Ministry of Economics
Republic of Latvia

# ECONOMIC DEVELOPMENT OF LATVIA

# REPORT

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Comments, questions or suggestions are welcomed:

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**Dear reader,**

The experts of the Ministry of Economics have prepared the 31st ***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 perspectives.

In 2009, as the financial problems in the world remained, the economic recession in Latvia continued. However, the statistical data shows that the economic recession in comparison with the beginning of 2009 is not as rapid and the situation is starting to improve. Since April, the manufacturing industry has started to stabilise. The production volumes have already been increasing over the recent months in the wood-processing, chemical industry, metalworking, as well as in the production of paper, printing and publishing sectors. The exports have also increased slightly. In the 3rd quarter of 2009, in comparison with the 2nd quarter of 2009, it has increased by 1% (according to seasonally adjusted data). We are forecasting that, in general, a positive economic growth will resume in the mid-2010.

At the moment, it is clear that the economic model which has existed before, when due to the inflow of foreign capital the domestic demand has grown rapidly and many entrepreneurs have not even felt the need to think about exports, does not exist anymore. Currently both, the government and the entrepreneurs must purposefully transfer to a sustainable economic model where the main driving force is export. The first signs are showing that the situation is really improving in sectors where there are export opportunities. The expectations of the entrepreneurs in these sectors are also becoming more optimistic.

In the sectors based on domestic demand, e.g., trade and construction, the decrease rates kept growing in 2009, and the situation might stabilize only in 2010. However, with increased revenues from exports, the situation in the domestic market will also start to improve slowly. As a result, the economy will be based on the right foundations and the industry will become the driving force of growth. There are still many unused opportunities to increase the revenues from exports not only in the manufacturing industry, which forms a rather small share in Latvia's GDP, but also in the services sectors – information and communication technologies, transport and logistics, tourism and others.

We are on the so-called internal adjustment road, reducing various costs, incl. wages, in order to improve our competitiveness. Both, the price dynamics and other indicators show that these measures have been proven to be effective. The real effective exchange rate of the lats against the currencies of 13 main trade partner countries, as calculated by the Bank of Latvia, shows that, since March 2009, Latvia is slowly regaining its competitiveness.

In 2010, the main priorities of the economic policy are as follows: support to exports and microenterprises, as well as promotion of energy independence. This will be mainly achieved by implementing the economic recovery plan, by directing the EU Structural Funds financing towards the support for exports and by eliminating the bureaucratic obstacles for entrepreneurship.

Speaking about support of exports, the main task for 2010 is to implement in practice the medium-term economic recovery plan approved by the government in November 2009.

Taking into account both, the analysis of economy sectors by the Ministry of Economics and the surveys of the Bank of Latvia, several state support priority areas have been determined, which are as follows:

- competitive enterprises with high growth and export potential;
- manufacturing industry sectors with significant contribution in the value added and export growth, as well as high growth and export potential in the future;
- export-oriented services sectors.

The main state support directions for the support of these priority areas are tax incentives, the EU Structural Funds and financial support instruments, education and science, as well as, in certain sectors, additionally identified specific measures, the implementation of which is necessary for fostering competitiveness.

In 2010, in the framework of the economic recovery plan, the Ministry of Economics has envisaged:

- to prepare the *Action Plan on Promotion of Latvian Exports of Goods and Services and Attraction of Foreign Investments in 2010–2011*, which will comprise concrete contractual measures and support instruments for increased competitiveness;
- to continue improving the business environment. It is planned to adopt new *Insolvency Law*, to draft new *Construction Law*, to optimise the process of cadastral measurement of buildings, as well as to introduce the one-stop shop principle for work and residence permits, and to introduce support measures for microenterprises, etc.;
- to develop a *cluster support programme for 2010*;
- to develop compensations transaction policy and legislative acts for its implementation;
- to complete the work on the development of a new legal framework for types of trade that are subject to approvals by the local governments,

which will decrease the administrative burden to the market participants;
- to continue the work on improving the legal framework of consumer crediting and arrangement of the consumer crediting market by creating a licensing system of providers of non-bank consumer crediting services.

Besides, with the help of the EU Structural Funds financing, several programmes have been launched – such as *Introduction of New Products and Technologies into Production*, *Support to Technology Transfer Contact Points*, and *Development Programme for Innovation Centres and Business Incubators* 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.

In the field of competitiveness, the weak positions of Latvia in the global markets are showed by the *Global Competitiveness Index* of the World Economic Forum and *Doing Business* index of the World Bank.

In order to improve business environment in Latvia and in the result to increase Latvia's *Doing Business* position to 25$^{th}$ ranking by 2011, several measures are being planned for 2010.

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

Moreover, it is also important to implement a concept on support measures for microenterprises in 2010, as well as implement different measures, which will simplify registration, operation, tax declaration for microenterprises.

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

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

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

In the Report, you will find information about the development of main economic and social indicators, national economy sectors, external economic environment, as well as the economic policy of the government for promotion of growth and jobs, foreign trade policy, utilisation of the EU Structural Funds and the Cohesion Fund, innovation and entrepreneurship policy, and other economic reforms. In the conclusion, the authors of the Report give recommendations for the improvement of the national economic policy.

The Cabinet of Ministers has not assessed all the issues addressed in the Report; hence several conclusions on the economic development of the country and proposals for further action reflect purely the opinion of experts of the Ministry of Economics.

I hope that the Report will be useful for economists and entrepreneurs, as well as for everyone interested in the economic development issues 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.

December 2009

**Artis Kampars,**
Minister of Economics

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# Abbreviations

**Abbreviations**

| | |
|---|---|
| BSR | Baltic Sea Region |
| CC | Competition Council |
| CF | Cohesion Fund |
| CHP | Combined Heat and Power |
| CIF | Price of goods created by the value of goods inclusive of freight and insurance costs till the border of the importing country |
| CIS | Commonwealth of Independent States |
| CRPC | Consumer Rights Protection Centre |
| CSB | Central Statistical Bureau |
| CSMEC | Council of Small and Medium-Sized Enterprises and Crafts |
| EAGGF | European Agricultural Guidance and Guarantee Fund |
| EC | European Commission |
| EEA | European Economic Area |
| EIB | European Investment Bank |
| EIF | European Investment Fund |
| EMU | Economic and Monetary Union |
| ERDF | European Regional Development Fund |
| ERM II | European Exchange Rate Mechanism |
| ESA | European System of Accounts |
| ESF | European Social Fund |
| EU | European Union |
| EU-15 | European Union Member States before the enlargement on May 1, 2004 |
| EU-27 | European Union Member States after the enlargement on May 1, 2004 |
| EU SF | European Union Structural Funds |
| FCMC | Financial and Capital Market Commission |
| FDI | Foreign Direct Investment |
| FIFG | Financial Instrument for Fisheries Guidance |
| FOB | Price of the good, including value, and transport and insurance costs to the border of exporting country |
| GDP | Gross Domestic Product |

| | |
|---|---|
| HPP | Hydro-Power Plant |
| ICT | Information and Communication Technologies |
| IDAL | Investment and Development Agency of Latvia |
| IMF | International Monetary Fund |
| IT | Information Technology |
| JSC | Joint Stock Company |
| LGA | Latvian Guarantee Agency |
| LLC | Limited Liability Company |
| LNAB | Latvian National Accreditation Bureau |
| LP | Limited Partnership |
| LVS | Latvian Standard |
| LTDA | Latvian Tourism Development Agency |
| MLBL | Mortgage and Land Bank of Latvia |
| NATO | North Atlantic Treaty Organisation |
| NEC | National Economy Council of the Ministry of Economics |
| NGO | Non-Governmental Organisation |
| NSFD | National Strategic Framework Document |
| OECD | Organization for Economic Co-operation and Development |
| OP | Operational Programme |
| PIT | Personal Income Tax |
| RSE | Riga Stock Exchange |
| SEA | State Employment Agency |
| SF | Structural Funds |
| SJSC | State Joint Stock Company |
| SLS | State Land Service |
| SMEs | Small and Medium-Sized Enterprises |
| SOLVIT | EU Internal Market Problem Solving System (SOLVIT Network) |
| SPD | Single Programming Document |
| SRS | State Revenue Service |
| USA | United States of America |
| VAT | Value Added Tax |
| WB | World Bank |
| WTO | World Trade Organisation |

## Country Abbreviations

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

## Symbols

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

# 1. Economic Situation: Brief Overview

**In 2009, with financial problems prevailing in the world, the economic recession continued in Latvia.** During the first three quarters of 2009, GDP decreased by 18.6%. However, in comparison with the beginning of 2009, the decrease of economic activities has slowed down. In the 3rd quarter of 2009, in comparison with the previous quarter, GDP has decreased by 4% (according to seasonally adjusted data). Since the peak of Latvia's economy at the end of 2007, GDP has fallen by almost one fourth, and the economy is currently at the level of 2004–2005.

**Economic recession also continues in the neighbouring countries.** In Lithuania, in the 3rd quarter of 2009, GDP was by 14.2% and, in Estonia, by 15.6% lower than in the 3rd quarter of 2008.

It must be noted that in the world's most prominent developed countries and in several developed economies, positive development tendencies are beginning to appear. In the second half of 2009, economic recovery started in several countries. The increase of economic activities to a great extent has been promoted by monetary and fiscal policy impetus introduced at the very beginning of recession, as well as improved consumer and entrepreneur confidence. Revival of the global economic growth also promotes the recovery of the world trade.

**In 2008 and 2009, Latvia had the largest decrease of GDP in the whole EU.** It is related to the high current account deficit of the balance of payments during the previous years of a rapid growth and therefore the increase of vulnerability of Latvia's economy. Due to 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. **In the 3rd quarter of 2009, domestic demand was by 29.3% lower than in the respective quarter of 2008** (in comparison with the 2nd quarter of 2009, it was by 26.1%, while, in the 1st quarter – by 19.8% lower than in the respective quarters of 2008).

Private consumption has been shrinking over eight subsequent quarters, and the rate of decrease is growing. In the first three quarters of 2009, private consumption has decreased by 23.6%. In the same period, public consumption has decreased in total by 6.9%, while especially rapidly, i.e. by 12.4%, it decreased in the 3rd quarter of 2009 (in comparison with the 3rd quarter of 2008). The decreased public consumption in the 3rd quarter is related with the amendments to the 2009 budget adopted in June.

Lack of financial resources in the private sector and decreased public investments are the main factors accountable for faster fall of investments in fixed assets which in the first three quarters of 2009 were by 37.4% lower than in the respective period of 2008. As a result of the rapid fall in investments, their share in GDP has decreased substantially. In 2007, it was over 35% of GDP, while, currently, investments in fixed assets comprise slightly over 20% of GDP. It must be noted that substantial investments in fixed assets are decreasing in the majority of EU Member States, since the global financial market has still not recovered from the economic crisis, and irrespective of the expansionary monetary policy in Europe the commercial banks are not eager to re-launch crediting.

With a significant decrease in the domestic demand, imports of goods and services are decreasing. In total, in the first three quarters of 2009, imports have decreased by 36.3% in comparison with the respective period of the previous year.

With gradual improvement of the economic situation in the majority of our main trade partner countries, **exports have slightly increased**. In the 3rd quarter of 2009, in comparison with the 2nd quarter of 2009, it has increased by 1% (according to seasonally adjusted data). However, in comparison with the 3rd quarter of 2008, exports have decreased by 14.7%.

**Due to the fall of domestic demand, the external imbalance has shrunken.** The large and constantly increasing current account deficit present in Latvia over several years started to decrease since the second half of 2007, and, since the beginning of 2009, there is a current account surplus in the balance of payments.

In the 1st quarter of 2009, the current account surplus was 1.3% of GDP, in the 2nd quarter – 14.1%, while in the 3rd quarter – 10.1%. Changes in the current account are related to the improved foreign trade balance. In the first nine months of 2009, in comparison with the respective period of the previous year, foreign trade deficit has decreased by almost 11 percentage points and was 7.5% of GDP, which was due to much faster decrease of imports than exports. In the first eleven months of 2009, exports and imports in current prices decreased by 25% and 42% respectively in comparison with the first eleven months of the previous year. It must be noted that since the 2nd quarter of 2009 a small increase of exports has been observed.

Adjustments in the current account can be explained by the changes of the financial account. Since the 4th quarter of 2008, the outflow of private foreign capital has been observed. The negative effect of private capital outflow on the financial account situation is slightly decreased by long-term loans of the public sector.

Table 1.1

**Latvia: Key Indicators of Economic Development**

| | 2006 | 2007 | 2008 | 2009e | 2010f |
|---|---|---|---|---|---|
| (changes in comparison with the previous year, %) | | | | | |
| Gross domestic product | 12.2 | 10.0 | -4.6 | -18.0 | -3.0 |
| Private consumption | 21.2 | 14.8 | -5.5 | -23.0 | -5.9 |
| Public consumption | 4.9 | 3.7 | 1.5 | -9.4 | -5.9 |
| Gross fixed capital formation | 16.4 | 7.5 | -15.6 | -36.8 | -12.2 |
| Exports | 6.5 | 10.0 | -1.3 | -15.4 | 3.0 |
| Imports | 19.4 | 14.7 | -13.6 | -33.6 | -3.3 |
| Consumer prices | 6.5 | 10.1 | 15.4 | 3.5 | -3.5 |
| (% of GDP, unless indicated otherwise) | | | | | |
| General government budget fiscal balance | -0.5 | -0.3 | -4.1 | -10,0 | -8.5 |
| General government debt | 10.7 | 9.0 | 19.5 | 34.8 | 55.1 |
| Current account balance | -22.5 | -22.5 | -12.6 | 8.0 | 4.0 |
| Employment rate (share of economically active persons in the total population aged 15–64 years, %) | 66.3 | 68.4 | 68.6 | 60.9 | 58.4 |
| Unemployment rate (share of job-seekers in the number of economically active persons aged 15–74 years, %) | 6.8 | 6.0 | 7.5 | 17.2 | 16.0 |

e – estimation; f – forecasts

**In total, in the first three quarters of 2009, the decrease of output had been observed in all main sectors of the economy.** Most significantly the economic activities decreased in construction, trade and manufacturing sectors.

**In the first three quarters of 2009, construction sector activities have decreased by 31.8%.** Over the year, construction of residential buildings, as well as trade and industrial production buildings has decreased by 70%. However the construction of health and social care buildings, local pipelines and cables, and ports has increased in the given period. In general, in Latvia, just like in Lithuania and Estonia, construction has contracted to the level of 2004.

In 2009, **the rapid** decrease **of retail trade turnover continued**. In December, retail trade turnover was by 30.2% lower than a year before. Overall, in 2009, retail trade turnover was by 28% lower than in the previous year. Since the mid-2007, when retail trade had reached its peak, it has decreased by over 40%.

**In January–November 2009, manufacturing output has decreased by 19.2%** in comparison with the eleven months of the previous year. The most rapid decrease in the volume of the manufactured production was observed at the beginning of 2009. This was not only due to the weak domestic demand, but also due to recession in the main trade partner countries. Due to an improved situation in the foreign markets, the sector is experiencing certain stabilisation signs. Since August, the production volumes, in comparison with the previous month, have been gradually increasing. However, irrespective of the positive tendencies of the recent months, when considering the year in general, there is still a decrease in manufacturing. In November, the manufacturing output was by 16.9% lower than in November 2008.

In the first eleven months of 2009, in comparison with January–November 2008, in the subsectors of manufacturing, the production volumes of machinery and equipment, as well as transport vehicles production have decreased by more than a half. Light industry, production of non-metallic minerals, and production of electrical and optical equipment have decreased by one third. In the first eleven months of 2009, the wood-processing volumes, however, have increased by 0.1% in comparison with January–November 2008.

**Over the recent months, positive tendencies have been observed in such sectors as wood-processing** (over the last six months, the production volumes have exceeded the level of the respective months of 2008) and **chemical industry** (in comparison with the previous months, since August, an increase has been observed). Likewise, over the recent months, in comparison with the previous month, the increase of production volumes **in metal working, as well as paper production, printing and publishing sectors** has been observed.

Taking into account the gradual improvement of the economic situation in the trade partner countries, the share of exported production in the total volumes sold is constantly growing. Similarly, over the recent months, producer prices of the exported production have been growing. Also, in the future, the opportunities of increasing sales revenues will mainly depend on external markets.

The results of the conjuncture survey show that **optimism of enterprises with respect to the economic situation assessment and future growth opportunities is slowly increasing**, however, it is still relatively low. In December, the economic sentiment indicator of Latvia was 67.3 points (the lowest level was observed in March 2009 (52 points), while, in November 2008, it was higher (82.4)). Similar tendencies can be observed with respect to industry, retail trade, construction, services, and consumer confidence indicators.

Taking into account changes of GDP in the first three quarters of 2009 and the operative statistics of recent months, it is expected that **the fall of economic activities in 2009 will be 18% as forecasted before.**

With the reduction of domestic demand and the affecting factors of supply, **since the mid-2008, the average inflation has been gradually decreasing.** The fall of prices has been observed over the last nine subsequent months, and, in December, the 12-month inflation was -1.2% (in December 2008, the 12-month inflation was 10.5%). In total, over the year (December compared with December), the prices of goods have decreased by 1.2%, while the prices of services – by 1%. The first prices to react to the decreased domestic demand were prices of goods, which started to fall already in the 2$^{nd}$ half of 2008, while prices of services started to fall only in March 2009.

Deflation is to be expected also in 2010, and during the year prices may decrease further by some percentage. In 2010, the overall price level will decrease mainly due to the weak demand related to lower income of population resulted from reduced wages in the public and private sectors, as well as due to higher unemployment.

**The situation in the global financial markets has negatively influenced the financial sector of Latvia.** Due to the rise in the price for money resources, crediting has decreased, whereas the limited availability of money reduces household consumption and weakens the development capacity of businesses, as well as increases the necessity to generate savings.

Since November 2008, the amounts of new loans granted to residents monthly have been lower than loans repaid, and the loan surplus amount has decreased. The largest fall was in March, April and May 2009. Over the following months, the decrease was lower.

In 2009 the number of loans with delays in payments has grown rapidly which can be explained by the low solvency and limited savings of households. However, in December 2009, for the first time since autumn 2008, the credit balance of loans without delays in payments increased. On December, the total amount of problematic loans decreased and at the end of the year reached LVL 3.9 billion or 25% from the total credit portfolios of the banks.

**The rapid fall of economic activities and decreased domestic demand have negative effect on the general budget revenues.** The Central government basic consolidated budget revenues in 2009 were LVL 4 734.7 million which is by 17.3% less than in 2008 and is mainly due to decreased tax revenues. On the other hand, the expenditure in 2009 was LVL 5626.8 million which is by 10.2% less than in 2008. In 2009, the financial deficit of the general government consolidated budget was LVL 892.1 million.

The total tax revenues in the general government budget in 2009 were 1 663 million which is by 31.5% less than in 2008 and was mainly due to lower revenues from the value added tax and corporate income tax.

**The fall in economic activities started to influence the employment indicators increasingly.** The employment rates started falling in the 4$^{th}$ quarter of 2008 when the number of employed persons fell by 5.5% in comparison with the 4$^{th}$ quarter of 2007.

In 2009, with the decrease of economic activity, the number of employed persons continued to drop rapidly – in the 3$^{rd}$ quarter, there were 953.9 thousand employed persons or by 15.8% less than in the 3$^{rd}$ quarter of 2008. In the 3$^{rd}$ quarter, the unemployment level reached 18.4%. The year before, in the 3$^{rd}$ quarter of 2008, it was 7.2%.

In 2009, the most significant decrease of the number of employed persons has been experienced in the construction sector where this number has decreased by almost a half or by 63.1 thousand (in the 3$^{rd}$ quarter of 2009 in comparison with the 3$^{rd}$ quarter of 2008). The number of persons employed in manufacturing has decreased by one fourth (43.1 thousand persons). In the public utilities sectors, this number has decreased by 27.9 thousand (by 12%).

Along with the fall in employment, the unemployment has grown rapidly. In November, the unemployment level in Latvia was 22.3% being the highest in the European Union.

According to the State Employment Agency's data, at the end of 2009, 179.2 thousand unemployed persons were registered which is 16% from the economically active population of the country. The most rapid increase of registered unemployment was observed at the end of 2008 and at the beginning of 2009. Since April, the growth rate of registered unemployment decreased, which can be explained with seasonal works. However, since September, a more rapid increase of unemployment can be observed again.

Along with lower labour demand since the 4$^{th}$ quarter of 2008, the tendency of growing wages has stopped, and, since May 2009, a gradual decrease of average wages has been observed in the economy. In September 2009, the average monthly gross wage was LVL 433. In comparison with September 2008, it has decreased by 10.2%.

**The recovery of Latvia's economy in the coming years will largely depend on how fast the global financial system and the main foreign trade partner countries will recover and how successfully Latvia will be able to compete in the open markets for goods and services.**

Although in several world countries certain recovery signs are observed already now, the world economy perspectives are still subjected to a great uncertainty. Although the effect of macroeconomic stimulus introduced and policy measures implemented during the crisis were more efficient than initially expected, a risk still exists with respect to a strong feedback between the real and financial sector, increase of prices for oil and other goods, as well as increased protectionism. The stable growth recovery of the world economy is related with such risks as withdrawal of national economic impetuses, as well as rapid deterioration of the labour market.

Thus, in 2010, considerable growth of external demand should not be expected. On the other hand, the domestic demand of Latvia will continue to fall due to budget consolidation measures (decreased expenditures and increased tax rates).

Therefore, **the Ministry of Economics forecasts a decrease of GDP also in the first half of 2010, while its growth could resume in the 3rd quarter** when GDP will not be decreasing anymore in comparison with the previous quarter (according to seasonally adjusted data). However, in comparison with the respective quarters of 2009, its level will be lower. In this case, **in 2010, GDP will decrease by 3%**.

**Economic growth may revive in 2011**, in the case if the global financial markets stabilise fully and crediting revives, which will give positive impetus to the local enterprises, as well as ensure a gradual increase of external demand in our goods and services export partner countries. Therefore, in 2011, a more rapid development of export oriented sectors can be expected. At the same time, domestic demand will be renewed, and it is forecasted that positive growth tendencies will be observed also in the domestic market oriented sectors. **In 2011, it is forecasted that GDP will grow by 2 – 2.5%.**

**In general, the recovery of the labour market is expected later than the recovery of the economic growth since the latter will be based on growth of productivity, not on the number of employed persons.** In 2010, lower labour demand is expected. Social problems related to the low employment level will be prevailing over the next 3–4 years. In the medium-term, the labour demand will not exceed the level of 2008.

In 2010, the number of employed persons will decrease in all sectors, and the number of unemployed persons will be growing in comparison with the data of 2009. The annual average unemployment level (share of job-seekers in the number of economically active population), in 2009, will exceed 17% and may remain at the same level in 2010. A gradual decrease of unemployment can be expected not earlier than 2011, when the unemployment level may drop to 14% from the number of economically active population.

# 2. DEVELOPMENT OF WORLD ECONOMY [1]

Growth has resumed in the world economy, which is evidenced by the good economic indicators of Asian countries, as well as by stabilisation of slight growth in certain countries. In the developed countries, recovery has been promoted by active interference of governments in the economic processes. The emerging and developing countries are largely still aiming for recovery. Many developing countries in the Eastern Europe and CIS countries have suffered fiercely from the crisis, and growth in these countries will be delayed.

The global recovery rates are still low and the activities are still at a much lower level than during the pre-crisis period. Growth is supported by industrial recovery and cyclic adjustments in inventories. Consumer confidence is returning and housing market is starting to become active, retail trade is stabilising. Owing to a better perspective, the commodities prices have increased slightly, in comparison with the record-low level which was observed at the beginning of the year. This promotes the recovery of global trade.

Table 2.1

**GDP Growth**

(percentage in comparison with the previous year)

| | 2007 | 2008 | 2009 f | 2010 f |
|---|---|---|---|---|
| **World**, including: | **5.2** | **3.0** | **-1.1** | **3.1** |
| USA | 2.1 | 0.4 | -2.7 | 1.5 |
| Japan | 2.3 | -0.7 | -5.4 | 1.7 |
| **EU**, including: | 3.1 | 1.0 | -4.2 | 0.5 |
| Eurozone countries | 2.7 | 0.7 | -4.2 | 0.3 |
| United Kingdom | 2.6 | 0.7 | -4.4 | 0.9 |
| CIS | 8.6 | 5.5 | -6.7 | 2.1 |
| China | 13.0 | 9.0 | 8.5 | 9.0 |

Source: "The World Economic Outlook October 2009", International Monetary Fund;
f – forecast

It is considered that the recovery from crisis has been mainly supported by governmental policy aimed at promoting demand implemented during the crises in both developed and developing countries. Basically, this policy prevented the concerns about the global depression which led to the sharpest trade decline since the World War II. The central banks reacted promptly with considerable interest cuts, nonstandard measures for liquidity and crediting maintenance. The governments developed significant fiscal promotion programmes, at the same time ensuring guarantees and capital investments for the banks. Overall, these measures have decreased uncertainty and increased confidence, promoting improvements of the financial conditions, which is evidenced by the recovery of many markets and renewal of international capital flows. However, financial environment has still not fully stabilised, and several risks exist.

Over the next development period, policies that are supporting the current recovery will gradually lose effect and growth will be facilitated with the help of actual and financial sectors, although they are currently still weak. Fiscal impetuses will decrease, and consumption and investments will increase only slightly, since in many countries the financial systems are still stressed.

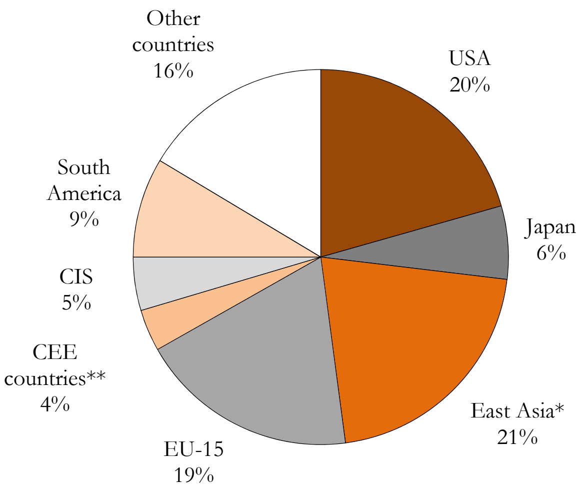
Thus, after the recession of the world economy by about 1% in 2009, already for 2010 growth of about 3% is forecasted – at a much lower level than during the pre-crisis period.

With growing unemployment, the growth forecasts for developed economies for 2010 are low. Growth in 2010 could be slightly over 1% which is a rather good indicator after the fall in 2009.

[1] For the preparation of the section, "World Economic Outlook" of the International Monetary Fund has been used.

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", October 2009, International Monetary Fund.
* China, South Korea, Malaysia, Singapore, Thailand, the Philippines
** Central and East European countries- Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Malta, Poland, Romania, Serbia, Montenegro, Slovakia, Slovenia, Turkey

In the developing countries, the increase of actual GDP is forecasted to be more rapid – by about 5% in 2010, in comparison with almost 2% in 2009. This growth is mainly influenced by the expansion of China, India and other rapidly growing economies of Asian countries. The growth of economies of other developing countries is more moderate, and supported by political impetuses, as well as by improvements of world trade and financial conditions.

Negative growth risks still persist, although they are slowly reducing. The main short-term risk is related with the beginning of lasting stagnation. The early withdrawal of stimulatory monetary and fiscal policy is also assessed as a considerable risk, since the recovery signs may be deceitful and may be incorrectly identified as recovery of the private demand. The world economy is still sensitive towards various shocks, such as rise of oil prices and other geo-political events.

At the same time, short-term development should not be linked to risks only, but also to positive impetuses, which is evidenced by the recent improvements of financial conditions that have been introduced faster than expected. This may facilitate faster growth of consumption and investment flows in several developing and developed countries. Thus, also in the medium-term, growth risks and perspectives are related with development of the financial sector.

In the USA economy, stabilisation has been observed. Output decreased considerably in the 1st half of 2009, and unemployment reached the highest level since the beginning of 1980s. However, unprecedented monetary, financial, and fiscal policy interferences are helping to stabilise consumption and housing and financial markets, which show a moderate recovery of growth in the 2nd half of 2009.

Although export-oriented Asian economies suffered greatly at the beginning of the rapid global recession, economy perspectives in this region improved considerably in the 1st half of 2009. The most recent developments show strengthening in the domestic demand and export, yet, the question still exists whether it will be sufficient for the growth rates to be faster than in the rest of the world.

The most recent data about the European countries show that the fall rates have slowed down. In the 2nd and 3rd quarter of 2009, Eurozone GDP reduced less than forecasted before. In France and Germany, a positive growth was observed, while in UK – a moderate recession. In many new EU Member States, stagnation persists and in some – even recession, while in Poland growth has been positive in the 3rd quarter of 2009. Therefore, the recovery in Europe is slow. The financial market conditions in the region have improved, yet the financial systems will require time to recover fully. Strict crediting conditions restrict the private investments, and the growing unemployment determines the fall in demand. The new EU Member States will have to adapt to stricter foreign funding restrictions.

**After a deep global recession, the economic growth has become positive, thanks to supportive national policies that promoted demand and decreased uncertainty and risks in the financial markets. The recovery will be slow, since the financial system is still vulnerable. The supportive national policy will be gradually reduced, while households will not increase consumption since it will be impeded by the high unemployment level and the necessity to renew savings which suffered from the significant fall of assets prices. The main aim of the global economy policy is to renew the stability in the financial sector by maintaining supportive macroeconomic policy until reaching full stability in the financial sector.**

# 3. Growth

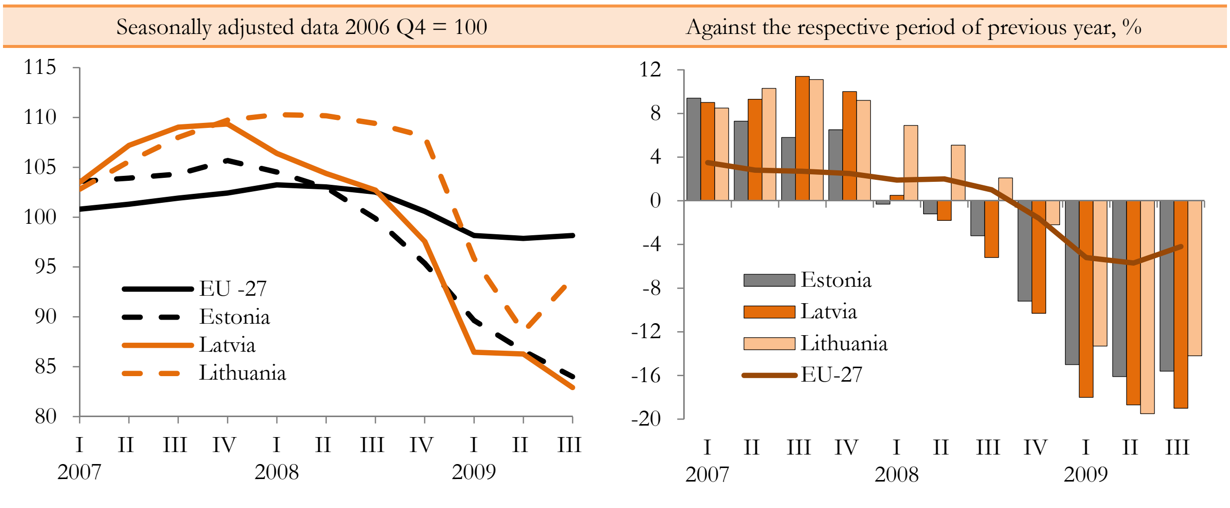
## 3.1. GDP Dynamics and Aggregate Demand

### 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%, a deep recession has started in the economy of Latvia. It started in the 1st quarter of 2008 when the domestic demand decreased swiftly.

Figure 3.1

**GDP Dynamics by Quarters**




In the 1st quarter of 2008, GDP decreased by 2.7% 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. Over the following quarters, the recession rates gradually increased, and the GDP was already below the level of 2007. On average, in 2008, GDP decreased by 4.6%.

During the 1st quarter of 2009, recession rate increased considerably and GDP decreased by 11.4% 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. Over the following quarters, recession was not as rapid (respectively, by 0.2% and 4% in the 2nd and 3rd quarter of 2009, according to the seasonally adjusted data), and the total decrease of GDP in comparison with the 4th quarter of 2007, after which recession begun, reached 24.2%.

Table 3.1

**Gross Domestic Product of Latvia, Expenditure Items**

(percentage change in comparison with the previous year)

| | 2008 | | | 2009 Q1-Q3 against 2008 Q1-Q3 | |
|---|---|---|---|---|---|
| | **structure** | **growth rates** | **contribution to growth** | **growth rates** | **contribution to growth** |
| **Gross domestic product** | **100** | **-4.6** | **-4.6** | **-18.6** | **-18.6** |
| Private consumption | 61.8 | -5.5 | -4.0 | -23.6 | -17.4 |
| Public consumption | 19.7 | 1.5 | 0.2 | -6.9 | -1.0 |
| Gross fixed capital formation | 29.4 | -15.6 | -5.6 | -37.4 | -11.6 |
| Inventories | 2.2 | – | -3.7 | – | -4.0 |
| Net exports | -13.1 | – | 8.5 | – | 15.3 |
| *– exports* | *41.7* | *-1.3* | *-0.5* | *-16.4* | *-7.3* |
| *– imports* | *-54.8* | *-13.6* | *9.0* | *-36.3* | *22.6* |

Deterioration of the economic situation in Latvia is largely determined by the processes of the global financial crisis, which substantially decreased both the 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 in the 4th quarter of 2008 (according to *Eurostat* seasonally adjusted data against the previous quarter) and by another 2.4% in the 1st quarter of 2009.

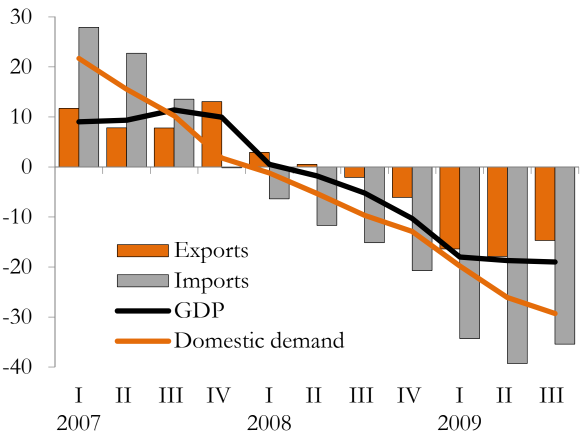
In the 1st quarter of 2009, GDP considerably decreased in such big economies as Germany (by 3.8%), Sweden (by 0.9%), Italy (by 2.6%), and France (by 1.2%). In Lithuania and Estonia, the recession in the 1st quarter of 2009 was 10.5% and 6.1%, respectively.

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

Figure 3.2

**Quarterly Changes in GDP and major Expenditure Items**

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




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

## 3.1.2. Private and Public Consumption

The decrease of private consumption started already in the 4th quarter of 2007, when it decreased by 1.4% in comparison with the previous quarter (according to the seasonally adjusted data). Over the following quarters, the recession rates gradually increased, and in the 4th quarter of 2008 they reached 6.3% or were at 86.3% level from the volume of the 4th quarter of 2007.

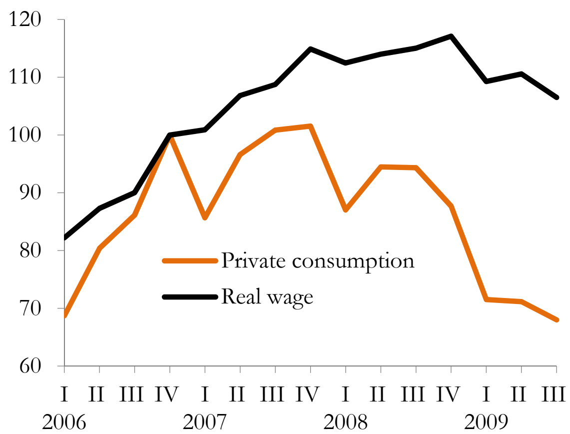
In 2009, a considerable decline in private consumption continued – respectively by 6.9%, 9.1% and 9.3% over the first three quarters of the year. Overall, in comparison with the 4th quarter of 2007, in the 3rd quarter of 2009, private consumption has declined by a third which means that this reduction is faster than that of GDP.

Contrary to the previous years of rapid growth, when households afforded to increase consumption more rapidly than the increase of actual wages, already in 2007, another tendency was present when private consumption stopped increasing, despite the growth of real wages (see Figure 3.3). The real wages were increasing during the whole 2008 (a slight decrease in the 1st quarter of 2008), but in the 1st quarter of 2009 it started to decrease. In the 3rd quarter of 2009, the level of actual wages was already by 7.4% lower than the year before.

Figure 3.3

**Growth of Real Wages and Private Consumption, Quarterly Profile**

(2006 Q4 = 100)




The essential decrease in private consumption in 2008 was largely determined by the limitation of household crediting. Crediting slowed down already in the 2nd half of 2007. The volumes of granted consumer credits and mortgages, but almost until the end of the 2008, the credit balances continued to increase slightly. Yet, already in December 2008, they reduced. The reducing tendency continued also in the

1st quarter of 2009. During the previous rapid growth years, the availability of credit resources influenced significantly also the possibility to increase the domestic demand, and with resources running out the domestic demand rapidly decreased.

In 2009, the reduction of private consumption was more significantly influenced by the decrease of real wages and by the increase of unemployment.

The changes in the number of the employed persons and changes of real wages in relation to the decrease of economic activities started in the 2nd half of 2008, when employment decreased and the 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 to 18.4% in the 3rd quarter of 2009. The situation in the labour market may remain tense until 2011 when growth will start again. Therefore, private consumption will remain on a low level for at least two years.

Public consumption or public services amounts to approximately one fifth of the aggregate domestic demand and it's value is determined by the volume of the provided public services. Within the years of 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.

Public consumption started to decrease only in 2009 when the budget consolidation measures were implemented. In the 3rd quarter of 2009, its volume was by 12.4% smaller than in the 3rd quarter of 2008, and its proportion in the aggregated demand started to reduce.

### 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 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 *Eurostat* data, the average annual investment growth rates during this period exceeded the average annual investment growth rates in the EU Member States by almost four times. Latvia's lagging behind other EU Member States also considerably decreased regarding the volume of investments per employed person: in 2004, the investments 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 investments are greatly determined by profitability of business investment projects, financing possibilities and the current situation in the markets, as well as by forecasts of entrepreneurs regarding the future.

Table 3.2

**Gross Capital Formation**

| | 2004–2007 (average annually) | 2006 | 2007 | 2008 | 2009 9 months |
|---|---|---|---|---|---|
| | Real growth (%) | | | | |
| **GDP** | **10.4** | **12.2** | **10.0** | **-4.6** | **-18.6** |
| Gross Capital Formation | 15.3 | 18.3 | 11.6 | -24.4 | -51.7 |
| – gross fixed capital formation | 17.6 | 16.4 | 7.5 | -15.6 | -37.4 |
| | % of GDP | | | | |
| **Gross Capital Formation** | **37.6** | **39.7** | **40.4** | **31.5** | **19.3** |
| – gross fixed capital formation | 31.7 | 32.6 | 33.7 | 29.4 | 20.8 |
| – changes in inventories | 5.9 | 7.1 | 6.7 | 2.2 | -1.5 |

Deterioration of the situation in the global financial markets at the end of 2007 and at the beginning of 2008 has decreased the credit standing of the banking sector, which negatively affects investment 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 deteriorates thereby restricting internal sources for financing investment.

In 2008, the investment volumes in the economy of Latvia were by 13.2% lower than in 2007.

In 2009, the investment processes were negatively influenced by deterioration of investment environment, low domestic and foreign demand, as well as the production capacity load level. During the first three quarters of this year, the investment volumes were almost three times smaller than in the respective period of 2008.

The largest reduction of investment volumes in 2008 and 2009 was in the private sector. In the public sector[1], in 2008, positive investment dynamics was

[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.

maintained, while in 2009 reduction was observed. Due to substantial investment decrease in the private sector and rather stable investments in the public sector, the share of both sectors in the total investment structure is equal.

**Sectoral structure of investments.**[1] 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 care and education. Largely it was determined by financing conditions favourable for investments and by rapidly increasing demand.

In 2008, positive investment dynamics was maintained in the primary sectors and majority of services sectors. The investment volumes in other sectors were smaller in comparison with 2007. Especially large decrease of investment volumes was in the 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 sectors related to the real estate market in which investments process largely depend on accessibility of external financing.

Table 3.3

**Sectoral Dynamics and Structure of Investments**

| | Growth rates | | | | Structure | | | |
|---|---|---|---|---|---|---|---|---|
| | **2004–2007 (average annually)** | **2007** | **2008** | **2009 9 months*** | **2004–2007 (average annually)** | **2007** | **2008** | **2009 9 months*** |
| Primary sectors | 7.6 | -17.8 | 19.8 | -43.2 | 4.4 | 3.5 | 4.3 | 5.2 |
| Manufacturing | 17.9 | 10.5 | -23.9 | -40.1 | 16.2 | 16.8 | 13.2 | 14.9 |
| Electricity, gas, and water supply | 13.2 | 51.6 | -28.5 | -11.9 | 7.8 | 8.5 | 6.3 | 15.7 |
| Construction | 26.1 | 14.1 | -14.8 | -71.9 | 7.2 | 8.0 | 7.1 | 2.2 |
| Trade | 5.0 | -16.6 | -3.2 | -53.9 | 13.2 | 10.6 | 10.6 | 9.4 |
| Transport and communications | 3.0 | -15.6 | 5.6 | -24.1 | 13.2 | 11.1 | 12.2 | 16.3 |
| Other commercial services | 22.8 | 15.5 | 9.8 | -60.2 | 23.4 | 26.3 | 29.9 | 8.9 |
| Public services | 19.5 | 16.5 | 4.7 | -10.9 | 14.7 | 15.2 | 16.5 | 27.3 |
| **Total** | **15.6** | **7.5** | **-15.6** | **-37.4** | **100** | **100** | **100** | **100** |

* estimated using quarterly data

With deepening of the economic crisis, in 2009, the investment activities continued to reduce in all sectors. Over the first three quarters of 2009, investments in the sector of manufacturing goods decreased by 36.2% and in services sector – by 34.2% in comparison with the respective period of the previous year.

Since Latvia joined the EU, the annual investment volumes have almost doubled in the manufacturing industry. In 2008, the decrease of investment volume in manufacturing is comparatively small – by 9.7%, which is largely determined by an increase of investments in manufacturing of products of other non-metallic minerals, which partially compensated the reduction of investments in food industry, wood-processing, and other manufacturing sub-sectors.

It must 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 vehicles. To a certain extent such trends may be indicative of a decrease in 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 first three quarters of 2009 – by 32.1%. Such dynamics of investment is indicative of a substantial decrease in competitiveness of the light industry.

Since 2004, positive dynamics of investments has remained in the industries of wood-processing and production of construction materials. Moreover, during the period of 2006–2007, the annual investment growth rates were more rapid when compared to the preceding 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 decreased also in the wood-processing sector. However, investments increased in the production of construction materials.

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

Table 3.4

**Dynamics and Structure of Investment in Manufacturing**
(percentage)

| | Growth rates | | | | Structure | | | |
|---|---|---|---|---|---|---|---|---|
| | **2004–2007 (average annually)** | **2007** | **2008*** | **2009 9 months*** | **2004–2007 (average annually)** | **2007** | **2008*** | **2009 9 months*** |
| Food industry | -1.8 | -37.0 | -9.0 | -59.2 | 21.8 | 13.7 | 17.9 | 18.3 |
| Light industry | -13.3 | -3.5 | -56.5 | -32.1 | 2.7 | 2.1 | 1.5 | 3.7 |
| Wood processing | 18.2 | 19.1 | -22.5 | -78.4 | 26.4 | 28.3 | 19.4 | 7.1 |
| Paper industry and publishing | 20.2 | 4.9 | -46.5 | -81.7 | 7.2 | 7.3 | 4.9 | 1.4 |
| Chemical industry and related industries | 24.3 | 1.1 | -21.7 | -43.2 | 7.6 | 8.2 | 10.3 | 21.1 |
| Production of other non-metallic mineral products | 79.0 | 63.8 | 62.9 | 146.0 | 14.4 | 21.6 | 31.4 | 39.7 |
| Production of metals and metal articles | 20.5 | 46.4 | 9.7 | -64.1 | 7.1 | 7.8 | 6.8 | 4.4 |
| Production of machinery and equipment | 9.0 | 31.0 | -36.4 | -68.1 | 2.1 | 1.8 | 1.9 | 0.8 |
| Production of electrical and optical equipment | 7.1 | -15.7 | -2.6 | -72.9 | 2.5 | 1.9 | 2.2 | 0.9 |
| Production of vehicles | 25.0 | 5.9 | -26.0 | -51.8 | 2.3 | 2.0 | 1.5 | 1.1 |
| Other industries | 20.9 | -6.1 | -72.0 | -57.5 | 5.8 | 5.3 | 2.1 | 1.7 |

* estimated using quarterly data

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

## 3.1.4. Exports and Imports

<u>**Exports and imports of commodities**</u>

During the last quarter of 2008, the export volumes started to reduce significantly. The decrease continued in the 1st quarter of 2009, while in the 2nd quarter the situation stabilised and export of commodities was even increasing.

However, overall, in January–November, the commodities export volumes were considerably smaller than in the respective period of the preceding year (in current prices – by 21.6%, in constant prices – by 16.2%) (see Figure 3.5).

Commodities import, however, started to decrease in the second half of 2007 when the domestic demand decreased. The import decrease was larger than that of export and continued until the 2nd quarter of 2009.

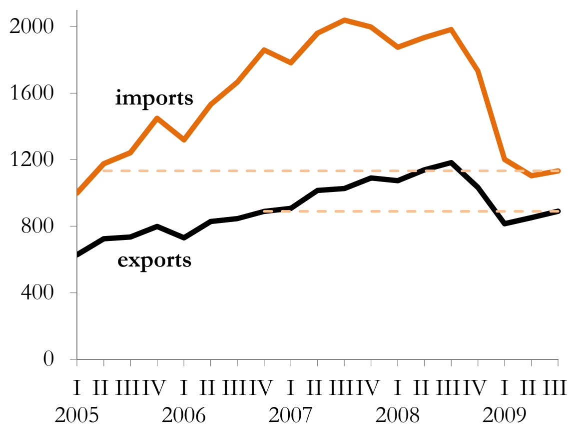
Overall, in January–November 2009, the import volumes in current prices were by 39.6% lower than in the respective period of the previous year (in constant prices – by 38%).

As showed in Figure 3.5, the export and import volumes have approximated mainly due to the rapid decrease of import. Just two years ago, export accounted for 52% of the total volume of import, in November 2009 it increased up to 83%.

In 2009, the changes in trading conditions negatively influenced **exports of commodities**, and the export prices decreased more rapidly than the import prices. The most significant reduction of an export unit value in 2009 was for wood and timber and metal and non-metallic products.

Figure 3.4

**Exports and Imports of Latvian Commodities by Quarters**
(million LVL)



The commodities export decreased for all commodities groups – less critically in such groups as agriculture and food products, as well as machinery manufacturing, while a more considerable decline in export was observed for metal-working products and wood and its products.

As showed in Figure 3.5, in 2009, export stabilised monthly, in September–November it even grew considerably in comparison with the average level of 2009. The largest contribution in this growth is by export of agriculture products, as well as of metal and its articles and increased export of equipment. It may be expected that also over the following months, export might be positively affected by increased external demand related to the recovery of global growth.

Figure 3.5

**Dynamics of Latvian Commodity Exports by Months**
(million LVL)

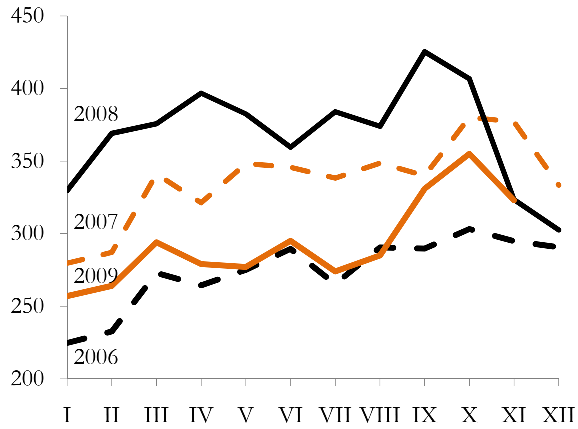



Table 3.5

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

| | 2008 | | January–November 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** | **9,6** | **-21.6** | **-21.6** |
| wood and wood products | 16.6 | -19.1 | -23.7 | -4.0 |
| metals and metal articles | 16.7 | 25.3 | -41.4 | -7.1 |
| light industry products | 6.1 | -8.5 | -26.1 | -1.6 |
| agriculture and food products | 16.9 | 29.0 | -10.5 | -1.7 |
| products of chemical industry and allied industries, plastics | 11.2 | 18.5 | -18.9 | -2.1 |
| machinery products | 12.5 | 24.7 | -12.2 | -1.5 |
| minerals | 4.2 | 11.2 | 3.1 | 0.1 |
| vehicles | 7.4 | 16.0 | -26.1 | -2.0 |
| other commodities | 8.4 | 5.2 | -20.8 | -1.8 |

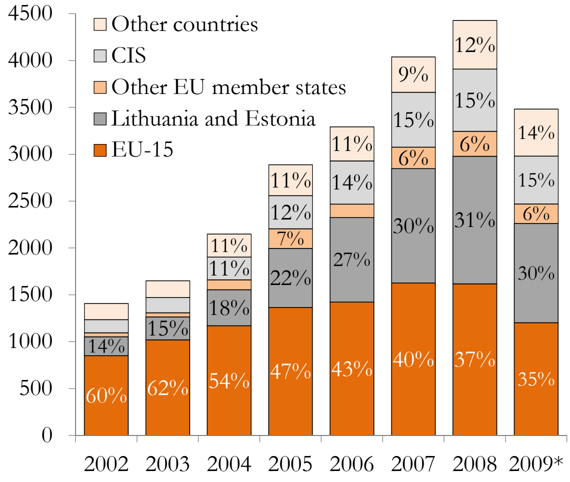
In January–November 2009, exports to the EU Member States decreased by 23.6% in comparison with the corresponding period of the previous year. Considering the large proportion of EU Member States in export of Latvia, the group of these countries was the main affecting factor in the total fall of export of Latvia.

