – to e-commerce, 4% – to tourism services, 2% – to accessories, and 18% of consultations were given on EU normative acts and other services.

Box 6.29**International cooperation of the CRPC****Measures of cross-border administrative cooperation**

In 2008, in accordance with the Regulation (EC) No. 2006/2004 of the European Parliament and of the Council on cooperation between national authorities responsible for the enforcement of consumer protection laws, the CRPC sent 10 requests to implement the necessary measures to eliminate violations of regulative normative acts in the field of advertising made by companies not registered in Latvia. Similarly, 8 requests were received from the competent authorities of Sweden, Estonia and other countries to carry out the respective actions to eliminate unfair agreement terms in website of a company registered in Latvia.

ICPEN International cooperation network

(International Consumer Protection and Enforcement Network)

Also in 2008, the CRPC participated in the Sweep Days (subject – Offers of Tourism Packages) organised by the ICPEN, in the framework of which the employees of the CRPC inspected websites of tourism companies, paying attention to whether the prices for tourism packages are indicated and whether consumers are being misled. The CRPC found potential breaches in 13 websites, which will now receive higher attention. In March 2008, the CRPC organised Fraud prevention month in the framework of which the agreements of 10 largest insurance companies were examined, as well as a discussion was organised with the representatives of insurance companies during which several agreements were reached on changes in insurance agreements as well as advice prepared for consumers when choosing their KASKO insurance.

The CRPC has involved and operates in such international organisations as PROSAFE concerning safety of goods and services, and there is also regular cooperation between the Baltic States, taking into account the cooperation agreements concluded with consumer protection institutions of the Baltic States.

In the 1st quarter of 2009, after the consumers had contacted ECC Latvia, 23 complaints were examined and 118 consultations provided in relation with solving of cross-border complaints of consumers. In the case of cross-border complaints, assistance is provided to a consumer in finding an institution for solution of a complaint, but decisions are not adopted in regard to a foreign entrepreneur.

48% of the received complaints concerned air traffic services, 9% – low quality household appliances, 9% – e-commerce, and 35% – other goods and services.

30% of the provided consultations were related to air traffic services, 8% – to low quality household appliances, 8% – to clothing and footwear, 12% – to e-commerce, 3% – to tourism services, 39% of consultations were given regarding EU normative acts and other services.

In relation with the contact exchange organised by the Representation of the European Commission in Latvia and in the framework of open day on September 19, 2008 consumers were informed about activity of the European Consumer Information Centre and informative materials were disseminated on EU normative acts in the field of consumer protection.

On November 3, 2008 the 4th Workshop of the Baltic States was organised concerning the exchange of good practices with respect to the system of settlement of extrajudicial disputes in the Baltic States, where ECC Latvia representatives from 8 ECC-Net EU Member States took part – Denmark, Estonia, Finland, Germany, Sweden, Poland, Lithuania and Hungary, as well as the employees of the Ministry of Economics and the Consumer Rights Protection Centre.

In order to provide wider information to consumers on consumer rights in the EU, the ECC

Latvia continues to regularly supplement the information in the homepage www.ecclatvia.lv, providing consumers with more qualitative information of cross-border purchases and information on how to act in the cases if poor quality goods or services are acquired. Since the opening of the ECC Latvia, the homepage has been visited 8485 times from 47 different countries of the world, including also the countries, which are not in the EU.

Market surveillance

In 2008, the CRPC set such priority directions in the market surveillance as toys and children's goods (cots, baby walkers, nappy changing tables), baby-proof lighters, individual protection equipment, electric appliances and wheeled transport. After performing safety tests of the goods, it was found that there is a negative trend of on average 50% of the goods to be unsafe. Unfortunately, in 2009, due to lack of funding, testing of goods was possible only to a small extent.

In 2008, the CRPC carried out 3208 inspections in trading and service provision companies. In the 1st quarter of 2009, 257 examinations were carried out and 1146 types of goods have been inspected.

In 2008, Twinning Project LV/2006/IB/EC/01 "Strengthening of market surveillance" was implemented. The general goal of the EU Bilateral co-operation project is to strengthen capacity of the CRPC by adopting knowledge and experience of consumer rights protection and market surveillance institutions of the United Kingdom in accordance with the EU directives.

The specific goals of the project were implementation of new market surveillance methods and procedures in the CRPC work and improvement of competence of the CRPC employees.

Box 6.30**In 2008, the following supervision projects were implemented:**

- **Project on safety of electric appliances and improvement of compliance**
 - Energy efficiency of luminescence light bulbs
 - Electric appliances
- **Project on improvement of compliance of construction services**
- **Project on improvement of compliance of individual protection means**
 - Improvement of safety and compliance of sunglasses
 - Improvement of safety and compliance of mountain skiers' helmets
 - Reflectors and reflective vests
- **Project on improvement of compliance of gas and pressure installations**
 - Pressure installations
 - Installations that use gas fuel
- **Project on improvement of compliance of toys and goods for children**

Additionally, in 2008 the CRPC has carried out inspections in the following fields:

- radio equipment and terminals of electronic communications network;
- compliance of lighters;
- procedure of supervising the indication of price;
- wheeled vehicles and their parts;
- children's playgrounds.

Within the framework of all projects, inspections were conducted at the trade sites of goods, as well as at importers by inspecting, whether the goods have all the necessary labelling, the necessary documentation stipulated in the normative acts, as well as samples of the goods were taken for testing. The market surveillance projects implemented by the CRPC may be viewed on the CRPC website www.ptac.gov.lv, as well as in the public report on 2008.

State metrological supervision

In 2008, the following measures of supervision have been carried out in the CRPC:

- in order to establish compliance of measuring instruments with the normative requirements, 22.1 thousand measuring instruments were subjected to state metrological supervision in 577 enterprises, incl.:
 - 5516 measuring instruments in 420 trading companies;
 - 14 992 measuring instruments in 124 production companies;
 - 1387 measuring instruments in 24 health care companies;
 - 178 measuring enterprises in 9 public administration institutions.

Out of the inspected measuring instruments 963 or 4.4% of the total number were acknowledged as noncompliant with the normative requirements, among them measuring instruments without the necessary certifications of conformity assessment, inadequately labelled, as well as used by violating the repeated verification terms set by legislative requirements. As a result of the metrological supervision, binding instructions for prevention of violations were given and administrative violation reports for non-observance of metrological requirements were prepared for 19 natural and legal persons, administrative reports were prepared and decisions adopted in accordance with the Article 99 of the *Administrative Violations Code of Latvia*;

Projects for supervision of manometer market and fuel filling apparatus (FFA) market were implemented in order to clarify compliance of measuring instruments to be sold at wholesale trade sites with the

metrological requirements of normative acts, as well as to eliminate the established violations in order to reduce the risk of placing on the market and handing over for use in the regulated sphere such measuring instruments that are noncompliant with the normative requirements.

In order to verify the correct fulfilment of measuring processes, test measures in 72 gas stations that belong to 39 fuel selling companies were carried out. 144 metrological tests were conducted. In 15 fuel selling companies or 38% from the total number of examined companies non-compliances were found – the actual offset of measures exceeded the offset allowed by the normative acts.

Control of pre-packed goods was performed in 3 production and wholesales companies, where 344 consignments of goods were inspected (a test of statistical control was performed). Non-compliances were detected – 28 consignments of goods or 8.1% of the total number of inspected consignments did not comply with the normative requirements regarding the actual volume of content. During the report period, in total, administrative violation reports for non-compliance of the volume of content of pre-packed goods with the normative requirements were issued for 8 legal persons and decisions were adopted in accordance with the Article 99 of the Latvian Administrative Violations Code.

The CRPC continuously co-operates with metrological supervision institutions of other countries and takes part in the working groups WG5 “Metrological Supervision” and WG6 “Pre-packages” of the European Co-operation in Legal Metrology (WELMEC).

6.12. Quality Assurance

6.12.1. Quality Structural Policy

The main task in the area of quality assurance is to promote observance of the requirements of normative acts in the regulated and non-regulated sphere, as well as to improve the base of normative acts in accordance with the EU requirements, taking into account the needs of the national market and national economy, hence ensuring compliance of the products placed on the market and of the provided services, and encouraging increased competitiveness of enterprises and reduction of obstacles to international trade.

The national quality assurance system in Latvia is regulated by the *Law on Conformity Assessment*, the *Standardisation Law* and the *Law on Uniformity of Measurements*, as well as by the Cabinet of Ministers regulations deriving from the abovementioned laws.

The main directions of the policy are as follows:

- 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 economy in order to protect consumers and environment from low-quality products and services, promote growth of competitiveness of enterprises and reliability of products and services provided by the Latvian entrepreneurs;
- improvement of the informative and consultative base;
- participation of national institutions of accreditation, standardisation and metrology in international organisations, ensuring their international recognition and compliance of the Latvian quality assurance system with international requirements;
- maintenance and international comparison of the national base of metrology standards in order to ensure the necessary traceability of measurements and protect the society from inaccurately conducted measurements;
- encouraging introduction of quality management system, environmental and other voluntary quality systems in enterprises in order to ensure production of higher-quality products and provision of higher-quality services, as well

as competitiveness of Latvian enterprises in international markets;

- improvement of the market surveillance system in order to provide equal conditions to all market participants and protect consumers from the potential unfair competition of companies.

Taking into account the cut of state budget financing in 2009, the normative acts have been amended and stipulate that, as of January 1, 2009 the functions in the field of accreditation and metrology of the state agency “Latvian National Accreditation Bureau” and of the state agency “Latvian National Metrology Centre” are now assigned to the State Agency for Metrology and Accreditation.

Taking into account the amendments to the law “On the State Budget for 2009”, as well as implementing the Cabinet of Ministers Decree of May 29, 2009 No. 351 “On liquidation of the State Agency for Metrology and Accreditation” and transferring its functions to the SIA “Latvijas standarts”, the State Agency for Metrology and Accreditation has been liquidated and a company with limited liability “Standartizācijas, akreditācijas un metroloģijas centrs” (Standardization, Accreditation and Metrology Centre) was registered in the Republic of Latvia Enterprise Register on June 30, 2009. As of July 1, 2009 the company performs the tasks in the spheres of standardization, accreditation and metrology provided by the normative acts (Standardization law, law “On Conformity Assessment”, law “On Uniformity of Measurements”, as well as other related laws providing that the former functions of the State Agency for Metrology and Accreditation and SIA „Latvijas standarts” as of July 1, 2009 shall be performed by SIA „Standartizācijas, akreditācijas un metroloģijas centrs”).

As of July 1, 2009, the equipment and the sources of ionizing radiation of the Secondary standard dosimetry laboratory of the State Agency for Metrology and Accreditation have been passed to the Ministry of Environment.

With the purpose of improving the base of normative acts and thus also the conformity assessment infrastructure, a draft law “Amendments to the Law on Conformity Assessment” (See Box 6.31) has been developed.

Box 6.31

Draft law “Amendments to the Law on Conformity Assessment”

The draft law envisages simplifying procedures for notification and publishing by defining that the Latvian National Accreditation Bureau at the limited liability company “Standartizācijas, akreditācijas un metroloģijas centrs” (“Standardization, Accreditation and Metrology Centre”), in accordance with the notification procedure defined in 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, shall notify the European Commission about the competent authorities for conformity assessment which operate in the regulated sphere.

Box 6.31 continued

The draft law prescribes simplifying procedures for notification and publishing by defining that the State Agency for Metrology and Accreditation, in accordance with the notification procedure defined in the Regulation (EC) No. 765/2008 of the European Parliament and of the Council of July 9, 2008 setting out the requirements for accreditation and market surveillance relating to the marketing of products and repealing the Regulation (EEC) No. 339/93, shall notify the European Commission about the competent authorities for conformity assessment, which operate in the regulated sphere, as well as shall publish a list of the competent authorities for conformity assessment in the Official Journal of Latvia (“Latvijas Vēstnesis”).

The draft law defines the procedure for financing the accreditation system more clearly, providing that the assessment, accreditation and monitoring of the competent authorities for conformity assessment is not funded from the state budget.

In order to ensure the independence of decision making in the field of accreditation in accordance 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, the draft law envisages that decisions with respect to accreditation of the competent authorities for conformity assessment are taken by the Head of the Latvian National Accreditation Bureau of the company with limited liability “Standartizācijas, akreditācijas un metroloģijas centrs”.

The draft law prescribes authorising the Cabinet of Ministers to adopt regulations of the Cabinet of Ministers regarding the Latvian Quality Award by supplementing the respective section of the law, which lays down the operational principles of the national quality assurance system.

In the second half of 2009, by improving the infrastructure of the conformity assessment system, and at the same time ensuring the economy of the state budget resources, it is planned to gradually put in order the base of normative acts by drafting respective amendments also in the normative acts resultant from the related laws.

6.12.2. Metrology, Accreditation, Standardisation

Metrology. In the first half of 2009, the Metrology Bureau (MB) of the State Agency for Metrology and Accreditation (SAMA) carried out SAMA tasks in the field of metrology. As of July 1, 2009, the Metrology Bureau (MB) of the company with limited liability “Standartizācijas, akreditācijas un metroloģijas centrs” is the national metrology institution of Latvia and the aim of its activities is to ensure and develop certainty and traceability of measurements in the country. The following results have been attained in the first five months of 2009.

Calibration services. 86 reference standard and equipment calibration services have been provided. From these 64 calibration and additional 7 testing procedures have been performed by the Salaspils Secondary Standard Dosimetry Laboratory (SSDL).

Maintenance of national measurement standards. The calibration of mass comparators of the LLC LNMC to be used for MB mass measurements was performed. Mutual comparison (control measurements) of standard weights (1 mg ÷ 500 mg) was carried out.

Control of standard weights of national mass measurement standard LNE 08 ((1÷500) mg, (1÷500) g, 1 kg – (total amount – 26 pieces):

- analysis of standard weight stability, calculation and assessment of drift;
- entering of calibration results (relative masses of standard weights and their uncertainty) and of analysed weight drift in the ScalesNet 32 v.4. data processing programme.

In the interval of inter-calibration, control of the standard measurement parameters of national standards of LNE 01 length measure packages No. 839524; 815565; 938599; 840380; 431306; 839533; C-15059; 12750; LNE 02 No. 740124; LNE 03 No. 78717; No. 781; LNE 05; LNE 06; LNE 07 was performed.

The calibration follow-up of LNE 07 optical 24-facet prism was performed – calibration result and drift control, updating of uncertainty budget.

Stability and termoEDS measurements of electrical resistance measurement package No. LNE 15 (with adequate load) have been performed, as well as revision of temperature ratio.

The annual prevention and re-calibration of the SSDL irradiation standard equipment OB-34, OB-2, OB-6, as well as verification of the SSDL standard cameras with control sources (January, March) has been carried out. 3 SSDL technical procedures have been updated.

New version of software has been installed and adapted for the time signal transmission system TTS-3. Modernisation of the electricity supply system for national standard LNE 09 has been implemented – the new electricity distributors have been installed and the element connection circuit has been optimised (in order to equalise UPS load groups).

Approval of metering devices. 7 applications for type approval have been received, 3 certificates and 1 extension have been issued. Consultations on legislative normative acts with regard to type approval for foreign companies have been provided.

Comparative inter-laboratory projects. In the framework of the national project No. SP2-2009 “Calibration of Mass Standards (Weight)”, measurements are performed among laboratories accredited in Latvia.

The supply to BIPM of the Time standard data (National time standard scale UTC(LV)) has continued.

Preparations are implemented for the EURAMET Project 672 “High-accuracy flatness inter-comparison”.

Training. Training of the LLC LNMC employees on the following subjects: “Calibration of plates”, “Ultrasonic thickness meter calibration” and “Self-calibrating potentiometer”. A training programme has been prepared for the LLC “Sistemservis”.

International cooperation. The MB expressed its willingness to take part in the new EURAMET project “Survey of European countries legal time regulation and practices”. The work in the framework of the European Union project BALTICTIME is coming to a conclusion.

The IAEA has received the annual report on operation of SSDL in 2008.

Quality system. The MB and the SSDL have submitted the annual written quality management system report for 2008 to EURAMET TC-Q. The abovementioned TC has been sent a report on the MB activities as of January 2009. The quality management system and the list of calibration procedures have been upgraded in the MB and the SSDL. A cooperation agreement has been concluded with the LLC LNMC.