Just like in the overall export of Latvia, also in the export to the EU Member States, the largest decreases were in metal working products and wood and its products, together corresponding to almost a half of the total export decrease to the EU Member States. A less critical decrease was for machinery and agriculture and food products export.

Within this period, export decreased considerably also to the CIS countries, and most significantly – in the machinery and agriculture and food product groups. Out of the total export to the CIS countries, this decrease corresponded to almost 40%. Export of the chemical industry products decreased to a lesser extent.

Figure 3.6

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




* estimation of the Ministry of Economics

In January–November 2009, **the commodities import** decreased in all commodities groups from which the largest – machinery manufacturing and vehicle groups (mainly from the EU Member States), as well as metals and their products that together corresponded to more than a half of the whole decrease of import. Import of agriculture and food products decreased to a lesser extent.

Import from the EU Member States has decreased more rapidly than the total import of Latvia. Import from the CIS countries has decreased to a lesser extent.

Figure 3.7

**Commodity Imports by Months**
(million LVL)

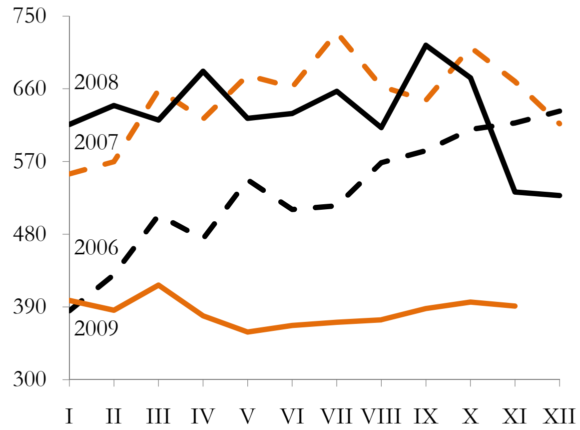



Table 3.6

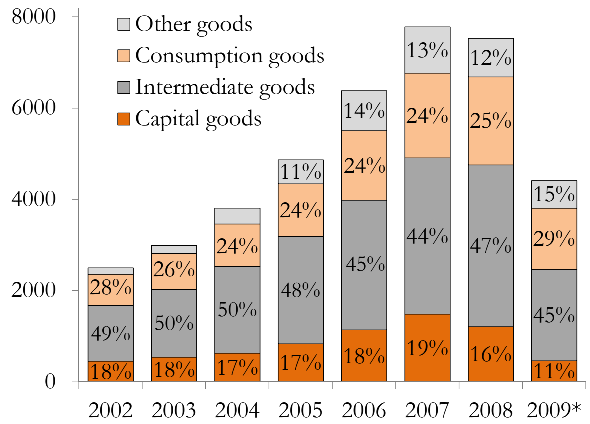
**Imports by Main Groups of Commodities**
(%, in current CIF prices)

| | 2008 | | January–November 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** | **-39.6** | **-39.6** |
| wood and wood products | 1.9 | -46.7 | -54.8 | -1.0 |
| metals and metal articles | 10.3 | 3.7 | -52.6 | -5.5 |
| light industry products | 5.2 | -8.8 | -29.6 | -1.6 |
| agriculture and food products | 13.7 | 18.4 | -18.5 | -2.5 |
| products of chemical industry and related industries, plastics | 14.5 | 8.5 | -28.8 | -4.2 |
| machinery products | 18.3 | -15.1 | -48.4 | -8.8 |
| minerals | 15.6 | 30.9 | -32.7 | -5.1 |
| vehicles | 10.7 | -28.9 | -63.9 | -7.0 |
| other commodities | 9.8 | -8.5 | -40.9 | -4.0 |

Over the last year, import of capital goods decreased considerably which is related to the decline of investments. A slight reduction is observed also for intermediate consumer goods, and the commodities share has grown respectively (see Figure 3.8).

Figure 3.8

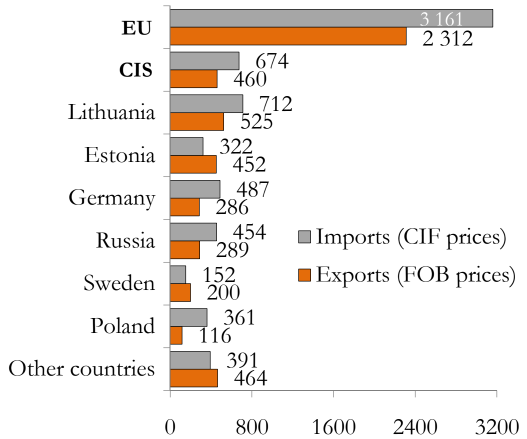
**Imports by Classification of the Broad Economic Categories**
(in connection with the basic sections of national accounts, in current CIF prices, million LVL)




* estimation of the Ministry of Economics

Figure 3.9

**Foreign Trade Turnover of Latvia* in January–November 2009**
(million LVL)




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

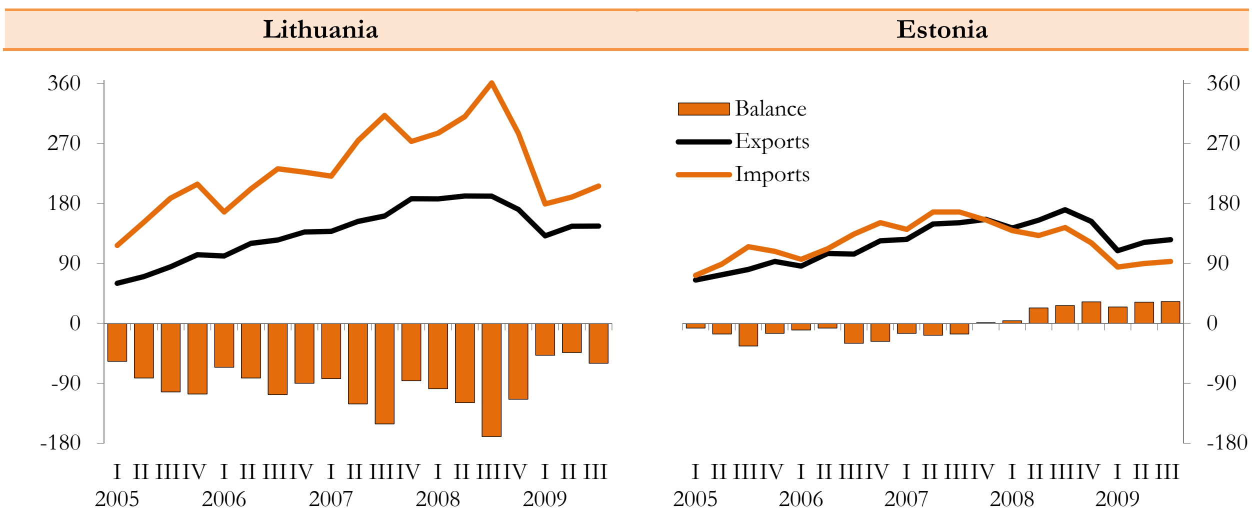
The main **trading partners** of Latvia in the period of January–November 2009 were Lithuania (16.6% of the total foreign trade turnover), Estonia (10.4%), Germany (10.4%), Russia (10%), Poland (6.4%), as well as Sweden (4.7%).

The main foreign trade partner countries of Latvia are **Lithuania** and **Estonia**. During the last years, the share of these countries in the total share of foreign trade has been continuously increasing. Likewise, during the rapid increase of trade, a deterioration of trade balance with both Baltic States was observed, yet, starting with the 2nd half of 2008, when the total import volumes started to fall, the balance of foreign trade with Lithuania and Estonia started to improve (see Figure 3.10).

As Figure 3.10 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–November 2009 exceeded the exports by 36%, while the exports to Estonia exceeded imports by 41%, although it must be noted that the total trade volume with Estonia is slightly smaller than with Lithuania. The main groups of goods exported to Estonia and Lithuania are agriculture and food products, products of machinery manufacturing, as well as products of the chemical industry. The main groups of goods imported from Lithuania and Estonia are agriculture and food products, mineral products, as well as products of the chemical industry.

Figure 3.10

**Latvia's Foreign Trade Turnover with Lithuania and Estonia by Quarters**
(million LVL)



**<u>Exports and imports of Services</u>**

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

Table 3.7

**Exports and Imports of Services**

(percentage)

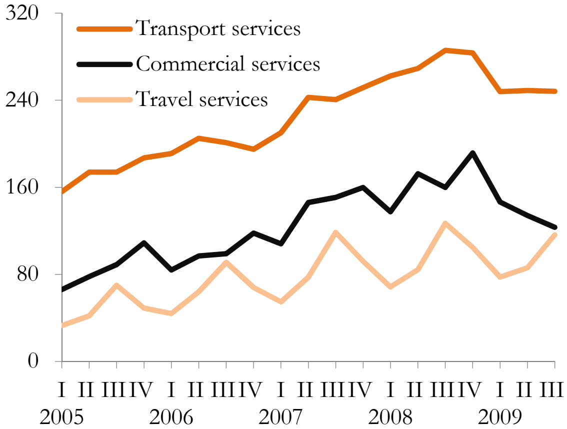
| | 2008 | | | | January–September 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | structure | | change compared to the previous year | | structure | | change compared to the corresponding period of the previous year | |
| | exports | imports | exports | imports | exports | imports | exports | imports |
| **Services – total** | **100** | **100** | **16.0** | **10.6** | **100** | **100** | **-9.5** | **-26.4** |
| including: | | | | | | | | |
| Transport services | 50.8 | 25.5 | 17.1 | -3.2 | 51.5 | 26.6 | -8.8 | -35.4 |
| – sea transport | 17.2 | 5.8 | 3.3 | -8.4 | 18.5 | 5.8 | 0.3 | -38.0 |
| – air transport | 8.0 | 8.4 | 25.1 | -4.0 | 8.4 | 8.7 | -8.0 | -27.4 |
| – other transport | 25.6 | 11.4 | 25.9 | 0.2 | 24.7 | 12.1 | -14.9 | -40.0 |
| Travel | 17.6 | 35.7 | 12.1 | 15.1 | 19.4 | 35.8 | 0.1 | -22.1 |
| Commercial services | 30.4 | 36.9 | 17.1 | 17.0 | 27.9 | 35.7 | -16.0 | -23.8 |
| Other services | 1.2 | 1.9 | 4.9 | 24.6 | 1.1 | 1.8 | -16.2 | -30.7 |

Slightly more than a half of the services export is made of the revenues from transit haulage. Although, in January–September 2009, the revenues from transport decreased, especially from the road transport, this reduction is smaller than the total reduction of the sector. Revenues from tourists coming to Latvia have increased slightly, while export of commercial services has decreased considerably.

Figure 3.11

**Export of Services by Quarters**

(million LVL)




## 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 the 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 74.3% when compared to 71.8% in 2000. According to the employment rate, the structure of national economy considerably differs from that 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 ensured by trade sectors (wholesale and retail), as well as by 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**
(percentage)

| | By value added | | By number of employed | |
|---|---|---|---|---|
| | 2000 | 2008 | 2000 | 2008 |
| Primary sectors | 4.8 | 3.5 | 14.5 | 8.2 |
| Manufacturing | 13.7 | 10.5 | 17.9 | 15.2 |
| Electricity, gas, and water supply | 3.6 | 2.8 | 1.9 | 1.9 |
| Construction | 6.1 | 8.9 | 5.9 | 11.2 |
| Trade, hotels, and restaurants | 17.9 | 18.9 | 17.7 | 19.6 |
| Transport and communications | 14.0 | 10.7 | 8.3 | 9.4 |
| Other commercial services | 23.0 | 28.6 | 12.4 | 15.4 |
| Public services | 16.9 | 16.1 | 21.4 | 19.1 |
| **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 as it was during the current financial crisis.

Table 3.9

**GDP Growth**
(percentage)

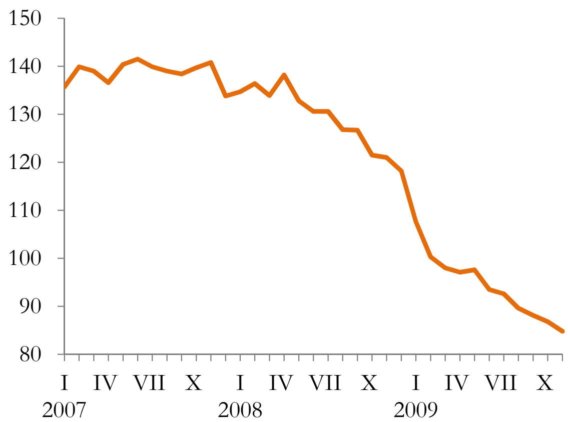
| | Growth rates | | | Contribution to growth | | |
|---|---|---|---|---|---|---|
| | 2004–2007 (average annually) | 2008 | 2009 Q1-Q3 | 2004–2007 (average annually) | 2008 | 2009 Q1-Q3 |
| Primary sectors | 5.1 | 0.0 | -4.1 | 0.2 | -0.1 | -0.2 |
| Manufacturing | 4.8 | -6.5 | -22.5 | 0.7 | -0.9 | -2.8 |
| Electricity, gas and water supply | 3.6 | -2.4 | -11.2 | 0.1 | -0.1 | -0.3 |
| Construction | 16.5 | -2.6 | -31.8 | 1.2 | -0.4 | -2.8 |
| Trade, hotels and restaurants | 15.4 | -8.4 | -28.4 | 3.4 | -2.4 | -6.9 |
| Transport and communications | 9.1 | 1.1 | -16.3 | 1.3 | -0.1 | -2.6 |
| Other commercial services | 12.2 | -0.2 | -5.3 | 3.0 | -0.5 | -1.8 |
| Public services | 4.0 | 0.7 | -7.8 | 0.6 | -0.1 | -1.1 |
| **GDP** | **10.4** | **-4.6** | **-18.6** | **10.4** | **-4.6** | **-18.6** |

Due to decreased external financing, essential decrease was observed also in the domestic demand, which directly affected the economic activities of the sectors. Retail sales, activities in the real estate market, and construction output rates have decreased particularly rapidly.

More essential reduction is observed in services related to the domestic demand, but transport transit services, for instance, railway transport and freight turnover at ports, have decreased very slightly.

Figure 3.12

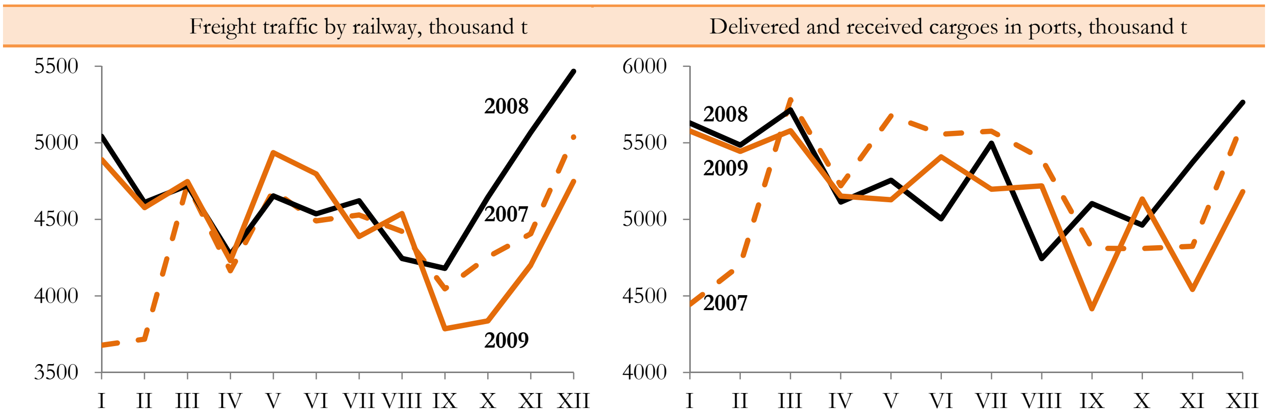
**Retail Trade Turnover**
(seasonally adjusted data,
average monthly turnover in 2005 = 100)



The main determining factor for GDP reduction in the first three quarters of 2009 was the decrease of the trade services which reduced GDP by 7%, i.e. by more than one third from the total GDP reduction. Construction output reduction which took place more rapidly than the fall of trade services, reduced the aggregated economic output by 2.9% as the proportion of this sector is much smaller.

Figure 3.13

**Freight Turnover**




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

## 3.2.2. Manufacturing

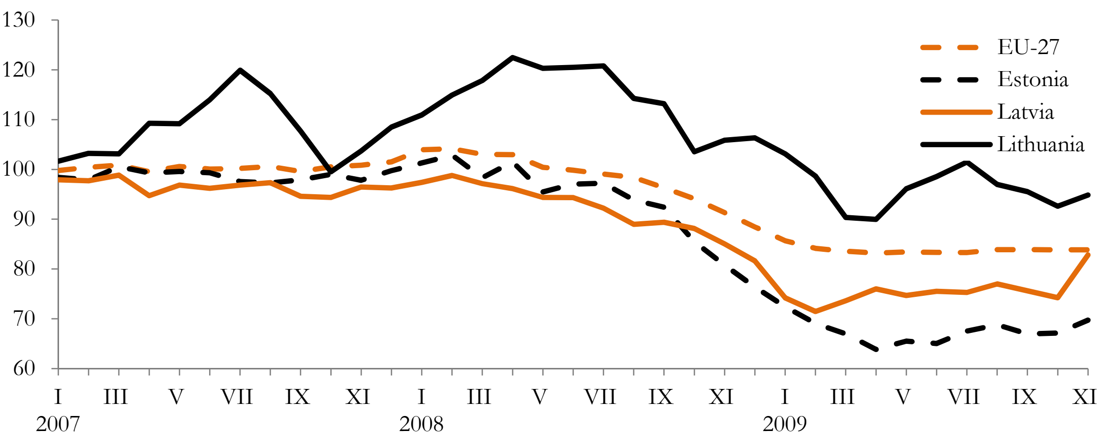
Both in Latvia and Europe overall, in 2009, manufacturing experienced the most rapid output decline during the recent years.

In Europe, the manufacturing industry volumes in certain sectors have fallen from their peak (reached in 2007) to the level of 1998. However, the economic recession has not equally harshly affected all sectors. The most significant output declines are observed in production of machinery and equipment, metal and their products, vehicles, as well as electric and optical equipment. On the other hand, the chemical industry and food production output remained relatively stable. It must be noted that the manufacturing industry has suffered much more than the majority of other sectors, especially services, e.g., financial intermediation, operations with real estate etc.

Figure 3.14

**Volume index of Production in manufacturing**

(seasonally adjusted data, December 2006 = 100)



It also must be noted that over the recent months there has been a relatively stable growth of volumes for new procurements in the manufacturing industry and the confidence indicators have improved. This is indicative of certain signs of recovery of the sector. However, when looking at the future, a risk still persists that the stable growth of the manufacturing industry will be hindered by restricted access to financial resources for short-term financing, incl. export credits, as well as for implementation of large-scale investment plans in the medium-term.

In 2009, the manufacturing industry in Latvia was largely affected by the rapid decrease of external demand. Also, the domestic demand continued to fall which was the main reason for a declining output in 2008 when over the course of the year the production volumes decreased by 4.7%.

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–XI |
|---|---|---|---|---|
| **Manufacturing – total** | **6.4** | **0.3** | **-4.7** | **-19.2** |
| Food industry | 6.0 | 1.3 | -5.3 | -16.8 |
| Light industry | 4.2 | 0.4 | -10.8 | -38.7 |
| Wood processing | -2.7 | -6.0 | -12.1 | 0.1 |
| Paper industry and publishing | 7.7 | 0.2 | -4.2 | -17.1 |
| Chemical industry and related industries | 20.3 | 3.1 | -2.6 | -19.7 |
| Production of other non-metallic mineral products | 10.0 | -17.1 | -5.6 | -34.2 |
| Production of metals and metal articles | 11.3 | 11.5 | 1.8 | -24.3 |
| Production of electrical and optical equipment | 16.4 | 3.8 | 4.5 | -29.4 |
| Production of machinery and equipment | 16.2 | 5.0 | 12.2 | -50.1 |
| Production of vehicles | 14.9 | 10.7 | 8.1 | -50.2 |
| Other industries | 1.6 | 3.0 | -8.0 | -18.6 |

* according to NACE Rev. 2 Classification

From January to November 2009, the manufacturing industry output has reduced by 19.2% in comparison with the first eleven months of the previous year. The most rapid decrease of the manufactured production was observed at the end of 2008 and at the beginning of 2009. Since November 2008, the production rates had reduced by more than 3% monthly, while, in January 2009, in comparison with the previous month, the industry production rates had reduced by 9.1% (according to seasonally adjusted data). This was mainly due to not only the weak domestic demand, but also to the recession in the main trade partner countries. Due to improved situation in the external markets, the sector experienced certain stabilisation signs, however, since August, the production rates in comparison with the previous month have been gradually increasing, besides in November, in comparison with October, the sector output increased by 11.6% (according to seasonally adjusted data) and thus the manufacturing industry production rate was by 1.5% lower than in November 2008.

In the eleven months of 2009, in comparison with January–November 2008, in the subsectors of manufacturing industry, the production amounts of machinery, equipment, as well as vehicle production have reduced by more than a half. The light industry, non-metallic minerals, as well as electric and optical manufacturing output has decreased by one third. Only in the wood-processing sector, during the first eleven months of 2009, the production rates grew (by 0.1% in comparison with January–November 2008).

Table 3.11

**Structure of the Manufacturing in 2009***

(percentage)

| | By value added | By number of employed | Share of exports in sector's sales |
|---|---|---|---|
| **Manufacturing – total** | **100** | **100** | **53.9** |
| Food industry | 24.2 | 25.1 | 23.8 |
| Light industry | 5.2 | 11.9 | 81.4 |
| Wood-processing | 18.3 | 16.5 | 72.6 |
| Paper industry and publishing | 8.6 | 6.3 | 46.1 |
| Chemical industry and related industries | 9.3 | 5.6 | 73.3 |
| Production of other non-metallic mineral products | 6.0 | 3.8 | 32.1 |
| Production of metals and metal articles | 10.3 | 11.2 | 71.9 |
| Production of electrical and optical equipment | 6.7 | 5.4 | 81.8 |
| Production of machinery and equipment | 2.3 | 2.6 | 86.4 |
| Production of vehicles | 3.8 | 3.2 | 86.6 |
| Other industries | 5.3 | 8.3 | 48.9 |

* estimation of the Ministry of Economics

From January to November 2009, the Sales of production of the manufacturing industry in current prices were by 27.5% lower than in the first eleven months of 2008. The rapid fall of the sales revenues is determined not only by contraction of the production volumes, but also by falling producer prices in the domestic and foreign markets.

In 2009, with the domestic demand continuing to decrease, the sales volumes in the domestic market decreased considerably. In January–November 2009, the sales revenues from the sold production were by 31.4% lower than in the respective period of the previous year.

From January to November 2009, the Sales of production in both the domestic and the export markets, decreased in all sectors of the manufacturing industry in comparison with the same period of the previous year.

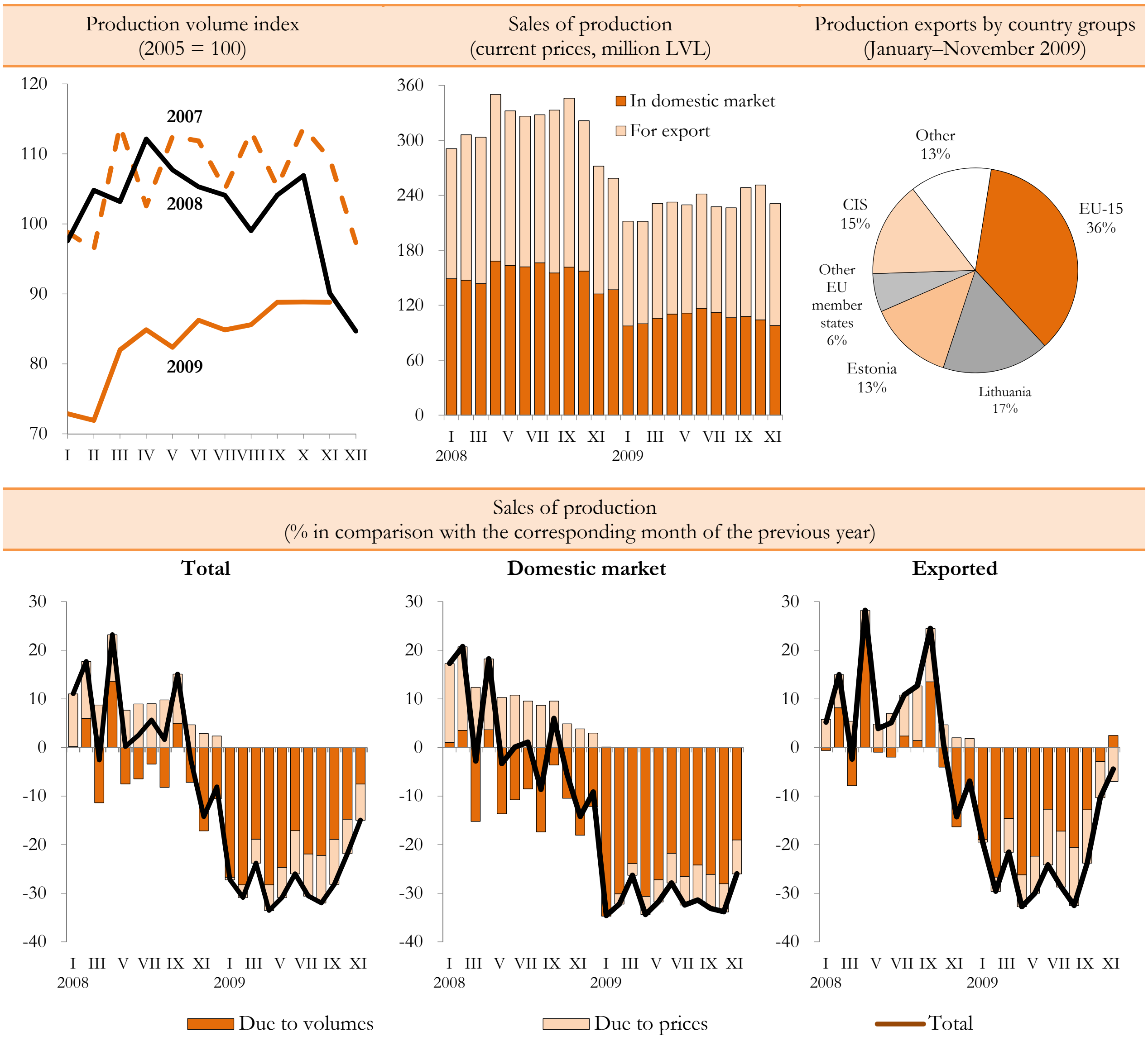
The processes in the global financial markets have affected the growth of the main export markets of Latvia – Lithuania, Estonia, the EU, and Russia, therefore, despite the positive export growth tendencies during certain months, from January to November 2009, the sales volumes of goods manufactured decreased by 23.9%, in comparison with the respective period of the previous year. However, considering the gradual improvement of economic situation in trade partner countries, the proportion of exported production of the products sold from the manufacturing industry of Latvia is constantly growing. Over the recent months, the producer prices are also increasing for the exported products, and also in the future the possibilities of increasing sales revenues will be mainly related to the foreign markets. It must be noted that currency devaluation in trade partner countries decreases our competitiveness, while tax changes increase the production costs. Likewise, export opportunities to CIS countries are deteriorating, as these countries are developing and introducing measures for the protection of domestic producers. A significant factor restricting manufacturing is also the lack of liquid assets, credit resources and export guarantees.

With the domestic demand reducing more rapidly than the external demand, the share of export has increased almost by 3 percentage points in the sales of the sector. During the eleven months of 2009, it was 53.9% of the total sales of the sector.

The export structure of manufacturing remains almost unchanged in the recent years. Almost 75% of the product exports are related to the EU markets, slightly more than a half of which – to the EU-15 and 30% – to Lithuania and Estonia. During the eleven months of 2009, exports to the CIS countries amounted to 15% of the produced goods.

Figure 3.15

**Manufacturing Industry Indicators**



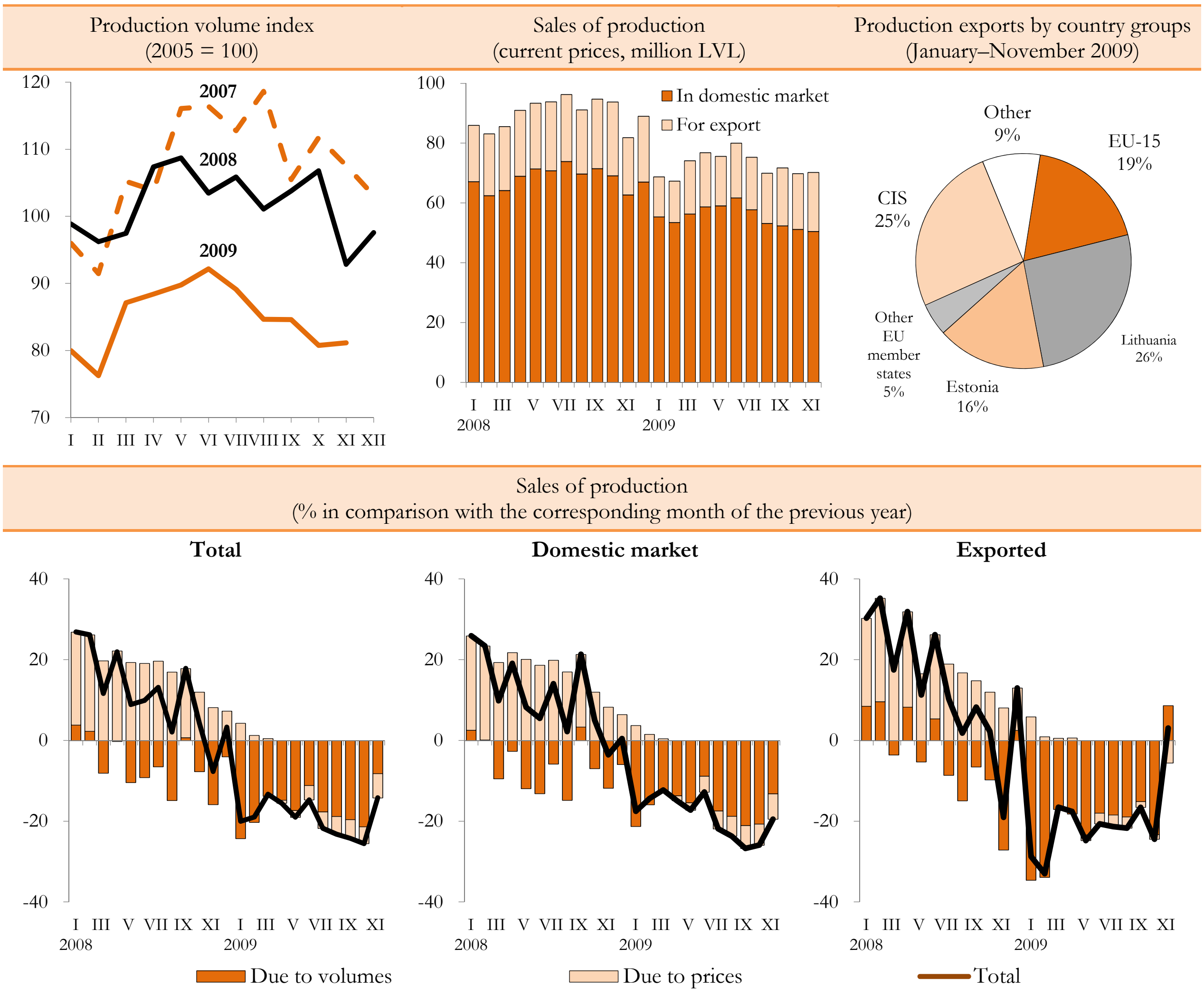

The average growth rate of the producer prices in manufacturing in 2008 was 8.3%, while in November 2009, in comparison with November 2008, the prices were by 7.7% lower. The fall of the producer prices started in mid-2008, besides the prices of exported products reduced more rapidly. Since July 2009, the producer prices have been stabilising and during certain months they even increased slightly, however, in November, in comparison with October, the producer prices for both exported and in domestic market sold products fell.

In 2009, the total producer price level was reduced mainly by a fall in prices in the metal production, wood-processing, and food industry. Although the competitiveness of Latvian producers increases when prices are reduced, the current producer price deflation is to be considered a negative aspect since it does not facilitate an increase of economic activities.

***The food industry*** in 2009 constituted about 25% of the value added of the manufacturing industry. In January–November 2009, the sales volumes were by 16.8% lower than in the respective period of the previous year. The decline in the food production started already in the end of 2007, which was determined by both decrease of the domestic and external demand. From January to November 2008, the sales volumes of products sold on the domestic market and exported decreased considerably (by 16.3% and 19.3%, respectively). Since January 2008, the production rates of the industry have declined by almost 30%.

Figure 3.16

**Food Industry Indicators**




Since the end of 2007 and the 1st half of 2008, the reduced production rates of the industry were still compensated by the increasing prices of the manufactured production, therefore the sales revenues in the food industry increased. However, since the end of 2008, with decreasing purchasing power of the residents, decreasing food prices in the global markets, as well as shrinking industry output, sales revenues have considerably fallen (January–November 2009, by 19.3%, in comparison with the respective period of the previous year).

The producer prices in the food industry in November 2009 have on average annually decreased by 1.8%, while the producer prices for the exported production despite the fluctuations in 2009 remained at the level of 2008 prices.

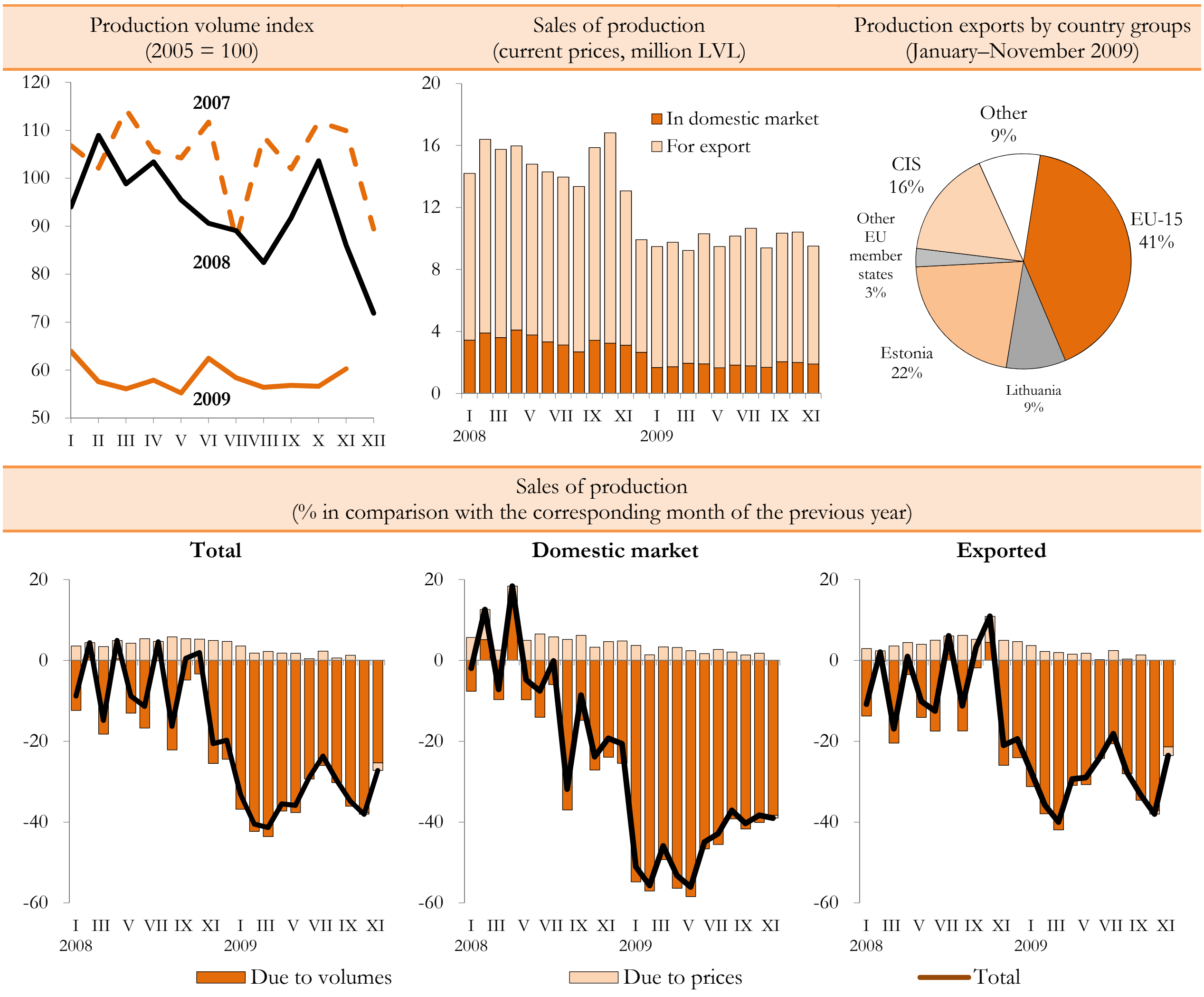
The main market for Latvian producers is the domestic market. Overall, one fourth of the production manufactured in the sector is exported, mainly to Estonia, Lithuania, and Russia, besides export of food products to Lithuania and Estonia constitutes 42% of the total food products export from Latvia. As recognised by a representative of the industry, third country markets, e.g. Russia, Kazakhstan, and Azerbaijan, are perspective export markets for food products manufactured in Latvia.

At the moment, the main problems encountered by the food industry are the lack of liquid assets, decreased purchasing power of the domestic market, and growth of the shadow economy, which particularly affects manufacturing of alcoholic beverages.

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

Figure 3.17

**Light Industry Indicators**




The main markets of the light industry are the old EU Member States therefore the industry was significantly affected by the recession of the European economy. In the eleven months of 2009, the industry output decreased by 38.7%, in comparison with January–November 2008. The sector experienced a particularly rapid fall during the period of October 2008 – March 2009 when the production rates of the industry fell by almost 50% (according to seasonally adjusted data).

The slight rise of producer prices did not compensate the decrease of production volumes, thus, in the first eleven months of 2009, the sales revenues of the industry decreased by 33.9%. Just like the majority of manufacturing industries, the light industry also experienced its most critical decline at the end of 2008 and at the beginning of 2009.

In the light industry, in November 2009, the prices had on average annually grown by 2.5%, besides despite the rapid decrease of demand – in the domestic market. The increase of producer prices at this time was 4.4%.

Despite the fact that the industry received new procurements at the beginning of 2009, due to lack of financial resources it was not possible to fulfil them. Along with the unstable economic situation, many producers have lost the trust of their raw material suppliers. Previously, raw materials were purchased from suppliers with a 25% prepayment, however, now, the prepayment reaches 100%, thus increasing the production costs.

Considering the recession in the traditional sales markets of Latvia, the businesses of the industry have started looking for new export markets. At the moment, the main export markets have not changed – the old EU Member States where more than 40% from the total industry exports.

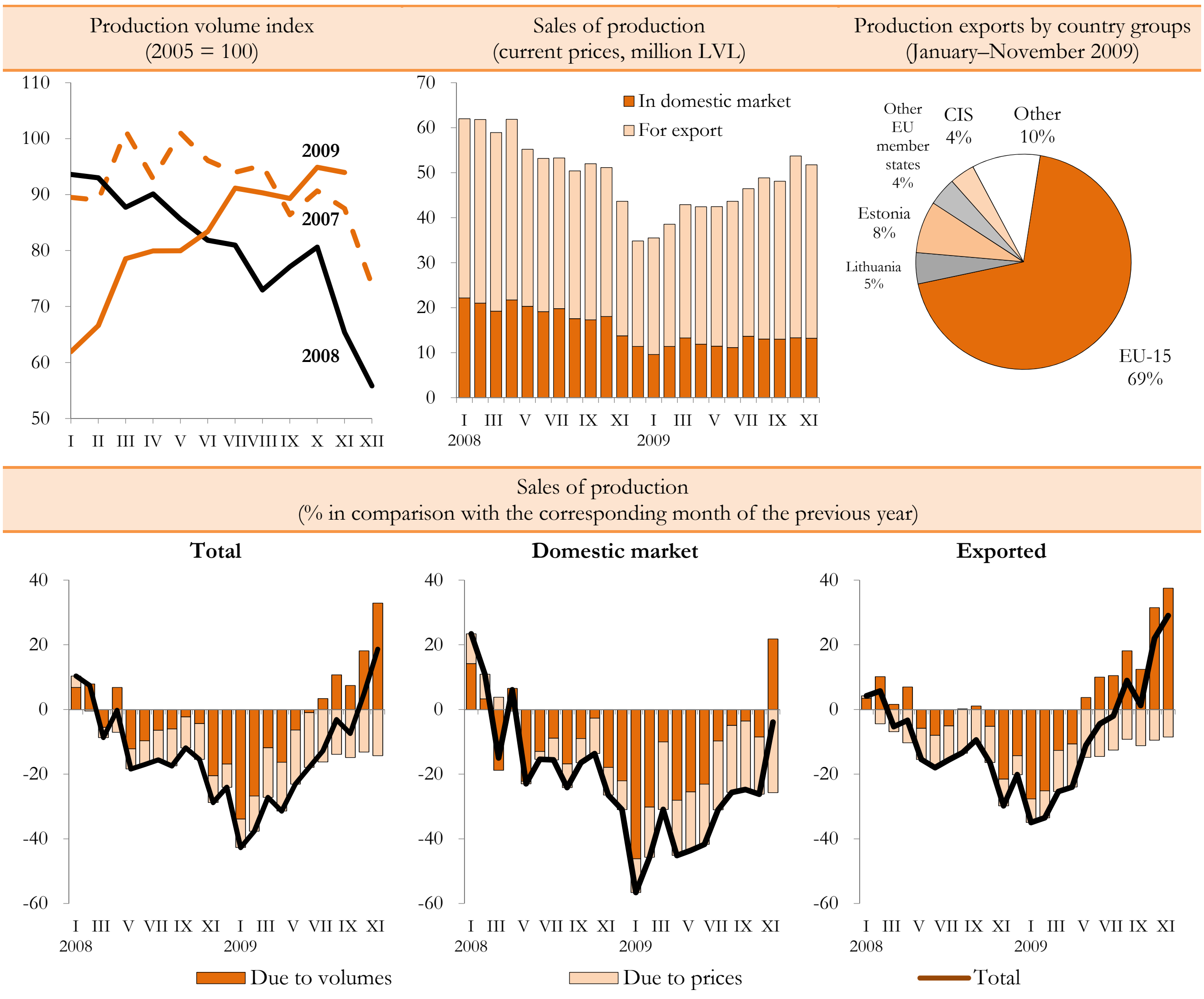
***Wood processing*** is the only sector of the manufacturing industry that increased its production volume in 2009. In the first eleven months of 2009, the sales volumes were by 0.1% higher than in the respective period of the previous year. The proportion of the wood processing sector in the industry's value added constitutes over 18%, and one third of the production manufactured is exported. The main export markets of the sector are the old EU Member States.

Recession in the sector was observed only until February 2009. After that, the production of the sector has increased by 4%, in comparison with the previous month. As a result, in November 2009, the sector reached the level of 2006 in terms of volumes.

However, in the first eleven months of 2009, the sales revenues were by 18.1% lower than in 2008, since the growth of production rates did not compensate for the falling prices. From January to November 2009, the export production of the sector in current prices was by 8.7% lower than in the first eleven months of 2008. A decrease of revenues had affected all assortments of wood and its products.

Figure 3.18

**Wood processing Indicators**




This can be mainly explained with lower prices for wood and its products. Timber export in 2009, in comparison with 2008, decreased only by 13.3%, while the revenues from their sales in foreign markets have decreased by more than 30%.

In order to expand the usability of their products, several lumbermen of Latvia have renewed sales of their produce in the cheaper groups of products, thus creating lower revenue than from more expensive product groups – in 2009, in comparison with 2008, the variety of exported products is very different.

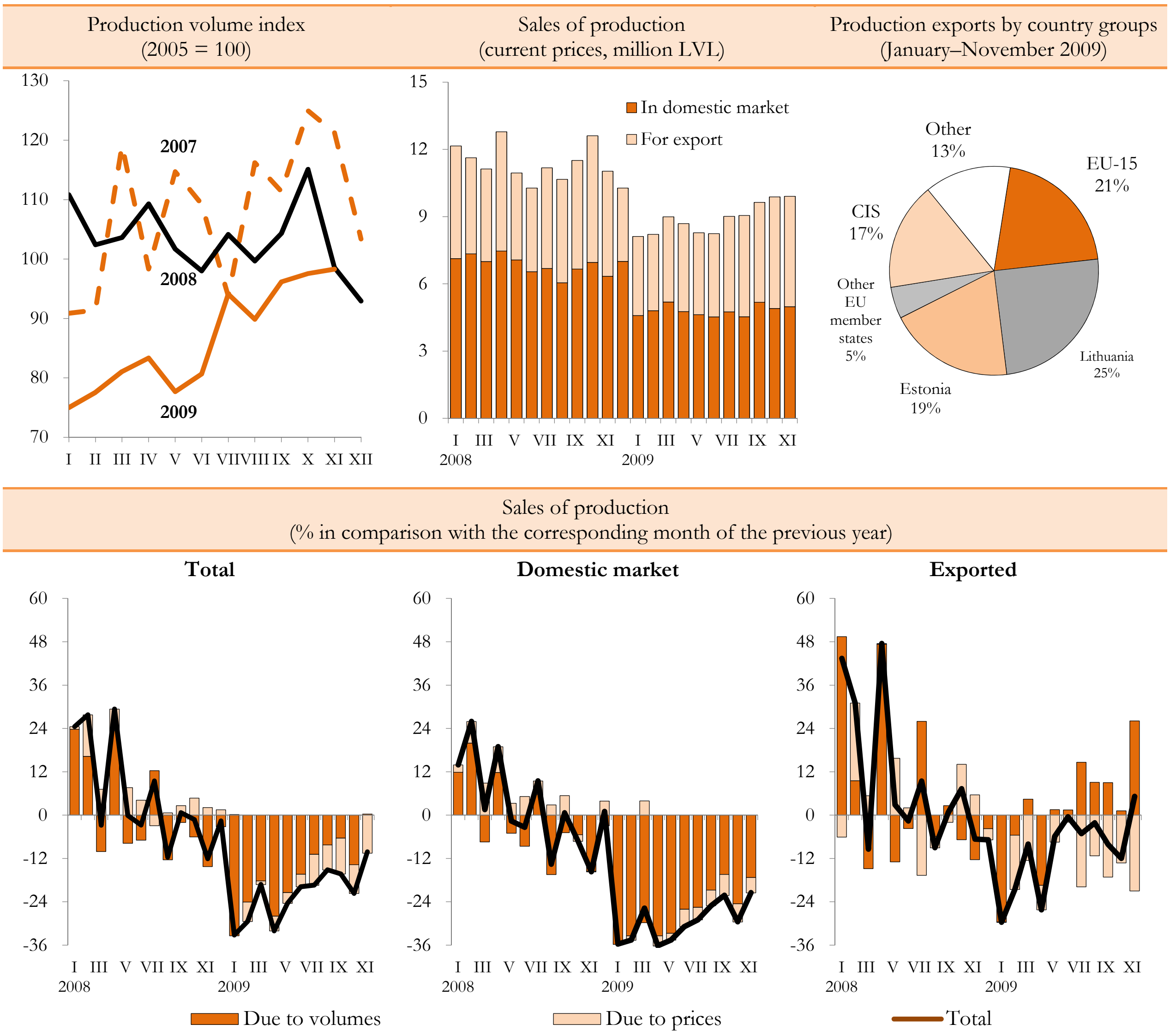
The producer prices of the wood processing sector have been gradually decreasing already since mid-2007, however, at the end of 2008 and at the beginning of 2009, the decrease was particularly rapid. In November 2009, the average annual decrease of producer prices in the wood-processing sector was 14.7%, while the prices of the exported production have decreased on average by 10.6% annually. Over the recent months, the producer prices have again gradually increased, especially for exported production.

The output of the ***paper industry and publishing*** sector in 2008 decreased by 4.2%, and the fall of production rates continued over the first eleven months of 2009 (by 17.1%, in comparison with the corresponding period of 2008).