Communication with the society. The MB website www.mava.gov.lv is being maintained and updated. 13 sections of the website have been updated.

Accreditation. Latvian National Accreditation Bureau, which as of January 1, 2009 was a structural unit of the state administration institution Metrology and Accreditation state Agency under the supervision of the Ministry of Economics, and pursuant to the law “On Conformity Assessment” as of July 1, 2009 is a Latvian National Accreditation Bureau at the company with limited liability “Standartizācijas, akreditācijas un metroloģijas centrs” (hereinafter LATAK), ensures the operation of the national accreditation system. For the purpose of European law, LATAK is a National Accreditation Institution.

According to the Law on Conformity Assessment, the main functions of the LATAK are as follows:

- to evaluate, accredit and supervise the testing and calibration laboratories and certification and inspection institutions for conformity with the prescribed requirements of normative acts, Latvian national standards, EU or international standards;
- to organise examination of skills and coordinate inter-laboratory comparative testing in compliance with the international requirements;
- to represent Latvia in the international accreditation organisations;
- to maintain and update the informative base of accredited institutions.

Over the recent years, the number of accredited institutions testifies the importance and stability of the accreditation process in the sphere of competence assessment. At the moment, the status of accreditation is maintained for 190 accredited institutions. The competent authorities for conformity assessment are annually accredited in new spheres. New competent

authorities for conformity assessment in the field of personnel certification – certification of energy auditors and competent experts for labour safety issues. Also, a new inspection institution in the field of waste management has been accredited. One laboratory has acquired product safety testing. The conformity of one institution is maintained in accordance with the principles of good laboratory practice. The LATAK continues provision of accreditation services in Ukraine, where 1 institution for personnel certification has been accredited.

The LATAK has confirmed conformity of the accreditation system in 6 spheres of accreditation with the Multilateral Recognition Agreement (MLA) of the European Co-Operation for Accreditation (EA). In order to conform to these requirements constantly, the LATAK participated in several committees – EA Inspection and Certification Committee, EA Laboratory Committee, meetings of the Multilateral Recognition Agreement Committee and General Assemblies.

In the framework of international cooperation, cooperation is also developed with accreditation institutions of Belarus, Ukraine and Uzbekistan. Cooperation with Georgian accreditation institution has been successfully initiated, by providing assistance to implementation of the European and international requirements.

The LATAK has also encouraged the participation of the national laboratories in the international inter-laboratory comparative testing programmes and organised examinations of skills.

Standardisation. As of July 1, 2009, the functions and tasks of the company with limited liability “*Latvijas standarts*” in the field of standardization is performed by the Standardization Bureau (hereinafter LVS) of the company with limited liability “Standartizācijas, akreditācijas un metroloģijas centrs”.

In January 2009, it was 10 years since LVS was established. During these years, the LVS has become a development organisation with a stable position amongst the national standardisation organisations of Europe. The LVS coordinates the work of about 500 technical experts, who participate in 50 technical standardisation committees and four working groups in different economy sectors.

After examining the documented information available in the archive, it was concluded that 2009 was the 70th year since a regular and systematic work was started in Latvia in the field of standardisation as, in February 1939, the first Latvian national standardisation institution – Institute for Economy Rationalisation – launched its operation and the first standard was issued – RIS 1 “Paper formats”.

Since 2004, the LVS is a fully fledged member of the European Committee for Standardisation (CEN) and of the European Committee for Electrotechnical Standardization (CENELEC). The LVS is also a corresponding member of the International

Organization for Standardization (ISO) and an associated member of the International Electrotechnical Commission (IEC).

The main functions of the LVS are, in cooperation with international and European organisations of standardisation, to set up Latvian fund of standards and issue Latvian standards.

According to the approved plans, the priority directions of activity of the LVS in 2008 were to involve the users of standards and their funds in the standardisation processes, to introduce the electronic sale system of standards (e-shop), translate the standards of the regulated sphere into Latvian, to implement further and maintain the legal requirements with regard to mandatory copies, to improve the cooperation with the international, European and national standardisation organisations.

Until January 1, 2009, 28 982 standardisation documents have been registered in the LVS, including 27 555 European standards adopted in the status of a Latvian standard. 50 standardisation technical committees coordinated by the LVS and 3 working groups have adopted 1485 European standards, 69 mandatory applicable standards on 2883 pages have been translated into Latvian.

In the first three months of 2009, 458 EU standards have been adopted, and 1627 standardisation information services have been provided to legal and natural persons.

In 2008, the LVS actively performed implementation of the electronic sale system of standards (e-shop). In January, only 1% of standards was sold in the e-shop; at the end of the year – 15% of all standards were sold in the e-shop.

In 2008, the LVS Information fund has provided standardisation information services to 6593 legal

and natural persons. The automatic electronic information notification system introduced by the LVS has provided a free service to clients – “Monthly Report on the Standards Registered in Latvian Status and Cancelled Latvian Standards” – in the fields concerning the clients. Service has been received by 530 regular clients, who have been sent 6199 current notices.

Standardisation activity is popularised on the LVS website on a regular basis. 7 articles about current standardisation problems in Latvia have been placed in the regular column “Standardisation” of the magazine “Quality”.

In 2008, the LVS has signed a cooperation agreement in the field of standardisation with Ukrainian and Uzbek national standardisation organisations. This agreement helps to create conditions for preventing trade barriers and to ensure provision of safety of mutually deliverable products.

In the framework of the economic promotion programme based on business activity and knowledge, the LVS has started establishment of a technical infrastructure in order to provide access to the European standards databases for small and medium-sized enterprises, as well as to the information on links of these standards to the EU legislation.

According to the approved plans, the priority directions of activity of the LVS in 2009 are as follows:

- to supplement and update the Latvian standards fund;
- to improve the LVS information technologies for improved quality of client service;
- to improve the electronic sale system of standards.

6.13. Privatisation

The goal of privatisation is, by changing ownership of a state or local government property, to create a 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 the mass privatisation implemented in Latvia has been basically achieved, the Saeima adopted the *Law on Completion of the State and Local Government Property Privatisation and Use of Privatisation Certificates* (hereinafter – *Privatisation Completion Law*), which came into force on September 1, 2005 prescribing the procedure for completing the privatisation process and land reform and ensuring termination of the use of privatisation certificates (see Box 6.32).

Privatisation of state-owned property units and land

Privatisation of state-owned property units or land is performed and privatisation proposals are summed up by the state joint stock company “Privatizācijas aģentūra” (hereinafter – Privatisation Agency) pursuant to the *Law on Privatisation of Property Units Owned by the 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 natural or legal person.

625 proposals for privatisation of real estate, 57 proposals for privatisation of state capital shares and 4285 proposals for privatisation of land lots or

proposals to continue their privatisation have been registered by the *Register of Privatisation Proposals* of the Privatisation Agency from September 1, 2005 (when the *Privatisation Completion Law* came into force) until April 1, 2009. 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 later transferred according to the jurisdiction to the Privatisation Agency.

Box 6.32

Law on Completion of the State and Local Government Property Privatisation and Use of Privatisation Certificates

The Privatisation Completion Law prescribes:

- the deadline of August 31, 2006, by which every legal or natural 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 decision is adopted to bring the state or local government property to privatisation;
- that privatisation may be denied and the property remains in possession 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 or a local government could take decisions on bringing the state or local government property to privatisation by December 30, 2007;
- that state joint stock company “Latvenergo”, state joint stock company “Latvijas pasts”, state joint stock company “Starptautiskā lidosta “Rīga””, state joint stock company “Latvijas dzelzceļš”, state joint stock company “Latvijas gaisa satiksme” and state joint stock company “Latvijas valsts meži” will not be privatized or alienated;
- the terms according to which the persons willing to redeem land allocated for permanent use have to submit land redemption application (November 30, 2007) or according to which the land boundary plan or confirmation of the land redemption payment executed in privatisation certificates before conclusion of the land redemption contract has to be submitted to the State Land Service or local municipality (September 1, 2008), as well as an application for passing a decision on assigning the land as the property for payment (August 31, 2009) and that the land purchase agreement has to be concluded by December 30, 2009;
- that the privatisation certificates do not have an expiry term, but may be only used in the framework of the privatisation process;
- the procedure of ending the issuance of privatisation certificates. The deadline of April 28, 2007 is set for persons, by which they can submit an application for privatisation certificates.