The total growth in the sector was considerably affected by both the decrease of demand and increase of the VAT rate at the beginning of 2009. For the accounting sector, which highly sensitive to prices, the increased rate has reduced the retail sales volumes of books and publishing of new books. The increased prices also affect the export of publishing products as it is closely linked to capability or incapability of printing houses to invest in the development which is ensured by larger procurements of the local publishing houses. The increase of the VAT rates led to a decline in production volumes in the domestic market and significantly affected the successfully launched book export to foreign countries. The paper industry also feels the negative influence created by the decline in public procurements.

Figure 3.19

**Paper Industry and Publishing Indicators**




The paper industry largely depends on the overall economic situation, therefore, already at the end of last year, the industry experienced negative tendencies – a decrease in printing advertising materials, decreased volumes and number of copies of newspapers and magazines, a sharp fall of food packaging printing. At the moment, the situation in the industry is stabilising.

About 46% from the sector sales are formed by export. Moreover, over January–November 2009, its proportion has increased, in comparison with the previous years. Almost a half of the exported products are sold in Lithuania and Estonia. A further increase of the exported volumes is an essential stimulus for growth of the industry.

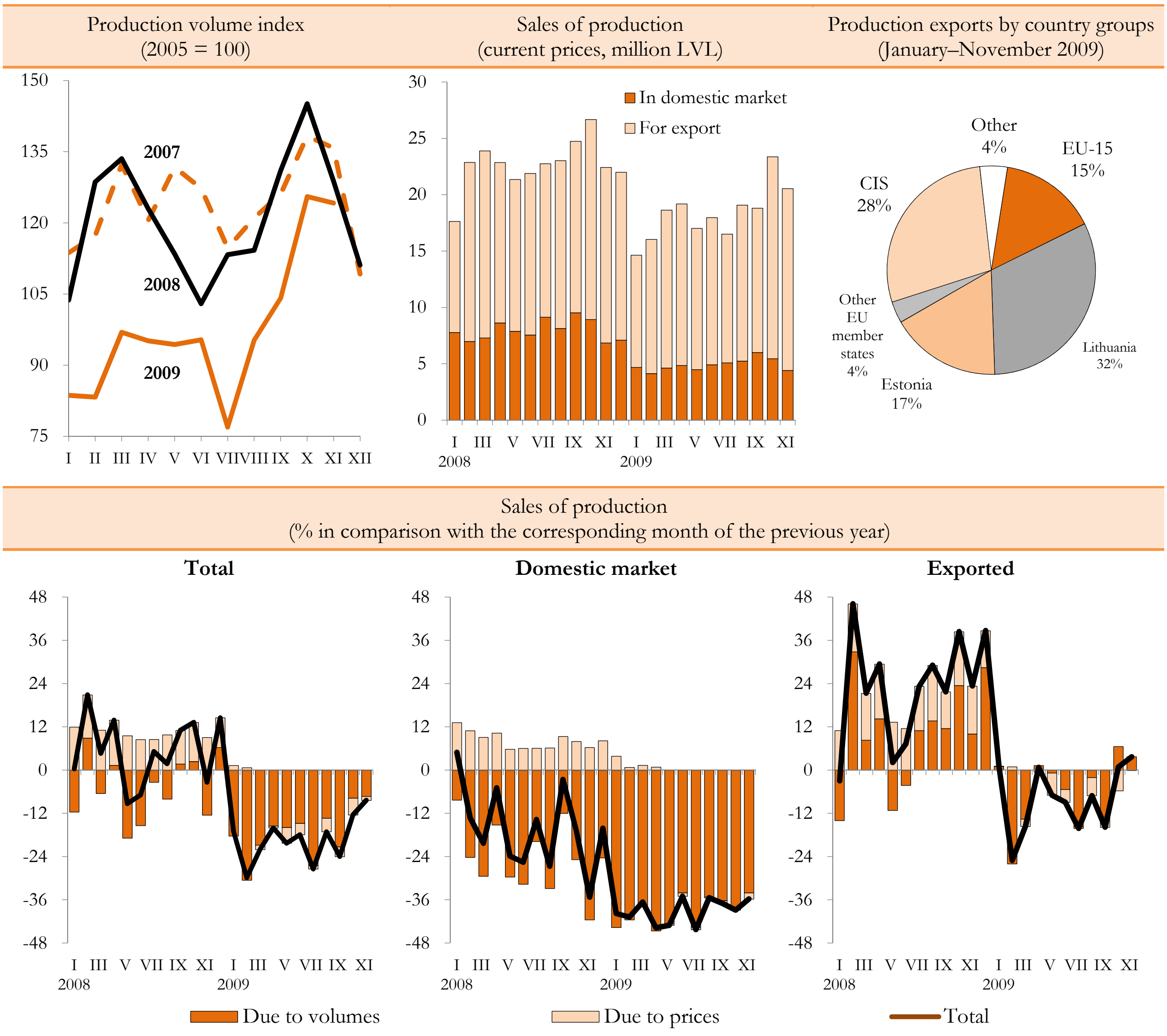
In November 2009, the producer prices were by 9.5% lower than the year before, while the producer prices of the exported production decreased more rapidly over a period of 12 months – by 16.6%.

***The chemical industry*** includes manufacturing of chemical substances and products, pharmaceutical raw substances and products, as well as rubber and plastic articles. The proportion of these sectors in the total value added of the manufacturing industry in 2009 accounted for 9.3%. In January–November 2009, the sectoral output decreased by 19.7%, in comparison with the respective period of 2008. With declining domestic demand, during the first eleven months of 2009, the sales volumes decreased by 39.4% in the domestic market, while the sales volumes of exported products reduced by 8.4%, in comparison with the first eleven months of 2008.

In 2009, the proportion of export in the sales of the sector continued to increase, and it constitutes almost three fourths from the production manufactured. In 2009, in the export structure, the proportion of export to Lithuania has grown, while smaller volumes are exported to the old EU Member States.

Figure 3.20

**Indicators of Chemical Industry and Related Industries**




In November 2009, the annual average level of producer prices decreased only by 0.1% which is related to the growth of annual average price in the domestic market for the products sold (by 1.1%), while the prices of exported products in November were by 1.6% lower than in the previous year.

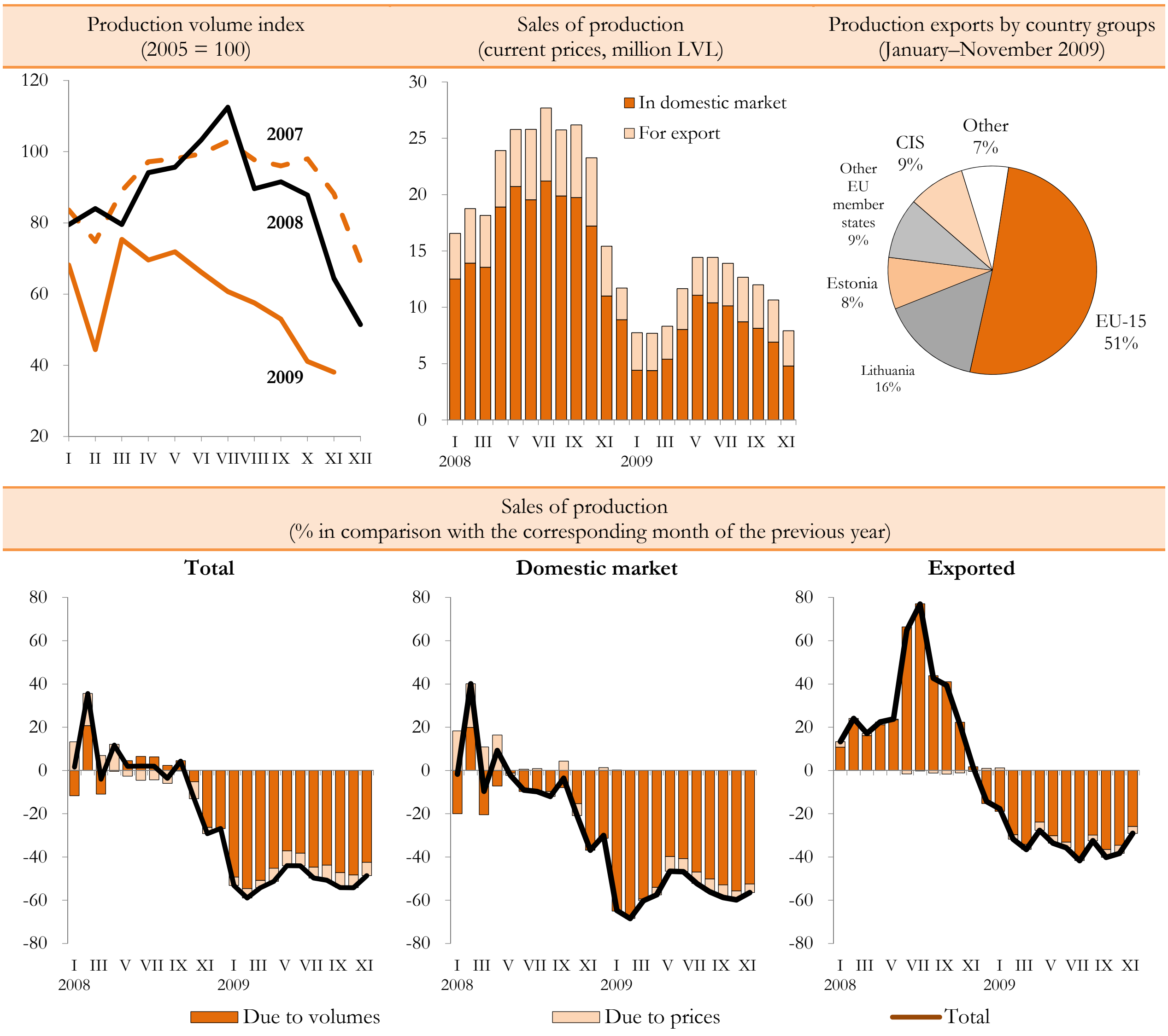
In the near future, a slight, but stable growth is forecasted in the sector. For promotion of sales, the businesses are investing considerable resources to foster sales in the existing markets, as well as to enter new markets. The main growth risks are linked to further devaluation of local currencies and protectionism in the export target markets. For promotion of sales, the businesses are investing considerable resources to foster sales in the existing markets, as well as to enter new markets.

The decrease of manufacturing volumes of ***other non-metallic mineral products*** is affected by the considerable decline in construction output. The fall of production rates in the sector started in mid-2008. Over the first eleven months of 2009, the output has fallen by 34.2%.

Over the first eleven months of 2009, the sales volumes of products manufactured decreased by more than a half, in comparison with January–November 2008. Production volumes sold in the domestic market have decreased by 56.2%, while the volume of exported production in January–November fell by one third.

Figure 3.21

**Other Non-Metallic Mineral Products Indicators**




Since the sector is oriented to the domestic market, its export share is increasing due to the decreasing domestic demand and slowing sales in the domestic market.

In January–November 2009, more than 32% of the products manufactured were exported which is by 8 percentage points more than in 2008. The main export market is the EU, where 84% of the exported products are sold.

Considering the rapid decline of demand, the producer prices have decreased considerably, too (in November 2009, on average annually by 6.3%). At the same time, producer prices for the exported products decreased by 3.3%.

Development perspectives of non-metallic mineral products sector are closely linked to the future of the construction sector. Lack of investment has had a significant impact on the development of non-metallic mineral manufacturing. The main risks in the sector are related to the increase of energy costs and the possible devaluation of national currencies of the neighbouring countries which would decrease the competitiveness of the sector.

The sector of ***metals and metal articles*** developed successfully during the years of rapid growth, which was due to favourable conjuncture in the domestic and foreign markets. In 2009, the sector formed over 10% of the value added of the manufacturing industry.

Taking into account the large export proportion of the sector sales, the global economic recession considerably affected development of the sector. During the eleven months of 2009, the output of the sector fell by 24.3%, besides, taking into account also the reduction of prices, the total sales revenues of the sector decreased even more rapidly – by 41.8%.

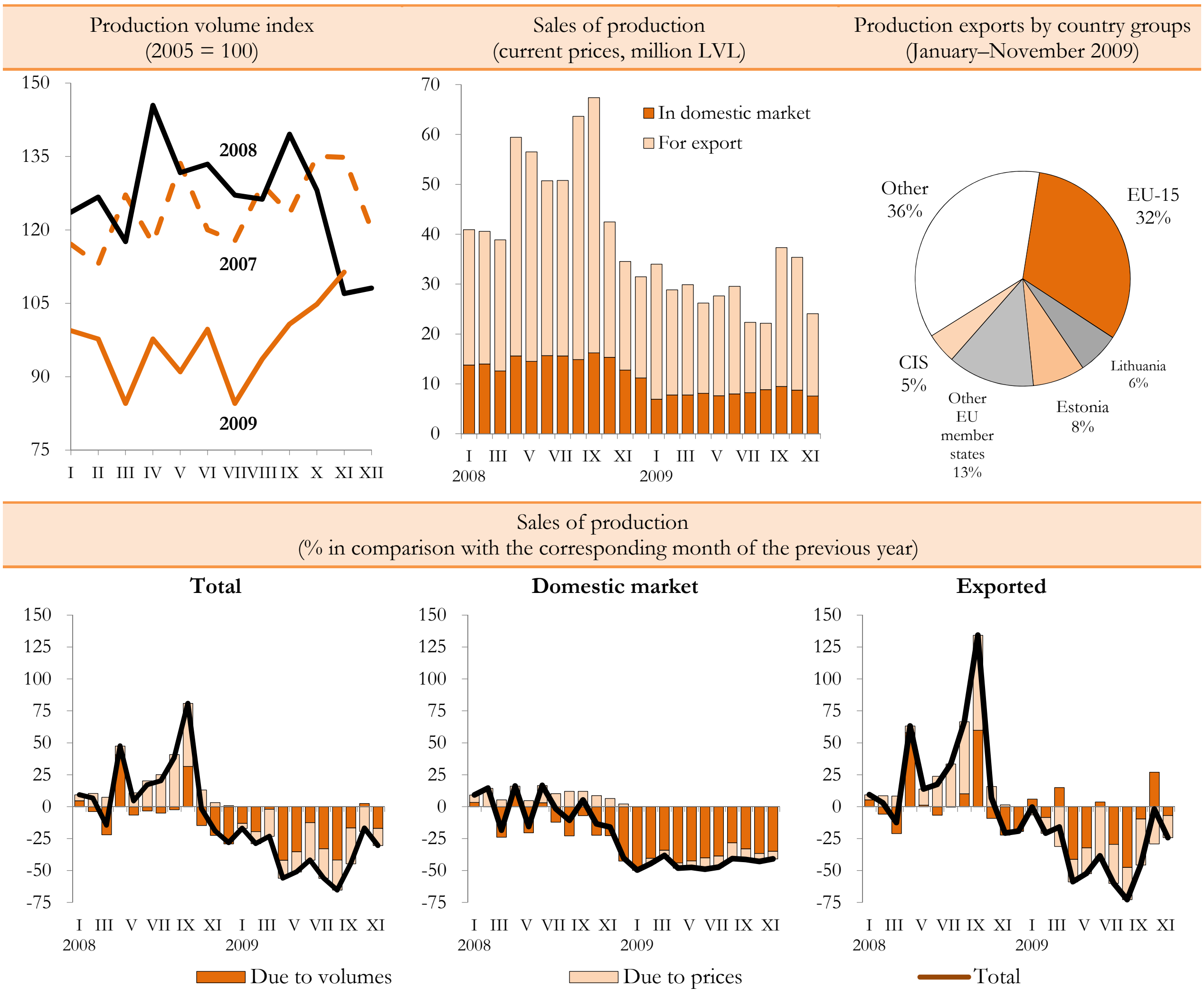
After the sharp fall in the end of 2008, the sector has been gradually recovering since mid-2009. In comparison with the previous month, the production rates are increasing slightly, and in the recent months, with growing producer prices, the sales revenues of the sector are also increasing. Particularly positive sales tendencies in the export markets were observed in September and October 2009.

Metals and metal articles produced in Latvia have high competitiveness in the world. Over 70% of the production manufactured is exported to the EU Member States, and a half of that – to the old EU Member States.

At the beginning of 2008, due to the global price tendencies, the producer prices of the sector increased rapidly, and as a result they increased on average by 14.4% annually. However, in November 2009, the prices had already reduced on average by 22% annually. The producer prices of the exported production reduced on average by 28.9% annually due to the considerable decline in demand and prices in the global markets.

Figure 3.22

**Metals and Metal Articles Manufacturing Indicators**



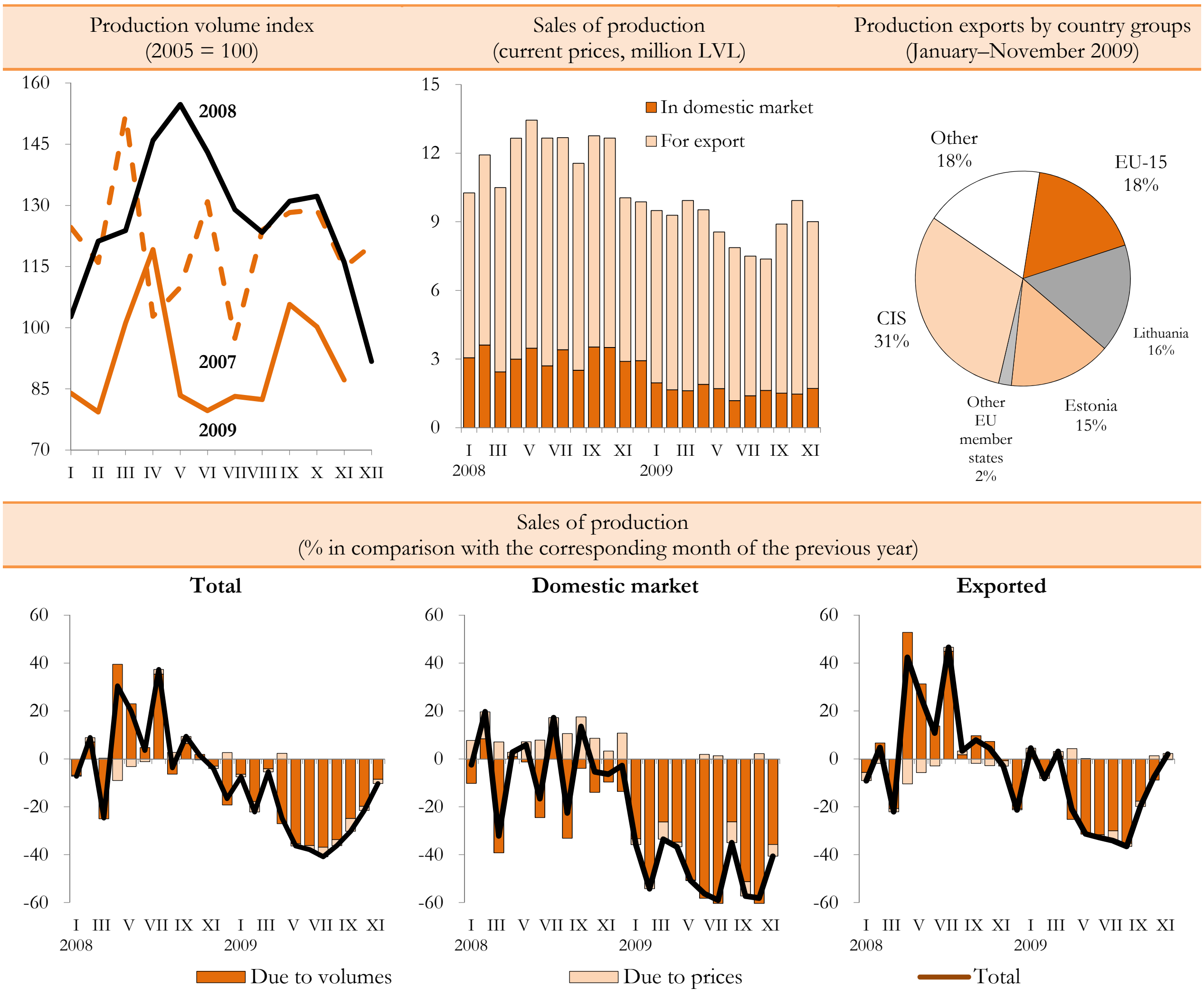

Positive tendencies for producers are to be expected in relation with the recovery of Scandinavian and German markets, and several businesses have started working in such markets as India, China, Latin America, South Asia, and East Asia. Over the last two years, growth tendencies have been observed in the global manufacturing industry, however, the situation of Latvian producers largely depends on development of other sectors, to which the metal working industry supplies raw materials.

In 2009, the proportion of ***electric and optical equipment manufacturing*** in the manufacturing industry was 6.7%, which is related with the successful development of the sector during the years of rapid growth. Over the first eleven months of 2009, the output fell by 29.4%.

In the first eleven months of 2009, the production volumes sold in the domestic market fell by 48%, while the exported volumes – by 17.9%. After the sharp fall in the end of 2008 and the beginning of 2009, the sector is gradually recovering, and particularly positive tendencies are observed with the Sales of production in export markets.

Figure 3.23

**Electric and Optical Equipment Manufacturing Indicators**




The sector already exports over 80% of its products, besides the share of exports is increasing due to decreasing sales in the domestic market. The sector has stable partners for the sale of its production in CIS countries and Estonia, and over the last year, export to the developed countries, incl. EU-15, has grown considerably.

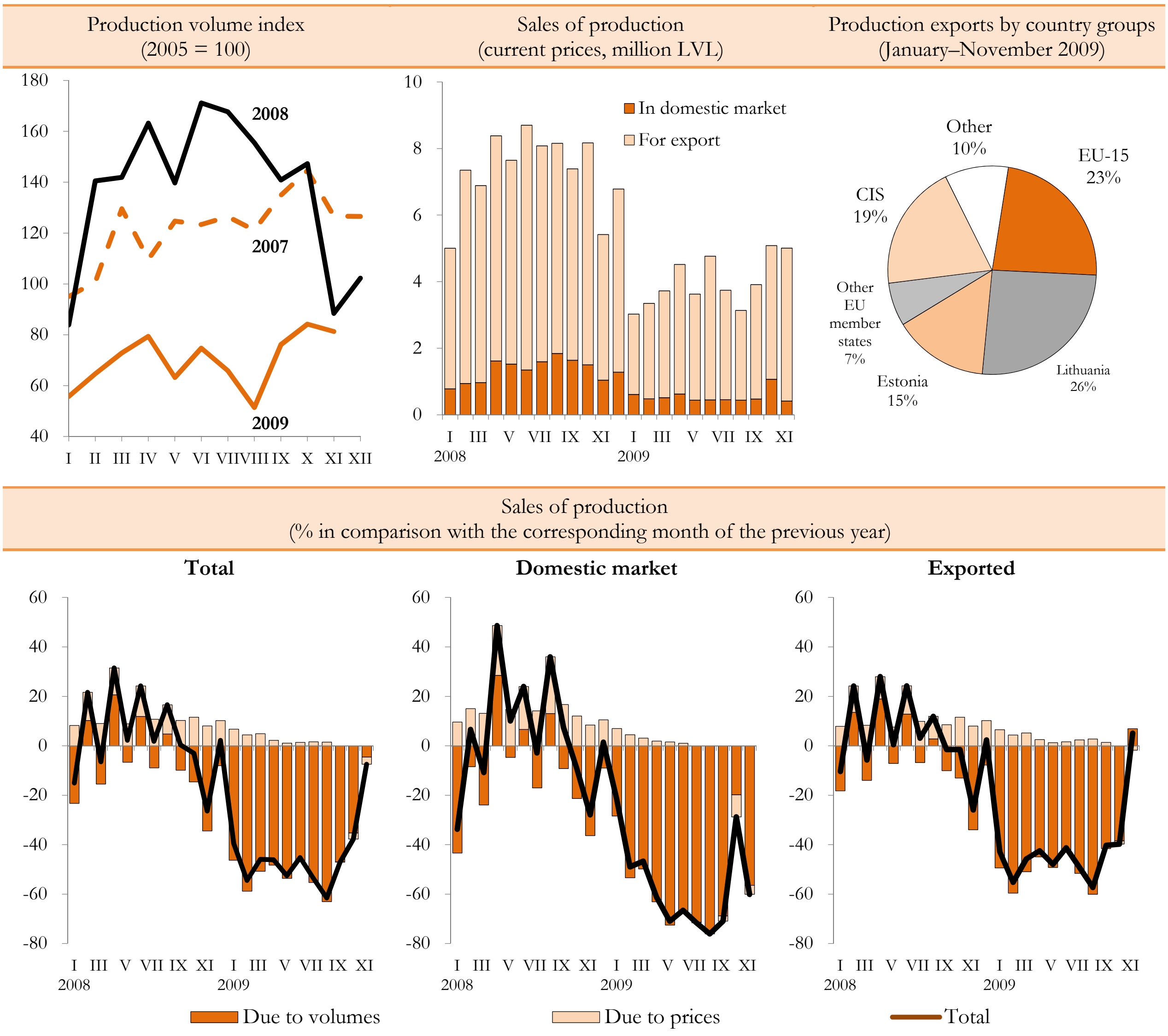
In the beginning of 2008, a small increase of producer prices was observed in the sector, which was determined by the price increase of products sold in the domestic market. In 2009, sharp price fluctuations were observed, especially in the domestic market. Overall, with decreasing foreign and domestic demand, the producer prices fell. In November 2009, the prices decreased by 0.4%, in comparison with November 2008. At the same time, the producer prices for products sold in the domestic market decreased by 7.7%.

***The sector of machinery and equipment manufacturing*** is mainly the supplier of manufacturing materials and technologies to other sectors, thus, the economic crisis hit this sector particularly hard, just like elsewhere in Europe. Over the last months of 2008 and at the beginning of 2009, the output of the sector decreased significantly. From January to November 2009, the production rates were by 50.1% lower than in the corresponding period of 2008.

Also, in the eleven months of 2009, the sales volumes in the domestic market decreased by 60%, in comparison with January–November 2008. At the same time, sales of exported production fell by 43%.

Figure 3.24

**Machine and Equipment Manufacturing Indicators**




In the machinery and equipment manufacturing, just like in majority of industries, the sharpest production decline was from the end of 2008 until the beginning of 2009, when in comparison with the previous month the volumes fell on average by 14% monthly.

The industry is exporting more than 86% of its production. The main export markets are the EU Member States, besides more than 40% from the exports are sold in Lithuania and Estonia. A relatively big part of exports of the sector is related to the markets of CIS and other countries.

During the previous years, with rapid increase of demand, the producer prices grew. The average price growth in 2008 was 11.4%. In November 2009, the prices showed an annual decrease of 3%. This was mainly determined by the considerable decrease of prices for the production sold locally.

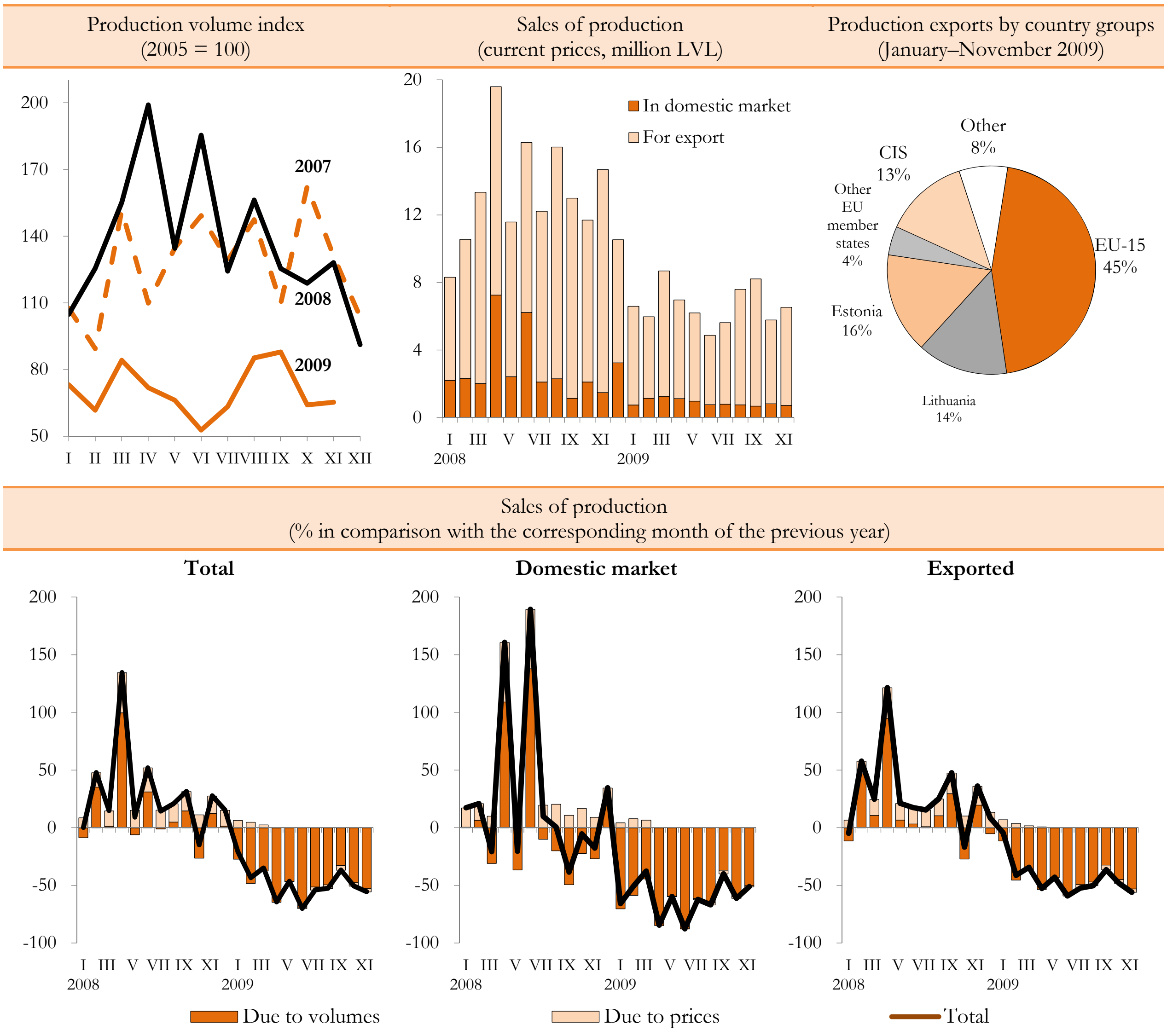
The future tendencies of the sector will be largely determined by foreign demand and global metal prices. In comparison with other countries, in the current system, the industry of machinery and equipment manufacturing has certain advantages, since the businesses are rather small and flexible.

The output of ***vehicle manufacturing*** grew by 8.1% in 2008, in comparison with 2007, which was determined by the increase of new procurements at the beginning of 2008 in both, the domestic market and foreign markets. In 2009, with rapid decrease of new procurements, the output of the sector shrunk considerably and in the first eleven months of 2009, it was by 50.2% lower than from January to November 2008. Over this period, the production volumes in the domestic market decreased much more rapidly (by 68.9%) than the exported volumes (by 45.3%).

At the end of 2009, the sector showed recovery tendencies. The production rates over the recent months have been increasing when compared to the previous month. However, this should be assessed cautiously, since a significant seasonality by months is characteristic for the output.

Figure 3.25

**Vehicle Manufacturing Indicators**




Over 86% of the production is exported. The main export markets are the old EU Member States where 45% of all exported production is sold. The main trade partners are also Lithuania and Estonia where, respectively, 14% and 16% from the exports of the sector are sold.

Changes in producer prices in both the domestic and foreign markets for the products sold are rather similar. A significant rise of prices in the sector was observed in 2008 when the prices in the domestic market grew on average by 19.2% annually and on average by 12.6% annually for the exported products. Despite the decline in demand, the prices continued to rise also at the beginning of 2009. In November, the producer prices rose by 0.4% on average annually. At the same time, the prices for products sold locally have grown on average by 2.8% annually, while for exported products – decreased by 0.3%.

## 3.2.3. Energy Sector

Both the imported (natural gas, liquefied petroleum gas, petroleum products, coal) and local energy resources (firewood and peat) are used in Latvia to supply fuel, electricity and heat to sectors of economy, commercial consumers and residents. A part of electricity is generated by Latvian HPPs and CHPs, whereas other part is imported. Mainly the imported fuels (natural gas and petroleum) and local fuels (firewood) are used in heat generation.

Table 3.12

**Consumption of Energy Resources in Latvia**
(TJ)

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|---|
| **Total consumption of energy resources** including: | **190912** | **194851** | **198438** | **205796** | **211202** | **202988** |
| petroleum products | 59288 | 61029 | 61896 | 67473 | 73313 | 69269 |
| coal | 2648 | 2570 | 3146 | 3409 | 4248 | 4248 |
| natural gas (GCV) | 62675 | 61983 | 63169 | 65436 | 63247 | 62015 |
| wood | 46969 | 49434 | 49396 | 49748 | 48706 | 46018 |
| other fuel | 1523 | 917 | 959 | 823 | 858 | 961 |
| electricity | 17809 | 18918 | 19872 | 18907 | 20830 | 20477 |

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 petroleum products – 32.6%, coal – 2.1%). Among local energy resources, wood was used the most (firewood, remainders from wood-processing, woodchip, wood briquettes and granules), comprising 22.7% of the total energy consumption. The share of 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 in the Daugava River. Also, electricity imports from Russia, Estonia, and Lithuania play a rather substantial role in the electricity supply.

In 2008, the JSC "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 0.3%.

Table 3.13

**Electricity Supply in Latvia**
(billion kWh)

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

Source: JSC "Latvenergo", the Ministry of Economics, CSB
* Daugava cascade and Aiviekste HPP (HPP of JSC "Latvenergo")
** CHP of JSC "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 accounting for 30–35%. Of the total amount of heat sold, 1.6% was sold to industry, 73.8% to households, and 24.6% to other consumers.

The largest consumers of natural gas are CHPs of "Latvenergo" and heat supply enterprises (57.1%), industry (19.9%) and other consumers (~23%). The region of Riga accounts for about 70% of the total natural gas consumption in Latvia. In Kurzeme region, the largest natural gas consumption is in Liepaja and reaches ~11% (by JSC "Liepajas siltums" and

JSC “Liepajas metalurgs”), while in Zemgale region it amounts to ~4% (in Jelgava city and Bauska district).

***Petroleum products*** are used both as heating fuel and liquid fuel. The prices in the petroleum products market are liberalised and competitive with respect to other types of heating fuel. In Latvia, free market principles function with regard to petroleum products supply.

In the energy resources market of Latvia, the petroleum products play a significant role – their market share is slightly above 30%, including the share of heavy fuel oil in the oil fuel balance amounting to approximately 1.6%. The largest consumers of heavy fuel oil are heat suppliers (55.6%) and industry (37%). Complying with the requirements of the EU *Directive 1999/32/EC*, on 2 March 2004, the Cabinet of Ministers adopted Regulations No. 125 *On 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 fuels*** used in Latvia are coal imported from the CIS and local fuels (firewood, peat, and straw). 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 largest consumers of firewood are households (65.4%), heat supply enterprises (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

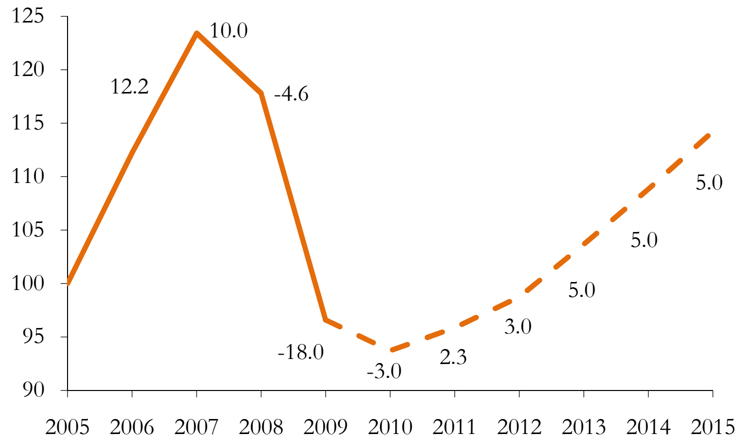
The Ministry of Economics has developed medium-term economic development forecasts for the period until 2015.

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

Figure 3.26

**Forecast of Latvian GDP**

(%, 2005 = 100)




The issue of global financial crisis developments and its depth is still rather uncertain. The majority of international experts (IMF, WB, European Commission etc.) point out that in the 2nd half of 2009 stabilisation signs could be observed in the global economy. However, risks still persist that the recovery may be long and unstable. The main policy priority in the global economy is still related to the recovery of the financial sector, taking into account the consequent effect of recession of the actual sector on the financial sector.

When developing forecast for the development of the economy of Latvia, the Ministry of Economics is taking into account the fact that currently the growth paradigm in the world economy is changing. If until now the main economic force was the global financial flows, then in the future the competitiveness of the countries in the open goods and services markets will have the determinant role.

**Development of economy for 2009–2010**

Considering the GDP changes in the first three quarters of 2009 and the operative statistics of recent months, it is expected that there will be a fall of 18% of the economic activities in 2009, as forecasted before. Concerning the sectors, in 2009, the output rates will fall in all principal sectors of the economy.

The recovery of the economy of Latvia in the coming years will largely depend on how fast the global financial system and the main foreign trade partner countries will recover and on how successfully Latvia will be able to compete in the open goods and services markets.

Although in several world countries certain recovery signs are observed already now, the world economy perspectives are still subjected to great uncertainty. Although the results of the introduced macroeconomic impetuses and implemented political measures during the crisis were more efficient than initially expected, a risk still exists with respect to a strong feedback between the actual and financial sector, increase of prices of oil and other goods, as well as increased protectionism. The stable growth recovery of the global economy is related with such risks as withdrawal of national economy impetuses, as well as rapid deterioration of labour market.

Thus, in 2010, considerable growth of external demand should not be expected. On the other hand, the domestic demand of Latvia will continue to fall due to budget consolidation measures (decreased expenditure and increased tax rates).

Therefore, the Ministry of Economics forecasts a decrease of GDP also in the 1st half of 2010, while its growth could renew in the 3rd quarter when the GDP will not be decreasing anymore in comparison with the previous quarter (according to seasonally balanced data). In this case, in 2010, GDP will decrease by 3%.

In 2010, the private consumption may continue to decrease, since the employment level and wages will not increase.

The decrease of investments in the private sector will be mainly affected by deterioration of the access conditions to financial resources, as well as pessimistic future expectations of entrepreneurs. The decrease in investments will be partially compensated by the policy implemented by the government to improve availability of financial resources.

The net exports will improve, i.e. the deficit of export–import will decrease, because, as a result of domestic demand decline, the imports will continue to decrease. However, the imports of intermediate consumer goods may increase when growth resumes in the manufacturing industry, which is related to the increase of export.

Table 3.14

**Forecast of Latvian GDP by Expenditure Items**

| | 2009 | 2010 | 2011–2015* |
|---|---|---|---|
| growth rates, % over the previous year | | | |
| **Gross domestic product** | **-18.0** | **-3.0** | **4.0** |
| Private consumption | -23.0 | -5.9 | 3.7 |
| Public consumption | -9.4 | -5.9 | 1.1 |
| Gross fixed capital formation | -36.8 | -12.2 | 4.9 |
| Export | -15.4 | 3.0 | 5.1 |
| Import | -33.6 | -3.3 | 4.7 |
| Structure, % | | | |
| **Gross domestic product** | **100** | **100** | **100** |
| Private consumption | 60.6 | 58.3 | 58.1 |
| Public consumption | 21.3 | 18.8 | 16.5 |
| Gross fixed capital formation | 21.4 | 19.3 | 21.2 |
| Changes in inventories | -1.0 | 3.5 | 3.7 |
| Export | 40.8 | 43.6 | 47.3 |
| Import | -43.0 | -43.6 | -46.9 |
| Export–import balance | -2.2 | 0.0 | 0.4 |

* annual average growth, structure in 2015

In terms of sectors, in 2010, GDP reduction will be determined by a decrease in the construction sector, as well as continued reduction of trade and other commercial services volumes. The public budget decrease will directly affect the public services sector (public administration, health care, and education). Increased demand in foreign markets, however, will give positive growth impetuses to the exportable sectors, mainly to the manufacturing industry, as well as transport and communications sector.

Table 3.15

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

| | 2009 | 2010 | 2011–2015 (average annually) |
|---|---|---|---|
| **Gross domestic product** | **-18.0** | **-3.0** | **4.0** |
| Primary sectors | -3.4 | 0.4 | 2.1 |
| Manufacturing | -20.0 | 0.9 | 6.5 |
| Electricity, gas and water supply | -10.1 | 0.2 | 1.5 |
| Construction | -31.8 | -6.9 | 5.0 |
| Trade, hotels and restaurants | -27.7 | -4.2 | 4.7 |
| Transport and communications | -15.4 | -1.8 | 5.1 |
| Other commercial services | -5.2 | -0.5 | 3.3 |
| Public services | -9.9 | -5.5 | 1.8 |

**Development perspectives for 2011–2015**

Positive economic growth may resume in 2011, provided that the financial markets will have stabilised, which will give a positive stimulus to the domestic businesses, as well as promote gradual growth of economic activities in our goods and services export partner countries, especially the EU Member States.

The main growth stimulus for Latvia in the coming periods must be related with the expansion of export opportunities. Therefore, competitiveness of key export-oriented industry sectors both in international and domestic markets has a determinant role for ensuring growth. It should not be ignored that in the markets of goods and services the price competition is becoming fiercer which in conditions of crisis often leads to competitiveness adjustment of countries with devaluation of national currencies and direct protectionism.

The competitiveness of Latvian industry was largely based on relatively cheap labour force and low general costs. Due to increasing labour force costs and prices in 2006 and 2007, these advantages were lost to a great extent. The current crisis conditions with low demand and strong budget restrictions when wages are considerably cut in the public sector put a considerable pressure on the general level of wages and prices that partially improves the competitiveness of Latvian producers. However, it must be noted that along with growth recovery in the rest of the EU Member States, it will not be possible to maintain the economic competitiveness in Latvia with such methods, therefore a corresponding productivity increase and increased complexity of export products will play a critical role, allowing for competition in the international markets much more successfully.

In order to ensure average growth of 4% in 2011–2015, the production volumes of manufacturing should increase by at least by 6.5% annually. In addition, it is foreseen in the forecasts that the external services balance of Latvia should also improve, where the major contribution has been provided by transport services.

It is forecasted that the future growth will not be possible with rates observed in 2005–2007, since its driving force will not be the large financial inflows that promoted the domestic demand and fostered mainly the development of services and activities with real estate. Increased economic competitiveness will be the main supporting factor for growth in open goods and services markets that for Latvia are mainly related with development of the manufacturing industry and transit services.

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

# 4. MACROECONOMIC STABILITY

## 4.1. Public Finances

### 4.1.1. Fiscal Policy and Public Debt

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

Table 4.1

**General Government Budget**

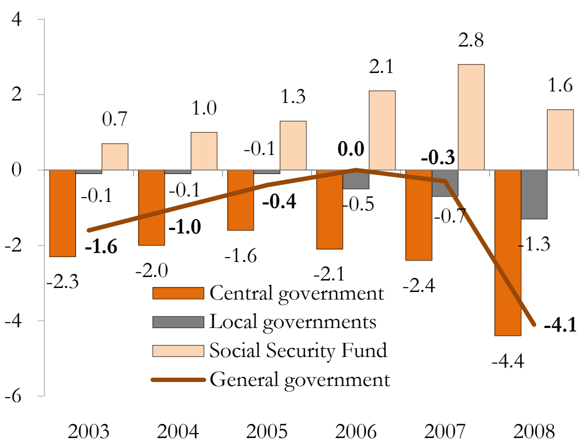
| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|---|
| Revenues (million LVL) | 2120.2 | 2583.2 | 3184.1 | 4210.4 | 5253.6 | 5635.9 |
| (% of GDP) | 33.2 | 34.7 | 35.1 | 37.7 | 35.5 | 34.6 |
| Expenditures (million LVL) | 2223.6 | 2659.6 | 3220.8 | 4263.6 | 5300.1 | 6307.4 |
| (% of GDP) | 34.8 | 35.8 | 35.6 | 38.2 | 35.9 | 38.8 |
| Balance (million LVL) | -103.5 | -76.5 | -36.7 | -53.1 | -46.5 | -671.5 |
| (% of GDP) | -1.6 | -1.0 | -0.4 | -0.5 | -0.3 | -4.1 |

In 2008, the general government budget deficit was determined by the deficit in the central government budget and local municipalities budget (see Figure 4.1). The social insurance budget has run at a surplus in the recent years; however, it has slightly decreased in percentage of GDP in 2008.

Figure 4.1

**General Government Budget Balance by Sub-Sectors**

(% of GDP)




Similarly the average level of the budget deficit in the EU Member States 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). The budget position has deteriorated in 23 EU Member States in 2008. In 2008, the highest general government budget deficit as a percentage of GDP was observed in Greece, Ireland, Romania, and the United Kingdom. Eight EU Member States had surplus of the general government budget in 2008, of which the highest surpluses as a percentage of GDP were in Finland, Denmark, Luxemburg, and Sweden.

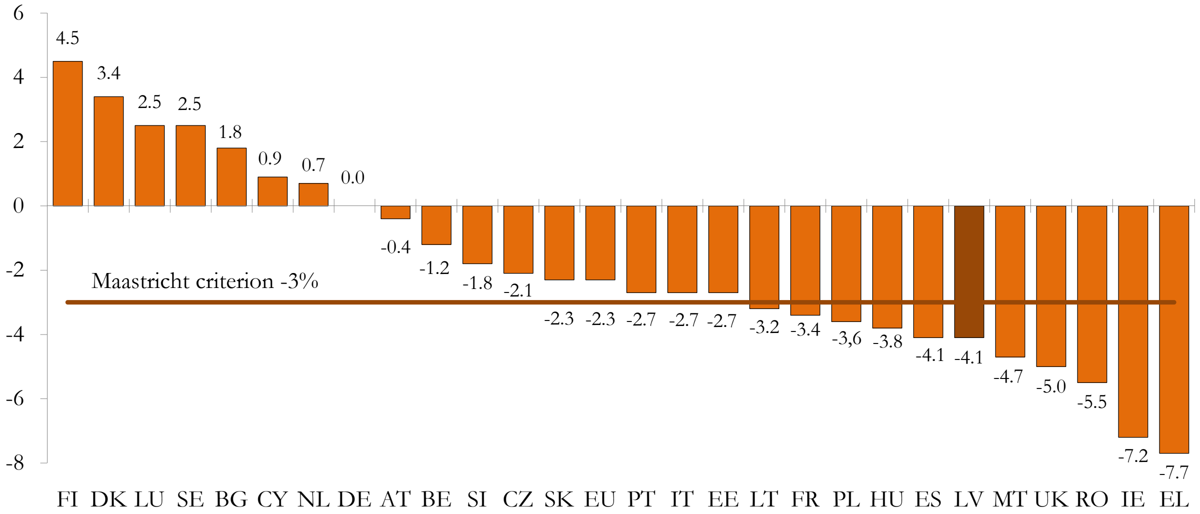
According to the forecasts of the European Commission in autumn 2009, the budget situation in the EU Member States in 2009 and also in 2010 will continue to deteriorate. In 2009, the average budget deficit of the EU Member States is forecasted to be in the amount of 6.9% of GDP, while in 2010 – 7.5% of GDP. In 2009 and 2010, the largest budget deficits exceeding 10% of GDP are to be expected in Ireland, United Kingdom, Greece, and Spain.

In November 2008, the Saeima of Latvia approved the **state budget of 2009** with a deficit in the amount of 1.8% of GDP. Yet, due to deterioration of the economic situation, two amendments were introduced in the state budget in 2009 in order to balance the budget expenditure and decreasing state revenue. The goals of budget deficit established in July 2009 for the years 2009, 2010, and 2011 are 10%, 8.5%, and 6% of GDP, respectively. In order to ensure a further decrease of deficit of the combined budget, the aim to be reached via consolidation measures is to decrease the deficit of the combined budget in 2012 by up to 3% from GDP.

[1] According to the methodology of European System of Accounts ESA 95. Taking into account that EU member states follow the Maastricht criteria regarding the government budget deficit and debt, their notification results are used according to the methodology of European System of Accounts ESA 95. The rates calculated by applying such methodology are defined according to the so-called accrual concept, however the budget deficit calculated by the Ministry of Finance is defined after cash-desk principle, therefore assessments are slightly different.

Figure 4.2

**General Government Budget Deficit/Surplus in EU Member States in 2008**
(% of GDP)




To balance the budget expenditures and the reducing state revenues, the government (with the amendments of the budget for 2009) implemented optimization and reduction measures of state expenditure. Significant reforms are planned in the health care system and education, by increasing the quality of the provided services and by reducing the total costs of the sectors. Despite the considerable decrease of budget expenditures, the government supports restructuring of enterprises and projects for increasing their competitiveness by means of special financial instruments, especially in implementation of projects co-financed by the EU structural funds.

In order to ensure implementation of budget strategic goals under the circumstances of hardly predictable economic environment, 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. In case of necessity, the Minister of Finance may order the Treasury to delay or reduce allocations for a set period of time in compliance with the *Law on Budget and Financial Management*.

The efficiency of the budget expenditure will be increased also by the launched transition to a medium-term budget, i.e., the budget law for the next year, as well as establishment of the maximum admissible total gross expenditures for the next two years. The ministries introduce strategic planning gradually, thus the budget formation is based on the financing of targets and results of an action-oriented policy.

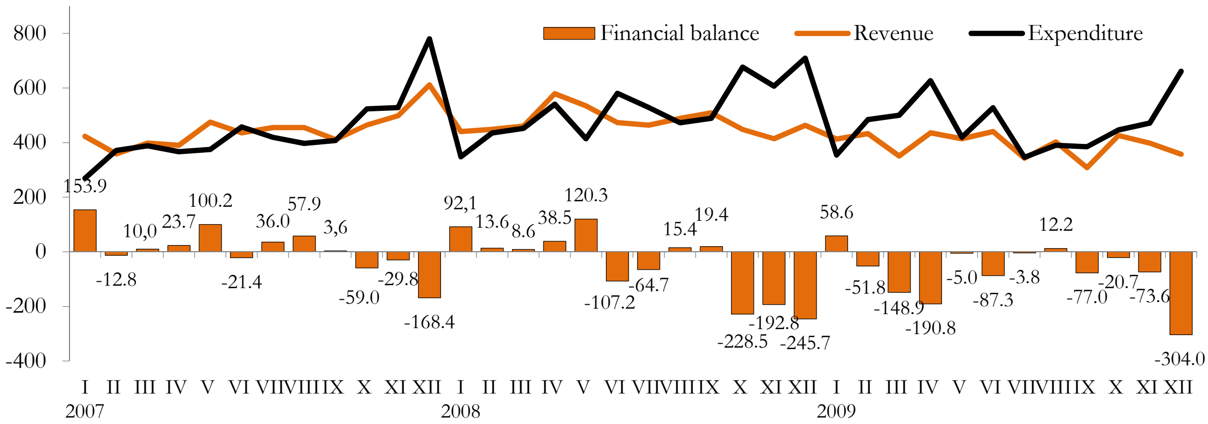
To create basis for sustainable economic development and to implement constantly the fiscal responsibility, it is foreseen to develop a *Draft Law on Fiscal Discipline*, which would set the budget deficit level corresponding to the forecast changes of GDP and macroeconomic indicators, state budget expenditure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

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

When preparing the budget of 2010, the government has adopted consolidation measures in amount of LVL 500 million. Increase of all the possible revenues and decrease of expenditure will be evaluated in cooperation with the social partners.

Figure 4.3

**Total Government Consolidated Budget**
(million LVL)

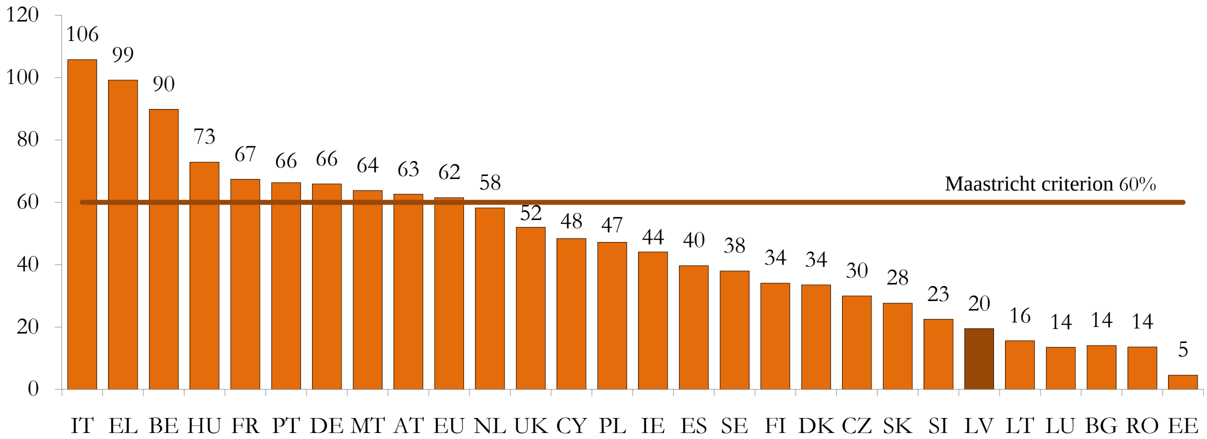



**The level of the general government debt**[1] in Latvia is one of the lowest in EU (see Figure 4.4).

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). 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 percentage of GDP was observed in Italy, Greece, and Belgium, while the lowest general government debt in percentage of GDP was registered in Estonia, Luxembourg, Romania, and Bulgaria.

Figure 4.4

**General government debt in EU Member States in 2008**
(% of GDP)




The general government debt in Latvia has gradually increased until 2007 – from LVL 933.9 million at the end of 2003, until LVL 1329.8 million at the end of 2007, it has even decreased in percentage of GDP from 14.6% to 9%. However, it increased very rapidly in 2008 to ensure national funding commitments and reached LVL 3181.4 million or 19.5% of GDP at the end of the year (see Figure 4.5). The debt level is mainly influenced by the gross debt of the central government.

At the end of 2008, on the basis of the *Economic Stabilization and Growth Revival Programme of Latvia,* the International Monetary Fund, European Commission, World Bank, European Bank for Reconstruction and Development and several EU Member States have agreed on providing financial support to Latvia in the amount of EUR 7.5 billion. The allocated financing will be available from 2008 until 2011 and will determine the increase of the central government debt in 2009 and in the following years.

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 set in the *Maastricht Treaty*.

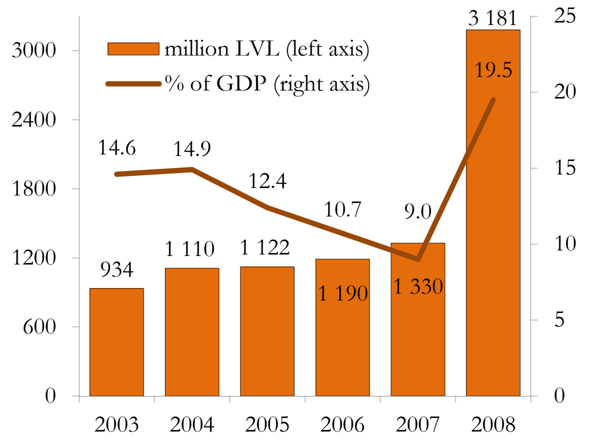
In order to provide more favourable development of the Latvian government debt securities market in the context of the planned introduction of the euro, strategic guidelines are developed in addition to the set

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

redenomination principles of the public debt, which will foresee the direction of desirable market changes (initial disposal methods of securities, depositary and trading systems, investor base, etc.). However, the time of implementation of particular measures within the framework of the abovementioned strategic guidelines will mainly depend on the expected date of the euro introduction.

Figure 4.5

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




In the current situation, when the credit rating of the country has been reduced several times, and taking into account the unstable situation in the financial markets, the borrowing possibilities (with regards to the borrowing terms and available financial instruments) of Latvia in the financial markets are limited. As the situation in the financial markets is stabilising, the main tasks in the field of the public debt management for 2009–2010 are as follows:

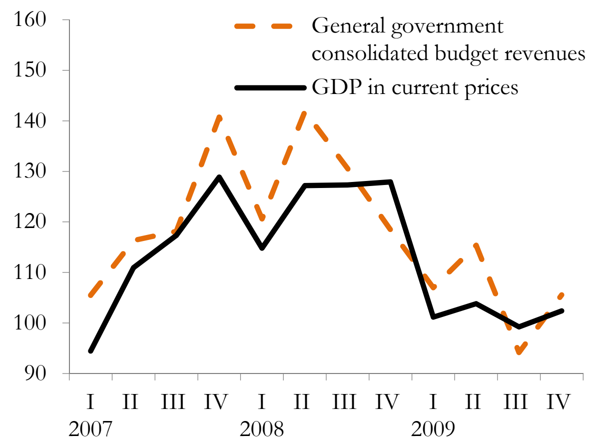
- to implement the necessary measures, to renew the ability of Latvia to borrow successfully in external financial markets, by diversifying the investor base for providing borrowing opportunities as favourable as possible and by improving the spectrum of financial instruments to be used (in domestic and foreign markets), borrowing mechanisms and technologies in accordance with trends in the international financial markets;
- to ensure efficient and safe management of financial resources by limiting financial risks, providing the necessary liquidity in time and to the full extent for fulfilment of the state financial obligations by improving the methods to be applied and expanding the spectrum of financial instruments, as well as technologies in order to increase efficiency of financial resource management.

## 4.1.2. Budget Revenues

Due to the rise in costs of money resources, crediting has decreased, whereas the restricted availability of money reduces household consumption and weakens the development capacity of businesses. The rapid fall of economic activities and decreased domestic demand have negative effect on the general budget revenues.

Figure 4.6

**GDP in Current prices and General Government Consolidated Budget Revenues by Quarters**
(2006 Q4 = 100)




In 2009, the total revenues of the state consolidated budget amounted to LVL 4734.7 million, which is by 17.3% less than in 2008. During the years of the rapid growth, the budget revenues grew almost by 30% annually. Reduction of the budget revenues started at the end of 2008 and it was determined by the rapidly decreasing domestic consumption.

Table 4.2

**Budget revenues***
(% of GDP)

| | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|
| **General government consolidated budget revenues** | **35.9** | **36.2** | **35.2** | **35.6** |
| ***I Tax revenues*** | ***29.9*** | ***29.5*** | ***29.1*** | ***26.4*** |
| *1. Indirect taxes* | *11.8* | *11.4* | *10.3* | *9.9* |
| – value added tax | 8.3 | 8.1 | 6.9 | 6.0 |
| – excise tax | 3.3 | 3.0 | 3.3 | 3.8 |
| – customs duties | 0.2 | 0.2 | 0.2 | 0.1 |
| *2. Income taxes and property taxes* | *8.7* | *9.2* | *9.8* | *7.5* |
| – corporate income tax | 2.3 | 2.7 | 3.1 | 1.5 |
| – personal income tax | 5.9 | 6.0 | 6.3 | 5.5 |
| – real estate tax | 0.6 | 0.5 | 0.4 | 0.5 |
| *3. Social security contributions* | *9.0* | *8.6* | *8.6* | *8.8* |
| *4. Other taxes* | *0.4* | *0.4* | *0.3* | *0.2* |
| ***II Non-tax revenues*** | ***6.0*** | ***6.7*** | ***6.1*** | ***9.2*** |

* according to the official data of the State Treasury

Tax revenues constitute almost 75% of the total budget revenues, and in 2009 they were LVL 3515 million, which was by 25.8% less than in 2008. More than ¾ of the total tax revenues consist of three taxes – mandatory state social insurance payments, personal income tax, and value added tax. The decrease of tax revenues in 2009 was the result of reducing economic activities – drop of retail turnover, increase of unemployment etc.

In 2009, despite the increase of some tax rates, the total tax revenue reduced.

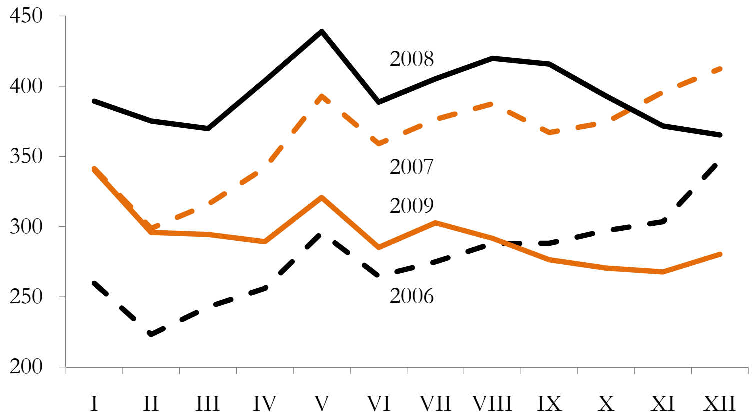
Figure 4.7

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

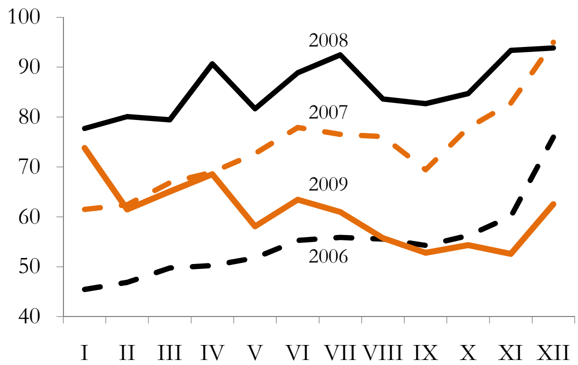

* according to official data of monthly reports of the State Treasury

Figure 4.8

**Tax Revenues by Months***
(million LVL)




**Personal Income Tax**




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

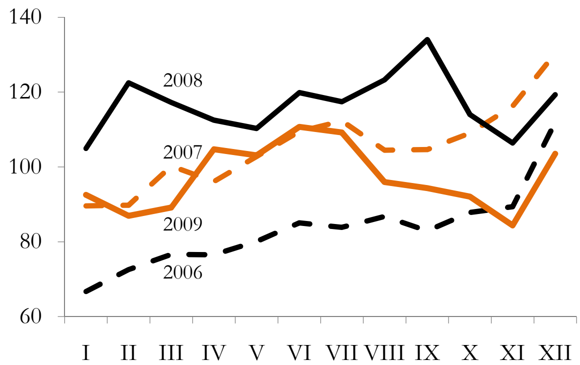
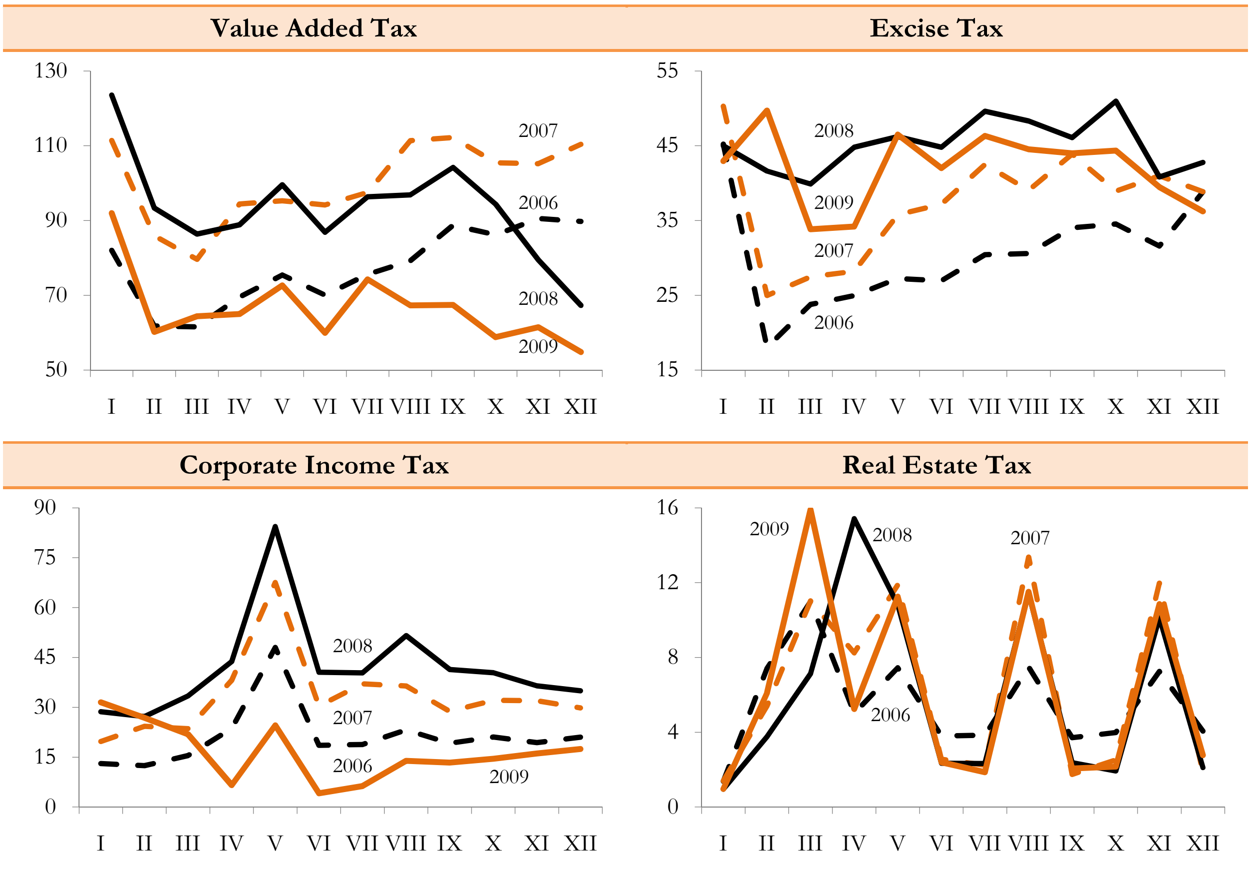


Figure 4.8 continued




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

Almost 54% of all the tax revenues in 2009 were made of **employment taxes.** Increase of the unemployment rate, reduced work pay, as well as the increasing illegal employment resulted in a decrease of the collected employment related taxes. In 2009, revenues from personal income tax reduced by 29.1%, while the reduction of the state mandatory social insurance contributions in comparison with the previous year was more moderate (by 16.8%). The more rapid decrease of revenues from personal income tax is caused by the amendments of the tax law introduced at the beginning of the year 2009, when the tax rate was reduced from 25% to 23%.

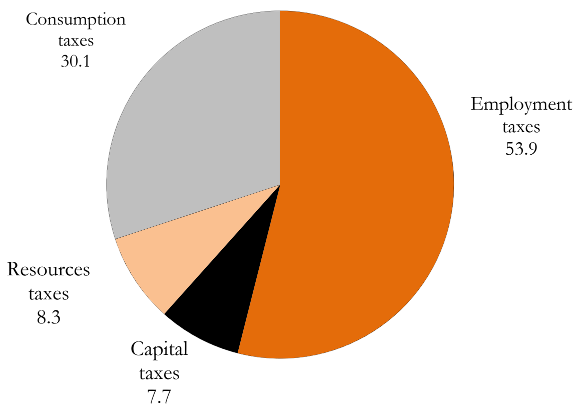
As of January 1, 2009, the breakdown of personal income tax revenues between the state and municipal budgets was changed. 83% (previously 80%) from the total revenues of the personal income tax are paid to the local government budget, but 17% – to the central budget (previously 20%).

As of January 1, 2010, new amendments of the *Law on personal income tax* take effect. The general rate of tax is increased from 23% to 26%, the basis of the personal income tax is expanded including all profits from capital -dividends and gains of interests will be liable to 10% rate, but the capital increase – 15%. Personal income tax will be also imposed for using employer's passenger car for private needs; income tax for self-employed persons is raised subjecting them to the general rate of personal income tax and other changes will take place.

Figure 4.9

**General Government Consolidated Budget Tax Revenues by Tax Groups in 2009**

(percentage)



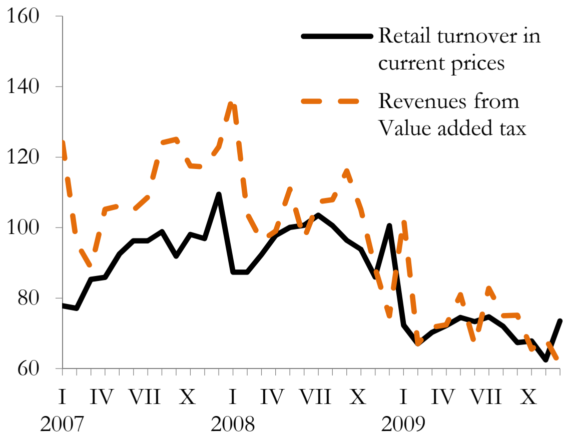

The share of **consumption taxes** in the tax structure reduces. The consumer taxes were the most rapidly growing taxes in the previous years, which were fostered by the increasing domestic demand and high inflation. Starting with the second half of 2008, when the domestic demand declined and the growth rates of prices slowed down, the revenues of consumer taxes reduced. In 2009, this trend continued and the revenues from consumption taxes reduced substantially.

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

Figure 4.10

**Retail Turnover in Current Prices and Revenues from Value Added Tax**

(December 2006 = 100)




On January 1, 2010, several norms of the *Law on value added tax* will take effect, aimed to develop business environment and promote competitiveness of small enterprises, which in general is to be regarded as a positive stimulation of national economy. These amendments simplify or abolish statutory requirements (for example, regarding presentation of value added tax invoices and submitting of annual declaration of value added tax), thus reducing the administrative burden for entrepreneurs.

The most essential changes in the VAT policy in the context of 2010 budget are connected with the taxation period, including a three calendar months long taxation period for taxable persons, the value of taxable transactions whereof during the pre-taxation period does not exceed LVL 35 000; a special VAT payment procedure and deduction of pre-tax (the so called "cash desk principle") for some groups of taxable persons; the period for tax payment into the state budget is prolonged to 20 days after the end of taxation period; a new system for refunding of surplus VAT has been introduced which will refer to surplus VAT paid after July 1, 2010, compensation of VAT for farmers is increased from 12% to 14%, and others.

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

The share of **the capital tax** in the total tax revenues continued to increase gradually until 2008 (12.1% in 2008), however in 2009, with reducing economic activities and increasing number of insolvent companies, the collection of company income tax drastically fell by 60.8% compared to 2008. Thus the share of the capital tax has gone down by almost 5 percent points in one year and in 2009 accounted for 7.7% of all tax collections.

Comparing to 2008, the real estate tax revenues have not changed much. It was LVL 73.1 million in 2009 (3.3% increase compared to 2008).

Regarding the company income tax, it is essential to point out that starting with 2010 the norm of representation of expenses that can be deduced from the taxable income is reduced (from 60% to 40%); for the purpose of company income tax calculation, the share of costs not associated with economic activity and maintenance of the social infrastructure objects, which is not included in the expenditures, is increased 1.5 times; taxpayer's option to decide whether to pay reduced advanced payments in the event of falling incomes has been increased. It is foreseen that when the difference between recapitulative tax calculation and advance payments established by the taxpayer does not exceed 20% of the recapitulative tax calculation for the taxation year, the additional part of tax payable will not be regarded as overdue and penalty will not be applied to it.

As of January 1, 2010, the real estate tax rate is raised for land and buildings used for commercial activity to 1.5%, minimal payment is fixed as LVL 5 for each taxable object, uncultivated lands are subjected to the increased rate of 3%, the real estate tax must also be paid for engineering-technological buildings. Starting with 2010, the real estate tax base is expanded – the residential houses with cadastral value below LVL 40 000 are subjected to 0.1% of cadastral value, with cadastral value LVL 40 001–75 000 – 0.2%, with cadastral value above LVL 75 000 – 0.3%.

Changes in the group of **resources 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 increased by 2 percentage points and amounts to 8.3% of the total tax revenues. In 2009, the excise tax on oil products was collected in the amount of LVL 284.1 million, which exceeded the collection of the year 2008 by 0.3%. This was mostly related with the increase of the excise tax rate on oil products.

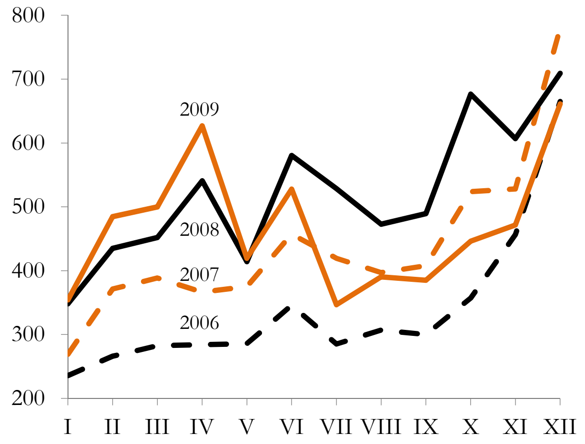
## 4.1.3. Budget Expenditures

The declining budget revenues are forcing the government to enact policy for reduction of budget deficit which in the short-term creates additional pressure on the diminishing internal demand and narrowing internal market.

Figure 4.11

**General Government Consolidated Budget Expenditures by Months***

(million LVL)



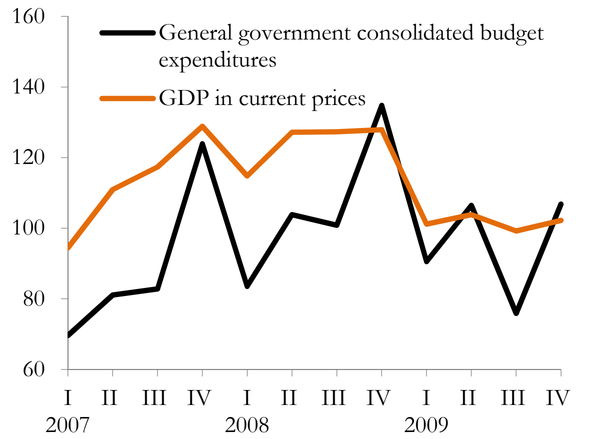

* according to official monthly report data of the State Treasury

In 2009, the budget expenditures was LVL 5626.8 million, and it is by 10.2% less than during the respective period of the previous year.

Figure 4.12

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

(2006 Q4 = 100)



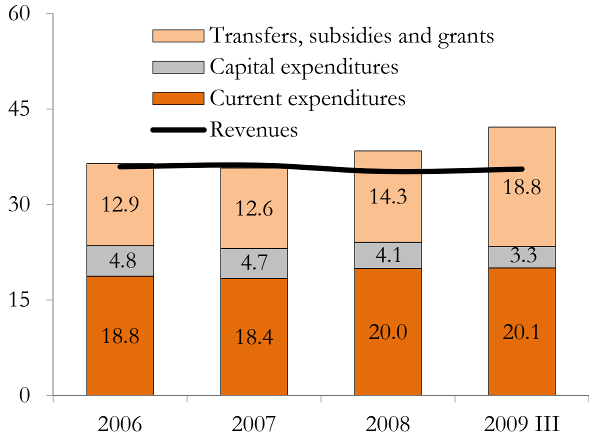

Yet, in 2009, the expenditures for subsidies and grants continued to increase. In comparison with 2008, these expenditures have increased by 6.5%. It is mainly related with the constant rise in the number of unemployed persons and unemployment benefits paid, increase of dismissal benefits for employees released in the public sector, as well as other social benefits. Expenditures for subsidies and grants makes almost half (44.5%) of the total expenditure of the general government consolidated budget.

Expenditures for capital investments in 2009 reduced by more than 34% compared to the year 2008. Current expenditures maintained a large share (47.5%) of expenditure, yet during this time period it reduced by 18.3%.

Figure 4.13

**General Government Consolidated Budget Revenues and Expenditures**

(% of GDP)




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

In 2009, in proportion to expenditures according to the functional categories, the expenditure increased for social protection (by 14.6% compared to 2008) and environmental protection (by 11%). In 2009, essential reduction of expenditure was observed in other groups, for instance, security and maintenance of territories of the local municipalities (by more than 40%), public order and safety, economic activities, as well as recreation, culture, and religion (by more than 20%).

Optimization of the state administration and separate sectors has been implemented in order to reduce the general government consolidated budget expenditure, namely, the number of employees in the ministries has been reduced on average by 30%, the number of state agencies has been reduced from 76 to 25, the number of hospitals has been reduced from 59 to 24, approximately 100 schools have been closed. Reduction of salaries in public sector has been implemented as well – in September 2009, on the yearly basis, the salaries in the government sector was by 24.8% lower. Starting with the year 2010, a unified remuneration system is being introduced for the state and municipalities employees; which is applicable to almost all employees of state and municipal institutions, with the exception of the employees of the Bank of Latvia and Financial and Capital Market Commission.

Table 4.3

**Expenditures of the General Government Consolidated Budget by Functions***
(percentage)

| | 2008 | | 2009 Q3 | |
|---|---|---|---|---|
| | structure | of GDP | structure | of GDP |
| **Expenditures – total** | **100** | **38.4** | **100** | **42.2** |
| General public services | 13.6 | 5.2 | 14.8 | 6.2 |
| Defence | 3.5 | 1.3 | 2.4 | 1.0 |
| Public order and safety | 5.0 | 1.9 | 4.5 | 1.9 |
| Economic affairs | 18.1 | 6.9 | 15.7 | 6.6 |
| Environmental protection | 2.4 | 0.9 | 2.2 | 0.9 |
| Housing and community amenities | 3.6 | 1.4 | 2.1 | 0.9 |
| Health | 8.1 | 3.1 | 7.5 | 3.2 |
| Recreation, culture and religion | 4.0 | 1.5 | 3.4 | 1.4 |
| Education | 20.2 | 7.8 | 19.6 | 8.3 |
| Social protection | 21.5 | 8.3 | 27.9 | 11.8 |

* according to the official data of the State Treasury

Yet, such budget consolidation results in reduction spiral – by reducing budget expenditures, the total output reduces and as a result the tax revenues decrease, and again ways should be sought to limit expenditure.

To reach the goal set forth by the government - the budget deficit in the amount of 3% of GDP, the budget expenditure during 2011–2012 should be reduced by additional LVL 700–800 million.

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

Table 4.4

**Public demand**
(percentage)

| | % of GDP | | | Increase in comparison with the previous year | | |
|---|---|---|---|---|---|---|
| | 2007 | 2008 | 1st half of 2009 | 2007 | 2008 | 1st half of 2009 |
| **Public Demand** | **23.1** | **24.5** | **25.0** | **10.0** | **-4.3** | **-6.6** |
| *Public consumption* | 17.4 | 19.7 | 22.0 | 3.7 | 1.5 | -4.2 |
| – central government | 9.5 | 10.9 | - | 1.4 | 2.0 | - |
| – local government | 7.9 | 8.9 | - | 6.6 | 1.0 | - |
| *Gross fixed capital formation* | 5.7 | 4.8 | 3.0 | 27.8 | -17.8 | -16.6 |
| – central government | 2.8 | 1.8 | - | -3.7 | -40.0 | - |
| – local government | 2.8 | 3.0 | - | 91.3 | 4.5 | - |

In 2008, the public demand decreased slightly slower than GDP. Reduced demand was mainly determined by a reduction of expenditures by 40% on gross fixed capital formation of central government compared to 2007. At the same time, the expenditures of local governments for investments increased by 4.5% in 2008.

In the 1st half of 2009, the reduction of public demand continued. It was mainly determined by essential reduction of investment volumes (by 16.6% compared to the respective period of 2008). In general the public demand is by 6.6% lower than in the 1st half of 2008.

## 4.2. Prices

### 4.2.1. Consumer Prices

After the accession of Latvia to the EU, the country experienced high inflation that reached 18% in the middle of 2008 (price changes during 12 months).

In 2009, consumer prices decreased by 1.2%. The main reason for deflation of consumer prices is the rapid decrease of the domestic demand.

Price decrease started in November 2008, when the prices reduced by 0.4% (compared to the previous month) and in December – by another 0.5%.

During 1st quarter of 2009, the consumer prices started increasing again. This was determined by demand factors related to the increase of administratively regulated prices (transport services and different utilities services), as well as by the increase of the value added tax rate and the excise tax rate. As of April 2009, the consumer prices reduce every month.

Figure 4.14

**Consumer Price Changes**
(12-month inflation, percent)

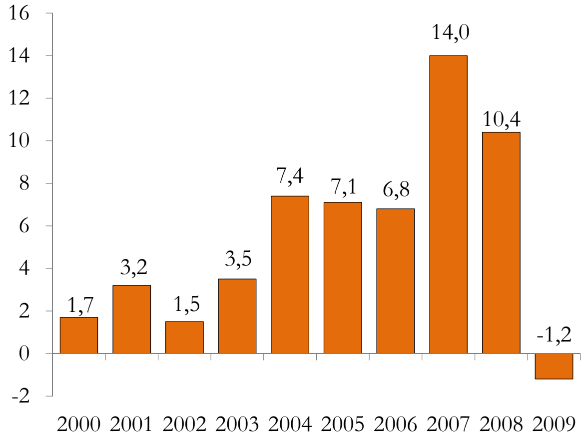
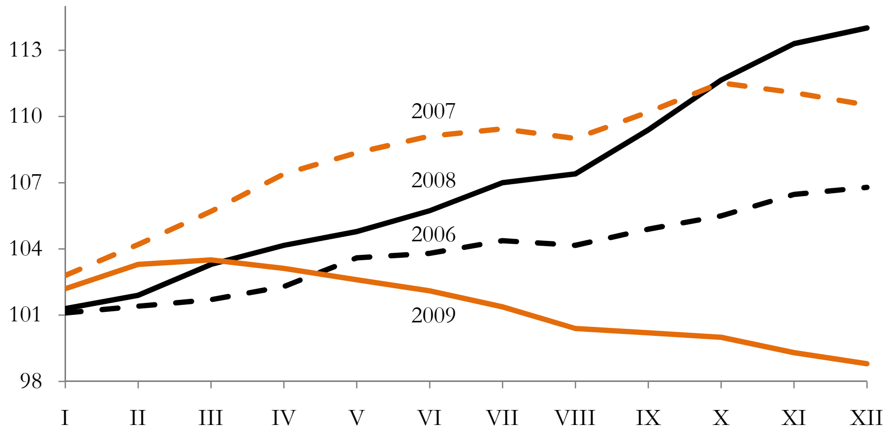
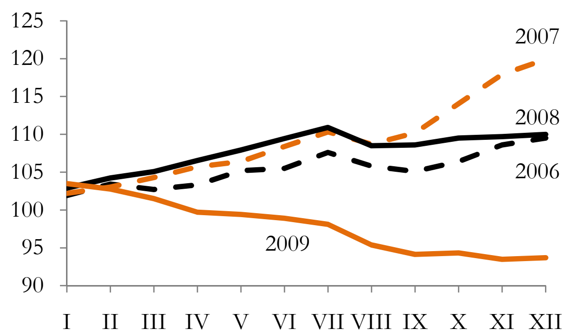



Figure 4.15

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




**Food and soft drinks**




**Administratively regulated prices**

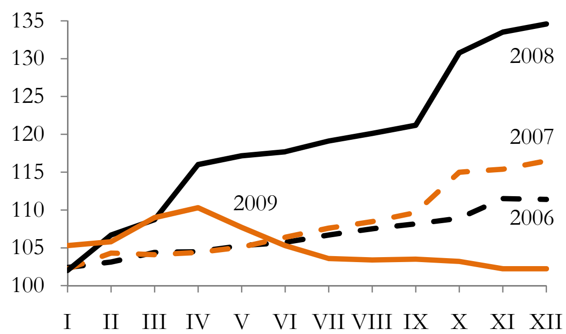
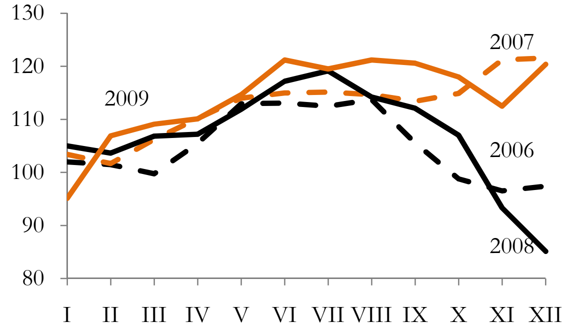
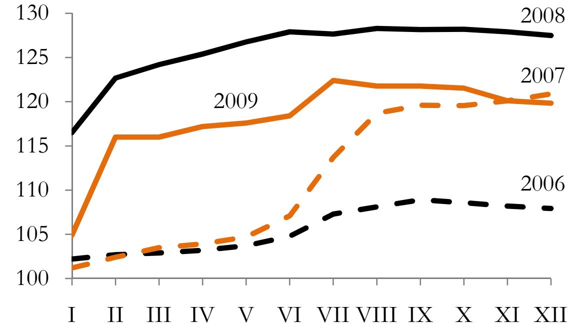


Figure 4.15 continued

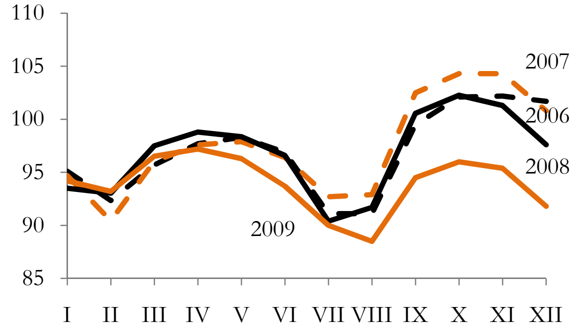
**Fuel**



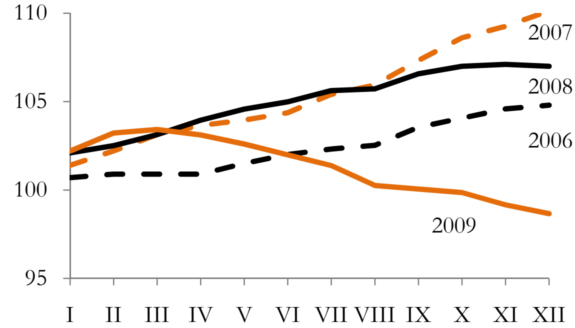

**Alcoholic beverages and tobacco**




**Clothing and footwear**




**Other groups of commodities and services**




As it was already mentioned, in 2009 the consumer prices reduced by 1.2%, including – by 1.2% for commodities and by 1% – for services. The first prices to react to the decreased domestic demand were the product prices which started to fall already in the 2nd half of 2008, while the prices for services mainly started to fall only in March 2009.

In 2009, due to the decrease of economic activities in the whole EU, the inflation growth rate slowed down and 5 countries (Ireland, Estonia, Latvia, Malta, and Portugal) faced deflation. The highest deflation was in Ireland and Estonia. Up to now, Lithuania has managed to avoid the deflation.

In 2009 in general, the price reduction in Estonia was by 1 percentage point more rapid than in Latvia. Deflation in Estonia started already at the beginning of the year, while in Latvia during the first three months of the year the prices were increasing mainly due to the increase of the VAT rate and the excise tax rate. The dynamics of separate price groups of commodities and services is also different.

Table 4.5

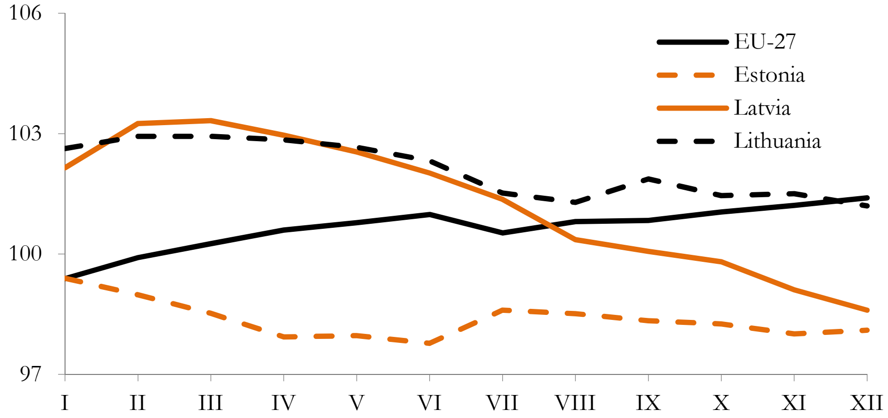
**Consumer Price Changes by Months**

(percentage)

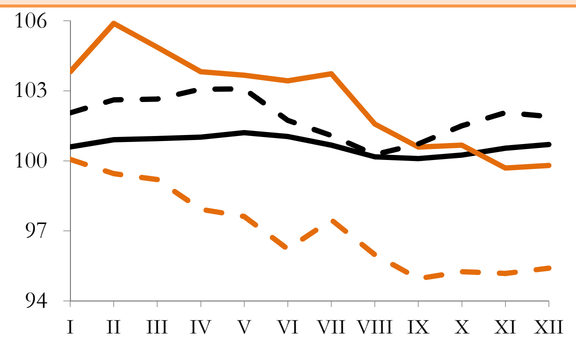
| | Compared to previous month | | Compared to respective month of the previous year | | Average during the year | |
|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 | 2008 | 2009 |
| January | 2.8 | 2.2 | 15.8 | 9.8 | 10.8 | 14.9 |
| February | 1.3 | 1.1 | 16.7 | 9.6 | 11.6 | 14.3 |
| March | 1.5 | 0.2 | 16.8 | 8.2 | 12.3 | 13.5 |
| April | 1.5 | -0.4 | 17.5 | 6.2 | 13.0 | 12.5 |
| May | 0.9 | -0.5 | 17.9 | 4.7 | 13.8 | 11.4 |
| June | 0.7 | -0.5 | 17.7 | 3.4 | 14.6 | 10.2 |
| July | 0.3 | -0.6 | 16.7 | 2.5 | 15.2 | 9.1 |
| August | -0.4 | -1.0 | 15.7 | 1.8 | 15.6 | 7.9 |
| September | 1.1 | -0.2 | 14.9 | 0.5 | 15.9 | 6.7 |
| October | 1.2 | -0.2 | 13.8 | -0.9 | 15.9 | 5.5 |
| November | -0.4 | -0.7 | 11.8 | -1.2 | 15.7 | 4.5 |
| December | -0.5 | -0.5 | 10.5 | -1.2 | 15.4 | 3.5 |

Figure 4.16

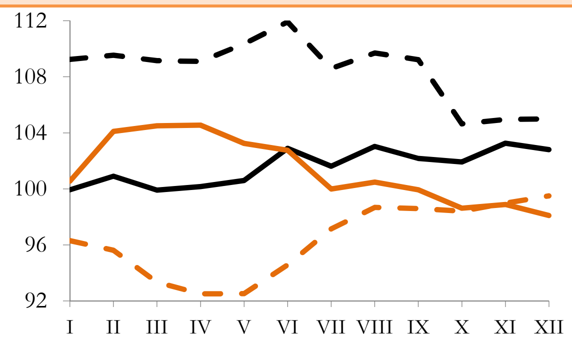
**Harmonised index of consumer prices by months**
(December 2008 = 100)




**Food products**
(including alcohol and tobacco)




**Energy**




The decrease in the prices for food products was more rapid in Estonia than in Latvia; this can be partially explained with the increase of the VAT rate in Latvia at the beginning of the year. During the following months, the pace of food product price reduction in Latvia was similar to Estonia. The dynamics of energy prices is also essentially different, which is indicative of inflexibility of energy prices in Latvia.

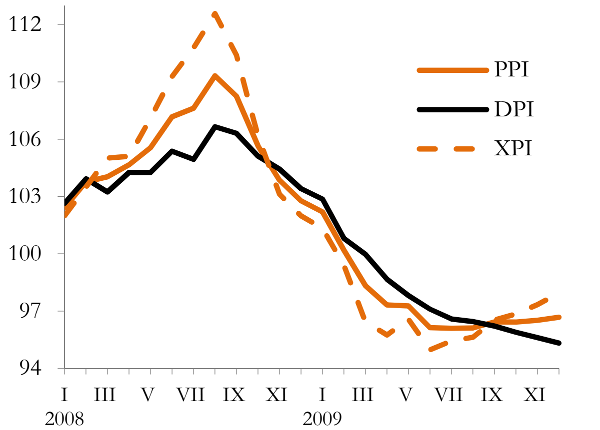
## 4.2.2. Producer and Foreign Trade prices

The decrease of **producer prices** started before the decrease of consumer prices. The producer prices started to decrease already in September of 2008. The decrease of prices affected both domestic sold and exported products; the price decrease of exported products was more rapid, especially during September–November 2008.

In 2009, price deflation of both domestic sold and exported products is observed. The price decrease of domestic sold products was related mainly with the rapid decrease of domestic consumption, while the price decrease of exported products was related with the price decrease in the global market of the main export products of Latvia – timber and food products. Over the year (December 2008 compared to December 2009), the price decrease of domestic sold products was more rapid than the price decrease of exported products by 9.9% and 5%, respectively.

Figure 4.17

**Producer Price Changes in Manufacturing**
(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

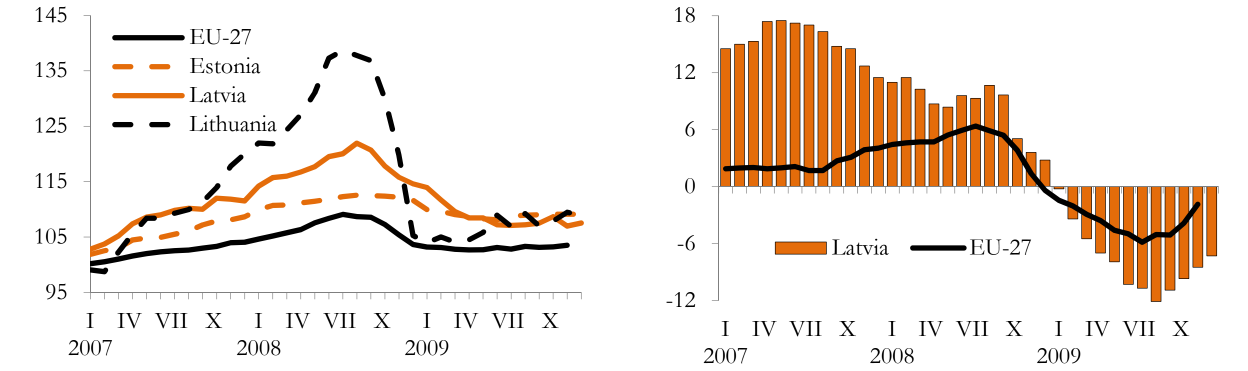
Dynamics of producer price index in manufacturing in Latvia slightly differed from the total

EU dynamics. The manufacturing prices of EU 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 in the entire European Union. Since December 2008, the deflation of producer prices was observed in the EU.

Figure 4.18

**Producer Price Index by Months in Manufacturing**

| **December 2006 = 100** | **Increase in comparison with the corresponding period of the preceding year** (percentage) |
|---|---|



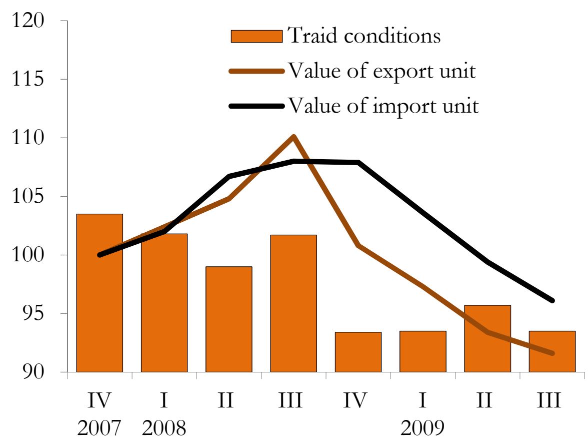

In 2009, the most rapid decrease of producer prices in manufacturing in the Baltic States was observed in Lithuania – by 16.3%, while in Latvia and Estonia it was by 7.5% and 2.4% respectively.

Over the course of the year, the trade conditions in Latvia have deteriorated – the export prices have decreased more rapidly than import prices – by 16.8% and 11% respectively (the changes of an export and import unit value in 3rd quarter of 2009 in comparison with the 3rd quarter of 2008).

Figure 4.19

**Export and import unit values and trade conditions indexes**

(export and import unit value index in 2007 Q4 = 100, trade conditions index, % of the respective quarter of the previous year)



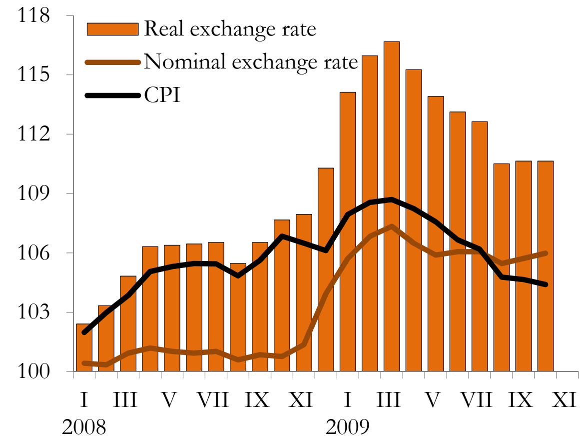

The export prices have reduced more rapidly than the import prices for such product types as metals and metal products, timber and timber products, textiles, as well as products of chemical industry and communications sectors. Regarding food products, the decrease of import prices was more rapid.

It should be noted that the deflation of 2009 has slightly increased the competitiveness of Latvian businesses – the real effective exchange rate of lats has decreased.

Figure 4.20

**Effective Exchange rate of Lats***

(December 2007 = 100)




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

Yet, the deflation should be deeper in order to compensate the increase of the real effective exchange rate due to devaluation of currencies in some trading partner countries and the high inflation in Latvia during the previous years. The current real effective exchange rate is by 10.6% higher than at the beginning of 2008 and by 2.5% higher when compared with the situation before several trading partner countries of Latvia devalued their currencies (November 2008).

# 4.3. Balance of Payments

## 4.3.1. Current Account

The current account of the balance of payments undergoes adjustment in Latvia. The large and constantly increasing current account deficit present in Latvia over several years started to decrease since the second half of 2007, and since 2009, the balance of the current account has been positive.

In the nine months of 2009, the positive balance of the current account has reached 8.5% of GDP (1.3% in the 1st quarter, 14.1% in the 2nd quarter, and 10.1% in the 3rd quarter). Changes in the current account are related to improved foreign trade and revenue balance headings. The deficit of foreign trade in the nine months of 2009 compared to the respective period of the previous year has decreased by almost 11 percentage points and was 7.5% of GDP. This was determined by the decrease of import volumes, which was more rapid than that of the export volumes. The increase of the positive revenues balance is mainly related to the reinvested profit, which in nine months of 2009 reached 6.5% of GDP, thus being indicative of the big losses of the foreign investors. The balances of the current account services and current transactions are positive with a slight trend to increase.

It should be noted that essential adjustments of the current account were determined by the reduction of the dynamics of capital flows in 2008 and change of direction thereof in 2009. Under the influence of the global financial crisis, due to the decreased capital inflow, there was a significant decrease of the domestic demand, which resulted in substantial adjustments in the economy and the balance of the current account.