In order to ensure successful and open progress of privatisation completion processes, the Cabinet of Ministers has set the procedure on how the institutions conducting privatisation and land reform have to establish the publicly available registers of privatisation proposals and land redemption.

A natural or legal person eligible to acquire movable or immovable property in Latvia can be the subject in privatisation of state-owned property (real estate, capital shares, and land). The payments for the property units have to be executed in lats (LVL) and/or privatisation certificates.

In accordance with the *Privatisation Completion Law*, the Cabinet of Ministers has taken decisions on bringing 251 properties to privatisation and on denials of bringing to privatisation for 184 properties by April 1, 2009.

From April 17, 1994 until April 1, 2009, the privatisation rules had been approved in the statutory procedure for 2406 state property units (excluding land). 94 enterprises have been reorganized into public joint stock companies by issuing and emitting into public circulation 439.14 million shares. The revenues received 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 1.658 billion, of which LVL 393.264 million in cash and the nominal value of LVL 1.265 billion in privatisation certificates. The new owners have taken over the liabilities of the privatized state companies (enterprises) for more than LVL 185.8 million. The established investment volume was LVL 143.8 million but the actual volume of the investments reaches LVL 265.2 million.

The Privatisation Agency carries out privatisation of state-owned lands since 1997. 4757 state-owned land lots with total area of 7 072.77 ha were privatised (purchase agreements signed) by April 1, 2009. The total sales price for the privatised state lands reached LVL 195.02 million, of which LVL 92.81 million in cash and LVL 102.21 million in property compensation certificates. As of April 1, 2009, the income from privatisation of these land lots amounted to LVL 170.28 million, of which LVL 77.43 million in cash and LVL 92.86 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, province, rural municipality). The decision is taken on the basis of a privatisation proposal submitted by any natural or legal person.

A natural or legal person eligible to acquire movable or immovable property in Latvia through 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, and land). The 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 property privatisation commission of the respective local government (rural municipality, city, district, region).

Compliance of privatisation projects, rules and announcements approved by a local government with provisions of the *Law on Privatisation of Property Units Owned by the State and Local Governments* and the *Privatisation Completion Law* is ensured by the Ministry of Economics.

From February 17, 1994 until April 1, 2009 the Ministry of Economics has reviewed and accepted for information 3224 privatisation projects for the total relative price of LVL 146.3 million (including payments in certificates for the nominal value of LVL 56.9 million).

From January 1, 1997 until April 1, 2009, the Ministry of Economics has reviewed and accepted privatisation rules in respect to 1668 built-up and vacant local government land lots (announcements about privatisation of built-up land lots separately as of September 1, 2005) with the total value of land lots in the amount of LVL 26.3 million (of which LVL 13.33 million to be paid in property compensation certificates).

According to the Part 7 of Article 5 of the *Privatisation Completion Law*, since 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 apartment houses

Privatisation of apartment houses in Latvia was initiated in 1995. Privatization was implemented by the Central Apartment Houses Privatisation Commission (renamed as the state agency “Mājokļu aģentūra” (Housing Agency) – from January 1, 2004 and “Būvniecības, enerģētikas un mājokļu valsts aģentūra” (Construction, Energy and Housing Agency) – from January 1, 2008) and apartment privatisation commissions of the respective local governments in compliance with the procedure laid down in the *Law on Privatisation of State and Local Government Apartment Houses*.

In compliance with the information provided by the local municipalities and state statistics, there are 30 346 apartment houses with 502 181 apartments to be privatized in Latvia, including 25 152 local municipalities' houses with 451 811 apartments and 5194 state apartment houses with 50 370 apartments.

The privatisation process of the state apartment houses – decisions on bringing 5092 apartment houses to privatisation have been adopted until April 1, 2009, which amounts to 98.04% of the total amount of state apartment houses. 5070 apartment houses have been offered for privatisation. Privatisation announcements have been sent to 50 286 tenants of state apartments,

but 22 849 announcements on conclusion of purchase agreements have been sent to the persons, who have obtained apartments in possession until privatisation of an apartment house. The possession of 22 977 apartments has been transferred by the decision until privatisation of an apartment house. 44 216 state apartments have been privatised until April 1, 2009, which constitutes 87.78% of the total number of the state apartments. In the 1st quarter of 2009, 16 state apartments have been privatised.

The privatisation process of local government apartment houses – 24 331 local government apartment houses have been prepared and offered for privatisation. Privatisation announcements have been sent to 440 166 tenants of local government apartments, but 164 093 announcements on conclusion of a purchase agreement have been sent to the persons, who have obtained the apartments in possession until privatisation of the apartment house. 30 apartment houses with 269 apartments have been offered for privatization during the 1st quarter of 2009. Within the decisions of the local government, 171 589 apartments have been transferred to ownership upon privatisation of apartment houses. Ownership relations have been arranged for 42 947 owners in 1705 apartment houses privatised for the shares of agricultural enterprises. As of April 1, 2009, 399 822 local government apartments have been privatised, which constitute 88.49% of the total number of local government apartments.

As of April 1, 2009, 9 299 apartment houses have been transferred for management by apartment owners, including 5693 local municipality apartment houses and 3606 state apartment houses, in which more than 50% of apartments have been privatized. In the result of this process, 415 apartment owners' companies and unions have been established in Latvia, of which 305 are in seven biggest cities and 110 – in the districts of Latvia. Authorisation agreements for property management have been signed with the apartment owners for 2873 apartment houses.

Land reform

The main goal of the land reform is to change 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 cognizable 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 implemented in relation to the rural and urban land reform, which is under way in the country.

Allocation of land for use has been finished in cities to the owners of the living houses or users of orchards to which the land was allocated for making orchards with the building right. City land

commissions have reviewed statements on the right to receive the land as property for payment and have finalized inclusion of these in the City Land Redemption Register. The decision-making is continuing with regards to termination of land usage rights and concluding land rent agreements with persons which had not performed the land cadastral survey or prepayment until September 1, 2008. The decision-making is continuing with regards to allocation of the land as a property for payment in compliance with the adopted opinions included into the City Land Redemption Register, along with concluding agreements on land redemption (purchase) in compliance with the Cabinet of Ministers Regulation of August 25, 2008 No. 686 “Procedure for Signing Land Redemption (Purchase) Agreement”. As of April 1, 2009, the SJSK “Latvijas Hipotēku banka” (hereinafter – Mortgage Bank of Latvia) has signed a total of 72 477 agreements, of which 57 agreements were signed during the 1st quarter of 2009.

Allocation of free (unclaimed) rural land cognizable to the state for permanent use, i.e., until June 1, 2006 and submission of redemption claims to the State Land Service for redemption of rural land allocated for permanent use, i.e., until November 30, 2007 have been finished. After submission of a redemption claim, the State Land Service verified the claimant’s rights to acquire ownership of land. If the claimant was entitled to redeem the land, the State Land Service included this land redemption claim into the Rural Land Redemption Register. The person whose land of permanent use is included in this Register, but for which a cadastral survey has not been performed had to submit a land border plan registered in the information system of the Real Estate State Cadastre, settle a pre-payment for the land to be redeemed (purchased) in privatisation certificates and to submit a confirmation of land redemption payment in privatisation certificates before conclusion of land redemption agreement to the respective regional bureau of the State Land Service by September 1, 2008. A cadastral survey for land units for which the pre-payment has been executed before September 1, 2008, must be performed until August 31, 2009.

As of April 1, 2009, 67 970 claims for 106 017 land units with the total area exceeding 417 170 ha were included into the Rural Land Redemption Register.

According to the information system of the Real Estate State Cadastre, a cadastral survey has been made for 69 250 land units included in the Redemption Register with area exceeding 305 820 ha or 65% and land border plans have been registered in the information system of the Real Estate State Cadastre.

Regarding 4610 land units included in the Redemption Register with total area slightly exceeding 16 710 ha or 5%, proof has been received about performing pre-payment in privatisation certificates until September 1, 2008, but the cadastral survey has not been made until April 1, 2009.