Figure 4.21

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

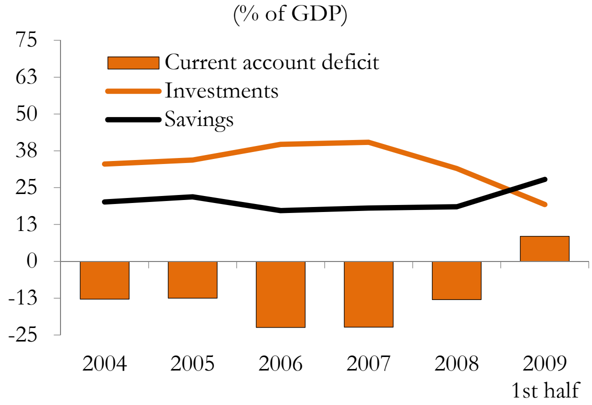



Table 4.6

**Balance of Payments of Latvia**
(% of GDP)

| | 2005 | 2006 | 2007 | 2008 | 2008 I–IX | 2009 I–IX |
|---|---|---|---|---|---|---|
| **A. Current account** | **-12.5** | **-22.5** | **-22.3** | **-13.0** | **-14.8** | **8.5** |
| Trade balance | -18.9 | -25.6 | -23.9 | -17.6 | -18.2 | -7.5 |
| *export* | 33.5 | 30.7 | 28.5 | 28.2 | 29.2 | 26.0 |
| *import* | -52.4 | -56.3 | -52.4 | -45.8 | -47.4 | -33.5 |
| Balance of services | 3.8 | 3.3 | 3.5 | 4.0 | 3.9 | 6.2 |
| Net revenues | -1.1 | -2.7 | -3.3 | -1.6 | -3.1 | 6.5 |
| Current transfers, net | 3.7 | 2.4 | 1.3 | 2.2 | 2.6 | 3.3 |
| **B. Capital account** | **1.3** | **1.2** | **1.9** | **1.5** | **1.6** | **2.5** |
| **C. Financial account*** | **16.3** | **30.5** | **24.6** | **11.3** | **16.6** | **-6.9** |
| Direct investment | 3.6 | 7.5 | 6.8 | 3.0 | 5.0 | 0.4 |
| *abroad* | -0.8 | -0.9 | -1.3 | -0.7 | -1.2 | 0.3 |
| *in Latvia* | 4.4 | 8.3 | 8.1 | 3.7 | 6.2 | 0.1 |
| Portfolio investment** | -1.3 | 0.2 | -1.6 | 0.8 | 1.8 | 3.2 |
| *assets* | -1.3 | -1.3 | -1.0 | 1.8 | 0.6 | 4.3 |
| *liabilities* | 0.0 | 1.5 | -0.5 | -1.0 | 1.2 | -1.1 |
| Other investments | 14.0 | 22.6 | 19.3 | 7.5 | 9.8 | -10.5 |
| *assets* | -2.7 | -9.7 | -21.7 | -1.4 | -0.4 | -4.2 |
| *liabilities* | 16.7 | 32.2 | 40.1 | 8.9 | 10.2 | -6.3 |
| **D. Net errors and omissions** | **-1.9** | **0.6** | **-0.8** | **-1.8** | **-1.5** | **1.2** |
| **E. Reserves** | **-3.2** | **-9.9** | **-3.4** | **-2.0** | **-1.9** | **-5.2** |

* without reserve assets
**portfolio investment and derived financial instruments

The rapid inflow of foreign capital until 2007 positively affected investment on the one hand, but on the other hand it became a substantial factor for decreasing the level of savings. Private consumption increased rapidly and the level of savings decreased from 20.2% of GDP in 2004 to 18.1% in 2008 respectively, while the investment level in the national economy increased from 33% to 40.4% respectively.

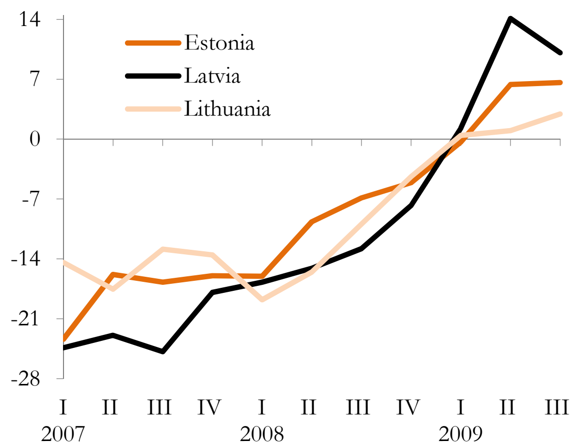
In 2008, the investment level was almost by 10 percentage points lower than in 2007. The level of national savings remained relatively stable confirming substantial adjustment of the domestic consumption. The large debt burden, deterioration of the economic situation, decrease of income, as well as uncertainty about the development in the future has facilitated economy of households. Along with increasing level of savings, investments are rapidly decreasing. In the nine months of 2009, share of investments of GDP was 19.3% or almost twice lower than in the nine months of the previous year, but the level of savings was 27.8% of GDP.

It should be noted that rapid changes of the current account balance are observed also in the neighbouring countries.

In Estonia current account surplus in the 3rd quarter of 2009 reached 6.6% of GDP – compared to the 6.9% deficit a year before. In Lithuania, however, the positive balance of the current account in the 3rd quarter of 2009 reached 2.9% (9.9% of GDP a year ago).

Figure 4.22

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




Source: *Eurostat*

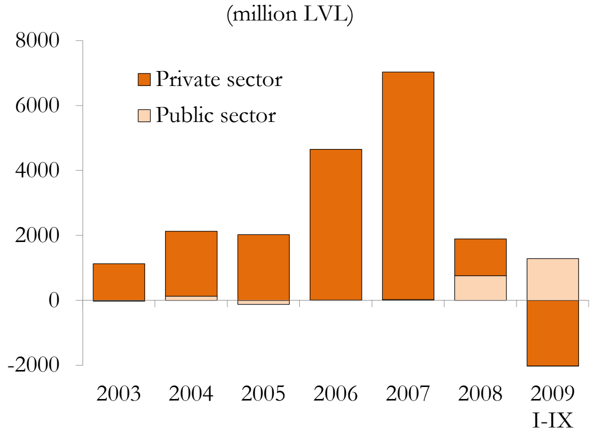
## 4.3.2. Financial Flows

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

Increased inflow of foreign capital started in Latvia at the beginning of transition, which was fostered by liberalisation of the 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 the taxes. Also all residents of Latvia are free to use the financial services of any foreign company. There are no restrictions for operations with securities. The purchase and sale of real estate is not restricted as well.

Figure 4.23

**Inflow of Foreign Investment in Latvian Economy**
(million LVL)



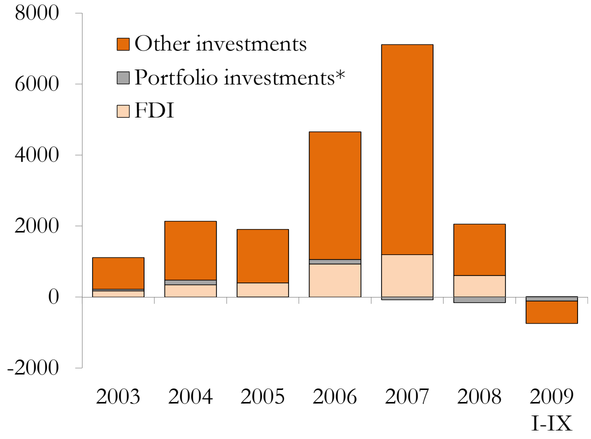

During the previous years, foreign investment was mainly attracted by the private sector. As of 2004, foreign investments grow rapidly and their volume increased 1.5 times in 2007 compared to the previous year, but in 2007 compared to 2004 – increased by almost 3.5 times. In 2008, the inflow intensity of foreign investments was much slower, which was mainly determined by the unfavourable conditions in the global financial markets. In 2008, the inflow volumes of private capital compared to 2007 was almost by seven times smaller. Since the 4th quarter of 2008, private foreign capital outflow is observed, which increased in the 1st quarter of 2009, exceeding the volume of incoming private capital during the previous year. The outflow of private foreign capital continued in the 2nd and 3rd quarter of 2009, although in smaller volumes. The negative effect of private capital outflow on the financial account situation was slightly decreased by long-term loans of the public sector.

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

During the period from 2005–2007, the foreign direct investments in the inflowing foreign capital structure on average constituted almost 20%. In comparison with 2004, the volume of FDI has tripled and it covered 35–37% of the negative current account balance. In 2008, compared to 2007, the FDI stock decreased by almost a half and reached 30% of the negative balance of the current account. In the 1st quarter of 2009, the FDI flows were positive, yet they were almost 15 times smaller than in the respective period of the previous year, while in the 2nd quarter the balance of FDI flow was negative, but in the 3rd quarter – positive. This was determined by the investments into the equity capital of companies.

Figure 4.24

**Inflow of Foreign Investments in Latvian Economy by Types of Investment**
(million LVL)

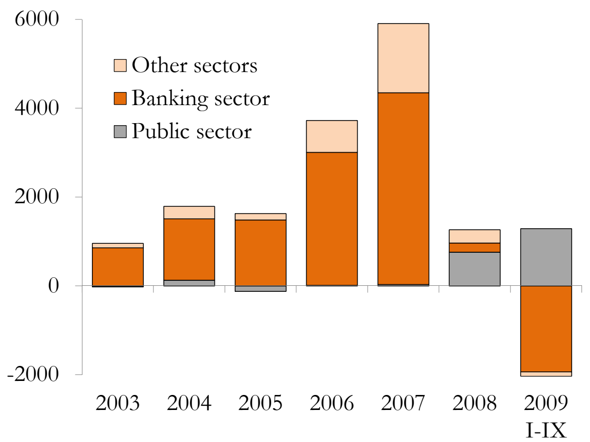



* portfolio investments and derived financial instruments

The share of portfolio investments in the incoming financial flows is small and does not exceed 10% in the last three years. In 9 months of 2008 and 2009, the balance of portfolio investments was positive mainly due to the financing attracted by the Latvian government in a form of bonds and promissory notes.

Figure 4.25

**Net Foreign Investment Flows by Sectors***
(million LVL)




* excluding foreign direct investments

A large share of the total foreign investments consists of other investments (financial deals not included in the direct and portfolio investments). These are trade loans, other credits and borrowings, cash and deposits, etc. Since 2005, they have increased by 4.4 times. In the 1st quarter of 2008, for the first time in the last four years, the flow of these investments was negative. This was mainly determined by reduced deposits of non-residents in the monetary financial institutions and the decreased borrowing rate of the private sector.

In 2008, the investment flows were positive, yet two times less than in 2007. Mainly this was determined by the decrease of short-term flows. In the 1st and 2nd quarter of 2009, the flows of other investments were negative (-21.1% and -27.5%, respectively) – due to the rapid fall of liabilities in the banking sector as a result of transactions. During the 3rd quarter of 2009, the balance of other investments is positive (18% of GDP), which was determined by the government long-term loans.

The foreign capital attracted under the influence of the global financial crisis, exceeded the volume of GDP by 11.6% in 2008. Yet, during the nine months of 2009, the flows of private foreign capital were negative.

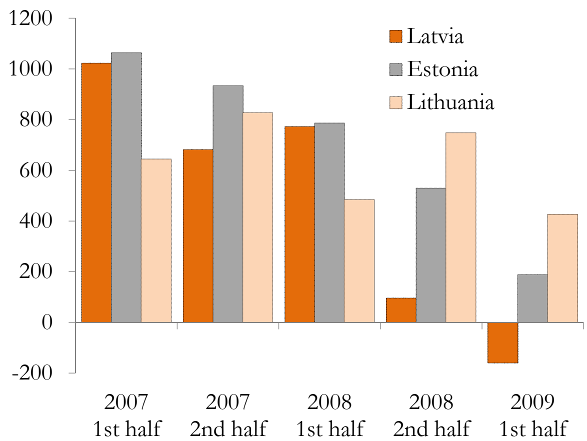
At the end of the 3rd quarter of 2009, the debt of Latvia to the rest of the world amounted to 145.8% of GDP, including the government debt – 22.3% of GDP. Since the end of 2008, the foreign government debt has doubled.

### 4.3.3 Foreign Direct Investment

Under the influence of the global financial crisis foreign capital flow in Latvian economic situation has significantly decreased. This influenced the FDI flows, although the FDI flows compared to other financial flows were more stable.

Figure 4.26

**Inflow of FDI in the Baltic States**
(million EUR)




The intensity of the FDI flows in Latvia, as well as in other Baltic States is rather cyclic. They increased considerably after accession of Latvia to the EU, however decreased when the economic situation deteriorated. In the period of 2004–2007, the 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. The decrease of FDI inflow is observed also in Estonia and Lithuania. Yet, contrary to the neighbouring countries, the balance of incoming FDI flows in Latvia were negative in the 1st half of 2009.

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

In 2008, the volume of incoming FDI has been by 49.2% lower and reached LVL 606.5 million (EUR 869 million) comparing to 2007. This was mainly determined by the reduction of the reinvested profit. Since the 4th quarter of 2008, the direct investment companies operate with losses. In nine months of 2009 they reached LVL 811.8 million (EUR 1155 million). In 2009, the volume of other capital and own capital has increased (especially in the 3rd quarter), which compensated the losses of the direct foreign companies, thus the incoming FDI flows during 3 quarters of this year were positive (LVL 12.7 million).

According to the international investments balance of Latvia, the FDI stock in the Latvian economy at the end of September 2009 reached LVL 5780.2 million which is almost by 4% less than a year ago. Comparing with the end of 2008, FDI has increased by 1.2%, its share in the structure of foreign capital structure has increased by 0.5% and at the end of September 2009 it was 23.5% – this is determined by more rapid decrease of the inflow of other foreign capital investments than FDI.

In Latvia, the investments from the EU member states are dominating in the foreign direct investment geopolitical structure. At the end of September 2009, they amounted to 80% of the total FDI stock, and one-third of it is related to investments of the new EU Member States.

Figure 4.27

**FDI in Latvia**

(received during the quarter, million EUR)

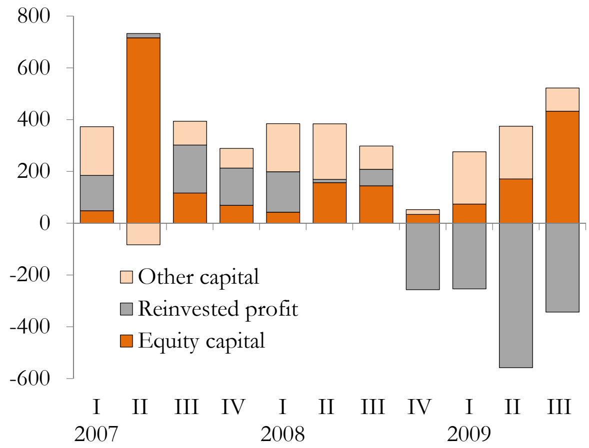
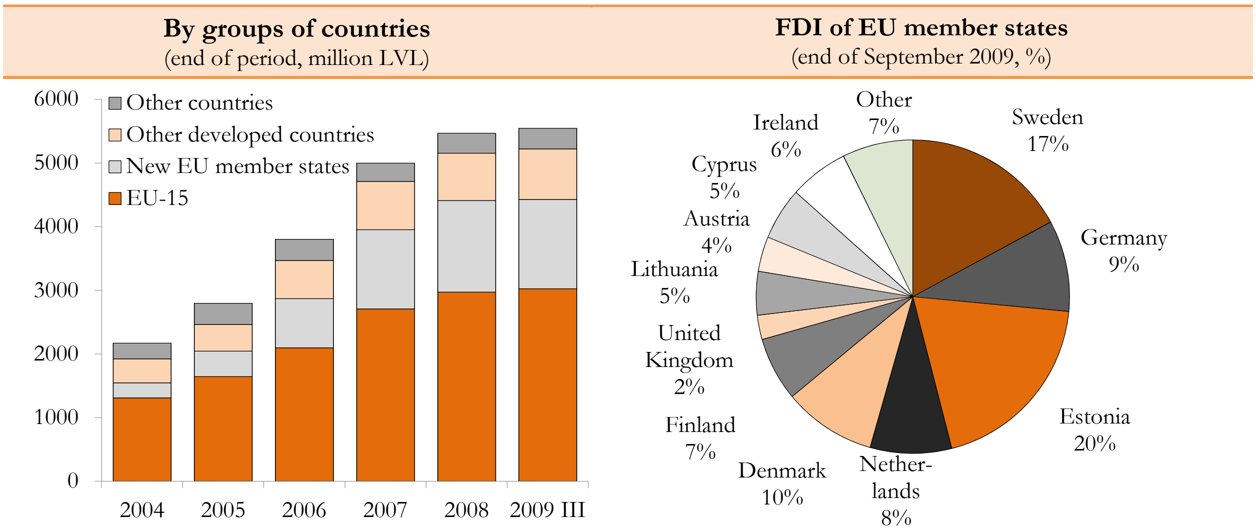



Figure 4.28

**FDI Stock**




The biggest investor countries in the economy of Latvia are Sweden, Estonia, Germany, and Denmark. At the end of September 2009, the FDI stock of these four countries comprised almost 55.7% of the total FDI stock in Latvia. They were mainly concentrated in the sector of financial mediation. Since the end of 2008, the FDI stock of the mentioned countries in the financial mediation sector has reduced by 4.4% and at the end of September 2009 it was 67.5% of the FDI stock of the sector, which is almost by 4.2 percentage points less than a year ago.

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

At the end of 2007, the largest proportion of FDI stock was that of commercial services and financial mediation (22% and 28% of FDI stock, respectively).

Table 4.7

**FDI Stock by Sectors**

(end of period, million LVL)

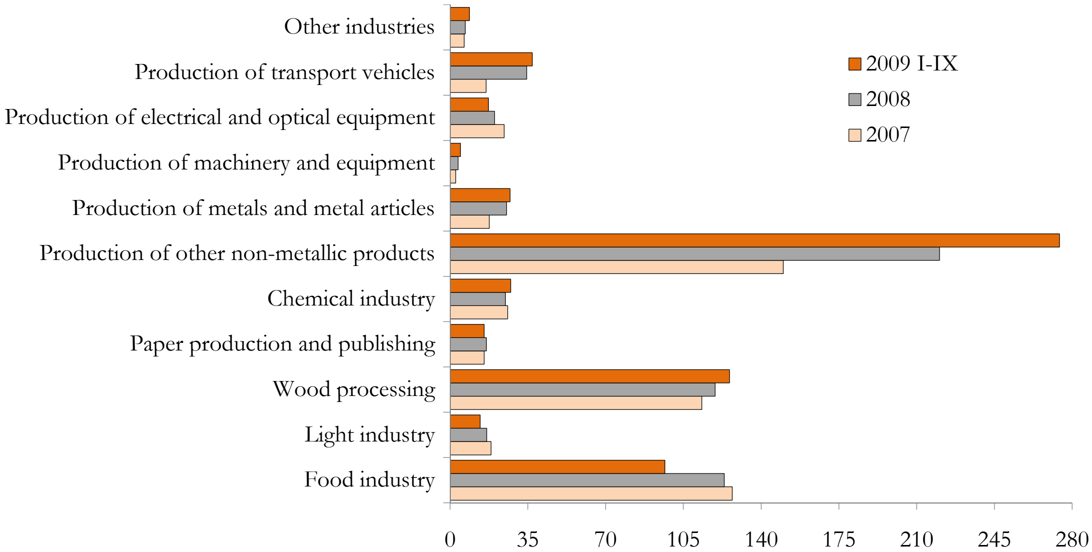
| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 Q3 |
|---|---|---|---|---|---|---|
| Primary sectors | 49.8 | 59.5 | 71.6 | 113.1 | 145.2 | 156.3 |
| Manufacturing | 276.1 | 376.0 | 395.8 | 516.8 | 611.0 | 647.6 |
| Energy Sector | 164.7 | 327.6 | 348.1 | 270.7 | 204.9 | 246.0 |
| Construction | 36.5 | 49.7 | 67.6 | 85.5 | 107.1 | 126.6 |
| Trade | 395.7 | 437.8 | 562.3 | 676.4 | 862.0 | 872.5 |
| Transport and communications | 333.3 | 336.4 | 347.0 | 392.5 | 466.3 | 433.2 |
| Financial intermediation | 375.9 | 625.4 | 964.6 | 1486.2 | 1647.3 | 1635.4 |
| Other services | 439.2 | 529.0 | 795.3 | 1223.5 | 1251.3 | 1367.0 |

In 2008 in general, the FDI stock in all sectors had increased. This proves that despite the reduction of economic activities, the investors had not essentially changed their plans. Yet, the growth rates of FDI have slowed down almost by three times. In 2008, the FDI stock in the services sectors increased by 12% (including financial intermediation – by 10.8%, trade – by 28%, transport and communications – by 18.8%), while regarding deals with real estate, the FDI stock remained on the level of the previous year. Yet, the decrease in the growth rates of the FDI stock in the production of goods was insignificant. In 2008, the FDI stock increased by 8.3% or almost 1.5 times slower than in the services sectors. During nine months of 2009, the increase of FDI stock in the services sphere is rather small – by 2%, while in production it increased by 10.1%, including manufacturing – by 6%.

Figure 4.29

**FDI Stock in Manufacturing**

(end of period, million LVL)




After the accession of Latvia to the EU regarding attraction of FDI, substantial changes are observed in the sub-sectors of manufacturing. In comparison with the end of 2003, the FDI stock decreased almost by 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 increase of FDI in manufacturing in 2008 was by 18.4% (in 2007 – by 30%) and in three quarters of 2009 – by 6%, which proves that the deepening crisis and the duration thereof makes foreign investors more precautious in implementing their investment plans. Yet, it should be noted that the interest of foreign investors about this sector has not decreased. Like in the previous years, there was an increase in the sectors for production of other non-metallic mineral products. During the nine months of 2009, they increased by 24%. In 2009, the investments in the sectors of production of machinery and equipment, production of means of transport, and metal processing increased. Compared to the end of 2008, the FDI stock in these sectors increased by 30.5%, 7.2%, and 6.3%, respectively. The changes of FDI stock in other manufacturing subsectors (except for food industry in which the FDI level at the end of September 2009 is by 21.6% lower than at the end of 2008) are insignificant.

The most attractive manufacturing sectors for foreign investors are the food industry, wood processing, and production of other non-metallic mineral products. The FDI stock by quarters in these sectors at the end of September 2009 constituted 77% of the whole FDI stock in manufacturing (including production of non-metallic mineral products – 42.3%). The investors from Denmark, Finland, Germany, Sweden, and Ireland have made bigger investments in manufacturing within the last four years. In Latvia, direct investments of the investors from Ireland are increasing especially rapidly. Since the end of 2007, they have increased almost four times and at the end of June 2009 constituted 31% of the FDI stock in manufacturing (at the end of 2007 – 10%). It should be noted that the investments from Russia into manufacturing have also increased almost by 3.5 times during the last one and a half years. At the end of September 2009, they constituted 3.4% of FDI stock in manufacturing.

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

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.

For example, in 2008, among the successfully completed foreign direct investment projects there are the household objects production unit of the Dutch company "Brabantia" and the second automobile parts production unit of the Swedish company Leax in Latvia.In 2009, Norwegian company JSC "BAU-HOW" opened its production unit in Ventspils.

Currently, IDAL actively works on developing a new service related with the company merger and acquisition possibilities (Merger & Acquision). The Agency gathers information on Latvian companies that would be interested to find a cooperation partner/potential investor to continue their activities successfully. Currently, the potential investors have an opportunity to invest into companies of such sectors as renewable energy, electronics, IT, industrial immovable property, and wood processing.

## 4.4. Financial and Capital Markets

### 4.4.1. Monetary Policy and the Exchange Rate

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

Since the mid-February 1994, the Bank of Latvia had unofficially pegged the exchange rate of lats (LVL) to the SDR[2] basket of currencies (1 SDR = LVL 0.7997) thus *de facto* implementing the fixed exchange rate policy. As of January 1, 2005, the peg of lats to the SDR basket is replaced with the peg to Euro (1 EUR = LVL 0.702804). The change of the peg of lats was determined by the plans of Latvia to join the European Exchange Rate Mechanism II (ERM II) and after fulfilment of the required criteria to join the Economic and Monetary Union (EMU[3]). *The Economic Stabilisation and Growth Revival Programme of Latvia* contains an undertaking that the Cabinet of Ministers and the responsible public administration institutions will take all the necessary measures in order to fulfil the Maastricht Convergence criterion, which would ensure introduction of the Euro. Introduction of Euro is expected not sooner than in 2014.

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.

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

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

[3] 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.

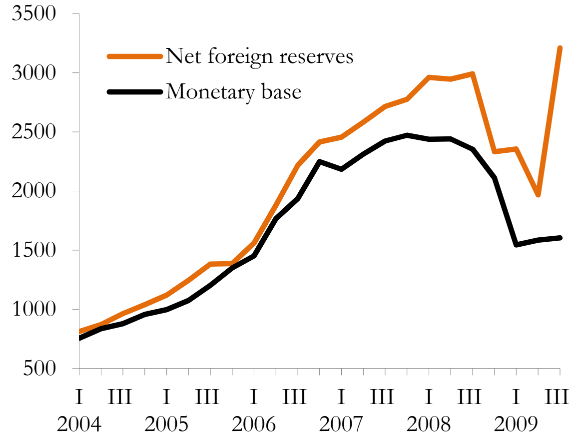
However, Latvia commits unilaterally to keep the exchange rate fluctuations margin within +/–1%, retaining the former width of the corridor of fluctuations of lats, which was habitual to the financial market since 1994, when lats was fixed to the SDR, and was kept when lats was re-pegged to Euro on January 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 money 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 4.30).

Figure 4.30

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



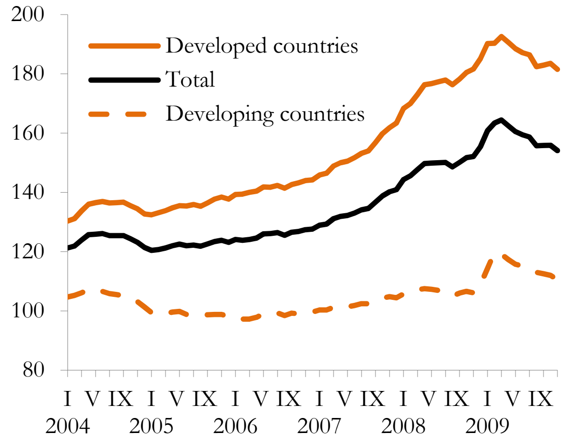

The coverage of money base (currency in circulation and deposits in the Bank of Latvia) with net foreign assets was 200% at the end of September 2009 (at the end of December 2008 – 110.5%).

Foreign currency reserves are invested in safe and liquid financial instruments, mainly in debt securities issued by the governments of the USA, Euro zone countries, United Kingdom, and Japan, as well as by their agencies and international organisations. Foreign reserves of the Bank of Latvia (including gold reserves) amounted to USD 6702 million at the end of September 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 lats[1] against the currencies of 13 countries, which are the main trading partners of Latvia[2]. It shows the relative export competitiveness of Latvia in global markets (see Figure 4.31).

Figure 4.31

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




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

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 mid-2006 – also with regard to currencies of the developing countries. Especially rapid increase of the rate of lats was in the second half of 2008 and at the beginning of 2009. Since April 2009, the exchange rate decreases. The decrease of the real effective exchange rate of the lats is favourable for Latvian exporters.

## 4.4.2. Market Structure and Development

In the 3rd quarter of 2009, 21 banks operated in Latvia and eight branches of foreign banks were registered, 2 of which are planning to start their activities in 2010. 247 branch banks are operating in Latvia, besides in foreign countries 10 branch banks of Latvia are operating. Banking services in Latvia can also be provided by the 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), which already

[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.

starting from July 1, 2001 are responsible for the surveillance of financial sector. In 2009 FCMC tightened control over all banks and invented new requirements for account administration and on regular basis continued to perform stress tests in order to make wider assessment of risks which are inherent to every institution.

In the financial and capital market of Latvia, bank assets form the biggest share in the total assets. In 2009, the total amount of bank assets of Latvia has diminished in comparison with the appropriate period of the previous year. Total amount of the bank assets reached LVL 21.4 billion at the end of November 2009 (LVL 23.4 billion at the end of November 2008). At the end of 3rd quarter of 2009 the greatest part of assets (73%) was performed by the bank lending, most of which are lending to private non-financial corporations (37.2%) and lending to households (29.3%). Lending to house purchase forms the greatest part of all loans to households. Lending politics of the banks and limited financial resources have merely affected real estate market, which activity lately has almost stopped and also in 2010 the significant growth is not expected.

In November 2009, foreign assets of banking sector decreased by shrinking the liabilities to foreign holding banks.

The global financial market turmoil has also affected the Latvian banking system. In order to help the second largest, in terms of assets, bank to avoid problems created by the global financial crisis, in November 2008, the state, with intermediation of the *Mortgage and Land Bank of Latvia (MLBL)*, took over the controlling stock of shares of JSC "Parex banka". At the moment the holder of the 70.3% of the bank capital share is Latvian Privatization Agency and 25% - European Bank for Reconstruction and Development and the rest belong to minority share holders. On October 29, 2009, bank capital was increased by LVL 24.3 million. Increase of the capital was made by the biggest share holder – Latvian Privatization Agency, by obtaining shares without right of voting in appropriate amount. On November 17, 2009, the government has conceptually agreed on restructurization or inception of appropriation of JSC "Parex banka" and until the end of 2009 has delegated to the Latvian Privatization Agency to submit a new reconstruction plan.

In the 3rd quarter of 2009 all indices of banks of Latvia complied with regulatory requirements. At the end of 3rd quarter of 2009, the bank sector liquidity indicator was 54.4% (however at the end of 3rd quarter of 2008 it was 49.1% (minimal normative requirement is 30%).

Regardless of decrease of lending rate and rise of resource prices and decrease of available resources for the reserves, during the January to mid-December 2009, 11 banks of Latvia have increased their capital – in total by LVL 824.6 million. In first eleven month of 2009, 7 banks of Latvia were working with profit and earned LVL 17.7 million however in general banking sector was working with losses mainly created by the insecure loans. First 11 month of 2009 banking sector finished with LVL 719.8 million in losses.

At the end of 3rd quarter of 2009, the average capital adequacy ratio was high 13.6% (the minimum requirement stipulated by law is 8%). In comparison with the end of 2008 it was 11.8% and return on assets (ROA)[1] was 3.5% at the end of 3rd quarter of 2009, while return on equity (ROE)[2] amounted to 42,7% (1,2% and 14,7% at the end of 3rd quarter of 2008 respectively).

In Accordance with FCMC data, at the end of 3rd quarter of 2009, 14 **insurance companies**, four of which provided life insurance and 10 provided non-life insurance, as well as 11 branches of foreign insurance companies operated in Latvia.

The total amount of gross premiums signed in the insurance market reached LVL 174,5 million in the first 3 quarters of 2009, which was by 32,8% less than in the first 3 quarters of 2008, while the volume of paid gross rewards was LVL 117,5 million or by 14,8% less than in the first 3 quarters of 2008. In the first 3 quarters of 2009 the amount of gross premiums signed by the branches of foreign insurance companies increased more than twice in comparison with the appropriate period of 2008 and reached 13.7% in the total insurance market, and gross premiums reached 11,5%. Proportion of the direct life insurances in total amount of signed premiums of insurance companies in the first 3 quarters of 2009 was 7.5%. In the first 3 quarters of 2009 (in comparison with the appropriate period of 2008) the signed gross premium amount per one inhabitant of Latvia decreased by 21.7%.

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

The Stock Exchange NASDAQ OMX Riga is the only licensed regulated stock exchange organiser in Latvia. The activities of NASDAQ OMX Riga are licensed and controlled by the FCMC. Baltic securities market is formed by NASDAQ OMX securities in Tallinn, Riga and Vilnius. The goal of the Baltic securities market is to reduce differences among single Baltic securities markets, thereby facilitating cross-border trade and payments and attracting more investments to the region.

According to Baltic indexes, in the first quarter of 2009, share index decreased, however in the 3rd quarter rapid growth of share price was observed, followed by the slight fall in the end of the year. The most significant fall was observed for OMX Riga index. During the year it's value increased just by 2.8% (in comparison, Tallinn OMXT index value increased by 47.2% and Vilnius OMXV by 46%).

At the end of 2008, market capitalisation of Latvian companies at the Riga Stock Exchange (hereinafter RSE) was LVL 820 million, however in

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[1] ROA – ratio of profit/loss to assets.

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

the end of 2009 the 12.9% increase was observed and the market capitalization of Latvian companies was LVL 925,5 million and on the January 15, 2010, market capitalization was LVL 548,9 millions.

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 September *OMX Riga* index was 377 points.

At the end of 3rd quarter of 2009 incomes from commercial transactions of financial instruments performed 7.9% from all banking incomes, most of which was performed by foreign exchange transactions (7.3%) and transactions with other financial instruments (0.5%), in its turn smallest part of incomes from the transactions of financial instruments was transactions with securities (0.1%) which means that the stock market in Latvia is poorly developed, thus its influence on the economic development of the country is insignificant.

### 4.4.3. Deposits and Loans

At the beginning of 2009, with continued decrease of common commitments of the banks against the monetary financial institutions (e.g., re-payment of syndicated loans and funding attracted from parent banks), as well as with the decline of the amount of deposits attracted by the banks, the total volume of the assets of the banking sector decreased. At the end of 2009, LVL 667.3 million of cash was in circulation which is by 23% less than at the end of 2008.

Table 4.8

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

| | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|
| *(million LVL)* | | | | |
| Net foreign assets | -2634.7 | -4482.8 | -5914.6 | -3022.0 |
| Net domestic assets | 8114.6 | 10654.0 | 11846.1 | 8842.3 |
| Domestic loans | 9877.4 | 13 018.2 | 14 279.7 | 12 204.3 |
| to government (net) | 100.5 | -87.4 | -370.0 | -1474.6 |
| to companies and individuals | 9776.9 | 13 105.6 | 14 649.7 | 13 678.9 |
| Other assets (net) | -1762.8 | -2364.2 | -2433.6 | -3362.0 |
| Broad money M2X | 5479.9 | 6171.3 | 5931.4 | 5820.3 |
| Currency in circulation (less vault cash balance) | 969.3 | 900.0 | 866.1 | 667.3 |
| Deposits of individuals and companies | 4510.6 | 5271.3 | 5065.3 | 5153.0 |
| including: | | | | |
| demand deposits | 2974.5 | 2864.9 | 2308.0 | 2206.2 |
| time deposits | 1536.1 | 2406.4 | 2757.3 | 2946.8 |
| *(changes in comparison with the corresponding period of the previous year, %)* | | | | |
| Domestic loans | 53.3 | 31.8 | 9.7 | -14.5 |
| including: | | | | |
| to companies and individuals | 58.3 | 34.0 | 11.8 | -6.6 |
| Broad money M2X | 37.5 | 12.6 | -3.9 | -1.9 |
| Currancy in circulation (less vault cash balance) | 23.3 | -7.1 | -3.8 | -23.0 |
| Deposits of individuals and companies | 41.0 | 16.9 | -3.9 | 1.7 |
| **GDP (in current prices)** | **23.3** | **32.3** | **9.9** | **-18.2*** |

* estimation by the Ministry of Economics

In 2008, the **deposits** of the residents started to decline, and, at the end of 2008, their amount was by 3.9% below the level of the year before. Decline of deposits of residents – financial institutions, private non-financial corporations, households, as well as state non-financial corporations – continued to decrease in the 1st three quarters of 2009. At the end of September, deposits declined by another 3.8% in comparison with the end of 2008. With the situation stabilising in the financial market, at the end of 2009, the amount of deposits increased again and, at the end of December 2009, deposits of individuals and companies constituted LVL 5153 million which was already by 1.7% more than at the end of 2008.

In 2009, changes in the deposit currency structure continued – over the years, the amount of deposits in lats reduced by 12.1%.

Figure 4.32

**Dynamics of Broad Money (M2X) and its Components, Quarterly Profile**

(end of the period, million LVL)

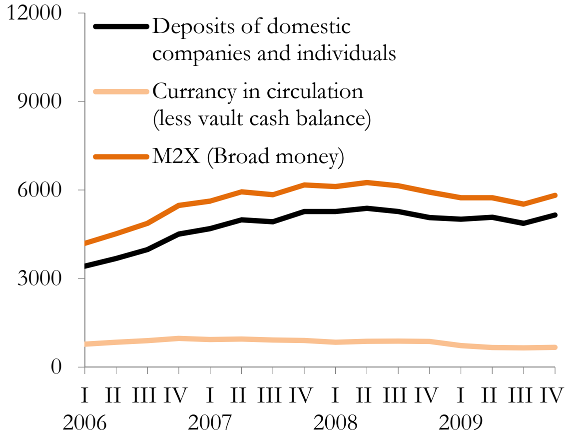
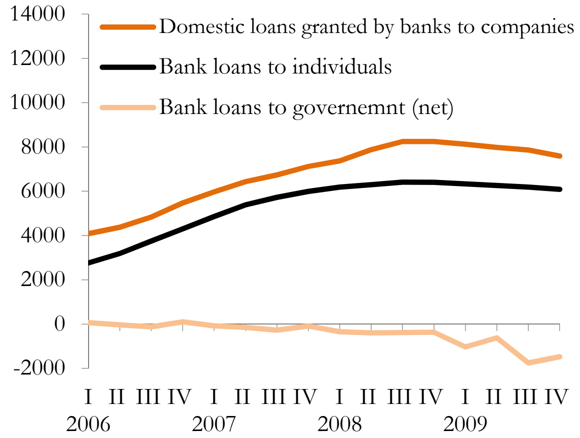



Figure 4.33

**Dynamics of Loans Granted by the Banks to Domestic Companies, Individuals and Government, Quarterly Profile**

(end of the period, million LVL)

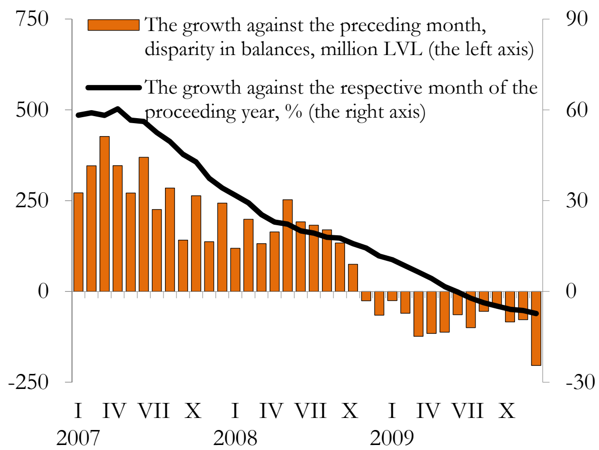



Balance of credits granted to domestic companies, individuals, and the government continues to decline. The surplus of loans granted to companies in December 2009, in comparison with the end of 2008, decreased by 8%, while the loans granted to households – by 4.9%. Since the beginning of 2009, a particularly rapid decrease has been observed with respect to the bank loans to the government, which at the end of 2009, had decreased by LVL 1091.5 million.

At the end of 2008, growth of credit balance declined significantly in comparison with the respective month of the previous year. In January 2008, the increase of loans granted was still 31.8% and in December, 11.7% (in comparison with the respective month of the previous year). Since June 2009, reduced surplus of loans granted has been observed, and was 7.3% in December 2009. Besides, since November 2008, the credit balance margin against the previous month has been decreasing.

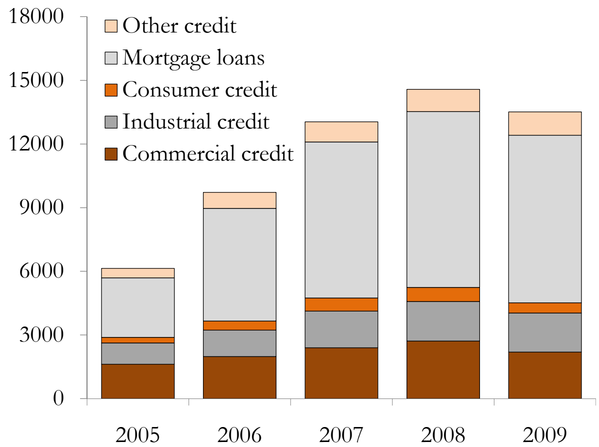
Figure 4.34

**Total Loans Granted to Resident Financial Institutions, Non-financial Corporations and Households**




**Amount and Structure of Loans Granted to Domestic Individuals and Companies**

(end of the period, million LVL)




The structure of loans granted to domestic companies and individuals is dominated by mortgage loans. The proportion of loans essential for the increase of company liquid assets – commercial credits and industrial credits (for the purchase of fixed assets and funding of long-term investment projects) – overall was only 30%.

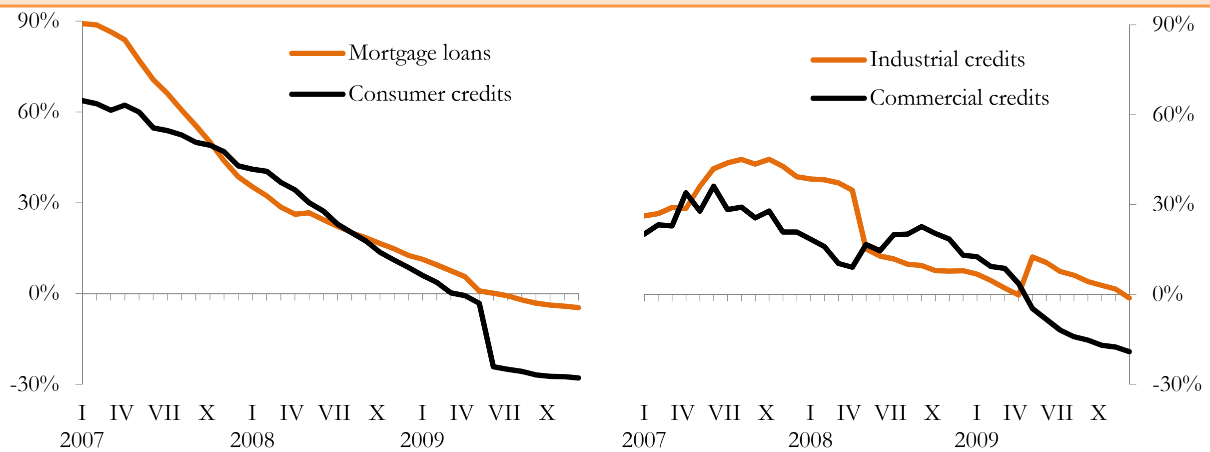
The amount of the granted mortgages grew very rapidly in the preceding years (by 39% in 2007 and by 13% in 2008). In 2009, mortgage crediting practically stopped (at the end of the year, in comparison with the end of 2008, credit balance decreased by 4.7%).

Since mid-2007, a decrease of the growth rate was observed also with respect to credit balance for consumer credits. In May 2007, in comparison with the respective period of the previous year, they still grew by 60%, while in December 2008, only by 8.6%, and since May 2009, credit balance, in comparison with the respective months on the previous year, have been decreasing. At the end of December 2009, the credit balance for consumer credits was LVL 482.2 million, which is by 27.9% less than at the end of 2008. The proportion of consumer credits is only 3.6% from all lending.

Figure 4.35

**Loans Granted to Financial Institutions, Non-financial Companies, and Households**

(increase in comparison with the respective month of the previous year, %)



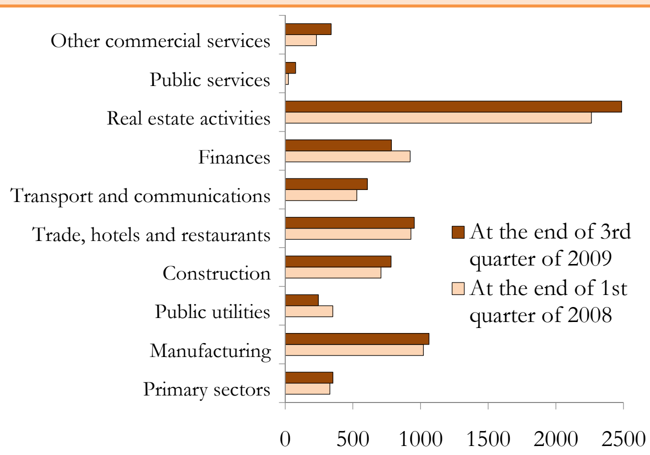

Monthly surpluses of commercial credits have been decreasing since November 2008 and continued declining also in 2009. In December 2009, surpluses of commercial credits granted to residents decreased by 19.1% in comparison with the end of 2008. Surpluses of industrial credits, however, remained almost at the level of 2008 (in December 2009, they were only by 1.2% lower than at the end of 2008). It must be noted that with certain recovery tendencies in the business sector, in particular in relation with the growth of export potential, in certain months at the end of 2009, slight growth of the industrial credits portfolio was observed.

Figure 4.36

**Loans to Residents by Sectors of Economy**

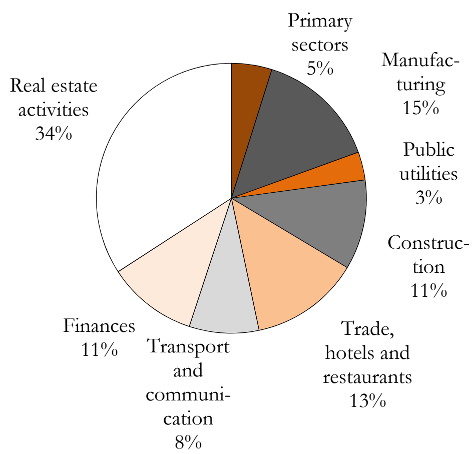
**Loans Granted**

(at the end of the 1st quarter of 2008 and the 3rd quarter of 2009, million LVL)




**Structure of Loans Granted**

(at the end of the 3rd quarter of 2009, %)



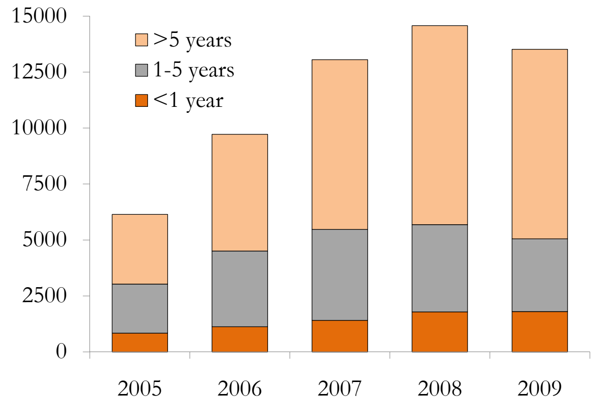

At the end of 2008, companies (financial institutions, and public and private non-financial corporations) had been granted loans in total of LVL 8177.3 million, while at the end of the 3rd quarter of 2009, loans in the amount of LVL 7696.3 million were granted. The largest credit balances were still related to real estate activities – LVL 2486.3 million (32.3% of the total loans granted to the sectors of economy). Loans granted to the manufacturing, trade, financial services, as well as to the construction sectors also constitute a comparatively large proportion. 10.4% of all loans granted to the sectors are loans in lats.

Over the recent years, the proportion of short-term and long-term loans is growing in the total maturity profile. Although in 2009, the decline in long-term credit balance was observed (at the end of 2009, in comparison with the end of 2008, by LVL 424 million less), still in December 2009, their proportion in the total credit portfolio increased to 62.6%. Short-term loan credit balance, however, increased by LVL 17.6 million over 2009, and their proportion in the total bank credit portfolio was 13.4%.

Figure 4.37

**Term structure of Loans Granted to Domestic Companies and Individuals**

(end of the period, million LVL)




At the end of 2008, in the total bank credit portfolio, 15% of the loans were loans with overdue payments. In 2009, with the increase of unemployment and decreased income of residents, the solvency of debtors deteriorated. The share of loans with overdue payment grew in the overall credit portfolio. However, in December 2009, for the first time since autumn of 2008, the share of loans without overdue payments increased, and at the end of the year, reached LVL 11.5 billion or almost three fourths of the total bank credit portfolio. In December, the total amount of loans with overdue payment decreased by 7.5% and at the end of the year, reached LVL 3.9 billion or 25% of the total bank credit portfolio.

In 2009, with the banks focusing on customers, who are experiencing difficulties, the amount of restructured loans increased (at the end of December 2009, it was 16.3% of the total bank credit portfolio). At the end of 2009, the larger part of the restructured loans and loans under recovery process were secured with a real estate. At the end of December 2009, the reserves of the banks for insecure debts reached LVL 1.4 billion or 9.4% of the total bank credit portfolio.

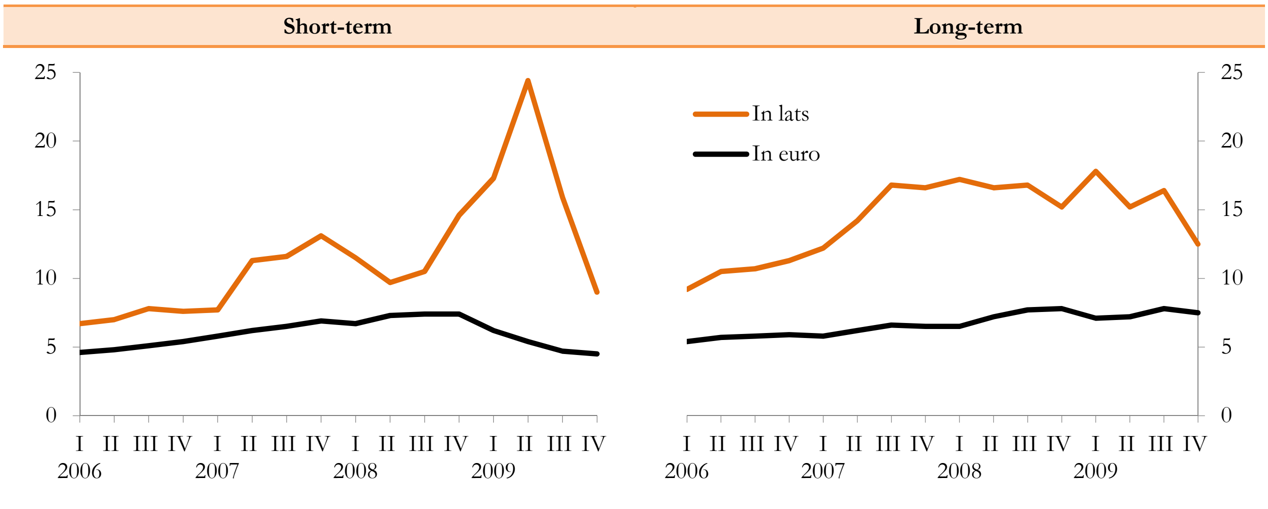
In the 4th quarter of 2008, the weighted average interest rate on short-term loans granted to companies and individuals was 14.6%. Taking into account the instable economic situation, at the beginning of 2009, the interest rate on short-term credits granted in lats grew sharply (in the 2nd quarter – to 24.4%). With the situation stabilising, the weighted average interest rate gradually decreased and was 9% at the end of 2009. Over the year, more moderate fluctuations were observed with respect to the weighted average interest rates on long-term loans, and they decreased from 15.2% at the end of 2008 to 12.5% in the 4th quarter of 2009.

The interest rates on loans granted in euros were, as usual, lower – at the end of 2008, the weighted average interest rate on short-term loans was 7.4% and on long-term loans – 7.8%. Over 2009, the interest rates on short-term loans granted in euros decreased gradually and in the 4th quarter they were 4.5%, while the interest rates on long-term loans granted in euros remained essentially unchanged and were 7.5% in the 4th quarter of 2009.

Figure 4.38

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

(percentage)



During the year, the weighted average interest rates on long-term deposits in lats in the credit institutions grew from 10.1% in the 4th quarter of 2008 to 12.9% in the 4th quarter of 2009. Over the same period, short-term interest rates have decreased respectively from 8.1% to 7%. The highest short-term interest rates were observed in the 2nd quarter of 2009, reaching 11.1%.

During the year, the weighted average interest rates on long-term deposits in euros have decreased from 6.5% at the end of 2008 to 5.6% in the 4th quarter of 2009. The short-term interest rates, however, decreased from 3.8% in the 4th quarter of 2008 to 2.1% at the end of 2009.

# 5. Labour Market

## 5.1. Employment and Unemployment

The sharp slowdown of the economy has had a negative effect on the labour market. At the end of 2008 and particularly in the 1st half of 2009, the number of employed persons declined rapidly and the unemployment level rose. During the 3rd quarter of 2009, the employment and unemployment rates continued to deteriorate, yet, at a slower pace.

Over the year, the number of employed persons reduced by 15.8% (the 3rd quarter of 2009 in comparison with the 3rd quarter of the previous year, residents of 15–74 years of age) or by 178 thousand people. Accordingly, the employment rate fell, and, in the 3rd quarter of 2009, was only 59.8%, while it was 69% in the respective quarter of the previous year (residents of 15–64 years of age).

According to SEA data, at the end of 2009, 178.2 thousand unemployed persons were registered which is 15.9% from the economically active population of the country.

In November 2009, Latvia had the highest unemployment rate in the EU (22.3% harmonised unemployment rate).

It must be noted that a high level of the economic activity rate of the residents was still maintained, and it started to decline only in the 2nd quarter of 2009. In the 3rd quarter, it was only by 1.1% lower than the year before.

Although not as rapidly as in 2009, it is expected that also in 2010 the unemployment indicators will continue to deteriorate and the unemployment rate will continue to rise since the economic recession is still progressing.

Table 5.1

**Key Indicators of Employment and Unemployment**

| | 2005 | 2006 | 2007 | 2008 | 2009 Q1-Q3 |
|---|---|---|---|---|---|
| Number of employed persons (15–74 years of age, thsd.) | 1035.9 | 1087.6 | 1119.0 | 1124.1 | 1000.0 |
| Economic activity rate (15–64 years of age, %) | 69.5 | 71.3 | 72.9 | 74.5 | 74.2 |
| Employment rate (15–64 years of age, %) | 63.4 | 66.3 | 68.4 | 68.6 | 61.8 |
| Unemployment rate (proportion of job-seekers of 15–74 years of age, %) | 8.7 | 6.8 | 6.0 | 7.5 | 16.3 |
| Registered unemployed persons (end of period, thsd.) | 78.5 | 68.9 | 52.3 | 76.4 | 147.8 |

Employment of men has had a more rapid decline. In the 3rd quarter of 2008, the employment rate of men exceeded the employment level of women by 7.5 percentage points, however, in the 3rd quarter of 2009, both levels had almost evened out (employment rate of men was 61%, while employment rate of women was 59%). Unemployment rate of men in the 3rd quarter of 2009, on the other hand, exceeded unemployment rate of women by 5.7 percentage points.

Figure 5.1

**Employment and Unemployment in Latvia**

(percentage)

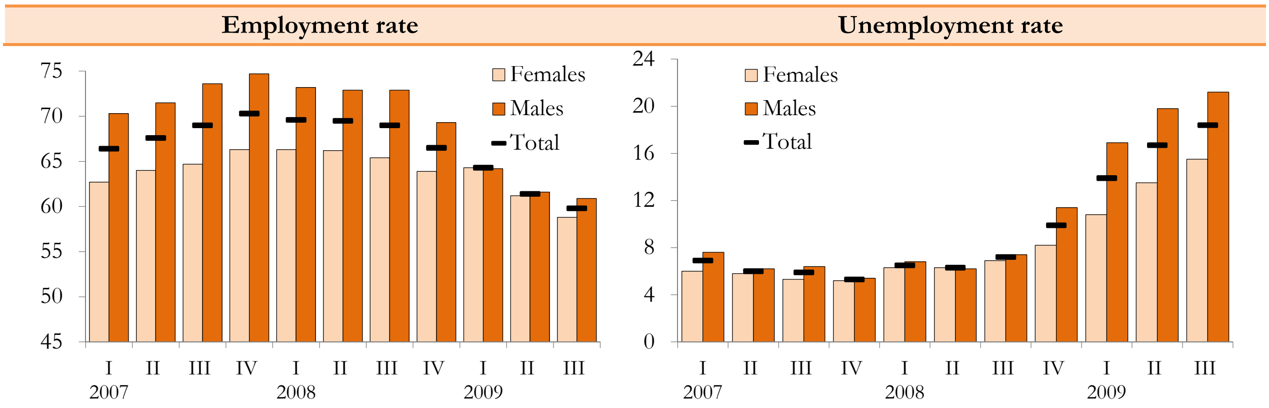
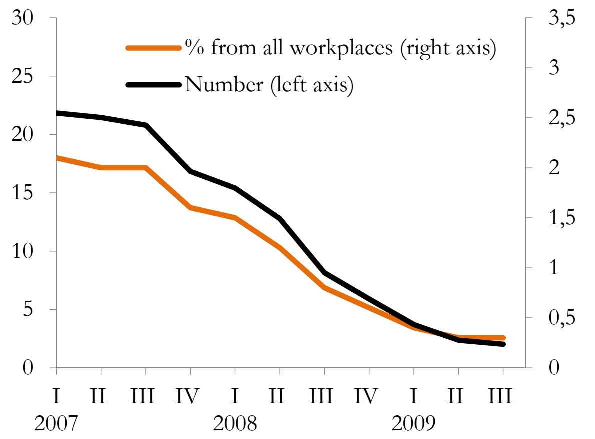


Figure 5.2

**Vacancies**




The decrease of the number of job vacancies also evidences the decline of demand for labour force (see Figure 5.2). At the end of the 3rd quarter of 2009, there were only 2 thousand job vacancies in the country. In comparison with the 1st quarter of 2009, the number has decreased by 1.7 thousand vacancies.

The number of job vacancies started to decrease since the second half of 2007. It means that already since mid-2007, the majority of Latvian enterprises have not foreseen the increase of production volumes.

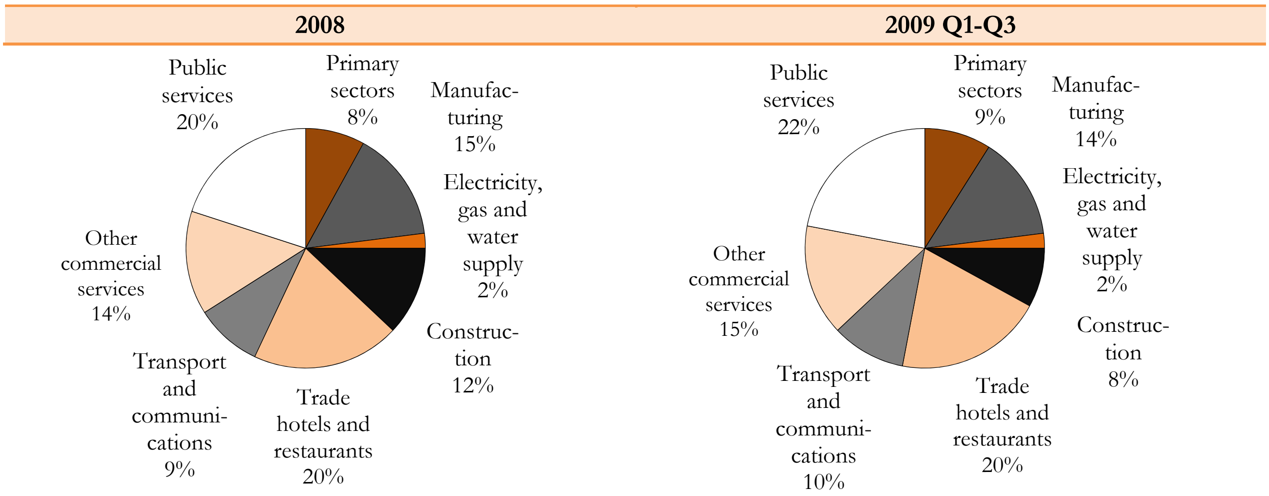
In 2009, the most significant decrease of the number of employed persons has been experienced in the construction sector where this number has decreased by almost a half or by 63.1 thousand (in the 3rd quarter of 2009 in comparison with the 3rd quarter of 2008). The number of persons employed in the manufacturing has decreased by one fourth (43.1 thousand persons). In the public services, this number has decreased by 27.9 thousand (by 12%).

Over this period, the number of employed persons has not decreased in the sectors of commercial services.

Figure 5.3

**Structure of Employed Persons (15–74 years of age) by Sectors of Economy**

(percentage)




Source: *Eurostat*

## 5.2. Labour Market Forecasts

In compliance with the economic development scenario for the period until 2015 (see Section 3.3), labour market forecasts have been developed.

It is forecasted that in the labour market positive tendencies (employment growth) may be expected slightly later than the economic development, besides the increase of the number of employed persons will be much slower than growth, since the output growth will be based more on the growth of work intensity (productivity growth) and in a lesser extent will affect the increase of the number of employed persons. Thus, the social problems related with the high level of unemployment will prevail over the next 3-4 years.

The economic development forecasts anticipate that the decline in demand for labour force will be observed also in the 1st half of 2010, but the situation will stabilise afterwards.

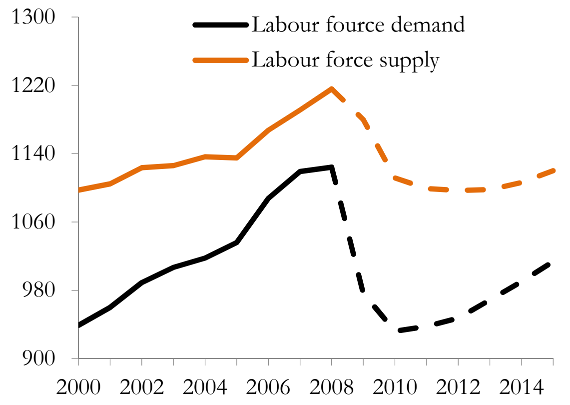
It is expected that the demand for labour force will start increasing again in 2011 however, as mentioned above, the increase will not be significant. Therefore, in 2015, the number of employed persons will be approximately by 10% less than in 2008.

The most considerable decline in the number of employed persons by sectors is expected in the construction sector. It is anticipated that in 2015 the number of employed persons in the construction will by almost one third less than in 2008. A significant decline in the number of employed persons will also be experienced in the manufacturing, primary sectors, and public services.

Figure 5.4

**Forecasts of Labour Force Demand and Supply***

(persons, thousands)




* until 2008, actual annual data has been showed.

The transport and communications could be the first to recover from the consequences of the economic recession, and in 2015 in comparison with 2008, the number of the employed persons in this sector could increase.

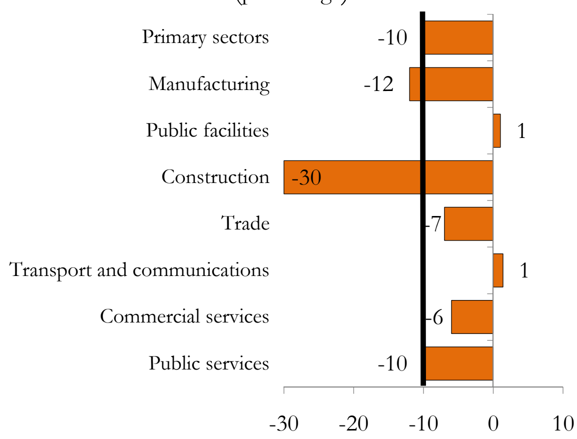
Due to the decline of labour force demand, over the following years the supply of labour force can also decrease. This, on the one hand, will be determined by the negative demographic tendencies and by the fact that long-term emigration of residents will increase, and on the other hand, by decreased economic activity which is related to a more rapid retiring of residents and a slower entrance of young people in the labour market. The economic activity rate of population will also be decreased because of prevailing pessimism to find a job.

An additional risk is posed by a faster recovery of global economics than economics of Latvia, which may cause the growth of economic emigration, thus, in the medium-term and long-term having a negative effect on labour force supply and hindering the recovery or Latvian economy. It must be noted that among the economic emigrants the proportion of qualified employees could increase in comparison with the emigration of previous years when mainly residents with low qualifications were emigrating. As from 2014, the first labour force insufficiency signs might appear in certain profession groups, which might have a negative effect on activities of certain sectors.

Figure 5.5

**Changes in Demand for Labour Force in 2015, in Comparison with 2008, by Sectors**

(percentage)




Despite the fact that along with the economic recession, the number of economically active population is falling, it is expected that until 2015 the labour force supply will significantly exceed the demand. Thus, the average unemployment rate over the period 2010–2015 will remain rather high, i.e. 10–13%. The highest unemployment rate was observed in 2009. Unemployment rate will continue to increase also at the beginning of 2010, however, as of mid-2010 unemployment rate can slightly drop, and in 2010 this level might be slightly lower than in 2009. Unemployment will continue to decrease also over the following years, and, in 2015, unemployed rate might be about 10% to economically active population.

Although unemployment rate might start declining already from 2010, the social tension in the country will remain high. The decline of unemployment rate will be mainly determined by the decrease of the number of economically active population, not by an increased employment rate. The employment rate will continue to fall also in 2010, and, as noted above, it might start growing only in 2011.

## 5.3. 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 implemented in the framework of the EU employment strategy. The directions of activities of the Member States and measures for the implementation of the EU employment strategy are reflected in the national *Lisbon programmes* (see Section 6.1).

The new *Lisbon Strategy* cycle was launched in spring 2008 when the European Council approved the *Integrated Guidelines for Growth and Jobs for 2008–2010*. In the framework of the employment policy coordination mechanism, assessment of the employment policies is carried out and the European Council forwards recommendations to the Member States.

In the framework of the coordination process of the employment policies, the spring 2009 European Council recommends to Latvia to maximize the labour force supply and productivity by implementing integrated *flexicurity* approach, via implementing activation measures and promoting the compliance of educational and training systems with the requirements of the labour market, including the implementation of a coordinated life-long learning strategy. Thus, the role of training and retraining is emphasised for the development of the labour market.

The main employment stimulation tasks for 2008–2010 of the *National Lisbon Programme of Latvia* are the following:

– 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 force and economic activities in the least developed regions;
– reduction of undeclared employment.

The economic recession in 2008 has left a rather insignificant effect on the labour market indicators – in the last quarter, unemployment level was 9.9%. More significant changes in the labour market were observed in 2009.

The number of unemployed persons registered in the State Employment Agency (SEA) at the end of 2009, was 178.2 thousand, which constitutes 15.9% of the economically active population. Among the unemployed persons of 25 years of age, a large proportion is comprised by persons with secondary education, while among persons of 26–30 years of age – with higher education, and among pre-pension group – with professional education. This indicates that there is a need to expand essentially the active labour market policy measures and modify them accordingly to the labour market tendencies.

Taking into account the socioeconomic situation and the possibility that the economic crisis might deepen, the implementation of three new, EU fund co-financed measures has been launched:

– extraordinary employment programme (traineeship with scholarship) – a labour market programme developed in accordance with the World Bank recommendations and actions in similar situations in other countries of the world. Since September 2009, the crisis employment measure has been launched for unemployed persons who are no longer receiving unemployment benefit. These persons receive LVL 100 scholarship for community work. The unemployed person is provided with supervisor, equipment, as well as compensated transport costs. The measure is being implemented in two stages: in 2009 (funding of LVL 8 million) it is envisaged to involve 17 500 persons; in 2010 (funding of LVL 15.9 million) it is envisaged to involve 32 500 persons. Until December 1, 16 328 unemployed persons were involved in measure *Traineeship with Scholarship*;
– support to the potentially unemployed persons – training opportunities for employees in enterprises which are experiencing temporary idle time due to the economic crisis, providing these persons also with scholarships. In 2009, as from September, it is envisaged to involve 2000 persons in the measure, while in general, at least 11 000 persons are planned to be involved in the measure. By 1 December 2009, 1958 persons had participated in this measure;
– professional educational programmes for unemployed persons have been adapted. The measure is directed towards unemployed persons with higher education who wish to acquire professional qualification by using the "training coupon" method. The unemployed person is free to choose the training programme and the educational institution.

SEA is the implementing authority of the state policy in the field of unemployment reduction and support to job seekers. SEA influences the labour market with **the active employment measures**. Their upgrading is carried out in close cooperation with municipal governments and social partners, so that these measures would better respond to the needs of the labour market.

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

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

Additionally, other measures are implemented such as measures for starting commercial activity or self-employment, work trials at a work place, training at the employer, as well as complex support measures.

During the years of economic growth, the need for active employment measures had decreased, while in 2009 due to the significant rise of unemployment, it considerably increased. In the active employment measures in total in 2007, 64.6 thousand unemployed persons were involved, in 2008 – 84.8 thousand unemployed persons, while in the first three quarters of 2009, the number of unemployed persons involved in the measures reached 160.8 thousand (one unemployed person may be involved in several activities).

Majority of these people were involved in measures to improve competitiveness. In the first three quarters of 2009, 133 400 unemployed persons participated in these measures. The rest of the measures were implemented to the following extent: 5 800 unemployed persons have been involved in professional training, re-training, and improving qualifications; 398 unemployed persons have started training with an employee; 10 700 persons have been involved in temporary paid employment; 567 unemployed persons – in the measures for certain groups of persons; 62 unemployed persons – in measures for starting commercial activity or self-employment; 7 000 unemployed persons – in the measure *Traineeship with Scholarship*; and 3 000 unemployed persons have participated in the complex support measures.

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

Over this period, the career consultation services have been provided to 43 900 persons, 35 400 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 is unemployed disabled persons and 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 being motivated to start commercial activity or self-employment. Unemployed persons participating in the measure prepare business plans, and if these plans are accepted, the necessary aid in a form of subsidy is granted for the first year of activity, as well as the assessment of business plan implementation during the first 2 years is provided. During 2008, 93 unemployed persons in Latgale and Riga region were involved in this measure, as a result from total number of developed business plans, 20 were accepted and their implementation have been launched. In the first three quarters of 2009, 62 unemployed persons were involved in this measure.

**For promotion of youth employment**, the project *Employment Measure during Summer Holidays for Persons Acquiring Education in General Special Education Institutions or Professional Education Institutions* has been implemented for several years. The aim of this measure is to promote summer employment of pupils and to create an opportunity for them to acquire work experience. In the project, the SEA financed wages for the pupils from the state budget resources in the amount of 50% of the minimum monthly wage determined in the country and covered the expenses of the manager of the work practice. The expenses of employers included pupils' wages in the amount of at least 50% of the minimum monthly wage, tax payments, bonuses, lunches, etc. 11 200 pupils were involved in this measure in 2008, including 173 pupils with special needs. Unfortunately, in summer 2009, due to the budget situation, SEA did not implement this measure.

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

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

After 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 new mothers.

In the labour market, there are still significant **regional differences**.

The measure *Promoting regional mobility of persons employed by enterprises* has been developed to promote the regional mobility of the employed, which have chosen a work place at a larger distance from their homes. Therefore, the unemployment risk related to movement of the employed persons between home and workplace would be reduced. The measure was launched in the 2nd half of 2008 however with the decline of vacancies the measure was not widely used.

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

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

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

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

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

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

For implementation of the guidelines, in November 2008, *Programme for Labour Security Development 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 doe snot affect health in a negative way. By 2010, reduction of the number of fatalities at work by 10% must be attained. It must be noted that in 2008, the number of fatalities at work per 100 thousand employed persons decreased by 23%, and this positive tendency continued in 2009.

Latvia has a relatively high **rate of undeclared employment** in certain sectors and that has a negative influence on employees and creates conditions of unfair competition. To solve this problem more intensively and to encourage the population to act in the formal economy, consolidation 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 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. In order to decrease undeclared employment, Draft Action Plan for 2010–2013 has been developed and it is envisaged to submit this plan to the Cabinet of Ministers by the beginning of 2010. The measures are planned in the following key directions: application of the undeclared employment control mechanism; decreasing unfair competition; revision of the penalties policy with respect to undeclared employment; raising the social awareness and education on consequences of undeclared employment.

An important component from the aspect of the employment policy is the development of the **education system** by putting a special emphasis on **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 at all levels, to increase participation and responsibility of regional governments and employers in providing availability of professional 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 group 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 relevant task is to reduce the number of drop-out students from education institutions, who do not continue their studies later.

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 group 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 in the EU. In comparison with the previous year, this indicator decreased by 0.3 percentage points.

In order to ensure implementation of the *Lifelong Learning Policy Guidelines for 2007–2013*, on 9 April 2008, the Cabinet of Ministers approved the *Programme for Implementation of the Lifelong Learning Policy Guidelines for 2007–2013 in 2008–2010*. The main target of the implementation of the programme is to ensure that the number of persons involved in the process of lifelong learning in 2010 amounts to 12.5% of the lifelong learning target group. The tasks and envisaged funding for 2009 as defined in these documents have been revised in accordance with the economic situation and the updated breakdown of Structural Funds measures.

# 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 national growth and employment. The Programme is a policy-planning document that shows how Latvia is going to achieve the *Lisbon Strategy* goals in 2005–2008 on the basis of the *Integrated Guidelines* adopted by the European Council in July 2005 (see Box 6.1).

**Box 6.1**

***Lisbon Strategy* and its legal framework**

The *Lisbon Strategy* was approved during the spring European Council meeting on March 23–24, 2000 in Lisbon, where the heads 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 implementation framework of the *Lisbon Strategy*, before the Treaty of Lisbon came into force on December 1, 2009, was defined in the Articles 98, 99 and 128 of the *Treaty Establishing the European Community*. After the *Lisbon Treaty* came into force, this framework has not undergone significant changes. According to the implementation framework of the *Lisbon Strategy*, the EU Member States shall conduct their economic policies with a view to contributing to the achievement of the objectives of the European Community (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 shall define their policies in the context of the broad guidelines of the Council which correspond to the recommendation of the European Commission. 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. On the basis of the reports submitted by the Commission, the Council monitors the economic development in the EU Member States and in the whole European Community, as well as the consistency of the economic policies of the EU Member States with the broad guidelines. For the purpose 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 important to note also that in accordance with the Commission's recommendation, the Council is entitled to address recommendations to the EU Member States with respect to their economic policy.

The essence of the described legal framework is in the *Lisbon Strategy* implementation instrument 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 transnational governance mechanism and it concerns the national policies of the EU Member States (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 on future actions.
3. Development of quantitative indicators to allow the assessment of whether the defined goals and targets have been achieved.
4. EU Member States develop specific measures and implement reforms.
5. Each EU Member State submits annual national progress reports to the Commission on the implementation of the national Lisbon programme; the European Commission prepares annual report where the progress in the whole EU and in each EU Member State is assessed, including the recommendations for the EU Member States.

**Re-launch of the *Lisbon Strategy* in 2005**

During the spring European Council of March 22–23, 2005 in Brussels, the *Lisbon Strategy* had been re-launched, because as it had been recognized in the assessment of the implementation of the *Lisbon Strategy* by the High Level Group under the leadership of Wim Kok in November 2004, the Member States were lacking the political will to implement 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 broad and the report emphasised that in the future it is necessary to concentrate on growth and jobs. It was decided that each Member State must develop national reform programme for 2005–2008 and submit it to the 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. Additionally, it was decided that the EU Member States have to prepare and submit to the Commission annual progress reports on the implementation of the national *Lisbon programmes*.

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

The Programme sets forth five main economic policy directions to reach the Lisbon goals in Latvia, namely:

- securing macroeconomic stability;
- stimulating knowledge and innovation;
- developing 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 funding is set. The Programme takes into account the EU approach regarding the necessity to separate economic growth from the use of resources so that the economic and social progress is not achieved at the expense of excessive use of natural resources and deteriorated environmental quality.

*Reports on Progress in Implementation of the National Lisbon Programme of Latvia for 2005–2008* were drafted in 2006 and 2007, as well as approved by the Cabinet of Ministers respectively on October 10, 2006 and October 9, 2007. The abovementioned progress reports contained assessment of the progress for 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 cycle of the *Lisbon Strategy* for 2008–2010.

According to a call expressed by a meeting of the European Council in March 2008, Latvia prepared the *Report on Progress in 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 comprised an assessment of the measures carried out in the previous cycle of the *Lisbon Strategy* (for 2005–2008), as well as set new tasks and measures for 2008–2010 on the basis of the updated *Integrated Guidelines* and country-specific recommendations adopted by the Council.

In accordance with the implementation process of the *Lisbon Strategy*, on October 13, 2009, the Cabinet of Ministers approved the regular *Report on Progress in Implementation of the National Lisbon Programme of Latvia*. This report assessed the measures implemented in the previous year (mainly focusing on progress since the 2nd half of 2008), as well as set new tasks and measures for 2009–2010. The Report also contained a reflection of the measures for implementation of the four priority areas approved by the Spring European Council in 2006. The Report is based on the policy planning documents adopted in the Republic of Latvia.

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

In order to ensure **co-ordination and supervision of implementation of the *Lisbon Strategy* in Latvia**, the government has developed a monitoring mechanism 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* coordinator. The Board comprises ministers and representatives of the Saeima, local governments and social partners, who are involved in the *Lisbon Strategy* process. The tasks of the Board are to co-ordinate the development of the *National Lisbon Programme of Latvia* and to involve public institutions, the Saeima, local governments and social partners in the development of the Programme, as well as to supervise fulfilment of the Programme and to 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 to include a representative from 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 at 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.

Meetings of the *Supervisory Board of the Lisbon Strategy* and *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 Enterprises and Crafts of Latvia, the Free Trade Union Confederation of Latvia, 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 above, the Commission carries out annual assessment on the implementation of the national *Lisbon programme* in each EU Member State and issues 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 priorities of the national economic policy and formulating the necessary reforms.

It should be noted that the assessment by the European Commission of implementation of the national *Lisbon programme*, as well as recommendations to Latvia (see Box 6.2) were reviewed 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 the implementation of the European Commission's recommendations were discussed during these meetings. The Commission's recommendations for Latvia have been included in the *Letter of Intent* concluded with the IMF and in the *Memorandum of Understanding* concluded with the Commission. In accordance with the decision of January 9, 2009 taken by the *Supervisory Board of the Lisbon Strategy*, the *Advisory Working Group of the Lisbon Strategy* has developed proposals for the implementation of Commission's recommendations, which were included in the Action *Plan on 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 the task to strengthen 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 compliance of the educational and training system to the labour market requirements by implementing the life-long learning policy;
– to strengthen *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 published 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 tradable sectors. Structural reforms are urgently needed to foster 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.

### Future of the *Lisbon Strategy* after 2010

Taking into account the fact that the *Lisbon Strategy's* implementation cycle is for a medium-term (3 year cycle and 5 year implementation assessment) with a long-term vision (10 years), the current *Lisbon Strategy's* implementation cycle will end in 2010. According to the conclusions of the spring European Council of March 13–14, 2008, the European Commission, the Council and the national *Lisbon Strategy* coordinators of the EU Member States (in Latvia, 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).

On November 24, 2009, the European Commission published a consultation document, where it outlined its vision of the new *Lisbon Strategy* after 2010. The consultation document is available on the website of the European Commission (*http://ec.europa.eu/eu2020*). In accordance with the consultation document of the European Commission, after 2010, the *Lisbon Strategy* will be called the *EU 2020 strategy*. The idea of the *EU 2020 strategy* is to develop a new sustainable social market economy, a smarter, greener economy, where prosperity will come from innovation and from using resources better, and where the key input will be knowledge.

In order to update the national opinion of Latvia with regard to the *Lisbon Strategy* after 2010 (*EU 2020 strategy*) and priorities essential for Latvia, on January 14, 2010, the Ministry of Economics organised a conference inviting representatives from the ministries, Saeima, local governments and social partners involved in the *Lisbon Strategy* process.

After completion of the public consultation (January 15, 2010), the European Commission plans to present an official document on the *EU 2020 strategy*, which is planned to be discussed during the meeting of the Spring European Council in March 2010. On the basis of the officially approved *EU 2020 strategy*, the EU Member States, including Latvia, will have to develop national reform programmes that define national economic priorities and targets, as well as structural policy measures.

**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, December 5, 2008 in Paris and April 22, 2009 in Prague. During the discussions, the Commission and the national Lisbon Strategy coordinators of the EU Member States spoke about the possible future challenges which 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 society on the implementation of the new strategy.

In general, the EU Member States expressed support for the continued implementation of the *Lisbon Strategy* also after 2010. The Member States are of the opinion that the governance mechanism of the *Lisbon Strategy* should be improved, since it should become more efficient, that the specific conditions 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, whose support 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.

## 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 the financial support from the instruments of the EU Structural Funds (hereinafter – SF) and the Cohesion Fund (hereinafter – CF), which are instruments for implementation of the EU regional cohesion policy.

**Programming period 2004–2006**

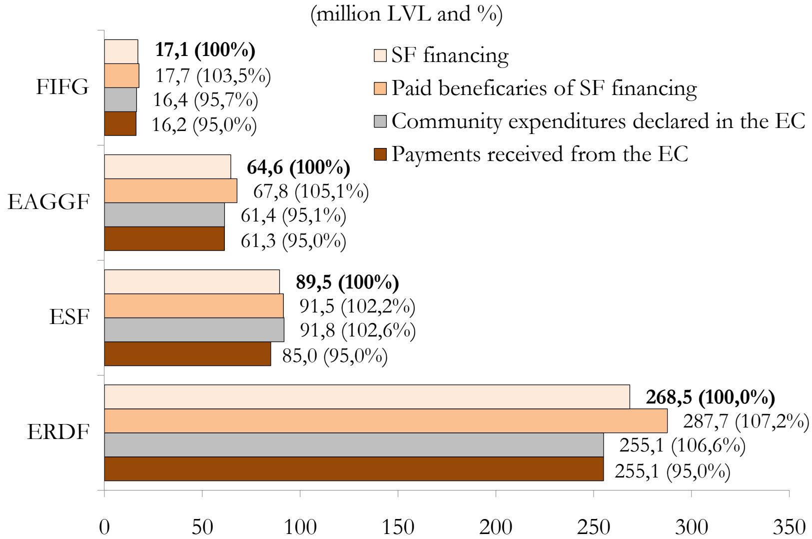
In the period of 2004–2006, the total available financing for Latvia in the framework of the SF programmes was EUR 625 million or LVL 439.6 million.

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

Figure 6.1

**EU Structural Funds absorption in the programming period 2004–2006 (full financial flow) by 30 June 2009***

(million LVL and %)




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

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

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

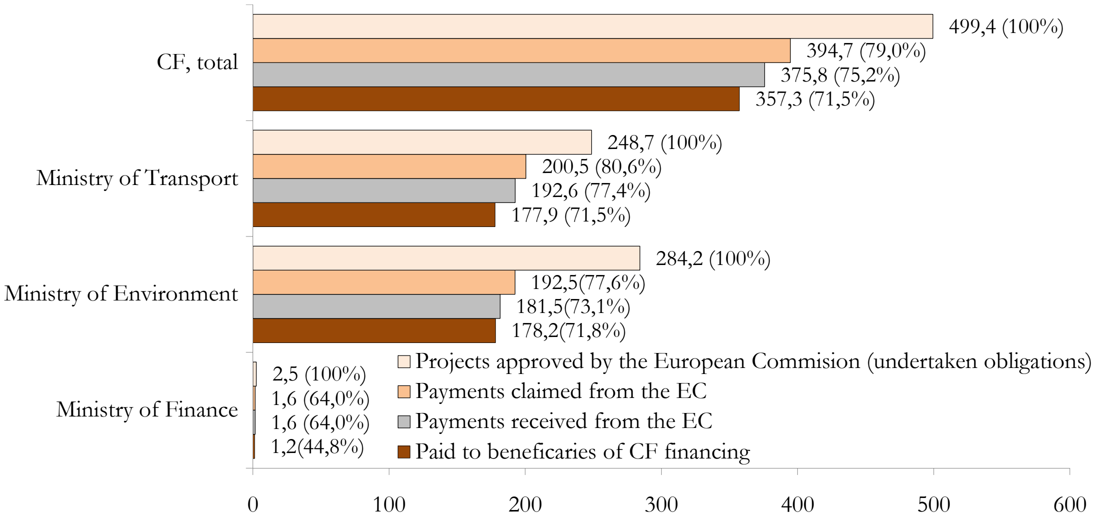
Figure 6.1 shows the progress of EU SF absorption until 30 June 2009.

The CF absorption until 30 September 2009 is showed in Figure 6.2.

Figure 6.2

**EU Cohesion Fund absorption in the programming period 2004–2006 (full financial flow) by 30 September 2009***

(million lats and %)




**Programming period 2007–2013**

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

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

The *National Strategic Framework Document* for the programming period of 2007–2013 (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 the *Operational programmes* (hereinafter – OP) and other financial instruments.

NSFD, on which distribution of the SF and CF financing in the amount of EUR 4.53 billion available to Latvia within the period of 2007–2013 is based, was approved by the Cabinet of Ministers on 19 June 2007. On 20 September 2007, it was also approved by the EC so that absorption of the programme and 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 implementation of the cohesion policy goals with the mediation of EU funds (European Regional Development Fund (hereinafter – ERDF), European Social Fund (hereinafter – ESF)) and CF.

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

- 1. OP *Human Resources and Employment* (ESF) – EUR 551 million or LVL 387 million;
- 2. OP *Entrepreneurship and Innovations* (ERDF) – EUR 737 million or LVL 518 million;
- 3. OP *Infrastructure and Services* (ERDF+CF) – EUR 3.2 billion or LVL 2.25 billion.

The EU fund financial progress until 30 September 2009 is outlined in Table 6.1.

Table 6.1

**EU fund absorption in the programming period 2007–2013 by 30 September 2009**

| Fund | Funding of EU funds | Contracts concluded | | Paid to the funding beneficiaries | | EC's payments received (incl. advances) | |
|---|---|---|---|---|---|---|---|
| | million LVL | million LVL | % | million LVL | % | million LVL | % |
| **ESF** | 387.0 | 184.5 | 47.7 | 10.5 | 2.7 | 40.2 | 10.4 |
| **ERDF** | 1714.9 | 578.2 | 33.7 | 151.4 | 8.8 | 257.5 | 15.0 |
| **CF** | 1082.2 | 413.1 | 38.2 | 32.4 | 3.0 | 113.6 | 10.5 |
| **Total** | **3184.0** | **1175.8** | **36.9** | **194.3** | **6.1** | **411.3** | **12.9** |

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

**Box 6.4**

**Activities under the responsibility of the Ministry of Economics**

A total of LVL 605 million is available for the activities of the Ministry of Economics in the programming period 2007–2013 distributed as follows:

1. OP *Human Resources and Employment* – LVL 56.2 million;
2. OP *Entrepreneurship and Innovations* – LVL 391.5 million;
3. OP *Infrastructures and Services* – LVL 157.3 million.

**Contracts concluded within the activities under the responsibility of the Ministry of Economics by 2 November 2009**

- Within activity *Support to Training of the Employed for Promotion of Competitiveness of Entrepreneurs – Support to Training Organised in Partnerships*, 13 contracts have been concluded with the total contracted amount of LVL 1.9 million.
- Within activity *Support to Individually Organised Training for Enterprises*, 99 contracts have been concluded with the total contracted amount of LVL 3.1 million.
- Within activity *Attraction of Highly Qualified Employees*, 4 contracts have been concluded with the total contracted amount of LVL 157.8 thousand.
- Within activity *Technology Transfer Contact Points*, 8 contracts have been concluded with the total contracted amount of LVL 1.9 million.
- Within activity *Development of New Products and Technologies*, 104 contracts have been concluded with the total contracted amount of LVL 7.1 million.
- Within activity *Introduction of New Products and Technologies into Production*, 55 contracts have been concluded with the total contracted amount of LVL 11.6 million.
- Within activity *Development of New Products and Technologies – Support to Strengthening of Industrial Property*, 8 contracts have been concluded with the total contracted amount of LVL 116.5 thousand.
- Within activity *Access to International Trade Markets – External Marketing*, 161 contracts have been concluded with the total contracted amount of LVL 2.3 million.
- Within activity *Measures to Encourage Innovations and Business Start-ups*, 1 contract has been concluded with the total contracted amount of LVL 2 million.
- Within activity *Co-financing to the Investments in Micro, Small and Medium-sized Enterprises Operating in the Specially Assisted Area*, 132 contracts have been concluded with the total contracted amount of LVL 7.9 million.
- Within activity *Maintenance and Renewal of Town Planning Monuments of National Importance and Infrastructure Adjustment to Develop a Tourism Product*, 8 contracts have been concluded with the total contracted amount of LVL 5 million.
- Within sub-activity *Development of Cycling Tourism Product of National Importance*, 7 contracts have been concluded with the total contracted amount of LVL 4.7 million.
- Within activity *Improvement of Heat Insulation of Residential Buildings*, 16 have been concluded with the total contracted amount of LVL 686.4 thousand.
- Within activity *Improvement of Heat Insulation of Social Residential Buildings*, 24 contracts have been concluded with the total contracted amount of LVL 2.7 million.

**Box 6.4 continued**

In the framework of the described activities, the enterprises will be allocated an investment in the equity capital (in cases of venture capital programmes), a loan (in cases of loan programmes), and a guarantee (in cases of guarantee programmes), 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 afore-mentioned instruments will operate as long-term support instruments.

**Activity *Support to Starting Self-Employment and Entrepreneurship***

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

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

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

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

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

By 22 January 2009, 514 agreements had been signed on the preparation of business plans, 122 business plans had been submitted, and 37 contracts concluded on granting loans for the total amount of LVL 691 thousand.

**Holding Fund**

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

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

1. venture capital – the selection process has been concluded and the venture capital fund manager *BaltCap Management Latvia* has been selected and approved by the Council of the European Investment Fund. On January 22 of this year, EIF and *BaltCap Management Latvia* concluded a contract for the foundation of the venture capital fund. It is envisaged that the fund established by *BaltCap Management Latvia* will launch investments to SMEs at the beginning of 2010, investing EUR 10 million in addition to the European Investment Fund investment of EUR 20 million. At the moment, attraction of private capital is in progress;
2. seed and start-up capital – he selection process has been concluded and the winner – *Imprimatur Capital Baltics* – was approved by the Council of the European Investment Fund. Now, the private capital has been raised and the launch of investments to SMEs could be in progress at the beginning of 2010. In total, the funding available for seed and start-up capital investments is planned in the amount of EUR 20.4 million;
3. high –risk loans – the bank selection process has been concluded, and the JSC "Swedbank" and JSC "SEB Banka" have been approved by the EIF as a winners of the tender. At the moment the agreement on provisions of the contract are in the process, in total, the funding available for SMEs is LVL 73 million.

Due to the economic situation at 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 LLC "Latvian Guarantee Agency") and *Loans the Improvement of Enterprise Competitiveness* (implemented by SJSC "Mortgage and Land Bank of Latvia"), as well as to decrease the funding of the activity *Holding Fund for the Investment in Guarantee, High-Risk Loans, and Venture Capital Funds and Other Financial Instruments* by EUR 91.5 million (50%).

In the framework of activity *Guarantees for the Improvement of Enterprise Competitiveness*, the enterprises started receiving guarantees starting with 20 April 2009.

In the framework of activity *Loans for the Improvement of Enterprise Competitiveness*, the enterprises started receiving loans starting with 30 April 2009.

**Activity *Guarantees for Improvement of Enterprise Competitiveness***

Since 20 April 2009, when a contract with LLC "Latvian Guarantee Agency" (hereinafter – LGA) was concluded, until 31 December 2009, 292 guarantees have been granted for the total amount of LVL 33.8 million. Similarly, by 12 January 2010, 16 export guarantees for the total amount of EUR 1.1 million (51 applications have been received from which 24 have been approved for the total amount of EUR 2.2 million).

**Export credit guarantees**

As from 1 July 2009, the guarantees of export activities risks are issued to the enterprises by the Latvian Guarantee Agency for the term of two years. The guarantor will guarantee compensation in case of a non-payment by a foreign debtor and in cases of their insolvency. The guarantee will cover up to 90% of the export activity value but not exceeding the equivalent of 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.

**Box 6.4 continued**

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 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 EUR 500 thousand, but does not exceed EUR 2 million, the number of employees does not exceed 250 employees, or the turnover is EUR 50 million, if they have been exporting for at least two years and the export turnover is at least 20% of the total turnover, 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 from the European Commission.

**Activity *Loans for the Improvement of Enterprise Competitiveness***

In the framework of this programme, the funding is available to small, medium, and large enterprises, which have economically justified further action plans, but are lacking financing of credit institutions due to increased risks. Enterprises can receive separate loan of liquid assets or investment loan, or both of the loans. The total amount of loan for improvement of enterprise competitiveness can't exceed LVL 6 million for one enterprise.

Two types of loans are available:

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

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

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

By 1 January 2010, 266 loans had been granted for the total amount of LVL 101.5 million.

**Activity *Improvement oh Heat Insulation of Residential Buildings***

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

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

Project applications have been accepted since 14 April 2009 until the notice of the termination of project applications acceptance, i.e. until the funding available in the framework of the activity will be used. Financing accessible in the framework of the activity is LVL 14.1 million.

By January 28, 2009, 117 projects had been submitted for the total ERDF amount of LVL 5.43 million. Inter alia 37 contracts have been concluded for the total ERDF amount of LVL 2.02 million, implementation of 3 projects for the total ERDF amount of LVL 93 thousand have been finished, but for the implementation of 41 approved projects contracts have not been concluded (for the total amount of LVL 2.16 million) and 7 projects for the total amount of LVL 0.2 million are being evaluated.

Projects have been submitted from 30 settlements. The majority of applications are received from Valmiera (34), Ventspils (15) Riga (13), and Liepaja (7), Limbazi (5), Salaspils (4) and Rezekne (3).

**Implementation of Objectives set in the Memorandum of Understanding**

In accordance with the memorandum of understanding on the loan concluded between the government, International Monetary Fund, and the EC (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). The funding absorption targets for 2009 and 2010 set in the framework of the memorandum have been reflected in Table 6.2.

Table 6.2

**Funding Absorption Objectives set in the Framework of the Memorandum of Understanding**

(million LVL)

| | 2009 | 2010 (cumulative) |
|---|---|---|
| ESF | 42.2 | 88.6 |
| ERDF | 190.0 | 394.5 |
| CF | 119.5 | 249.5 |
| **Total** | **351.7** | **732.6** |

Taking into account the support of the International Monetary Fund and the EC to the official proposal of the MF to increase the appropriation to sub-programme 41.08.00 *Funding for the Implementation of Projects and Measures Co-financed by Financial Aid of the European Union Policy Instruments and*

*Other Foreign States* defined in the *State Budget Law* of 2009, on 13 October 2009, the Cabinet of Ministers reached a conceptual agreement to increase the funding of 2009 for the EU fund projects by LVL 84 million. Thus, it may be concluded that in the State Budget of 2009, sufficient funds have been earmarked (LVL 570.5 million) to cover the needs of all projects currently under implementation and to fulfil the financing absorption objective (LVL 351.7 million) set in the *Memorandum of Understanding*.

By 31 December 2009, the actual results exceeded the preliminary goals. In total payments amount of LVL 478,7 million have been completed, which forms 136.1% from the target, inter alia the ERDF financing targets will be fulfilled to the extent of 134,9%, because LVL 256.3 million have been disbursed. CF objective had been fulfilled to the extent of 138.2% - LVL 165.1 million have been disbursed. ESF objective had been fulfilled to the extent of 135.8% - LVL 57.3 million have been disbursed.

Analysing the forecasts of the involved ministries with respect to the fulfilment of financing absorption objectives for 2010, the ministries are expecting to fulfil the objective for 2010 by 96.1%. However it must be taken into account that at the moment the state budget financing is available just for the current projects – there is no money for new projects. The Ministry of Finance has posted a letter to European Commission and IMF with a request to increase the expenditures for EU funds beyond the framework of budget deficit in order to cover all the expenditures planned for the 2010. In case IMF and European Commission will support the increase of expenditures for EU funds, the fulfilment of the expected objective will be higher.

**Funding for implementation of the EU fund projects in 2010**

In accordance with draft law *Law on Budget of 2010* supported by the government on 26 October 2009, in the budget of 2010, LVL 409.6 million has been envisaged (incl. technical aid) for the ERDF, ESF, and CF projects during the programming period 2007–2013, including LVL 180.5 million for the current long-term commitments and LVL 229 million additional funding under the government decision of 12 October 2009. In the state budget, the funds earmarked for the EU fund projects are envisaged for pre-financing of projects to be implemented by the public institutions and planning regions, and for advance or interim payments to other funding beneficiaries under the procedure as defined in the legislative acts.

The above mentioned public funds in the amount of LVL 409.6 million are sufficient to finance projects already under implementation and projects approved, and their implementation will be launched in the near future. In this amount of funding, financing for new projects, which are under evaluation or preparation, has not been envisaged. Moreover, according to the forecasts, this funding amount may not be sufficient to fulfil the condition included in the *Memorandum of Understanding* of the European Communities and the Republic of Latvia to execute payments of certain amount in 2010, in the framework of the EU fund projects of the programming period of 2007–2013. This amount also excluded expenditures of projects where the liquid assets are provided by the funding beneficiaries themselves, receiving payments after the declaration of expenditures to the EC (in total about LVL 82 million in 2010).

In accordance with the information provided by the responsible institutions, additionally, in 2010, another LVL 431 million would be necessary to finance all projects planned. Besides, Ministry of Finance, in cooperation with the Ministry of Transport and the Treasury, after consulting the international creditors, are looking for the possibility of envisaging loans of the Treasury for ensuring highway, railway, port, and airport project money flows also in 2010 and the following years (in 2009, such loans were successfully ensured for the EU fund highway projects). In order to ensure such opportunity for the port administrations as funding beneficiaries, changes have been implemented in the *Law on Budget and Financial Management*.

Taking into account the above considerations, the MF has launched negotiations with the international creditors about the possibility of increasing the expenditure related to the EU fund financing in the budget of 2010, without affecting other expenditure headings, increasing expenditure appropriations for the EU funds projects by LVL 84 million, like in October 2009.

**Amendments to the financial plans of the operation programmes in 2009**

In performing the task delegated during the sitting of the Cabinet of Ministers of 22 December 2008, at the beginning of 2009, the Ministry of Finance evaluated the possibility of starting or continuing the implementation of certain EU fund activities. Overall, evaluation was performed for:

1. 42 activities of the operational programme *Human Resources and Employment* with the public funding of 48% from the total initial public funding for the OP;
2. 10 activities of the operational programme *Entrepreneurship and Innovations* with the public funding of 13.5% from the total initial public funding for the OP;
3. 31 activities of the operational programme *Infrastructure and Services* with the public funding of 17.6% from the total initial public funding for the OP.

Upon assessment of the EU fund aid to the promotion of the economy of Latvia, funding in the framework of the OPs was redistributed for implementation of activities that would give more direct and efficient contribution to development of the country's economy, and implementation of the supported activities whereof should be considered as a priority in the current economic situation, considering the necessity to react to the socioeconomic situation as soon as possible by minimising the effects of the economic crisis and by increasing the economic potential. The funding cuts have affected the activities where it was not possible to decrease the scope of supported actions, thus focusing on the objective of the activity to setting other conditions in order to obtain the objective of the activity with smaller funding. It was proposed to postpone implementation of certain activities.