The process of rural land redemption has been finished and 38 470 land units with area of 157 540 ha or 36% of the land units included in the Redemption Register have been entered in the Land Register.

Users of 32 157 land units with the area of 94 640 ha or 30% had neither performed the land survey of the land allocated for use nor executed the pre-payment of land redemption until September 1, 2008 or have refused to buy out the land. Thus, their right for permanent use of the land has expired and they have acquired the right to sign a land rent agreement with the respective municipality until September 2, 2009. The vacant land units for which the former land user will not have concluded a land lease agreement with the respective local government by September 2, 2009, are to be included within the lands planned for completing the land reform.

Transfer of the rural land to possession for payment continues along with a conclusion of a redemption (purchase) agreement with the Mortgage Bank. The Mortgage Bank has concluded a total of 232 052 agreements, including 1426 agreements in the 1st quarter of 2009 on the sale of land with a total area of 1.688 million ha, including 7 248 ha in the 1st quarter of 2009.

In accordance with Section 16 of the *Law on the Completion of the Land Reform in Rural Areas*, the former land owners including persons, who up to July 21, 1940 had commenced the purchase (redeemed) the real estate property left in Latvia by German emigrants from the “Vispārējās Lauksaimniecības banka” (General Agricultural Bank) or the “Valsts zemes banka” (State Land Bank), as well as the heirs of such persons (hereinafter redeemers of German lands) had to submit a request at the Central Land Commission before December 28, 2007 regarding the restoration of land ownership rights. If the documentation confirming the land ownership and inheritance rights was not at the disposal of a person at the moment of submitting a claim, it was possible to submit it to the Central Land Commission until September 1, 2008. From January 2, 2009, after summarization of all the applications, the Central Land Commission had to start taking decisions on restoration of land ownership rights to the land planned for finishing the land reform. Review of the applications and making decisions will be taking place until December 30, 2009. In accordance with the information provided by the Central Land Commission, almost 2200 claims were received from the former land owners and their heirs for restoration of land ownership rights until December 28, 2007. According to the information summarised by the Central Land Commission and Service until September 1, 2008, out of the 2200 submitted claims, the documentation confirming the land ownership and inheritance rights has been submitted with 1155 claims for an area of more than 14 700 ha, 87 of which are claims of redeemers of German lands for the land in the area of more than 2090 ha and 25 claims for the area of more than

360 ha for the land of Abrene district. In accordance with the data of the information system of the Real Estate State Cadastre, on April 1, 2009, 8177 land units with the area of almost 25 115 ha have been registered as the land planned for finishing the land reform.

Privatisation certificates

A privatisation certificate is a state-issued dematerialised security that can be used only once as the means of payment for a state or local government property to be privatised.

The privatisation certificates are issued and used according to the *Law on Privatisation Certificates*. Until April 1, 2009, a total amount of 104.4 million privatisation certificates have been issued to 2.45 million people for the time they had 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, 4896.1 thousand for land in rural areas, 969.3 thousand for property ownership, 814.2 thousand for urban land, 461 thousand for companies and other property objects, 89.8 thousand for property deprived from politically repressed persons and 84.4 thousand for property alienated in illegal manner.

0.15 thousand property compensation certificates have been granted to 3 former owners or their heirs in the 1st quarter of 2009.

Since December 1, 2007, in accordance with the provision set in the Article 27 of the *Law on Completion of the State and Local Government Property Privatisation and Use of Privatisation Certificates*, 58 thousand persons have lost their rights to transfer 1.64 million privatisation certificates to their accounts.

According to the *Law on Privatisation of Land in Rural Areas*, 11 076 decisions have been made by April 1, 2009 concerning payments of cash compensations for former land ownership in rural areas. Compensations in the total amount of LVL 17.46 million have been paid to 8 411 persons, cancelling 0.62 million property compensation certificates.

Cash compensations in the total amount of LVL 4.64 million are paid to 26.2 thousand politically repressed persons as a payment for privatisation certificates by April 1, 2009. In compliance with the provision prescribed in Article 27 of the *Law on Completion of the State and Local Government Property Privatisation and Use of Privatisation Certificates*, 3.1 thousand persons have lost their rights to cancel 15 thousand certificates.

105.99 million privatisation certificates or 94.3% of the total number of issued certificates have been used for privatisation of state and local government property units by April 1, 2009 (see Table 6.6).

Table 6.6

Use of Privatisation Certificates
(as of April 1, 2009)

| Type of property | Number | Number of privatisation certificates (million) | including property compensation certificates (thousand) |
|---------------------------------------|---------------------------------------|---|--|
| Apartment houses | 433 thousand privatised housing units | 37.83 | 589.8 |
| Enterprises and other properties | accurate data not available | 7.23 | 109.6 |
| Capital shares (stocks) including: | accurate data not available | 44.45 | 954.0 |
| in public offering | 128.7 million shares | 37.14 | 820.0 |
| Land | 300.8 thousand land lots | 16.48 | 5 422.8 |
| Total: | | 105.99 | 7 076.2 |
| % of total certificates issued | | 94.3% | 88.4% |

2.3 million privatisation certificates or 2% of the total number of issued certificates, including 0.141 million compensation certificates, were deposited on the accounts of 389 thousand natural persons as of April 1, 2009.

As of April 1, 2009, the accounts of legal persons held 1.61 million privatisation certificates or 1.5% of the total number of issued certificates, including 0.019 million property compensation certificates.

In April 2009, holders of privatisation certificates could use the services of 15 licensed intermediary capital companies for transactions in the market of privatisation certificates. The total monthly transactions with privatisation certificates (buying from natural persons and selling), carried out by the intermediary capital companies in the 1st quarter of 2009 varied from 28.22 thousand privatisation certificates in January to 76.06 thousand privatisation certificates in February.

6.14. Public Private Partnership

The public private partnership policy (PPP) of Latvia aims at becoming a significant mechanism in providing public services and infrastructure, implementing increasing amount of investment projects, which attract private capital.

The main PPP policy planning documents, as well as implementation documents thereof are as follows:

- “*Concessions Promotion Concept (attracting private capital for performing the state functions)*”, adopted by the Cabinet of Ministers on April 16, 2002. Thus, a Concessions Department in the Ministry of Economics was established and the competence of the Investment and Development Agency of Latvia was expanded by including PPP issues.
- “*Promotion Guidelines of Latvian Public Private Partnership*” adopted by the Cabinet of Ministers on March 22, 2005 specifying the basic

principles, goal and its achievement indicators of PPP policy;

- “*Action Plan for Implementation of Promotion Guidelines of Latvian Public Private Partnership for 2006–2009*”, adopted by the Cabinet of Ministers on November 15, 2005, which prescribes the directions of activity for promotion of PPP for 2009.

Since 2003, the Ministry of Economics has been designated as the main public administration institution developing PPP policy and coordinating its implementation, but the draft Law of Public Private Partnership adopted by the Cabinet of Ministers prescribes the transfer of PPP policy development functions to the Ministry of Finance.

The Ministry of Finance is taking over the PPP functions from June 1, 2009, it also applies to financial and human resources provided for ensuring PPP functions.

Box 6.33

Definition of PPP and preconditions of successful PPP

A special definition of PPP is still not included in the European Community’s legislation, but only a general explanation of PPP is provided. The European Commission (EC Green Paper on PPPs and Community Law on Public Contracts and Concessions, April 30, 2004) classifies PPP as:

- **purely contractual PPP**, if co-operation between the public sector institution and private partner is implemented on the basis of a long-term agreement;
- **institutional PPP**, if co-operation between the public sector institution and private partner is implemented with the help of a joint enterprise.

In accordance with the abovementioned, PPP is usually understood as long-term contractual relations between a public and private entity or entities, in order to ensure implementation of the function of a public entity by constructing, reconstructing and maintaining an infrastructure object of public importance or providing a public service, where a private partner undertakes fulfilment of the obligations set in the PPP agreement by using the resources and knowledge of the private sector, as well as undertakes the risks related to fulfilment of the obligations set in the PPP agreement or a part of these risks.