As a result of the assessment, in the 2nd quarter of 2009, the Cabinet of Ministers adopted several decisions on redistribution of funding in the framework of the activities. During the sitting of the Cabinet of Ministers of 7 April 2009, financing redistribution in the framework of the OP *Infrastructure and Services* was approved, while during the sitting of 21 April 2009, financing redistribution in the framework of the OPs *Human Resources and Employment* and *Entrepreneurship and Innovations* was approved. In total, in the framework of the OP *Human Resources and Employment*, redistribution of the public funding was carried out in the amount of 17.2% of the total initial public funding for the OP; in the framework of the OP *Entrepreneurship and Innovations*, redistribution of the public funding was carried out in the amount of 7.5% of the total initial public funding for the OP; in the framework of the OP *Infrastructure and Services*, redistribution of the public funding was carried out in the amount of 1.8% of the total initial public funding for the OP.

In accordance with the decision made during the sitting of the Cabinet of Ministers of 7 April 2009, after 31 December 2009, assessment of financially intensive activities of the OP *Infrastructure and Services* will be begun, assessing the possibility and necessity of granting additional funding for the priority 3.6 *Polycentric Development*.

In accordance with the decision made during the sitting of the Cabinet of Ministers of 15 September, the Ministry of Finance will develop and submit proposals to the Cabinet of Ministers for amendments to the EU fund programming documents, envisaging possible funding redistribution from the large infrastructure projects with eligible costs above LVL 30 million to activities oriented to entrepreneurship support.

In accordance with the decision made during the sitting of the Cabinet of Ministers of 12 October 2009, the Ministry of Finance, in cooperation with the responsible ministries, has been requested to assess the possibility of decreasing the public funding amount of Latvia in the framework of the OPs *Human Resources and Employment*, *Entrepreneurship and Innovations*, and *Infrastructure and Services*, thus decreasing the financial burden for both, the state budget and the funding beneficiaries.

## 6.2.2. Foreign Trade Policy

**EU Common Trade Policy after enforcement of the *Treaty of Lisbon***

Upon enforcement of the *Treaty of Lisbon* on 1 December 2009, significant changes affect the EU Common Trade Policy, including work, competencies, and decision-making process of the parties involved in its implementation.

The *Treaty of Lisbon* stipulates that the Common Trade Policy is within exclusive competence of the EU. Thus, the former practice has been repealed which prescribed that in the approval of international trade agreements (involving issues within the competence of the Member States) the national parliaments of the EU Member States were involved along with the EU Council. At the same time, the role of the European Parliament has been increased, envisaging its participation in the approval process of legislative acts regulating trade policy issues and international trade agreements. The Treaty also provides that for adoption of decisions at the EU Council on sensitive issues, incl. cultural and audiovisual services, social, educational, and health care services, as well as for approval of internal legislative acts, where necessary, the principle of unanimity is to be applied. In general cases, the same as before, adoption of a decision in the EU Council with regard to the trade policy issues is to be based on the qualified majority. It must be noted that, as a result of the *Treaty of Lisbon*, the Trade Policy Committee (former Article 33 Committee of the EU Council) is the responsible EU Council institution for Common Trade Policy issues.

**Multilateral relations**

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

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

In the second half of 2009, in the framework of **WTO Doha Round (DDA)**, multilateral trade liberalisation negotiations were continued with the Member States agreeing on completing these negotiations in 2010. However, in order to achieve this arrangement, the gaps among positions of the developed and developing countries, especially the US and India, must be eliminated no later than in spring 2010.

On 30 November–2 December 2009, in Geneva, the Seventh WTO Ministerial Conference took place. In the framework of the conference, the WTO operation and future, contribution of the organisation in solving recovery, growth and development issues, declaration issues of the Sixth WTO Ministerial Conference in Hong Kong of 13–18 December 2005 were reviewed, including:

a) moratorium under which the WTO members undertake to initiate dispute solving in cases of intellectual property rights only in instances if the provisions of the *Agreement on Trade-Related Aspects of Intellectual Property Rights* (TRIPS) have been breached;
b) moratorium under which the members shall not impose the customs duties on electronic trading;
c) implementation of TRIPS agreement provisions, incl. in the field of geographical indications;
d) development aid to cotton producers;
e) integration of small economies in the multilateral trade system;
f) trade and transfer of technologies etc.

Taking into account the situation of DDA negotiations, it is essential that during the conference the WTO Member States emphasised the necessity and expressed preparedness for continued work in order to complete DDA negotiations as soon as possible.

Considering the threats of protectionism created by the global economic recession and considering deterioration of the international trade conditions, the WTO Secretariat and the EC (independently from each other) continue **to monitor the trade policy instruments** of the world countries launched in the beginning of 2009. In accordance with the reports carried out in the framework of this process, a number of countries, particularly Russia, Argentina, the US and China, have introduced or are planning to introduce market protection measures. These mainly concern trade in agricultural, car industry, and textile industry products, as well as electronics. However, taking into account the recovery indications observed in the international markets, in the second half of 2009, the dynamics of increased trade barriers has decreased. Accordingly it may be expected that the global economy will successfully avoid escalation of mass protectionism measures.

There are 29 candidate states **in the WTO accession process**, including Belarus, Kazakhstan, Russia, and Montenegro. Until mid-2009, Montenegro and Russia were the closest to accession in the WTO from the candidate states. However, for the WTO members to decide on the accession of Montenegro to the organisation, at the moment, it must conclude the bilateral market access negotiations on trading goods with Ukraine. In June 2009, Russia, Belarus, and Kazakhstan, however, publicised a statement with respect to the establishment of a common customs union as of 1 January 2010. In relation with this union, these countries are planning to harmonise the conditions under which they would enter in the WTO. It is expected, that harmonisation of the entries of these states as envisaged will significantly prolong the accession process of Russia and Kazakhstan, while the accession process of Belarus, which is currently in its early stage, may accelerate.

**Bilateral relationships in the framework of the EU Common Trade Policy**

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

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

At the same time, the EU has concluded a number of agreements comprising preferential trade conditions. Until now, such agreements have been concluded with the Balkan countries[1], the European Economic Area countries[2] and Switzerland, as well as Chile, South Africa and Mexico.

At the moment, negotiations on the EU preferential trade agreements are in process with the Andean countries[3], the Central American countries[4], the countries of the Association of Southeast Asian Nations[5] (hereinafter – ASEAN), South Korea, the countries of the Southern Common Market[6] (hereinafter – Mercosur), India, Canada, Libya, the Gulf Cooperation Council countries[7] (hereinafter – GCC), Ukraine and Mediterranean countries, as well as

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[1] Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, Montenegro, Serbia, and Turkey.
[2] Iceland, Liechtenstein, and Norway.
[3] Bolivia, Ecuador, Columbia, Peru.
[4] Guatemala, Honduras, Costa Rica, Nicaragua, Salvador, and Panama after its involvement in the Central American economic integration process.
[5] Myanmar, Brunei, Philippines, Indonesia, Cambodia, Laos, Malaysia, Singapore, Thailand, and Vietnam.
[6] Argentina, Brazil, Paraguay, Uruguay, and Venezuela.
[7] Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

negotiations on economic partnership agreements (hereinafter – EPA) with the African, Caribbean and Pacific Group of States (hereinafter – ACP). In the near future, it is planned to launch negotiations on preferential trade agreements with Armenia, Georgia, and Moldova. In addition to the described agreements, bilateral economic relationships between the EU and its most important global partners are promoted in the framework of frequent regulatory dialogues.

Thus, implementing the policy strategy adopted by the European Commission in 2006 with respect to economic relations with **China**, in 2007, negotiations were launched on revision of the Partnership and Cooperation Agreement, while, in 2008, the EU-China High Level Economic and Trade Dialogue was established aimed at solving issues of strategic importance in the framework of trade and economic relationships between the EU and China, as well as promoting the development of different sectors. In the framework of this dialogue, the EU and China discuss mutually important issues with respect to investments, market accessibility, protection of intellectual property rights etc. Until now, four EU-China High Level Economic and Trade Dialogue sittings have taken place, the most recent – in June 2009.

A significant instrument for promotion of the EU and **Japan** bilateral relationships is the EU-Japan Regulatory Reform Instrument launched in 1995 with the aim of decreasing barriers impeding mutual trade and investment flow. The next meeting in the framework of the dialogue is planned to take place at the beginning of February of 2010 in Tokyo.

The EU economic cooperation with the **USA** takes place in the framework of the Transatlantic Economic Council (TEC) established in 2007. TEC's task is to achieve harmonisation of the EU and US regulations, as well as to promote development of the trade and enterprise dialogue between the parties in such fields as intellectual property, trade security, financial markets, innovations and technologies, as well as investments. Up to now, four meetings of TEC have taken place, the most recent – in October 2009. It must be noted that on 3 November 2009, in Washington, the EU-US summit took place where a closer coordination in the framework of DDA and climate change issues was considered.

**<u>Economic cooperation agreements of Latvia and third countries and regions of third countries</u>**

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

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

Economic cooperation agreements concluded between Latvia and third countries require establishment of an Intergovernmental Commission (hereinafter – IGC) and/or Joint Committee, which ensures supervision of validity of these agreements and opportunities to analyse how to improve further cooperation (see Box 6.5).

**Box 6.5**

**<u>Current activities of intergovernmental commissions of Latvia and third countries</u>**

– On 4 June 2009, the 2nd sitting of the Latvia-**Ukraine** IGC in the areas of economic, industrial, scientific, and technical cooperation issues took place in Kiev. During the sitting, the officials of Latvia and Ukraine, as well as representatives of the enterprises discussed the bilateral relationships of both countries, paying significant attention to topicalities and potential of economic cooperation. The parties agreed to develop a Latvia-Ukraine economic cooperation programme for 2010–2011 and approved the statutes, which was signed in the framework of the sitting, regarding the establishment of Latvia-Ukraine Economic Cooperation Council (partners – the Employers' Confederation of Latvia and the Federation of employer's of Ukraine).
  Parallel with the 2nd sitting of Latvia-Ukraine IGC, in Kiev, Finance-Investment Forum organised by the Investment and Development Agency of Latvia and the Ukrainian Chamber of Commerce and Industry took place. 25 participants from Latvia and 60 participants from Ukraine – representatives of enterprises, state administration, and associations – took part in the forum.
– On 29 July 2009, the 3rd sitting of the Latvia-**Russia** IGC in the areas of economic, scientific and technical, humanitarian and cultural cooperation took place in Riga. During the sitting, Latvia-Russia economic cooperation issues were considered, and discussions were held on the topics of trade and economic cooperation of both parties, as well as development of contractual security base, cooperation in the field of tourism, energy, information technologies, transport, and cross-border, humanitarian cooperation and operation of the Latvia-Russia Cooperation Council, as well as perspective fields for further promotion of cooperation. In the framework of the commission, the parties agreed to establish a Regional Cooperation Working Group. Latvia has prepared a proposal on establishment of the above working group. During the sitting, the parties also agreed to complete the work on the Agreement on Cooperation in the Field of Tourism in 2009, as well as discussed the necessity to sign a contract on prevention of double taxation and tax default, as well as discussed the Agreement on Promotion of Investments and Protection.

**Box 6.5 continued**

- On 11 August 2009, the 3rd sitting of the Latvia-**Azerbaijan** IGC in the areas of economic, scientific, technical, and cultural cooperation took place in Baku, during which the parties discussed cooperation in various fields, as well as cooperation in the framework of the EU. At the same time when the Latvia-Azerbaijan IGC sitting took place, also the Latvia-Azerbaijan Business Forum took place. The delegation of Latvian entrepreneurs consisted of 75 representatives. 114 entrepreneurs from Azerbaijan took part in the forum. During the visit, several cooperation agreements were concluded, as well as business contacts established among Latvian and Azerbaijan entrepreneurs.
- On 16 September 2009, the 1st sitting of the Latvia-**Georgia** IGC took place in Riga. During the sitting, the parties discussed issues of strengthening bilateral economic cooperation, extending and strengthening the trade and investment relationships between both countries, cooperation in the framework of the EU-Georgia dialogue, as well as bilateral cooperation in various fields. During the 1st sitting of the Latvia-Georgia, the Latvia-Georgia Memorandum on Cooperation in the Field of Tourism, as well as Agreement on Cooperation in the Field of Accreditation was signed. Parallel with the sitting, the Latvia-Georgia Entrepreneur Business Forum and bilateral meetings of entrepreneurs took place. About 100 entrepreneurs (including 14 entrepreneurs from Georgia and more than 85 entrepreneurs from Latvia) participated in the forum.
- On 14–15 October 2009, the 5th sitting of Latvia-**Belarus** IGC for economic, scientific, and technical cooperation issues took place in Liepaja. This was the first IGC sitting that was organised in Latvia in order to draw attention of Belarus also to other economically active regions of Latvia, at the same time extending the international cooperation of both countries. In the framework of the visit, the Belarusian delegation was acquainted with the operations of the Liepaja Special Economic Zone, Liepaja Port and the largest enterprise of the city – "Liepajas Metalurgs", and discussed potential cooperation possibilities, as well as met with the mayor of Liepaja City – U. Sesks – and with the entrepreneurs of Liepaja. Belarusian representatives of IGC representing fields of education visited University of Liepaja. During the sitting, an agreement was achieved on the activation of the bilateral economic cooperation, as well as decisions and recommendations were adopted on various issues of economic cooperation. Also, issues related with establishment of Customs Union of Russia, Kazakhstan, and Belarus as of 1 January 2010 and cooperation possibilities between Liepaja and Gomel cities, and work of the Latvia-Belarus Economic Cooperation Council were discussed. Parallel with the 5th sitting of IGC, another sitting of the Latvia-Belarus Economic Cooperation Council took place with the aim to provide the possibility to the entrepreneurs of both countries to discuss cooperation issues concerning business. In the framework of IGC, also several agreements were signed, incl. between Liepaja and Belarusian city Gomel on cooperation for implementation of common projects in the field of culture and sports, Protocol on the execution of the agreement reached by the Belarusian State Committee for Science and Technologies and RL Ministry of Education and Science, Protocol on the cooperation of the Belarusian State Committee for Standardisation and the National Diagnostic Centre of the Food and Veterinary Service of Latvia.
- On 12–13 November 2009, the 2nd sitting of Latvia-**Uzbekistan** IGC for economic, industrial and scientific and technical cooperation issues took place in Tashkent. During the sitting, cooperation of both countries in various spheres was discussed. The light industry, food industry (fruit and vegetable processing), pharmacy, and transport are considered as perspective cooperation fields. At the moment, in Uzbekistan, the animal development programme is being implemented; it is planned that Latvia might participate in its implementation. The parties recognised that a significant stimulus to the development of bilateral economic dialogue was generated by the visit of the President of the Republic of Latvia V. Zatlers and more than 100 entrepreneurs to Uzbekistan in October 2008, during which the entrepreneurs identified a number of fields for development of further cooperation.
- On 20 November 2009, the 7th sitting of the Latvia-China Joint Committee took place. The agenda of the sitting included topical issues of the bilateral economic cooperation between both countries, including such fields as trade, investments, industry, transport, transit and logistics, as well as tourism and agriculture. Taking into account that import to Latvia from China considerably exceeds export, the parties agreed to examine further opportunities of directing Latvian goods towards the market of China. When discussing development of the cooperation in the field of transport, the representatives of Latvia and China recognised the necessity to pay greater attention to development of land cargo transportation, as well as paid attention to the possibilities of the Latvian ports to organise the transit of Chinese goods from Latvian ports to the East to Russia or other CIS countries. Further development opportunities were also discussed with respect to container transport routes between the Baltic Region and China in order to link the cargo flow of china towards the direction of the EU. The parties were positively inclined regarding cooperation of Latvia and China in the field of industry; they recognised that it is useful to extend cooperation is such fields as food industry, pharmacy, car industry and metal working, information and communication technologies, as well as engineering sciences. For development of cooperation in the field of agriculture, both parties agreed to establish a bilateral Agricultural Cooperation Working Group.

Although Latvia and Russia have concluded an agreement on economic cooperation, there is active cooperation also with the regions of the Russian Federation. On 9 April 2008, an agreement on economic cooperation with the government of Vologda Oblast was concluded, and also negotiations are currently held with the governments of Ivanovo, Yaroslavl and Kirov Oblast, the administration of Pskov Oblast and the government of Bashkortostan Republic regarding a conclusion of agreement in the field of economic cooperation.

## Sectoral issues of the EU foreign trade

### Steel

Steel is one of the most widely used industrial raw materials in the world. Metal industry forms a part from the general European competiveness in all links of the value chain, besides, the EU is the second largest steel producer in the world after China.

With the world steel production decreasing by 18%, in 2009, steel consumption in the EU decreased by 23% (only India and China have increased their steel production). Currently, the steel industry is experiencing the sharpest fall in demand since the oil crisis of 1974. The most rapid fall of steel production in the EU was in Romania, Sweden, Belgium, Bulgaria, Finland, and Italy. Since July, the global steel production has started to stabilise.

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 steel trade for 2007 and 2008, as well as agreed on its extension for 2009 and 2010, envisaging an annual increase of 2.5% in quotas. In 2008, the quotas in Russia were defined in the amount of 3.2 million. In regards to Kazakhstan, autonomous measures are currently being applied. Steel products import quota for Kazakhstan is 200 thousand tons. After admission of Russia and Kazakhstan to the WTO, the EU steel agreements with these countries will lapse automatically. The EU applies the Prior Surveillance system for the import of particular steel products from all third countries for the purpose of steel flow monitoring.

**Textiles**

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

For a long time, in the multilateral negotiations of the WTO, the textile and clothing sector was an exception for the progressive trade liberalisation of industrial goods, until in 1995, the developing countries made the WTO Member States gradually over a period of 10 years to introduce complete trade liberalisation of textile goods. However, until December 2007, the EU textile trade restrictions on certain textile goods particularly sensitive towards the rapid growth of import flows from China were extended, but as of 1 January 2009, the licensing of import of textile goods originating from China has been fully repealed.

The EU is currently applying quantitative restrictions only to the import of textiles from Belarus and North Korea, while the double-checking system (licensing) without quantitative restrictions applies to the import of certain textiles originating from Uzbekistan. It must be noted that these countries are not the Member States of the WTO, besides are recognised to be violators of human rights and democracy principles.

**Chemical industry**

The chemical industry is very varied, and its sub-sectors are closely interrelated with other sectors of the economy.

In February 2009, the EU High Level Group's Review on Competitiveness in the European Chemical Industry was approved, comprising such strategically important aspects for the industry development as innovations, use of energy resources, climate change, water treatment, food and health, as well as trade (see Box 6.6). On the basis of this review, in the framework of the Swedish Presidency, in the second half of 2009, remarkable work has been done in order to assess the role of competitiveness of the EU chemical industry and trade policy instruments in promotion of the industry.

**Box 6.6**

**Competitiveness of the chemical industry**

Historically, the chemical industry is one of the most competitive sectors taking a stable place in the EU's economy. About 20-30% from the production manufactured in all EU Member States is exported to third countries. The enterprises of the European chemical industry obtain better results from innovation-directed rather than cost-oriented sub-sectors. The situation in the export markets – high import duties of third countries and access to third countries chemicals market – considerably affects the competitiveness of the EU chemical industry enterprises. Considering that the chemical products are mainly sold in large batches with a low profit margin, for maintained and improved competitiveness of the industry it is particularly important to liberalise trade in all sub-sectors of the chemical industry.

The EU High Level Group Review on Competitiveness in the European Chemical Industry, approved In February 2009, has defined several tasks and the possible directions of action of the trade policy. The main tasks are to ensure availability of raw and source materials and to repeal export restrictions applied by different other countries (quotas, licensing, application of discriminatory double pricing, export duties), as well as to simplify customs procedures and to decrease transportation time and costs (documentation requirements, certification, registration, testing of samples, discriminatory fees). The main directions of action of the trade policy are as follows:

- multilateral trade negotiations – in 1995, as a result of the WTO Uruguay Round, the Chemical Tariff Harmonisation Agreement was concluded envisaging tariffs of 0%, 5.5%, and 6.5% for various chemical products. Also, in the framework of the DDA Negotiations Round, further opening of the market and decrease of tariffs in all chemical industry sub-sectors is envisaged. Involvement of a maximum number of Member States would ensure adoption of a new agreement. Similarly, in the framework of the WTO, negotiations on non-tariff barriers, promotion of trade, export restrictions and other horizontal issues are taking place. At the same time, the accession processes of Russia and Algeria to the WTO are currently important, as the commitments of these countries especially with respect to repealing different export restrictions and application of discriminatory double prices would solve important issues of the chemical industry in the EU Member States;

**Box 6.6 continued**

- bilateral trade negotiations – conclusion of the EU free trade agreements with priority trade partners is the most efficient way to fight against specific non-tariff barriers applied by other countries. It is expected that the most significant benefits to the EU chemical industry enterprises will be gained with conclusion of the bilateral trade agreements with South Korea and Ukraine which are currently under negotiation. It is also possible to solve the bilateral issues in the framework of the EU regulatory dialogues. At the moment, such dialogues have been launched with the US, China and Japan;
- various trade instruments and initiatives – the EU Market Access Strategy launched in 1996 and the EU Raw Materials Initiative launched in 2008 envisage integrated political solutions for supplying the EU industry with the necessary raw materials. In the framework of the above initiatives, important work has been done identifying the trade restrictions of third countries. Thus, in 2009, the EU, using the disputes solving mechanism, addressed the WTO with a claim against China with regard to the export restrictions applied by it for such raw materials as yellow phosphorus, bauxite, coke, fluorspar, magnesium, manganese, silicon metal, silicon carbide, and zinc. The EU has also encouraged launching of discussions on accessibility of raw materials among the OECD member countries. On 30 October 2009, the first workshop regarding this issue took place in Paris, France in the framework of the OECD Trade Committee.

**<u>Trade Defence Instruments</u>**

**Trade Defence Instruments of the European Community**

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

The goal of the anti-dumping and anti-subsidy measures is to protect the producers in the EU from losses caused by unfair competition from the enterprises of 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 domestic producers, but which are not indication of unfair competition.

At the end of 2009, in the EU, in total 129 anti-dumping and 7 anti-subsidy measures were applied to various products of other countries. More than a half from the afore-mentioned measures was applied to China, India, Indonesia, Russia, Taiwan, Thailand, and Ukraine. Mainly iron and steel, as well as chemical industry products are subjected to the defence measures.

Although in Latvia, the producers and consumers of goods alike are affected by the TDI procedures, the most essential economic interests of Latvia involve import and industrial use of the goods subjected to the TDI. In the second half of 2009, the most significant are the following:

- anti-dumping inspection with respect to import of **certain leather footwear from China and Vietnam**. Already in 2006 and consequently in 2009, Latvia did not support the application of a duty to such a commodity which is contradictory with both interest of Latvia and the Community. However, taking into account the voting of the Member States, application of the duty was continued for the following 15 months;
- anti-dumping inspection with respect to **import of ammonium nitrate from Russia**. Since accession of Latvia to the EU, Latvia has not supported the application of a duty to ammonium nitrate import as half of the amount consumed in Latvia is imported from Russia, and the anti-dumping duty applied by the EU significantly increases the costs to its end-users – the farmers. Due to the increase in the price of artificial fertilizers, many farms must choose cheaper alternatives or decrease the amounts of fertilisers considerably affecting the productivity and consequently the competitiveness of the farm. In this respect, positive development was the court decision adopted by the European Community whereby a duty for a number of ammonium nitrate compounds was repealed for one Russian enterprise.

**Trade Defence Instruments applied by third countries**

If the EU applies trade defence measures, other third party 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 economic interests of Latvia are most considerably affected by the anti-dumping measures introduced by the US with respect to import of steel bars from, *inter alia*, Latvia. In accordance with repeated reports of the WTO Disputes Settlement Institutions, the anti-dumping duty calculation method used by the US has been recognised as unjustified and non-compliant with the WTO's norms, and must be revised in the near future. Although the US since 2 June 2009 has slowly started implementation of the WTO's recommendations, the result still is dissatisfactory.

### 6.2.3. Internal Market of the European Union

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

In Latvia, implementation of internal market directives is taking place successfully and sufficiently high results have been achieved regarding the transposition efficiency of the directives. Among 27 countries, Latvia has taken the 12th place with the deficit of directive transposition of 0.7%, thus already ensuring the 2009 Lisbon target to transpose 99% of the directive requirements or to allow the directive transposition deficit of 1%. In July 2009, Latvia in total had not implemented 12 directives and 10 directives had been implemented partly.

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

**The procedure for submitting draft technical regulations** (Directives 98/34/EC and 98/48/EC), which prescribes the obligation of EU Member States to submit draft technical regulations to the European Commission and other EU Member States, as well as European Economic Area countries for further assessment, serving as a preventive, single and transparent monitoring instrument, in order to assess and avert inclusion of such requirements into the normative acts, which have the potential to create barriers to 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 products or the cross-border provision of information society services. Information on draft technical regulations of the Member States is freely accessible on the *Technical Regulations Information System (TRIS)* database. TRIS database is a free service and can be accessed on *www.europa.eu* portal. The majority of the notified draft technical regulations are available in all EU languages.

From May 1, 2004 until December 1, 2009, Latvia notified the European Commission about 80 draft technical regulations and received detailed opinions from the European Commission in 14 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 Agreement, 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 the EU Member States, the European Parliament and Council Regulation (EC) No. 764/2008 *laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State and repealing Decision No. 3052/95/EC* was adopted, which was enforced on September 2, 2008. Thereby, a substantial step was taken towards introduction of a new legal instrument at the EU level. The application of the requirements of the Regulation in Latvia and other Member States is ensured as from May 13, 2009.

The Regulation envisages setting 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 European Economic Area countries or put into free circulation, distribution of rights and obligations among the national competent authorities and performers of economic activity within the framework of mutual recognition procedure, as well as for the purposes of simplification of applicable administrative procedures the Regulation stipulates an obligation for the state to establish one or more information points for the informative support of performers of economic activity. The function of the product information contact point in Latvia is currently performed by the Ministry of Economics (e-mail: *pcp@em.gov.lv*).

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

The European Parliament and Council Directive 2006/123/EC on services in the internal market is essential for Latvia among EU legal acts of the recent years, and must be implemented by the state before the end of 2009. The 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 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 implement the requirements of the Regulation, on April 28, 2009 the Cabinet of Ministers adopted a concept *Establishment of a one-stop-shop in compliance with provisions of Directive 2006/123/EC of the European Parliament and of the Council of December 12, 2006 on services in the internal market* which provides creation of one-stop-shop by the public institutions, allowing service providers to perform administrative procedures remotely by using electronic means. By implementing the principle of one-stop-shop, the performers of economic activity will be able to reduce the administrative procedure costs and increase the quality of services provided. By using the advantages of one-stop-shop, service providers and customers will receive the information about requirements and procedures laid down by the state faster and easier. The model comprised in the concept is planned to be implemented by the end of 2009.

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

In order to improve the administrative cooperation abilities of the public administration institutions of the European Communities, since November 2007, in Latvia, the **Internal Market Information (IMI)** system has been established, which has been introduced and operates in a pilot project mode and ensures secure and fast exchange of data among the European institutions allowing effective communication despite the barriers created by differences of languages and administrative structures. The Member State authorities can verify authenticity of company documents submitted by persons and issued in another Member State or solve other problems by communicating with the country of origin using IMI, which means that the entrepreneur does not need to go back to the country of origin to receive an additional notice and to certify it at a notary, etc. At the moment, registration of the competent authorities in the IMI system is being implemented, in order to ensure usability of the system not only in the professional qualifications field, but also in the field of certain service provision.

In 11 months of 2009, the **SOLVIT Coordination Centre of Latvia** has reviewed 54 cases. From the cases solved, 87.5% have had a successful outcome – further violations of the European Community law have been prevented. In 2007, the proportion of such cases was 80%, in 2008 – 83%. In 2009, the number of claims concerning residence permits for family members of citizens of Latvia, as well as benefits in other Member States has increased considerably. Taking into account that many claim applicants point out that they found out about the support provided by SOLVIT in newspapers, in the future big attention will be paid to regular publishing of SOLVIT success stories in mass media. The task of the SOLVIT network is to find a quick and practical solution for EU internal market problems emerged as a result of operations of public institutions by incorrect transposition of EU legislation. The SOLVIT solves problems of both residents and entrepreneurs, and SOLVIT services are free of charge.

## 6.3. Sector-Specific Development Policies

### 6.3.1. Industrial Policy

Industrial policy in Latvia is developed in accordance with the policy development directions of the European Union, at the same time identifying and solving the issues that are urgent for local industrial enterprises in cooperation with the organisations, which represent the industrial enterprises. Industrial policy is closely connected with innovations, business activity, education, and other policies.

On 18–19 June 2009, the European Council reached an agreement to prioritise the reorienting of the European economy towards a knowledge-based, innovative, and eco-efficient economy. When developing the Lisbon Strategy for the period after 2010, the sustainable competitiveness and sector-specific policy, as well as transforming Europe into an eco-efficient economy should be set as some of the main priorities. Successful transition to an eco-efficient economy and implementation of a sustainable sector-specific policy will improve competitiveness and transform environmental challenges into business opportunities. More attention should be paid to efficiency of resources and energy, development of new low-carbon technologies, development of renewable resources and global carbon emission charges in order to promote investments in "clean" technologies. With the aim of ensuring a sustainable approach towards raw materials, the European Council supports three initiative pillars of the Commission, i.e. approach towards raw materials in the EU and outside the EU territory, more efficient and sustainable use of natural resources and raw materials, as well as calls on the Commission to identify the essential raw materials and the necessary activities in its Progress Report of 2010.

Amendments to the EU Emission Trading System Directive adopted at the end of 2008 (Directive 2009/29/EC) are especially important for the energy-intensive sectors. One of the key issues in the directive is to establish a common system for allocation of emission quotas and to identify those energy-intensive sectors that are subject to increased carbon leakage risk or risk to delocalise production outside the EU due to additional costs and loss of competitiveness that may be caused by direct or indirect participation in the EU emission trading system. The directive includes quantified criteria for determining sectors subjected to the carbon leakage risk, taking into account their involvement in the international trade and expected increase of expenses. On 18 September 2009, the Working Group of the Committee on Climate Change of the European Commission voted on the European Commission draft decision regarding the list of sectors subjected to a significant carbon leakage risk, which will be entitled to apply for free $CO_2$ emission quotas. The vote confirmed such energy-intensive sectors and subsectors important for Latvia as steel production, cement production, glass and glass fibre production, as well as production of plywood and wood-chip boards. The discussion on whether brick production should be included in the list continues. The list will be approved by the end of 2009.

On 10 and 11 September 2009, an international scientific conference *Development prospects of defence industry and related sectors in the Baltic States* took place, organised by the Ministry of Defence in cooperation with the Ministry of Economics and the Institute of Economics of Latvian Academy of Sciences. The aim of the conference was to discuss the main directions of sustainable development of the **military industry** in the Baltic States and to examine their opportunities to participate in the multinational military security systems (NATO, EU etc.), as well as to integrate in the *European Defence Technological and Industrial Base* (EDTIB). The participants of the conference were informed about the results of the scientific study *Development prospects of defence industry and related sectors in Latvia* (see Box 6.7).

**Box 6.7**

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

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

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

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

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

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

In October 2009, the *BSR InnoNet* (Baltic Sea Region Innovation Network) project was concluded with the participation of representatives from the Ministry of Economics and the Investment and Development Agency of Latvia (IDAL). The aim of the project was to promote cooperation among the technology development agencies of the Baltic Sea region and to improve the efficiency of the existing **cluster operations** by analysing them, as well as to promote the balance of support programmes for technology development of the countries participating in the project. In the framework of the conclusive activities of the project, on 8 October 2009, a meeting took place in Riga with the delegation of the leading organisation of the project – VINNOVA – during which its representatives presented the results obtained so far and described the future vision of the programme's continuation. Also, future cooperation opportunities were discussed.

In the framework of the international leading programme *Baltic Sea Region Programme for Innovation, Clusters and SMEs networks* (hereinafter – the programme), it is envisaged to launch implementation of several components, incl. launching of activities in order to ensure the transnational cluster cooperation in the Baltic Sea region.

The programme envisages implementation of the following components:

– global level cooperation of research, development and innovation systems;
– transnational cluster cooperation;
– cooperation of innovative SMEs networks;
– capacity building activities;
– attraction of direct foreign investment and development of the Baltic Sea Region brand;
– management of the programme and knowledge development.

For implementation of the programme, several working groups have been developed (*Task Force*). The Ministry of Economics takes active participation in the cluster working group. Whereas the IDAL representatives are involved in development programmes of the working groups for the promotion of cooperation among global level research, development and innovation systems and development of SME cooperation networks in the Baltic Sea region. It is planned for Latvia to participate in the working group for direct foreign investment attraction and the Baltic Sea Region brand development.

On 31 July 2009, the Ministry of Economics announced a tender for granting of co-financing for the implementation of cluster development programme. The aim of the programme is to promote cooperation of interrelated sector enterprises and of related institutions (education and research institutions) by supporting the implementation of common projects, thus promoting faster growth of competitiveness of the sectors and indirectly of the enterprises themselves, increase of export amounts, and innovations and production of new products.

The companies and establishments registered in the Latvian Register of Enterprises, as well as enterprises, which have signed a partnership agreement on the cluster initiative, could apply for the conclusion of contracts and funding. The maximum funding limit for one existing cluster project is LVL 30 thousand, for a potential cluster project – LVL 5 thousand.

In order to apply for co-financing, the applicant had to meet the following basic requirements: must operate in any of the defined economy sectors; must guarantee involvement of an expert experienced in similar project management; and must meet such economic criteria as export proportion, turnover amount, and number of employees.

In the framework of the tender, a total of 12 project applications were submitted, from which 7 existing cluster and 2 potential cluster projects qualified for support for all available funding of the programme – LVL 200 thousand. The deadline of project implementation is 7 December 2009 when the project implementers must submit the results of the activities implemented to the Ministry of Economics.

An important aspect for improved industry competitiveness is using the **industrial design** in enterprises thus increasing the added value of the end product and international competitiveness. For implementation of the *Competitiveness and Innovation Framework Programme 2007–2013*, several measures are being carried out, e.g., the creation and maintenance of the industrial design portal *www.designlatvia.lv*, consultations, and design audits in enterprises. In the framework of the project *Design Bus* (Dizaina autobuss), the Investment and Development Agency of Latvia is giving an opportunity to the Latvian designers to visit Latvian manufacturing enterprises of different sectors. The aim of the project is to promote cooperation among designers and entrepreneurs, to promote exchange of experience, knowledge, and ideas that would be transformed into competitive products and services. In the framework of the project, manufacturing enterprises are visited, and cooperation opportunities are discussed, as well as contacts established. This project was launched at the end of 2008 when the Latvian fashion designers visited the textile manufacturing enterprises (in total 12 designers participated in this visit and 5 different manufacturing enterprises were visited). Collections developed by popular fashion designers of Latvia or separate products from the collections are currently being manufactured in several of the enterprises visited during the trip. In June 2009, in the framework of the project, the manufacturing enterprises LLC "Baltijas Gumijas Fabrika", LLC "Evopipes", and LLC "Beaver" were visited. The designers were introduced with the production technologies, materials used for manufacturing and the production manufactured at the enterprises. In November 2009, in the framework of the project, the manufacturing enterprises LLC "Papirfabrika "Ligatne"", LLC "A-Plast", and LLC "Kvadrapak" were visited by 18 designers. At the end of 2009, it is planned to visit such textile manufacturers as "Lauma Fabrics", "Tonus Elast", and "Baltic Candles".

### 6.3.2. Energy Policy

The main directions of the energy policy (see also Chapters 3.3.3. and 6.9.) are aimed at improving security of energy supply of the country by encouraging diversification of supplies of the primary energy resources and creating conditions for increasing self-provision of 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 JSC "Latvenergo", which also ensures import and supply of electricity to the consumers. Since September 1, 2005 all functions of electricity transmission system operator are performed by the JSC "Augstsprieguma tikls". Since July 1, 2007 all functions of electricity distribution system operator are taken over by the JSC "Sadales tikls": the sole owner of both joint-stock companies is JSC "Latvenergo".

Latvia, as the EU Member State, has to ensure compliance with the single requirements set in the EU legal acts concerning the energy sector in the country (see Box 6.8). In the sphere of electricity supply, it means that the electricity sector in Latvia operates in compliance with the provisions of an EU directive concerning promotion of utilisation of renewable energy resources for production of electricity, joint electricity market regulations, cogeneration based on the useful heat demand, as well as safety of electricity supply and investment into the infrastructure.

**Box 6.8**

**Harmonisation of normative acts with the EU directives**

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

– **security of supply and oil and oil product reserves.** The Concept of the State Oil Product Reserve was approved on 27 June 2006. On June 27, 2006 the Cabinet of Ministers adopted Regulations *Procedure for the Establishment and Storage of Petroleum Product Reserve*, which regulates the procedure for oil product reserves to be established by the entrepreneurs;

– the regulatory framework for efficiently functioning electricity market, within which all the electricity users are supplied with electricity in a safe and qualitative way and at reasonable prices, to whom the rights are provided 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. On 15 august 2009, the Regulations of 11 august 2009 of the Cabinet of Ministers *On Permits to Increase Electricity Production Capacity or Introduction of New Production Units* came into force replacing the Regulations of 29 august 2009 of the Cabinet of Ministers *On Permits to Increase Electricity Production Capacity or Introduction of New Production Units*. In order to support electricity generation from renewable energy sources, in compliance with the Regulations of 24 February 2009 of the Cabinet of Ministers *Regulations on electricity generation from renewable energy sources and energy price calculation*, in 2009, decisions have been passed on assigning the right to sell electricity generated from renewable energy resources in the form of mandatory procurable electric energy volume – to 57 biogas power stations with total installed power of 52 372 MW, by providing the annual procurement volume of electric energy up to 405 029.636 MWh, to 20 wind power stations with power of 159.25 MW, by providing the annual procurement volume of electric energy up to 20 2514.926 MWh, to 2 solar power stations with total installed power of 0.91 MW, by providing the annual procurement volume of electric energy up to 614 MWh, and to 43 hydroelectric power stations with total installed power of 5209 MW, by providing the annual procurement volume of electric energy up to 21 477.77 MWh. In total in 2009 decisions to assign the right to sell electric energy generated from renewable energy resources in the form of mandatory procurable electric energy volume have been issued to 151 electric power stations with total installed capacity of electric energy production 247 921 MW, by providing the annual procurement volume of electric energy up to 851 713.793 MWh.
  The Regulations of 10 March 2009 of the Cabinet of Ministers *On Electricity Generation from Cogeneration and Price Calculation* are in force stipulating the criteria according to which cogeneration power stations are qualified in order to assign them with the right to sell the generated electricity in the framework of mandatory procurement or to receive a guaranteed payment for the electricity capacity installed at the cogeneration station, which also implement the European Commission Decision (21 December 2006) establishing harmonised efficiency reference values for separate production of electricity and heat in application of the Directive 2004/8/EC of the European Parliament and of the Council on the promotion of cogeneration based on a useful heat demand in the internal energy market, amended by Directive 92/42/EC;

– on 15 May 2008, law *Amendments to the Electricity Market Law* came into force. The amendments envisage 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 tender on establishment of new production capacities or reconstruction of the existing equipment.. The winner of the tender will obtain the right to receive payments for the new 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;

**Box 6.8 continued**

– **gas sector.** On 26 May 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 to harmonise the regulatory normative acts with the requirements of the 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 enforcement of particular sections of the *Energy Law*, the law prescribes that these provisions of the Energy Law will become effective as of 4 April 2014.
Delivery and utilisation of natural gas are regulated by the Regulations of 16 February 2008 of the Cabinet of Ministers *Regulation regarding Delivery and Utilisation of Natural Gas*.

At present, JSC "Latvijas Gaze" 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.

On 3 December 2009, the Saeima adopted a decision to postpone liberalisation of the natural gas market in Latvia until 4 April 2014. Article 42 of the former *Energy Law* stipulated that as of 1 January 2010 all users of natural gas are free to choose the natural gas supplier, as well as the end users that have a connection with the transmission system are free to choose the supplier without restrictions, informing the supplier or transmission system operator in advance. The decision adopted by the Saeima stipulates that the date of coming into force of Article 42 of the *Energy Law* is postponed until 4 April 2014. Taking into account the requirements of the EU directives, any "new market" of natural gas where the first supply in the framework of a long-term supply agreement has been rendered less than 10 years ago is entitled not to apply liberalisation of the natural gas market. The first natural gas supply rendered in the framework of a long-term supply agreement of 18 July 2003 was on 5 April 2004 therefore the natural gas market liberalisation date has been set for 4 April 2014.

Latvia's gas supply system is not connected to the EU common gas supply system, and Latvia has only one gas supplier – the open JSC Gazprom, which fully controls the gas supply system in Russia. Gas supply business environment in the region and the gas supply agreements in force practically exclude third parties, except regional transmission system operator and access to Incukalns underground gas storage. The capacity of the gas pipeline Valdaj–Pskov is not sufficient to ensure gas supply to the Baltic States and to the Northwest region of Russia during winter. Consequently, the gas market in Latvia may only be open formally. At the same time, it can be expected that already now the opening of gas market and division of JSC "Latvijas Gaze", in Latvia's situation, would considerably increase the tariffs for end users as the company's operational costs would increase. Therefore, opening of the market would not ensure the suppliers with new natural gas obtaining opportunities in short-term.

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 set 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 terminate 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.

In compliance with the provisions of *Directive 2003/30/EC* of the European Parliament and of the Council of 8 May 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* (adopted on 15 July 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 31 December 2010.

In order to reach the objectives set in the Directive and *Biofuel Law* 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).

In compliance with delegated tasks under Article 18 of the *Energy Efficiency Law for Buildings* implementing the requirements of Directive 2002/91/EC of the European Parliament and of the Council of 31 March 2004 on the energy performance of buildings, on 20 October 2009, the Cabinet of Ministers adopted Regulations *On Energy Efficiency Requirements for Centralised Heating Systems of Licensed Energy Supply Enterprises and Procedure for Verification of Compliance thereof* stipulating energy efficiency requirements for centralised heating systems of licensed energy supply enterprises and procedure for verification of their compliance.

**Investments in the energy sector**

In order to increase 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 Regulation of 17 February 2009 of the Cabinet of Ministers Regulations on activity 3.5.2.1 *Measures Regarding the Increase of Efficiency of Centralised Heat Supply Systems* have come into force 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*. Implementation of activity 3.5.2.1 has been launched. The project tender (1st selection round of project applications) was published on 14 April 2009. The submission of project applications was completed on 26 May 2009. 35 project applications have been received. Decisions have been adopted on approval of 16 project applications (on EU CF funding of LVL 7 481 453.82).

In order to increase considerably the production volumes of electricity and thermal energy from the renewable energy resources, diversify deliveries of primary energy resources and increase self-provision of electricity, thus reducing dependence of Latvia on the import of primary energy resources, the Regulations of 17 February 2009 of the Cabinet of Ministers Regulations on activity 3.5.2.2 *Development of Cogeneration Power Plants Utilising Renewable Energy Resources* of Supplement to the Operational Programme *Infrastructure and Services* have been enforced, which will prescribe the procedure, according to which financing is allocated in the framework of activity 3.5.2.2 *Development of Cogeneration Power Plants Utilising Renewable Energy Sources* of measure 3.5.2 *Energy* of priority 3.5 *Promotion of Environmental Infrastructure and Environmentally Friendly Energy* of Supplement to the Operational Programme *Infrastructure and Services*. Implementation of activity 3.5.2.2 has been launched. Project tender (1st selection round of project applications) was published on 14 April 2009. The submission of project applications was completed on 31 August 2009. 58 project applications have been received. Decisions have been adopted on approval of 7 project applications (on EU CF funding of LVL 7 481 454).

Co-financing is envisaged from the EU Cohesion Fund resources in the amount of EUR 127.4 million 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).

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 87 project applications were submitted and assessed. Co-financing of the European Regional Development Fund (ERDF) was granted to 29 projects. The projects envisage modernisation of heat supply systems according to environmental requirements and rise of energy efficiency both on the production and distribution side, as well as the end consumer side of the heat supply system. 6 projects 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 and Housing Policy

The main aims of the **building policy** are to promote development of the building sector by ensuring favourable and competitive business environment, decreasing administrative barriers, improving the control system, and ensuring operative circulation of the building information, as well as by promoting introduction of energy efficient and environmentally friendly building principles. At the moment, it is particularly important to promote sustainable building operations in Latvia by improving energy efficiency of buildings, improving the minimum heat resistance requirements and technical solutions, developing state aid initiatives for introduction of the existing energy efficiency improvement measures for buildings, as well as to promote construction of buildings with low energy consumption.

**Box 6.9**

**Development trends of Latvian construction sector**

In the 3rd quarter of 2009, the construction volumes decreased by 36.8% in comparison with the 3rd quarter of previous year. In comparison with the 3rd quarter of 2008, a particularly rapid decrease was observed in the field of residential building construction, including construction of one-apartment buildings, as well as construction of industrial manufacturing buildings and warehouses.

In the 3rd quarter of 2009, the building authorities have issued 584 building permits for one-apartment building construction, capital repairs, reconstruction, and renovation with the total area of 118.3 thousand m² which is by 42% less than in the 3rd quarter of 2008. 63% from the number of permits issued for the construction of one-apartment buildings have been issued for construction of new buildings (in the 3rd quarter of 2008, these were 67% from the total number of building permit issued).

In the 3rd quarter of 2009, the construction cost index decreased by 3.6% in comparison with the 2nd quarter of 2009. In 9 months of 2009, the construction production volumes (comparable prices), in comparison with the respective period of the previous year, decreased by 34.1%, including a decrease of the building construction volumes by 48.1%, and of engineering structures – by 17%.

In the 3rd quarter of 2009, the construction production volumes (in current prices) were LVL 288.1 million. In comparison with the 2nd quarter of 2009, according to seasonally balanced data in comparable prices, they have decreased by 20.2%, including construction of buildings by 29.5%, and of engineering structures – by 14.5%. In the 3rd quarter of 2009, in comparison with the respective period of the previous year, according to the balanced data of the working days in comparable prices, the production volumes have decreased by 36.8%, including the decrease in the volumes of building construction by 53.3%, and of engineering structures – by 19.5%.

**Box 6.9 continued**

The building and repair volumes have decreased in the field of highway and road construction, i.e. by 42.9%, of administrative buildings – by 60.3%, of residential buildings – by 73.1%, of retail sales and wholesales buildings – by 76%, and of industrial manufacturing buildings and warehouses – by 78.5%. However, the volumes have grown by 45.7% in the field of health care and social security building construction, as well as in the local piping and cable construction – by 28.8%, and construction at ports – by 24.5%.

With the decrease of investments in construction and increase of competition in the building sector, the building costs continue to fall, which is related both with reduced work remuneration for employees and with cheaper energy resources, as well as with cheaper machinery and equipment maintenance and operation costs.

The volume of Latvian builders' work abroad, in comparison with the total construction volume, is rather small. In the 1st quarter of 2009, construction works of about LVL 7.2 million have been performed abroad. Foreign builders in Latvia, however, have performed construction works of LVL 10.1 million in 2008. With decreased demand for construction services in Latvia, the building enterprises are becoming more active in extending their operations outside of the territory of Latvia.

The tendency that many building enterprises cannot compete in the internal market and they have to terminate their business activities in the building sector has continued in 2009. In the 3rd quarter of 2009, the number of building enterprises registered in the Construction Company Register has decreased by 34 % in comparison with the respective period in 2008. By 1 November 2009, out of 7690 registered enterprises 931 companies have been removed from the register.

**Improving business environment by reducing administrative obstacles**

Since 1995, the *Construction Law* is in force and 11 amendments have been implemented in it, thus creating mutual contradictions. The *Construction Law* is not harmonised with the *Administrative Procedure Law*, therefore the administrative processes in construction take place in accordance with the administrative case law which is often contradictory with the aim and meaning of the *Construction Law*.

The construction process does not conform to the existing situation and is rather rigid, as well as requires many inexpedient decisions and required coordination. In accordance with the assessment carried out in the framework of the World Bank's study *Doing Business*, Latvia takes the 78th place in the field of construction procedure coordination. At the same time, the existing structure of the *Construction Law* does not allow for an additional simplified procedure and definition of exceptions.

At the moment, the Ministry of Economics is forwarding a new draft *Construction Law* with the following aims:

- ensuring the construction of safe and high quality buildings, i.e. assigning particular importance to quality;
- promoting sustainable and harmonised development of the architectonic environment, by defining the tasks, responsibilities and rights of each construction process participant;
- ensuring balanced interests of the society and individuals in the construction process;
- promoting development of the building sector by increasing the positive impact on economic development;
- promoting rational use of environmental and natural resources and conservation of environmental quality.

The draft law envisages simplifying the administrative process of construction by waiving the drafting of inexpedient documents.