A similar definition of PPP is included also in the developed draft Law of Public Private Partnership, classifying PPP depending on the types of project implementation, for example, agreement conditions, schemes of the financing flow, specific character of the object or service as follows:

- Contractual – co-operation between the public sector and private sector is implemented concluding an agreement between public and private partner and executing partnership procurement agreement or concession agreement;
- Institutional – co-operation between public sector and private sector is performed in the statutory procedure establishing a joint enterprise, by which a public partner concludes a partnership procurement agreement or concession agreement as with a private partner.

The decision on implementation of some projects with the help of PPP must be well-considered and reasonable in order for the PPP to operate successfully. Therefore, PPP is mostly applied only in relation to large or several small joint projects of public importance, where social and economic benefits compensate the project costs. Taking into consideration the international practice, PPP operates with the most success particularly in such projects.

Improvement of legal regulation

Although the currently effective legal regulation¹ in Latvia enables implementation of purely contractual PPP, in the beginning of 2008, a working group was established by a Decree of the Prime Minister to develop a draft project not only to improve the legal

regulation of PPP, but also to arrange institutional environment for development of PPP.

Draft Law of Public Private Partnership developed by the working group defines PPP (first time on a level of a normative act), establishes application of competitive dialogue in selection of private partner, sets specific conditions for construction concession, establishes a selection procedure of the private partner in case of PPP, interference by sponsors rights, compensation mechanisms in case of early termination of PPP agreement, as well as introduces arrangements for

¹ Concessions Law (in force since February 16, 2000); Public Procurement Law (in force since May 1, 2006); Cabinet of Ministers Regulations No. 700 of August 10, 2004 “Procedure of registration, accounting and control of concession agreements” (in force since August 14, 2004).

handling complaints in selection of private partner. This normative act also determines establishment of a separate follow-up unit of PPP projects and expertise centre.

The draft law was reviewed by the Cabinet of Ministers on February 17, 2009 (meeting minutes No. 1 § 2). It is expected that the Saeima will adopt the draft Law by July 2009 and it could become effective as of October 2009.

Support to PPP project implementation

Over the recent years, increase in the interest about PPP has been observed, which demonstrates that the opportunities provided by PPP have been recognised both for implementing projects and ensuring public administration functions. Increased interest on PPP is shown also by the rapidly increased number of concession agreements in the last year – currently 44.

Taking into account the amendments made to the Law on Public Transport Services of November 6, 2008, allocating the public sector rights to choose a private partner using both traditional procurement and concluding concession agreement, most of the concession agreements concluded are on public transport of passengers in transport services.

Despite the current financial and economic imbalance in the country, the implementation of the following projects is continued:

- construction and management projects of new pre-school education institution in the local government of Tukums city, Ogre region, Mārupe rural municipality, and Ķekava rural municipality.
- road projects: “Road Section E77/A2 Riga bypass – Sēnīte” and Riga Northern transport corridor. At the beginning of this year, the opportunity to use PPP in implementation of the programme for reconstruction and maintenance of asphalted surface on the state main roads from 2009 to 2013;
- project of the administrative building of the JSC “Latvijas Valsts meži”;
- hazardous waste polygon management project in Zebrene, other PPP projects.

Based on experience of the previous years in providing support functions of PPP projects, in 2009 the support to implementers of PPP projects was mainly provided for implementing measures supporting preparation of documentation for special PPP projects, promoting cooperation between the institutions involved in PPP process and implementing information measures.

Programme for preparation of PPP projects

In 2009, in the framework of the programme “Promotion of Public Private Partnership in Latvia” co-financed by the Norwegian bilateral financial instrument, the previous activities have continued to support public and local government institutions by

implementing consequent and justified PPP approach for development of infrastructure and public services within their efforts. The manager of the programme is the State Agency Investment and Development Agency of Latvia under the supervision of the Ministry of Economics.

On May 27, 2008 the open tender regulations of the programme sub-projects were approved by the Cabinet of Ministers, and from August 14 to November 14, 2008 the ministries, the Secretariats of the Special Assignments Minister, and local or regional governments could submit application of sub-projects to receive financial support (in total of EUR 1 940 135) for activities directed at development of financial and economic substantiation for PPP project or development of PPP project tender documentation (including mandatory training of the employees involved in the sub-project of a sub-project application submitter and co-operation partner within the sub-project in both activities). 7 ministries and 10 local or regional governments have taken this opportunity, submitting in total 23 applications of sub-projects.

In March 16, 2009 the evaluation process of the applications of sub-projects submitted in the framework of the open tender programme was completed, taking decision on granting co-financing of the programme to 13 sub-projects, as the applications of the sub-projects within the framework of co-financing programme of open tender have received the highest assessment.

All supported projects will be implemented during 10 months period from the day of concluding the sub-project implementation.

Promotion of co-operation

On January 29, 2009 the Ministry of Economics organised a meeting of representatives of the public and private sector of the Baltic States in co-operation with Public Private Partnership Association (PPPA), in order to gain information on the development of PPP in the neighbouring countries, its legal framework, as well as PPP projects implemented, their advantages and disadvantages during implementation process, as well as to evaluate a future option of joint co-operation between the Baltic States in the PPP sector.

This meeting was planned as the beginning for co-operation development between the Baltic States on PPP issues studying the current situation in the neighbouring countries. It is planned to organise similar information measures for wider range of interest.

Taking into account that PPP development plays a significant role in acknowledgement of international experience, participation in two international events has been organised since May 2009 (“European PPP summit”, “The Potential of PPPs in Europe”), thus providing information also about PPP in Latvia beyond the borders of the Baltic States.

PPP information measures

Taking into account the fact that the interest about PPP has grown in the recent years, ensuring explanatory functions in relation to implementation of PPP projects is particularly crucial. Also in 2009, rendering advisory support to potential implementers of PPP projects has continued, informing about the applicable type of PPP transaction, carrying out the appropriate procurement procedure, financial and economic calculations and procedures for making them, possible legal solutions of the project agreement and other issues regarding PPP.

By the end of May 2009, 18 consultations have been provided to both the public and private sector concerning the topical issues of PPP project implementation.

The topical information and resources available about PPP at the disposal of the Ministry of Economics and the Investment and Development Agency of Latvia up to now is published in the internet's homepage www.ppp.gov.lv of the Ministry of Economics publicly available for all interested persons, in order to provide maximally extensive information to the society about the PPP.

6.15. Advisory Councils of the Ministry of Economics

6.15.1. National Economy Council

The National Economy Council of the Ministry of Economics (hereinafter – 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 operating in accordance with the bylaws of the Ministry of Economics and "Agreement on Co-operation in the National Economy Council" concluded on February 17, 1999,

and with the bylaws of the NEC of the Ministry of Economics.

The NEC is an advisory institution that participates in settlement of issues referring to business environment policy. The objective of its 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 in the country and to encourage the process of sustainable development of the country and participation of society in it, as well as to facilitate fulfilment of the goals in Latvia set by the Lisbon Strategy and to involve public institutions, local governments and social partners in fulfilment of these goals.

Box 6.34**NEC personnel**

In accordance with the decision of the Management Committee, the NEC personnel are approved by the Minister of Economics.

The NEC Steering Committee is a consulting and co-ordinating institution that takes part in settlement of issues referring to business environment 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 operations.

The structure of the NEC Steering Committee is approved by the Minister of Economics. The Steering Committee consists of five representatives of the NEC founders, who are simultaneously also NEC members:

- representative from the Ministry of Economics;
- representative from the Latvian Chamber of Commerce and Industry;
- representative from the Employer's Confederation of Latvia;
- representative from the Free Trade Union Confederation of Latvia;
- representative from the Latvian Association of Local and Regional Governments.

The NEC consists of 21 experts approved by the NEC Steering Committee, among them the Minister of Economics, the NEC Chairperson and representatives of business organisations of the Republic of Latvia, public institutions and other organisations of the Republic of Latvia.

Representatives of the Council of the Small and Medium-Sized Enterprises and Crafts of the Ministry of Economics and of the Foreign Investors Council in Latvia participate in the NEC meetings as observers.

Decisions on changes or additions to the structure of the NEC are taken by the NEC founders in the NEC Steering Committee meetings.

The NEC is chaired by the Chairperson elected by the members of the NEC Steering Committee from among the members in a rotation sequence for a term of office of one year.

The NEC meetings are held on average once per month.

The work of the NEC is organised by the Secretariat of the National Economy Council, the operation of which is ensured by the Ministry of Economics.

In between the NEC meetings, recommending decisions of the NEC are taken by the NEC Steering Committee.

The 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 the

development of Latvian economy. The NEC prepares proposals and adopts recommending decisions on these issues. The NEC conducts a dialogue between the entrepreneurs and the Ministry of Economics, as well as other public institutions and non-governmental organisations. The decisions adopted by the NEC have a recommending character.

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 "For growth, competitiveness and employment". The co-operation memorandum is aimed at co-operation and concerted action in implementation of objectives of the *National Development Plan* and the *Lisbon Strategy* – promotion of growth of Latvia's economy and employment, as well as active participation in development and implementation of the 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 model of co-operation with economic sectors.

The Ministry of Economics and the NEC have concluded a protocol of agreement on co-operation with the following councils of experts (CE) of industries – CE of Machine Building and Metal Processing Industry, CE of Chemical and Pharmaceutical Industry, CE of Light Industry, CE of Construction Materials Producers, CE of Timber Industry, CE of Food Industry, CE of Construction Industry, CE of Passenger Carrier Industry, CE of Business Education and Management Advisers, CE of Tourism Industry, and CE of Printing and Publishing Industry.

By signing the protocol of agreement, the parties agreed to unite their resources for development of programming documents, take measures towards implementation of the programmes on improvement of economic development and business environment adopted as a part of the governmental declaration, and that the councils of experts will assess and give an opinion on draft legislative acts elaborated by the ministries.

Box 6.35

NEC on priorities of economic policy

The NEC considers that the work must be continued in order to provide stable macroeconomic environment. In order to maintain a stable macroeconomic environment and encourage competition in Latvia, balanced budget must be developed; competition supervision strengthened and competition development promoted within the public interests within all economic sectors by timely identifying the risk sectors where competition law violations are possible restricting administrative and other barriers for competition.

The NEC still considers taxation policy and administration, labour education, macroeconomic stability and non-predictability of amendments to the legislative acts as one of the most problematic spheres.

At the same time, normative acts must be assessed already during their drafting process, in order to identify and prevent the possible competition law violations, technical barriers to trade and discriminating conditions within the sector of free movement of goods and services, as well as the sphere of the company law. State support and procurement supervision must be improved obtaining a high level of transparency for state support projects.

Establishment of efficient and competitive sectoral structure must be facilitated. Research, development and innovation must be promoted, especially within the private sector. Measures must be elaborated and implemented, which would facilitate co-operation of education, research and national economic sectors by ensuring transfer of knowledge and technologies.

Faster absorption of structural funds and new export markets and consolidation in the existing ones must be promoted. The institutional base for export promotion must be provided, as well as raising its capacity, development of external economic representations, access to financial instruments and support to companies in export marketing.

The NEC members and experts work in the following councils, committees and working groups:

- Consultative Board for Development Co-operation Policy Issues at the Ministry of Foreign Affairs;
- Supervisory Board of the Lisbon Strategy at the Ministry of Economics;
- Construction Council at the Ministry of Economics;
- Latvian Tourism Advisory Council at the Ministry of Economics;
- Export Promotion Council at the Ministry of Economics;
- National Standardisation Council at the Ministry of Economics;

- European Union Structural Funds Supervision Committee at the Ministry of Finance;
- Information Society National Council of Special Assignments Minister for Electronic Government Affairs;
- Advisory Council of the Investment and Development Agency of Latvia.

In the first half of 2009, 6 National Economy Council meetings have taken place, in which the following most important issues have been reviewed regarding:

- Proposals of the Ministry of Economics concerning the Action Plan on Implementation of the Economic Stabilisation and Growth Revival Programme of Latvia;

- Proposals for Latvian export promotion strategy;
- Proposals by the Ministry of Economics and the Ministry of Finance on implementation of financial support instruments of the “Action Plan on Implementation of the Economic Stabilisation and Growth Revival Programme of Latvia”;
- Impact of monetary policy on exports;
- Financing for science and research in 2009;
- Procedure of receipt of export credit guarantees;
- Short-term export credit guarantees;
- Proposals for improvement of foreign economic representative offices of Latvia;
- Draft Law on Public Private Partnership;
- Draft Law on Amendments to Public Procurement Law;
- Draft Law on Amendments to the Law on the State Budget for 2009;
- On priority directions of science.

6.15.2. Council of Small and Medium-Sized Enterprises and Crafts

The Council of Small and Medium-Sized Enterprises and Crafts (hereinafter – CSMEC) is an advisory institution of the Ministry of Economics.

The CSMEC consists of 21 representatives authorised by the organisation representing small and medium-sized enterprises (SME), *inter alia*, the institutions, societies, organisations and associations representing SMEs of different national economy sectors, as well as associating SMEs and representing their interests. The Ministry of Economics, Investment and Development Agency of Latvia and Riga City Council Entrepreneurship Co-ordination Centre participate in the status of observers.

The structure and statutes of the CSMEC are approved with a Decree No. 560 of the Ministry of Economics of December 11, 2007.

The goal of the activity of the Council is promotion of development of small and medium-sized enterprises and crafts and establishment of favourable business environment for SMEs in Latvia.

The main functions of CSMEC are as follows: to review and follow settlement of such issues (draft normative documents, national economy development policy documentation and other documents) that are important for development of SMEs, as well as to prepare proposals and make recommending decisions on these issues; to conduct 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 meetings of the CSMEC are held once per month on average and are chaired by the Chairperson

elected by the Council. The Ministry of Economics ensures the operations of the Council and performs the functions of its secretariat.

In the first half of 2009, 5 CSMEC meetings have taken place, in which the following most important issues have been reviewed regarding:

- Possible financial support to entrepreneurs;
- Proposals for Latvian export promotion strategy;
- Latvian National SEPA (Single Euro Payment Area) plan;
- Priorities of Czech Presidency and implementation of the European Commission’s communication “The Small Business Act of Europe”;
- Information on a meeting of the Minister of Economics and the largest Latvian sectoral associations, and NGOs on implementation of financial support instruments of the “Action Plan on Implementation of the Economic Stabilisation and Growth Revival Programme of Latvia”;
- Situation in the labour market and possible solutions for limiting unemployment;
- Riga City Council plan for improvement of the business environment;
- Draft Law on Payment Services;
- Loans for the improvement of enterprise competitiveness;
- EU Structural Fund programmes;
- Export credit guarantees;
- Guarantees to liquid asset loans;
- Draft Law on Amendments to the Labour Law;
- Globalisation Adjustment Fund and support programmes for entrepreneurs under the responsibility of the Ministry of Welfare;
- Topical issues with regard to risk capital in Latvia;
- Criteria of EU Structural Fund programmes.

The Council has continued the initiated positive and efficient dialogue with institutions representing businessmen, as well as with the Ministry of Economics and public institutions responsible for the improvement of the business environment in Latvia.

A positive trend to be mentioned is that through co-operative efforts with the Ministry of Economics businessmen are invited on a regular basis to assess the SME development issues and draft programming documents shaping SME development policy before their adoption by the government. Proposals for different legal acts, for example, for the Action Plan on Improvement of the Business Environment in 2009 have been developed, as well as proposals for information report on implementation of financial support instruments of “Action Plan on Implementation of the Economic Stabilisation and Growth Revival Programme of Latvia”.

In order to strengthen the role of the CSMEC regarding the improvement of the business environment, as well as ensure adequate representation of the non-governmental sector in absorption of EU Structural Funds and support programmes, the members of the CSMEC are delegated for participation in the 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 European Social Fund of the Ministry of Finance;
- Drafting development guidelines for the state tax and fee system of the Ministry of Finance in the working group;
- Export Promotion Council of the Ministry of Economics;

- Advisory Committee of the Ministry of Economics and Investment and Development Agency of Latvia;
- Business Development Board of Riga City Council.

By participating in entrepreneur delegations beyond the borders of Latvia, the Council's co-operation agreements have been concluded with similar organisations of the Republic of Azerbaijan and Republic of Israel.

The following issues are planned to be solved by the CSMEC in the next meeting:

- Implementation of the Action Plan on Improvement of the Business Environment for 2009 and Action Plan on Improvement of the Business Environment for 2010;
- Optimization of representation of Latvian foreign economic interests;
- and other issues.

7. RECOMMENDATIONS

The current crisis in Latvia originating in the non-balanced development during the economic boom has features of a structural crisis. The structure of Latvian economy is non-sustainable, with the low share of industry and inefficient public administration, education and health system. It means that coping with the crisis and economic growth revival is not possible without a state budget reform and crucial structural reforms in the economic regulatory system in general, including public administration, education and health care.

At the same time, bearing in mind the deepening of the global financial and economic crisis, the access to financing must be promoted and reduction of barriers for business activity must be continued, especially for micro enterprises in order to retain growth potential.

Despite the financial difficulties, projects on improvement of infrastructure of EU structural funds and Cohesion Fund must be continued since they promote domestic demand in the most efficient way. The competitiveness of the economy in the medium and long-term must not be neglected while solving short-term problems. The EU structural fund projects aimed at promotion of knowledge-based economy must be supported – introduction of new products, promotion of innovations, research and development, improvement of training and education, etc.

Taking into account the abovementioned, in our opinion, the most important and urgent tasks of the economic policy are as follows:

- **fiscal policy:**
 - to ensure strict fiscal discipline creating a responsible social policy and policy stimulating economy;
 - to draft a fiscal responsibility law, which would determine medium-term fiscal policy objectives, therefore facilitating implementation of a responsible fiscal policy on a regular basis;
 - to ensure fulfilment of the Maastricht convergence criteria by 2011, in order to join the euro area;
- **raising efficiency of budget revenues and expenditures:**
 - to improve efficiency of the public administration by minimizing bureaucracy and establishing a single state financial and human resource information and management system;
 - to facilitate introduction of the public-private partnership mechanism by linking it with public investment plans and programmes (local government, state and EU);
- **reduction of administrative barriers:**
 - to improve the process of entrepreneurship's registration, granting permits and tax administration. The opportunity to perform registration of the value added taxpayer simultaneously with the registration in the Commercial Register must be provided;
 - to simplify the insolvency and liquidation processes of enterprises by making amendments to the Insolvency Law;
 - to promote development of e-government and e-services in order to improve availability and efficiency of public 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 and functionality of the e-signature must be expanded;
 - to improve the flow of the state level official statistical information, as well as mutual harmonization of the indicators and terms to be included in the state registers and other information systems in order to prevent repeated enquiry of respondents;
 - to reduce the employment-related costs. It must be provided that the expenses of entrepreneurs related to attraction of labour force are considered as expenses related to the economic activity and are not subjected to the personal income tax;
 - to improve the real estate registration process by unifying the procedures – introducing a one-stop shop principle in the registration of real estate by reducing the number of days and procedures required for the registration, as well as to review and simplify tax and fee systems related to registration of real estate;
 - to assess the requirements for additional information and their administrative burden, which has been created during transposition of EU directives and reduce additional requirements on providing information set by the national laws and regulations;
- **introduction of the business-friendly tax policy and administration:**
 - to review the VAT repayment system by simplifying and accelerating repayment of VAT;
 - to increase operation efficiency of the State Revenue Service by continuing reorganization of the SRS to an institution, which helps the entrepreneurs;
 - to continue improvement of the normative acts regulating tax administration so that the degree of fault is taken into account, when applying punitive sanctions;
 - to assess thoroughly the overall influence of the planned amendments on entrepreneurship and

- national economy, when making changes in the tax system, as well as to create preconditions in order to improve competitiveness of Latvian entrepreneurs in the domestic market;
- to continue reduction of the tax burden for labour force and transfer the main tax burden to consumption, as well as speculations with the real estate, differentiate the real estate tax taking into account the value of residential buildings;
 - **Ensuring competition and determining administratively regulated prices:**
 - to turn against the most serious violations of competition as effectively as possible by ensuring efficient introduction of the amendments to the Competition Law by paying particular attention to the abuse of dominant position in retail trade;
 - to perform preventive and inspective measures for identifying prohibited agreements in the sectors important for national economy by paying particular attention to public procurements, as well as tenders and auctions of the structural funds in the priority fields;
 - **promotion of investments, business start-ups and access to finance:**
 - to support the enterprises having difficulties to receive a loan for implementing EU structural fund projects with the help of specially established financial instruments;
 - to pay more attention to allocation of financing for 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 review territorial plans of the regional centres by planning new industrial areas;
 - to foresee the accelerated procedure for the change of land zoning and transformation for industrial projects;
 - to address foreign enterprises more actively and inform them on Latvia's advantages in order to attract productive long-term foreign investment, which would have a positive financial influence also on Latvian enterprises – sub-suppliers, and promote creation of qualitative and sustainable workplaces;
 - to promote exchange of information between Latvian companies looking for strategic investors, and foreign companies willing to expand their business in the European market;
 - **to simplify the management system of structural funds and improve efficiency of structural funds' projects:**
 - to increase the speed of absorption of the funds, by reducing the time necessary for the administrative procedures, simplifying the procedure of development and approval of implementation conditions;
 - to harmonise the procedures between many institutions involved in absorption of the EU funds, and to improve communication and co-operation between the public administration institutions in the process of absorption of the EU funds;
 - **promoting exports:**
 - to ensure access to the export credit guarantees in order to increase the access to the markets with higher risk degree and promote exports of goods and services of Latvian origin;
 - to optimise the operations of the current external economic representation system in Latvia and substantially increase direct participation of entrepreneurs in the decision-making process;
 - to promote the participation of Latvian companies, entrepreneur organisations and public institutions in priority projects planned in the framework of EU Baltic Sea strategy to use them in more effective co-operation between Latvian entrepreneurs and partners in the Baltic Sea region and raising competitiveness in the global market;
 - **establishment of flexible labour market:**
 - to review the regulation of legal employment relations, including obligations related to payment of premiums and compensations, managing working time, promoting conclusion of collective agreements in the sectoral frameworks;
 - to solve the structural problems of employment by supporting the efforts to obtain suitable higher qualification in accordance with the requirements of the labour market and facilitating the labour mobility, especially, improving the transport infrastructure;
 - to reduce undeclared employment by relieving the tax burden on employment and 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 regulation system of labour demand and supply by ensuring preparation of medium and long-term forecasts of labour market and consider the population census of 2011 as an important data source for improvement of this system;
 - **ensuring efficient, safe and sustainable energy supply:**
 - by utilising the co-financing of EU structural funds and support mechanism of mandatory procurement of electricity by promoting use of

- renewable energy resources in production of electricity and heat supply;
- 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 in energy;
- **improvement of energy efficiency:**
 - to implement the state support programme for promoting renovation of multi-apartment houses by performing energy audits of residential buildings and renovation projects, as well as by raising interest and responsibility of joint owners in renovation of the residential buildings at the same time;
 - to implement the Measure “Energy Efficiency of Housing” of the Priority “Quality Environment for Life and Economic Activity” of the Operational Programme “Infrastructure and Services” of the EU Structural Funds for 2007–2013 by performing heat resistance improvement measures for multi-apartment houses and social residential buildings;
 - to integrate the energy efficiency policy into other sectoral policies (tax, transport, regional);
- **establishment of the knowledge-based economy:**
 - to facilitate co-operation of scientists and entrepreneurs by establishing competence centres in order to promote co-operation of the research and industrial sectors in implementation of industrial research, new products and technologies, as well as support the technology transfer contact points and technology transfer centres in order to purposefully develop the necessary research competence in higher education institutions and scientific institutes and facilitate introduction of the research work results in production;
 - to support entrepreneurship with high value-added by promoting investment in fixed assets;
 - to support development of new products and technologies by encouraging the entrepreneurs to expand industrial research, introduce new products, services and technologies in production, as well as secure the rights of industrial property;
 - to improve the normative acts regulating scientific activity by prescribing that scientific institutions may have owners of the intellectual property developed as a result of the research financed by the state.

A consequently implemented structural policy will promote economic recovery of Latvia, which will form the basis for increasing the standard of living of the population. Successful development and economic growth of Latvia will depend not only on the work of public institutions, but also on personal initiative of any person anywhere in Latvia under conditions of mutual understanding and dialogue within the society.