In order to decrease the number of necessary permits in construction designing, to promote increased energy efficiency in buildings, and to ensure sustainability of the buildings and efficient use of energy resources, amendments were implemented on 7 April 2009 in the Regulations of 1 April 1997 of the Cabinet of Ministers *General Construction Regulations* providing for:

- a simplified renovation procedure for new building façades that will make it easier for the owners of the buildings to renovate the facade, insulate the facade and roof, and change the roofing, which is especially important at the moment, as it will allow the apartment owners to participate in the absorption of the European Structural Funds. Implementation of such procedure has the following benefits: the customer is not required to submit a construction application–register card to the construction authority, and thus is not required to receive the planning and architecture specifications and a building permit; the project documentation is simplified and the building does not have to be commissioned;
- that the construction authority requests the customer to receive the technical and special regulations in cases when it is stipulated by the legislative acts in the respective fields, i.e. in the future, the customer will not be required to receive the technical and special regulations from the State Fire and Rescue Service and the Health Inspectorate;
- the procedure under which the construction authority is entitled to extend the validity term of the planning and architecture specifications and of an accepted construction design in case the construction works have not been started;
- a requirement that the construction authority issues the planning and architecture specifications along with the technical and special regulations issued by the respective local government;
- clarified content of the sketch project;

– a requirement to incorporate calculations of energy efficiency of the building in the technical project of the building.

**Box 6.10**

**Improvement of the normative base of construction**

Legislative acts passed in 2009:

1. The Regulations No. 26 of 13 January 2009 of the Cabinet of Ministers *Regulations on Energy Auditors*;
2. The Regulations No. 39 of 13 January 2009 of the Cabinet of Ministers *Calculation Method for Energy Efficiency of Buildings*;
3. The Regulations No. 40 of 13 January 2009 of the Cabinet of Ministers *Regulations on Energy Certification*;
4. The Regulations No. 167 of 24 February 2009 of the Cabinet of Ministers Amendments to the Regulations No. 520 of 18 December 2001 of the Cabinet of Ministers *Regulations on Latvian Building Standard LBN 207-01 "Geotechnique. Building Foundations and Base"*;
5. The Regulations No. 377 of 28 April 2009 of the Cabinet of Ministers Amendments to the Regulations No. 567 of 21 July 2008 of the Cabinet of Ministers *Regulations on Latvian Construction Standard LBN 208-08 "Public Buildings and Structures"*;
6. The Regulations No. 438 of 19 May 2009 of the Cabinet of Ministers Amendments to the Regulations No. 331 of 22 May 2007 of the Cabinet of Ministers *Public Hearing Procedure for Planned Buildings*;
7. Amendments to the *Construction Law* adopted by the Saeima on 12 June 2009;
8. Amendments to the *Law on Safety of Hydroelectric Power Plant Structures* adopted by the Saeima on 12 June 2009;
9. The Regulations No. 1000 of 1 September 2009 of the Cabinet of Ministers *Regulations on the Latvian Building Standard LBN 209-09 "Few-storey Residential Buildings"*;
10. The Regulations No. 1033 of 8 September 2009 of the Cabinet of Ministers Amendments to the Regulations No. 38 of 1 February 2000 of the Cabinet of Ministers *Regulation on Latvian Building Standard LBN 222-99 "External water supply network and objects"*;
11. The Regulations No. 1166 of 13 October 2009 of the Cabinet of Ministers Amendments to the Regulations No. 299 of 13 April 2004 of the Cabinet of Ministers *Regulations on Accepting Structures for Service*;
12. The Regulations No. 1181 of 13 October 2009 of the Cabinet of Ministers Amendments to the Regulations No. 600 of 13 July 2004 of the Cabinet of Ministers *Construction Procedure for Structures related to Radiation Safety*;
13. The Regulations No. 1192 of 20 October 2009 of the Cabinet of Ministers Amendment to the Regulations No. 10 of 8 January 2008 of the Cabinet of Ministers *Supervision Procedure for Construction, Reconstruction, and Maintenance of Municipal Roads, Commercial Roads, and Building Roads*;
14. The Regulations No. 1228 of 27 October 2009 of the Cabinet of Ministers Amendments to the Regulations No. 3 of 2 January 2008 of the Cabinet of Ministers *Railway Construction Regulations*.

**Optimising the institutional structure of construction**

On 12 June 2009, the Saeima adopted amendments to the *Construction Law*, in the framework of which reorganisation of the State Construction Inspectorate was performed, thus clarifying the competence of the Ministry of Economics with respect to the construction control, as well as distributing the functions of the State Construction Inspectorate among:

– the Public Utilities Commission – supervision and control of energy supply enterprises (and units thereof and energy using facilities and equipment) that carry out commercial activities which include production, purchase, transmission, distribution or selling of heat and electricity, but which, in accordance with the legislative acts, do not require a licence for these operations, and supervision of safety of hydro-technical structures of hydroelectric power plants, as well as control of conformity of these structures and their operation with the regulatory legislative acts requirements;
– the Consumer Rights Protection Centre – supervision and control of observation of legislative acts requirements for technical supervision of dangerous facilities;
– the Ministry of Internal Affairs – issuance and re-registration of registration certificates, their extension or cancelation for enterprises that wish to perform industrial blasting, provide pyrotechnic services, keep pyrotechnic products, explosives, detonators or auxiliary materials thereof necessary for performance and provision of the afore mentioned works and services.

As of 1 July 2009, the Building, Energy and Housing State Agency was also reorganised distributing its functions among the Ministry of Economics, Privatisation Agency, and the Investment and Development Agency of Latvia.

The aim of the **housing policy** is to foster quality and accessibility of the housing by ensuring a normative base for efficient management of residential buildings, fostering the establishment of a housing fund in the territories of local governments, and supporting energy efficiency measures in residential buildings.

**Residential building management** is a very important process, which becomes more essential after privatisation of residential buildings when they are handed over for management to the apartment owners.

The legislative acts adopted in the period from 1995 to 2002 regulated privatisation of apartments, rights of apartment owners, and provision of social support in the field of housing, as well as concerned the adjustments with respect to the use of land and housing construction. However, until now, in Latvia, there was no law regulating the management procedures of residential buildings. The legislative acts did not stipulate the minimum requirements for maintenance and conservation of residential buildings or the rights, duties, and responsibility of persons involved in the management process of residential buildings. Therefore, the management of residential buildings was in many cases of poor quality, which created or may create threats for people, property, and the environment.

In order to ensure qualitative management and administration of residential buildings, in 2009, *Law on Residential Building Management* was adopted, and this law is based on the following principles:

– continuity of the management process;
– optimum choice of management methods;
– maintenance and improvement of the area surrounding the residential buildings;
– inadmissibility of safety or health exposure of individuals;
– maintenance of the quality of residential buildings.

The *Law on Residential Building Management* defines the main activities to be performed in the framework of the management process of residential buildings, the qualification level of the residential building's owner, as well as the rights, duties, and responsibility of the owner of the residential building.

**Box 6.11**

**Accessibility and energy efficiency of buildings**

On average, the housing area used by one household in Latvia in comparison with other European Union Member States is the smallest – in 2003, it was 55.4 m², while in other European Union Member States this area was 80–125 m². The average living area per person in Latvia in 2003 was one of the smallest – 23.9 m², while in other European Union Member States it was on average 30–52 m². The housing fund on average per resident in Latvia during 1990–2008 has gradually increased by 7.1 m². These principal indicators of the housing fund show that, due to low purchasing power, the residents in Latvia mainly choose small housing areas which have a small number of square metres per person.

Taking into account that more than 97% of the state and municipal residential buildings have been handed over for privatisation, the local governments do not have a sufficient housing fund to fulfil their autonomous function – to support citizens in solving housing issues. In order to promote accessibility of housing areas, during 2006–2008, the local governments were granted earmarked subsidies for solving the housing issue – construction of social residential buildings, construction of municipal tenements, reconstruction of buildings owned by the local governments, and purchase of separate apartments. Owing to the earmarked subsidies, in the territories of local governments, 968 apartments have been built and reconstructed, which is approximately 0.1% from the total number of housing areas in Latvia in 2008.

The majority of apartments in Latvia using both the state and local government funds, and funds of physical and legal persons was built in 1990, i.e. 13 325 apartments. During 1996–2003, the volumes of apartment construction decreased – the number of apartments built ranged from 830 to 1483 apartments per year. After 2003, the highest indicator of apartment construction was reached in 2008 when the number of apartments built was 8084.

During 2006–2009, the state provided support to families with children and tenants of denationalised buildings or buildings handed over to their rightful owner, who could not privatise the apartment they were renting as the state handed this property over to its rightful owner. The Mortgage and Land Bank of Latvia issued 226 warranties amounting in total to about LVL 2.4 million for granting of mortgages to purchase or build housing areas to families with children, while tenants of denationalised buildings or buildings handed over to their rightful owner were issued 5 warranties amounting in total to over LVL 271 thousand. The state also granted co-financing to the local governments of approximately LVL 17.5 million for housing vacation allowances to 2405 tenants of denationalised buildings or buildings handed over to their rightful owner.

In Latvia, over 25% of the residential buildings were built before 1945, when mainly brick, stone wall, and wood structures were used, and more than 71% of the residential buildings were built in the period of 1945–1990, when the buildings were mainly constructed using building materials that are non-compliant with the modern heat and technical requirements, as well as with the environmental requirements. Therefore the housing fund in Latvia is outdated and has low heat resistance.

For quality performance of certain management activities, it is envisaged to define the minimum requirements with respect to sanitary maintenance of residential buildings to be carried out in the framework of technical maintenance, operating repairs, renovation, and reconstruction. It is also planned to define the minimum requirements for ensuring energy efficiency of residential buildings.

In order to promote housing fund sustainability and efficient use of energy resources, also improving quality of life of the residents, since 2009, the apartment owners can access co-financing of the state and the European Regional Development Fund (ERDF) for **the improvement of heat resistance of multi-apartment residential buildings.**

1) State co-financing for energy efficiency measures is granted to apartments owners for the following purposes:
   – energy audit of a multi-apartment residential building – 80% of the energy audit costs, but not exceeding LVL 400;
   – renovation of a multi-apartment residential building carried out in 2008 – 20% of the total eligible costs of the renovation project;
   – energy efficiency assessment particularization in accordance with the legislative acts requirements – LVL 100;
   – drafting of a technical project for a multi-apartment residential building or preparation of simplified renovation documentation if a standard solution is not available – 80% of the

technical project or simplified renovation documentation preparation costs, but not exceeding LVL 2500;
- preparation of a technical survey opinion for a multi-apartment residential building – 80% of the technical survey opinion costs, but not exceeding LVL 400.

The total co-financing of state for the aforementioned measures is LVL 698 034. At the end of October 2009, the state co-financing had been absorbed by 6.5% from the available amount. Using the state financial support, the necessary documents have been prepared for implementation of heat resistance improvement measures in 36 multi-apartment residential buildings.

2) ERDF grants co-financing to apartment owners for the following purposes:
   - construction works in parts of multi-apartment residential building owned by joint ownership, ensuring implementation of energy efficiency improvement measures defined in an energy audit;
   - preparation of project documentation and construction supervision, as well as author supervision of the project.

In the framework of the activity, the available ERDF funding is LVL 14.1 million, while the co-financing of funding beneficiaries is LVL 2.5 million.

The maximum allowed funding intensity is 50% or 60% (if 10% of apartment owners have moderate means) from the total eligible project costs.

For the local governments to be able to provide the population groups exposed social exclusion risk with quality and heat efficient housing, since 2008, ERDF co-financing is available for **the heat resistance measures of social residential buildings**.

ERDF co-financing is granted to local governments for the following activities supported by the project:
- preparing the project documentation and project supervision;
- decrease of energy resource consumption of the building;
- building renovation or reconstruction if implementation of at least two of the measures defined in the building energy audit is ensured.

The total ERDF co-financing available in the framework of the activity – LVL 6.9 million. The funding of the state and local governments is not less than LVL 2.3 million.

Co-financing of LVL 2.7 million or about 38% has been used from the available amount.

Implementation of the energy efficiency measures in residential buildings will decrease the heat consumption costs and will foster employment, which has an essential impact during the recession of the state economy. The available state aid for implementation of energy efficiency measures has to a great extent promoted also the taking over of the residential houses for management by the apartment owners. According to the data provided by the SJSC "Privatisation Agency", during the first half of 2009, the apartment owners took over by 36% more residential buildings for management than during the respective period of 2008.

In the framework of the state property privatisation and alienation, in 2009, the Ministry of Economics has prepared and forwarded 20 Cabinet of Ministers draft decrees regarding the handing over non-privatised parts of residential buildings and residential buildings belonging to the state to local governments, as well as regarding handing over the residential buildings belonging to the state for privatisation, and regarding selling the real estate of the state if the local governments have refused to take possession of them.

### 6.3.4. Tourism Policy

The main goal of Latvian tourism policy is to promote growth of the tourism sector turnover and its share in the economy, as well as to increase the export capability of tourism services in the medium term by stimulating changes in the structure of demand and supply.

In 2009, the Ministry of Economics, other ministries and social partners of the tourism sector continued active work to solve different issues concerning the tourism sector. In order to promote cooperation between the ministries, local governments, enterprises, as well as associations and foundations, and to foster development of tourism, the Latvian Tourism Advisory Council (LTAC) actively continued its work and met for joint meetings on January 28, June 17 and September 11, 2009. Taking into account the current situation in the tourism sector, the LTAC includes also representatives from the Riga City Council and the Latvian Association of Large Cities.

With the aim of solving issues related to tourist safety and ensuring efficient information exchange among the competent authorities, in August 2009, the Expert Commission of the Latvian Tourism Advisory Council had been established. The commission includes representatives from the Ministry of Foreign Affairs, Ministry of Finance, Association of Hotels and Restaurants of Latvia, Consumer Rights Protection Centre, Riga City Council, Riga municipal police, State Police, as well as Excise Goods Administration of the State Revenue Service.

In order to increase efficiency and decrease expenditures, in summer 2009, the Ministry of Economics carried out the reorganisation of the Latvian Tourism Development Agency (LTDA). Having analysed the functions of the LTDA and the resources necessary for their implementation, changes were implemented in its organisational structure and operational priorities. Effective positioning of Latvia and promoting its recognisability in tourism markets have been set as LTDA's operational priorities.

In order to ensure the involvement of public administration authorities and private persons in the implementation of the tourism policy, the LTDA's Advisory Council had been established. This council comprises authorised representatives from the Ministry of Foreign Affairs, Riga City Council, professional and regional tourism associations, as well as from the advertising sector.

In July 2009, in order to ensure the implementation of the tasks delegated to the Cabinet of Ministers under Article 11(5) of the *Tourism Law* (June 12, 2009 version *Amendments to the Tourism Law*), as well as to improve the legislative base regulating operation and responsibility of tourism firms (service providers offering tourism packages – tourism agencies and tourism operators), the Ministry of Economics established a Working Group, the task of which is to develop draft regulations of the Cabinet of Ministers establishing the procedure for development and implementation of tourism package services, information to be provided to the customer and customer's rights and obligations, procedure for registering tourism agencies and tourism operators in the tourism agency and operator data base.

**Box 6.12**

**The most significant changes in legislative acts regulating tourism:**

– the fine stipulated in the Latvian Administrative Violations Code for the unwarranted excess of the single fare (tariff) in taxi cabs has been cancelled, as currently the single tariff is not being applied anymore (draft law *Amendments to the Latvian Administrative Violations Code*, approved by the Cabinet of Ministers on September 1, 2009, submitted to the Saeima);
– the obligatory certification of tourism guides (draft laws *Amendments to the Tourism Law* and Amendments to the Law *On Regulated Professions and Recognition of Professional Qualifications*) has been cancelled, approved by the Cabinet of Ministers on July 28, 2009, submitted to the Saeima);
– the rights of the Licensing Commission had been supplemented, clarifying cases when the commission is authorised to annul, refuse to issue or refuse to re-register the special permit (license) or the place of operation entry in the special permit (license) (Regulations No. 1095 of the Cabinet of Ministers "Amendments to the Regulations No. 662 of August 30, 2005 of the Cabinet of Ministers *Procedure for Excise Goods Circulation*, approved by the Cabinet of Ministers on September 22, 2009);
– clarifications in relation with the competence of the Latvian Tourism Development Agency in compliance with its reorganisation (Law of June 12, 2009 *Amendments to the Tourism Law*);
– the obligation requiring that enterprises submit a filled-in non-resident's declaration to the police within 24 hours has been cancelled (Regulations No. 524 of the Cabinet of Ministers "Amendments to the Regulations No. 226 of April 3, 2007 of the Cabinet of Ministers *Regulations on the filling-in, keeping and submission procedure of non-resident's declaration forms*, approved by the Cabinet of Ministers on June 9, 2009).

In order to ensure the implementation of the state tourism policy as provided for in the *Tourism Law*, funding is allocated every year for the development of tourism in the framework of the public budget programme *Implementation of Tourism Policy*. In 2009, in the framework of the public budget programme *Implementation of Tourism Policy*, LVL 1.08 million were earmarked, but with the amendments to the state budget of June 16, 2009, the total amount was LVL 0.97 million.

**Box 6.13**

**Latvian tourism development indicators**

In 2008, the Central Statistical Bureau performed the first satellite account calculations of Latvian tourism, according to which the share of tourism specific sectors in the total output in 2004 and 2005 comprised 5% and 8% respectively.

In 2008, the export of tourism services formed 17.7% from the services export of Latvia. The share of tourism services in the total exports of goods and services of Latvia (LVL 6.7 billion) accounted for about 6%.

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). Total expenditures of foreign tourists in Latvia also increased reaching LVL 403.2 million, which is by 19.3% more in comparison with 2007 (LVL 338 million). In 2008, the number of persons employed directly in the tourism sector compared with the previous year remained almost unchanged – more than 34 000 persons.

The indicators of the tourism balance of payments were still negative – in 2008, expenditures of the residents of Latvia abroad exceeded the expenditures of foreign tourists in Latvia by LVL 181.9 million. In 2008, the average duration of visits of foreign tourists in Latvia remained unchanged – 1.4 days, not reaching the planned annual growth to 2.5 days, which may be explained by 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, in the end of 2008, there were about 491 tourist campsites in Latvia, which is by 22.8% more than in the end of 2007. In 2008, the number of persons served in hotels and other tourist campsites increased by 4.6% amounting to 1555.9 thousand.

In 2009, the economic situation in the country and in the world in general, as well as the increase of the VAT rate (especially to guest accommodation places) negatively influenced the overall development of the tourism sector.

In 2009, the absorption of the EU Structural Funds continued for the programming period of 2007–2013. The total planned financing for the measure 3.4.2 *Tourism* of priority 3.4 *Quality Environment for Life and Economic Activity* of the supplement to the operational programme *Infrastructure and Services* was LVL 29.8 million.

**Box 6.14**

**Utilisation of the European Regional Development Fund resources**

In 2008, the 1st selection round of the project applications was organised in the framework of the activity 3.4.2.1.1 *Development of Nationally Important Tourism Products by Conservation, Restoration and Adjustment of Urban Planning Monument Infrastructure* with the available funding of LVL 5.6 million from the ERDF financing. In 2009, 8 contracts on the implementation of projects were concluded for the total ERDF amount of LVL 5.22 million. It is planned to complete the implementation of these projects in 2012.

In 2008, the selection round of project applications was organised in the framework of the activity 3.4.2.1.2 *Development of Velo-Tourism Product of National Importance* for all available funding (LVL 4.92 million from the ERDF financing). In 2009, 7 contracts on the implementation of projects were concluded for the total ERDF amount of LVL 4.7 million. It is planned to complete the implementation of these projects in 2011.

In accordance with the Minutes No. 23 (§ 47) of the Cabinet of Ministers' meeting of April 7, 2009 the implementation of sub-activity 3.4.2.1.3 *Development of Cultural, Active, Health and Recreational Tourism Product of National Importance* and activity 3.4.2.2 *Development of Tourism Information System* had been postponed, withdrawing their funding. Thus, the ERDF financing earmarked for the measure 3.4.2 *Tourism* had been reduced to LVL 15.46 million.

From September 14 until October 16, 2009 the 2nd selection round of project applications had been organised in the framework of the activity 3.4.2.1.1 *Development of Nationally Important Tourism Products by Conservation, Restoration and Adjustment of Urban Planning Monument Infrastructure*. The ERDF financing available in the round is LVL 5.32 million.

The state policy for tourism development is implemented by the **Latvian Tourism Development Agency** (see Box 6.15).

**Box 6.15**

**Activities of the Latvian Tourism Development Agency in 2009**

By implementing the action plan for 2009, the Latvian Tourism Development Agency:

– organised the participation in 8 international tourism exhibitions in high priority markets (in Lithuania, Estonia, Latvia, Finland, Norway, Germany, Japan and Great Britain), in one of them – in the fair *ITB 2009* in Berlin, by participating in a joint Baltic stand together with the state tourism organisations from Lithuania and Estonia;
– organised 7 work seminars for tourism professionals: two of these were organised in Moscow (Russia), one in St. Petersburg (Russia), one in Kiev (Ukraine), one in London (Great Britain), one in Oslo (Norway) and one in Gothenburg (Sweden);
– published 10 types of informative materials on tourism: 5 types of regional maps of Latvia (in Latvian, Russian, English, German, Lithuanian and Estonian), brochures about top tourism objects in Latvia (in English and German), brochures about tourism routes in Latvia (in English, German and Russian), brochure with Christmas and New Year offers (in English);
– organised 30 journalist visits where in total about 80 media representatives from 17 countries took part;
– maintained and developed Latvia's tourism portal *www.latviatourism.lv* – created the content and the technical concept of the portal, its content database (information, audio, video, photo), electronic photos and tourism marketing material libraries, developed technical materials for webinars;
– in cooperation with the Lithuanian and Estonian national tourism organisations organised the campaign of promoting the Baltic tourism products *Grand Travelling round the Baltic States 2009*, including 10 objects from Latvia and organising a wide marketing campaign which attracted over 40 000 participants;
– organised already the third international work seminar for tourism professionals *Buy Latvia. Buy the Baltics 2009*, attracting 147 foreign and local tourism companies, which participated in 24 introductory tours during which they were provided an opportunity to visit and acquaint with different services and products offered by Latvian tourism sector companies;
– launched a foreign tourist survey in which a total of 3000 respondents were interviewed in order to find out their opinion about the service quality of Latvian tourism, sources of information, motivation and satisfaction level with respect to their trips to Latvia;
– ensured development of the 1st stage of the Tourism Services System of Latvia *Q-Latvia*, defining the procedure for granting *Q-Latvia*, developing assessment criteria for services in accommodations, TIC and tourism objects by testing assessment criteria and developing content of trainings;
– until July 1, 2009, maintained database with tourism service providers, registered and issued notifications to over 200 service providers;
– ensured publishing of the professional tourism magazine "Turisms" (Tourism);
– in cooperation with the Latvian Country Tourism Association "Lauku celotajs" (Countryside traveller), organised Latvian country tourism conference, while, in cooperation with the Association of Hotels and Restaurants of Latvia, organised a conference on the impact of the economic crisis on the tourism sector and operation of hotels in Latvia;
– in cooperation with the Ministry of Economics, the LTDA implemented the European Commission project *Most prominent European tourist destinations 2009* (EDEN), the theme of 2009 is *Development of tourism in protected nature territories*. In Latvia, the winner was Tervete Nature Park;
– ensured implementation of the activities of *Leonardo da Vinci* project *Improving Tourism Quality*;
– ensured preparation of 4 project applications promoting development of tourism in the framework of EU fund project tenders and other financial instruments;

**Box 6.15 continued**

– supplemented 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;
– organised the annual e-Business Academy conference of the European Travel Commission, in Riga, October 20–23, 2009;
– ensured the activity of the Baltic Tourism Bureau in Berlin which is active in the German market by popularizing tourism offers of Latvia and the Baltic States: 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;
– prepared 3 tourism newsletters in 3 languages (English, German and Russian) for foreign tourism professionals and mass media representatives;
– organised annual Latvian Tourism Forum;
– ensured the operation of tourist help-line and developed a new tourism information line providing tourists with 24-hour information a day in several foreign languages;
– organised a competition for the best tourism products and tourism marketing activities;
– created the strategy for Latvia's tourism image;
– organised a campaign for the promotion of the local tourism in Latvia using the social network website on the Internet and encouraging the Latvia's residents to travel around Latvia even after the end of active tourism season;
– implemented the pilot project for cooperation with Japan carrying out marketing activities on the Japanese market and attracting two charter flights to Latvia.

**International cooperation in the field of tourism**

In 2009, Latvia continued to develop and strengthen closer cooperation in the field of tourism with other countries. Issues related to the promotion of cooperation in the field of tourism are regularly included in the agendas of foreign visits of intergovernmental commissions and chief state officials.

The successful continuation of the cooperation in the field of tourism was discussed during the second meeting of the Latvian – Ukrainian Intergovernmental Commission for Economic, Industrial, Scientific and Technical Cooperation in Kiev, and during the 5th meeting of the Latvian – Belorussian Intergovernmental Commission for Economic, Scientific and Technical Cooperation in Liepaja.

During the visit of the President of the state, Mr. V. Zatlers, in Azerbaijan, which took place on August 9–13, 2009, in Baku, the third meeting of the Latvian – Azerbaijan Intergovernmental Commission for Economic, Scientific, Technical and Culture Cooperation was organised. In the framework of this meeting, the *Agreement of the Republic of Latvia and the Republic of Azerbaijan on cooperation in the field of tourism* was signed. The agreement stipulates that both countries shall mutually exchange information and knowledge in the field of tourism, promote exchange visits of mass media representatives, scientists and other experts of tourism sector, as well as foster the organisation of workshops, conferences, and working groups related to tourism with the aim of exchange of experience, etc.

On September 16, 2009, in Riga, during the first meeting of the Latvian – Georgian Intergovernmental Commission for Economic, Industrial, Scientific and Technical Cooperation, the *Memorandum of the Ministry of Economics of the Republic of Latvia and the Ministry of Economic Development of the Republic of Georgia on cooperation in the field of tourism* was concluded. This memorandum foresees promotion of development of group and individual tourism via national tourism administrations, as well as in the scope of the competence, to promote further development of direct flights in order to intensify the tourist flow between the two countries. The parties via their tourism administrations are planning to provide support in the establishment of contacts and cooperation development among tourism organisations, journalists and experts, as well as to promote organisation of events related to tourism.

In 2009, the Ministry of Economics repeatedly ensured coordination and approval of the draft *Agreement of the Republic of Latvia and the Russian Federation government on cooperation in the field of tourism.* The agreement was adopted and approved in the meeting of the Cabinet of Ministers on July 28, 2009. It envisages strengthening the development of group and individual tourism, cooperation of public and private sector, information exchange, cooperation in the framework of international organisations, exchange of journalist and expert delegations, as well as implementation of training and research. A Joint Tourism Committee will be established for the implementation of the agreement.

In order to ensure further international integration of Latvian tourism sector, representation of state interests, and adoption of better practice, international cooperation is being developed, e.g., taking part in the European Travel Commission of the United Nations World Tourism Organisation, Tourism Advisory Committee and Sustainable Tourism Working Group of the European Commission.

## 6.4. Business Environment

On 9 September 2009, the most recent **World Bank Study *Doing Business 2010*** was published. (Table 6.3 and 6.4)[1]

Table 6.3

**Baltic States Performance in the Study of the World Bank *Doing Business***

| | 2010 | 2009 | Changes |
|---|---|---|---|
| Latvia | 27 | 29 | +2 |
| Lithuania | 26 | 25 | -1 |
| Estonia | 24 | 22 | -2 |

In the most recent study, Latvia has improved its indicators by stepping up two places in the total rating. The neighbouring countries Lithuania and Estonia have lost their positions in the study respectively by 1 and 2 places, however, they are still ahead of Latvia.

Table 6.4

**Assessment of Latvia's business environment**
(place in the rating)

| | 2010 (183 countries) | 2009 (181 countries) | Changes |
|---|---|---|---|
| Starting business activity | 51 | 35 | -16 |
| Building permits | 78 | 78 | 0 |
| Regulation of labour legal relations | 128 | 125 | -3 |
| Property registration | 58 | 79 | +21 |
| Credit availability | 4 | 12 | +8 |
| Protection of investors' rights | 57 | 53 | -4 |
| Tax payments | 45 | 37 | -8 |
| Foreign trade | 22 | 17 | -5 |
| Contract execution | 15 | 2 | -13 |
| Termination of business activity | 88 | 89 | +1 |
| **Total ranking** | **27** | **29** | **+2** |

Latvia has received a considerably better position in the field of property registration; the reforms with respect to business termination have been assessed as positive, however, property registration, regulation of labour legal relations, receiving building permits, termination of business activity, as well as tax payments and starting of business activity are still the fields which require reforms in order for Latvia's business environment to become attractive for both local entrepreneurs and foreign investors.

Since 1999, the ***Action Plan to Improve the Business Environment*** in Latvia is being developed. The Action Plan of 2009, approved by the Cabinet of Ministers on 16 January 2009, includes 74 measures, which include the measures for improving the tax system, simplifying the building process and introducing territory planning, improving the insolvency process, improving the tax administration, developing the e-services, promoting the development of tourism, and rational use of land resources.

**Simplification of the insolvency procedures.** On 1 July 2009, the Law on *Amendments to Insolvency Law* came into force, envisaging simplified insolvency procedures – a judicial remedy process will be initiated when 51% of creditors vote approvingly (instead of former 2/3); the judicial remedy process has been extended to 2 years; creditor decision on bankruptcy does not need to be submitted to the court.

In order to improve the legal framework of insolvency, the Ministry of Justice has developed a draft *Insolvency Law*. The draft law determines that legal persons in a situation of insolvency will have the possibility of using two principal processes: judicial remedy process (JRP) and insolvency process of a legal person. "Settlement" and "Recovery" will be deleted from the law. The insolvency process may end with either execution of obligations or bankruptcy. A possibility to switch to JRP during the insolvency process has been envisaged. The draft law was adopted in the cabinet of Ministers sitting of 17 November 2009.

**Identification of pre-emption rights of the local governments.** The Ministry of Regional Development and Local Governments has developed amendments to Article 78(1) and (4) of the *Local Governments Law* stipulating that local governments have the pre-emption rights if, within the administrative territory of the local government a real estate is being alienated, which, in accordance with the territory planning of the local government, is necessary for execution of functions of the local government, and stipulating that the procedure according to which the local governments will be using the pre-emption rights and the procedure according to which the borders related with the use of the pre-emption rights of the local government will be registered in the land register, will be defined by the Cabinet of Ministers. Saeima adopted the draft law *Amendments to the Local Governments Law* during the first reading on 26 November 2009.

It must be noted that the stipulation of certain cases of pre-emption rights in the legislative acts has a positive impact on *Doing Business* indicator with respect

[1]The World Bank project *Doing Business* (*www.doingbusiness.org*) is an international, comparative business environment rating which annually measures the administrative procedures regulating business and application thereof in various world countries. Since 2004, when this rating was developed and examined business environment in 130 countries, including Latvia, it has been gradually improved and expanded. 2010 rating comprises business environment of 10 different fields in 183 countries.

to property registration section, i.e. the time has been reduced (20 days).

**Decreasing the number of procedures for real estate registration process.** As of 7 September 2009, at all Land Register's departments it is possible to pay with payment cards using POS terminals. *Regulations on State Duty for Registration in Land Book of Property Rights and Collateral Rights* of 27 October 2009 stipulate regulatory framework for verification of state duties in the State Treasury Information System, thus ensuring a possibility for the Land Register's department to check the execution of payments.

The amendments to the *Law on Real Estate Tax* provide that, as of 1 July 2010, statement in a paper form confirming the payment of real estate tax will not be necessary anymore, as the magistrates of the Land Register's departments, when registering the change of owners (if the property has been alienated or bestowed), will check the payment of real estate tax in the online data transfer mode.

**Defining technical requirements for certain types of buildings.** *Regulations on the Latvian Construction Standard LBN 209-09 "Low-rise Residential Buildings*" of 1 September 2009, stipulate minimum requirements that must be observed when designing new, reconstructed and renovated low-rise residential buildings and auxiliary constructions of all types. The construction standard stipulates the amount of information that the customer must define in the designing task in order to ensure that the designed building would satisfy the customer's wishes and initial idea. The construction standard stipulates the minimum content of the construction design of low-rise residential buildings.

**Defining hygiene requirements for buildings.** As a result of repeated discussions of the state and local governments, the Ministry of Health has concluded that development of additional hygiene requirements applicable to designing is not necessary.

It must be noted that withdrawal of this function has a positive effect on *Doing Business* indicator with respect to the building permits section, i.e. both the time (28 days) and the costs (LVL 13) are reduced.

**Simplifying the procedure of circulation of foreigner declarations.** It is envisaged to simplify considerably the work of tourism operators: the former provision of a 24 hour deadline for submission of filled-in declarations to the State Police has been deleted. The Cabinet of Ministers has approved amendments to legislative acts repealing certification requirements for tourism guides.

**Decreased requirements for the share capital of newly established companys.** The Ministry of Justice has developed a draft law *Amendments to the Commercial Law*, which was supported by the Cabinet of Ministers during a sitting of 24 November 2009 and which stipulates that the amount of the share capital of a limited liability company is LVL 100.

**Electronic submission of customs declarations.** On 17 June 2009, the Cabinet of Ministers adopted regulations *On Procedure of Electronic Submission of Customs Declarations when Carrying Out Customs Clearance* which stipulate that when submitting and signing the customs declaration electronically in the *Electronic Declaration System* (EDS), the person's user identification and password will be considered as a substitute for the person's handwritten signature on the customs declaration. This procedure concerns export and transit declarations and comes into force on 1 July 2009.

**Simplifying requirements for preparing waybills with SRS number.** On 1 December 2009, the Saeima adopted *Amendments to the Law on Taxes and Fees* repealing the use of waybills with the State Revenue Service (SRS) numbers, as well as the law *Amendments to the Law on Value Added Tax* providing for the procedure according to which a tax payer numbers the issued value added tax invoices and provides information to the SRS on locally supplied goods and provided services. The Ministry of Finance must draft and after the adoption of the *Amendments to the Law on Taxes and Fees* and the *Amendments to the Law on Value Added Tax*, following the defined procedure, must submit for consideration to the Cabinet of Ministers draft regulations Amendments to the Regulations No. 585 of 21 October 2003 of the Cabinet of Ministers *Regulations on the Conduct and Organisation of Accounting* in order to improve the regulatory framework of drafting and use of justifying accounting documents and organising accounting registers.

**Reducing information to be included in PIT statement.** On 1 December 2009, the Saeima adopted *Amendments to the Law on Personal Income Tax*. Amendments have been adopted to the *Budget Law 2010*. The provisions of the draft law stipulate that the employer must provide the employee with a statement on amounts paid to a physical person only upon a written request by the employee.

**Decreasing amounts of general excise goods guarantees in certain cases.** With Article 6 of the *Amendments to the Law on Excise Duties* the Cabinet of Ministers powers as granted by Article 32 of the *Law on Excise Duties* have been expanded providing the Cabinet of Ministers with the right to determine cases when the excise duty guarantee is not necessary. Considering the above-mentioned, the Regulations of 30 August 2005 of the Cabinet of Ministers *Regulations Regarding Guarantees of Excise Duty for Alcoholic Beverages, Tobacco Product,s and Mineral Oils* have been supplemented. Due to the amendments, entrepreneurs will be able to apply a 99% excise duty guarantee reduction in accordance with the criteria stipulated by the Regulations of 27 December 2005 of the Cabinet of Ministers *Regulations Regarding the Application of Customs Debt Guarantee in the Customs Institutions of the State Revenue Service.*

**Simplified technical requirements for cash-registers and cash-register systems with electronic control tapes.** In the amendments to the Cabinet of Ministers Regulations of 20 February 2007 *Regulations regarding Technical Requirements for Electronic Devices and Equipment for Registration of Taxes and Other Payments* that came into force on 22 August 2009, technical requirements have been stipulated with respect to cash-registers and cash-register systems with electronic control tape, envisaging:

– the possibility for registering tax and other payments to use also cash-registers and their systems that ensure a precise reproduction of all printed cashier's checks, requisites of X statement and Z statement in the electronic data carriers – electronic control tape;
– the possibility to use paper control tape in cash-registers and their systems has been maintained;
– it has been stipulated that the cash-register system may be equipped with the accounting mechanism for cash nominal received;
– now the cashier's checks do not have to include the number or name of the cash-register or cash-register system department provided that the requisite is shown on X and Z statements.

**Decreasing administrative burden for enterprises in the field of public procurements. The** amendments to the *Public Procurement Law* that came into force on 13 August 2009 comprise a provision that in the future the notices issued by the SRS and the Register of Enterprises for open tenders (procurement procedure used in most cases) are to be required only from the potential tender winner. A provision has been envisaged concerning all procurement procedures that stipulates that the contracting authority must obtain the respective information on candidates and applicants in the public data bases and only in cases when it is not possible to obtain it using such means the contracting authority is entitled to request the candidate or the applicant to provide notices comprising the necessary information.

**Simplified procedure for investigation of accidents at work.** The Regulations of 25 August 2009 of the Cabinet of Ministers *Procedures for the Investigation and Registration of Accidents at Work* envisage simplifying the investigation of accidents at work and their registration form, thus decreasing the burden on the employer with respect to investigation and registration of accidents at work (the registration form has been simplified merging it with the form on an opinion on the accident at work, which ensures that the form is on one page; the registration form will not envisage such codes as *Occupational Classificatory code*, *administrative-territorial code, General Economic Activity code*, codes of the injured body parts and types of health problems; it is envisaged that many of the documents currently requested will not be required, if they are not directly related with the accident thus decreasing the administrative burden.

**In the future, the minimum fine will be applied or a warning issued for violations of fire safety regulations, as well as integrated controls of large unit groups will be performed less frequently.**

In order to promote **economic development by tax policy aid** and to prepare proposals for amendments to legislative acts on taxation, in accordance with the Prime Minister's decree of 20 July 2009 *On a Working Group on Tax Policy Revision for Economic Development*, a working group was established comprising representatives from the public sector and NGOs.

The *Informative Report on Tax Policy Revision for Economic Development* was approved at the Cabinet of Ministers sitting of 15 September 2009. In accordance with the Cabinet of Ministers protocol decision of the sitting of 29 September 2009 *On Measures to be Implemented Regarding Tax Policy Revision for Economic Development*, the competent institutions were delegated tasks for implementation of the tax measures for economic development.

Several of these measures were included in the package of the *Draft Budget Law 2010* and approved by the Saeima on 1 December 2009:

– **simplified CIT advance payment procedure for newly established tax payers.**

In the first taxation period and period until the submission of annual statement, newly established tax payers will be able to make corporate income tax (CIT) payments voluntarily. The tax payer will be able to adjust his advance tax payments not only in cases when net turnover has decreased considerably, when the tax payer's type of activity or revenue and expenditure structure has considerably changed, but also if profit has decreased;

– **extended taxation period, as well as introduction of the "cash desk principle" for small tax payers.**

For small tax payers with annual turn over up to LVL 70 thousand, the "cash desk principle" will be applied – the Value Added Tax (VAT) will have to be paid after the money for the transaction has been received, and not upon receiving the invoice. Likewise, for enterprises with taxable transactions amount up to LVL 10 thousand a taxation period of 6 months has been defined, while for taxable transactions amount up to LVL 35 thousand – a quarter. The deadline of the VAT payment to the state budget has been extended to 20 days after the end of the taxation period instead of former 15 days;

– **new system for recovery of overcharged VAT.**

A new system for recovery of overcharged VAT has been developed defining that after receiving the tax declaration on taxation period, the SRS transfers within 30 days the overcharged VAT to the next taxation period until the end of taxation year covering the amount of VAT to be paid to the state budget over the next taxation periods (first covering the tax debts, if any). Upon conclusion of taxation period, the SRS repays the overcharge transferred to the next taxation periods within 30 days after 1 May of the year following the taxation year. In statutory cases, the taxable persons may request the overcharged VAT accumulated during the taxation period to be repaid before the end of taxation period;

– **possibility to extend the payment deadline of delayed tax payments.**

It will be possible for tax payers to request the tax administration to distribute repeatedly in certain periods or temporarily postpone up to six months delayed tax payments to be made to state and local government budgets, the payment deadline whereof had already been extended or distributed in periods.

Amendments to the *Law on Value Added Tax* concerning the guarantee for indebted VAT has been adopted by the Saeima on 22 October 2009 and came into force on 1 December 2009.

In 2010, it is envisaged to introduce tax exemption for large investments in priority sectors as defined by the Cabinet of Ministers, as well as it will be stipulated that the general guarantee certifications of the excise duty are termless, and ensured that the former guarantees will be timely withdrawn; the threshold of VAT registration will be increased up to LVL 35 thousand; the conditions for writing off lost debt will be simplified; as well as fiscal representation concept will be introduced in the legislative acts system of Latvia.

In 2009 (August–October), the Ministry of Economics in cooperation with LLC "Laboratory of Analytical Studies and Strategies" carried out another, already 5th, **Entrepreneur Inquiry – Study on Business Environment in Latvia.**

The aim of the entrepreneur inquiry is via stratified simple random sample sociological method to learn the opinion of Latvian entrepreneurs regarding the administrative procedures of the state and local governments in relation to registering of companies, building approval, registering of property, employment legal relationships, tax paying, foreign trade, licensing and permit issuance, environmental requirements, insolvency procedure, inspections, state aid, investor protection and availability of financial resources, as well as other fields.

The inquiry comprised 735 respondents using *face-to-face* interviews at the economically active enterprises in Latvia (the highest ranked official of the enterprise was interviewed).

In accordance with the results of the study, more frequently than other impediments the tax rates affecting entrepreneurship were mentioned as impediments, namely, in case of 76% entrepreneurs.

Over ½ of entrepreneurs recognised also laws and regulations in the field of taxation, tax administration (55%), and frequency of statutory and regulatory changes (52%) as impediments.

The entrepreneurship of approximately a half of the entrepreneurs is burdened by lack of financial resources (49%).

Comparatively fewer enterprises are affected by such impediments as organised crime and mafia (9%), registration process of new companies (9%), checks of the State Police (9%) and provisions concerning employment of foreigners (6%).

With respect to state and local government institutions and the quality of services provided by them, the entrepreneurs expressed the most positive opinion about the work of the State Fire and Rescue Service (SFRS) – 90% of the enterprises, where SFRS has performed inspections, have assessed the work of the service as very good, good or rather good. Also, relations with the SRS are assessed by the absolute majority of entrepreneurs as positive – 85% of the entrepreneurs have evaluated it as very good, good or rather good. However, relationships with the local government tax administrations have been assessed as positive in considerably fewer cases – only 39% of the entrepreneurs have given a positive evaluation. Observing the previous year in general, the following quality assessment changes can be seen with respect to the work of inspections: in every accounting period, evaluation of the work of the State Labour Inspectorate is gradually decreasing (from 4.7 points in 2007 to 4.4 points in 2009), over the last three accounting periods, the evaluation of the work of the State Sanitary Inspectorate has been gradually increasing (from 4.3 points in 2007 to 4.7 points in 2009).

**Better regulation.** In accordance with the *Guidelines for Development of the Public Administration Policy for 2008–2013*, the aim of Latvia is to reduce the administrative burden on average by 25% by 2013.

In **the field of environmental protection**, since 2008, work is carried out for reduction of the administrative burden under the recommendations of the European Commission. Since the beginning of 2009, amendments to the Regulations No. 294 of 9 July 2002 of the Cabinet of Ministers *Procedures by which Polluting Activities of Category A, B and C shall be Declared and Permits for the Performance of Category A and B Polluting Activities shall be Issued* have come into force envisaging the possibility for persons engaged in polluting activity to submit an application for a permit also in electronic format, as well as for the competent authority to issue the permit in electronic format for persons carrying out activities of simplified procedure "small" facilities (C category). Besides, activities with minimum impact on the environment have been excluded from the scope of category C under these Cabinet of Ministers regulations.

On 10 December 2010, the Saeima adopted *Amendments to the Law on Pollution* which incorporates a procedure for transition to issuance of termless A and B categories permits. A respective procedure for issuance of termless permits has been envisaged for water resources management permits. Since 2008, waste management permits issue under the procedure stipulated in the legislative acts, are valid for 8 years instead of former 5 years. All amendments to the legislative acts in the field of environmental protection are assessed from the perspective of reduced administrative burden.

In 2009, the **Ministry of Agriculture** has continued the research *Assessment of the administrative burden and costs with respect to the food safety legislative framework*, 2nd stage. Draft proposals have been developed for reduction of administrative burden in the field of food production and circulation. At the moment, specification and harmonisation of the draft among the Ministry of Agriculture and the authors of the research is in progress. Final results of the research will be available in December 2009.

**The State Chancellery** is the responsible institution for the implementation of activity 4.1.2 *Reduction of Administrative Burden and Improvement of Public Services Quality* of priority 4 *Administrative Capacity* of the EU Structural Funds *European Social Fund*. In the framework of the priority, the project *Reduction of Administrative Burden and Simplifying Administrative Procedures* has been submitted. The planned measures, *inter alia*, envisage *ex-post* analysis of the legislative acts for identification of administrative burden, identification and development of necessary actions (on the basis of results obtained in the framework of the research) for reduced administrative burden, as well as implementation of identified measures, implementation control and assessment. It is envisaged to implement the project from December 2008 to November 2013. During the 2nd half of 2009 – 1st half of 2010, interim research will be carried out to identify fields where it is expedient to apply the administrative burden measurements. The first results are expected in the second half of 2011.

In Latvia, for **impact assessment**, a legislative acts annotation system has been developed (competent institution – State Chancellery) which envisages impact assessment of the legislative acts (economics, incl. impact on business environment, social, environmental, administrative procedures aspect). This is regulated by the Cabinet of Ministers Instructions No. 20 of 18 December 2007 *Procedure for Filling the Draft Legislative Acts Annotation* which envisage an improved annotations system that came into force on 1 March 2008, while the calculation of the administrative burden in relation with impact on performers of economic activity and physical persons – on 1 July 2008.

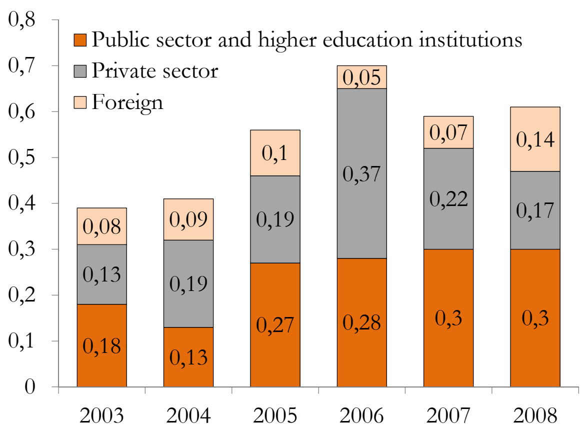
## 6.5. Innovation and New Technologies

During 2006–2008, on average only 19.5% of companies were innovative. The total financing for research and development in Latvia in 2008 was 0.61% of GDP or LVL 99.5 million, which is by LVL 11.6 million more than in 2007. At the same time, the private sector investment in research and development continues to decrease and it fell by LVL 5.1 million in 2008 when compared to 2007, and is only 0.17% from GDP. In 2008, foreign sector funding, incl. the EU Structural Funds, for research and development has increased significantly, and was 0.14% from GDP. In the public and high school sector funding for research and development in 2008 was 0.3% from GDP and has maintained the level of 2007. It is forecasted that during 2009–2010 the total funding for research and development may decrease as the state budget funding for scientific operations and innovation support measures has been significantly reduced; it is planned that partly this reduction could be compensated with the EU Structural Funds financing for research and development.

In 2009, mainly the activities launched during the previous years were continued in order to foster industrial research, development of new products, and introduction into the market.

Figure 6.3

**Funding for research and development for 2003–2008 by sectors**
(% of GDP)




Source: CSB

In order to promote technology transfer, the Investment and Development Agency of Latvia continues to support the activity of 8 technology transfer contact points (University of Latvia, Riga Technical University, Riga Stradina University, Latvia University of Agriculture, Ventspils University, Rezekne Higher Education Institution, Daugavpils University, and Art Academy of Latvia). The main directions of the activity of technology transfer contact points are: providing information concerning scientific institution services, knowledge and technology transfer, preparation of commercialisation offers of research results, organisation of cooperation seminars, conferences, and contact information exchanges among the entrepreneurs and scientists. The programme is financed from the resources of the European Regional Development Fund. The total available funding of the activity until 2013 is LVL 1.93 million.

In the framework of the Enterprise Europe Network project for 2009, the Investment and Development Agency of Latvia in cooperation with the Latvian Technological Centre continues to support technology transfer among enterprises. In 9 months of 2009, technology audits have been performed in 48 enterprises; conclusion of 12 technology transfer contracts has been initiated; 19 informative workshops regarding technology transfer issues, creative thinking and innovation have been organised.

The Investment and Development Agency of Latvia continues its support to 55 projects approved during the 1st selection round of the EU Structural Funds programme *Support to introduction of new products and technologies into production*. In the framework of the programme, businesses have an opportunity to receive support for initial investment in fixed assets (acquisition and mounting of equipment, acquisition of patents and licences), which directly ensure introduction of new products or technologies into production. The next project selection round is planned for the 1st quarter of 2010.

The Investment and Development Agency of Latvia also continues its support to 121 projects approved during the 1st selection round of the EU Structural Funds programme *Development of New Products and Technologies*. In the framework of the programme, businesses have an opportunity to receive support for industrial research and experimental development, *inter alia* development of prototypes. The next project selection round is planned for the 2nd quarter of 2010.

In 2009, the Investment and Development Agency of Latvia organised a project selection tender *Support for Establishment of New Export Enterprises*. The aim of the measure is to develop innovative entrepreneurship in Latvia by establishing new exporting enterprises, as well as to create a sufficient transaction flow for the existing risk capital funds. In the framework of the project, the authors of the business ideas had an opportunity to establish a cooperation with the mentors and potential investors, partners willing to cooperate within the idea implementation process, and the most successful authors had an opportunity to receive financing in the amount of up to LVL 5000 for development of the business idea. The authors of ideas could submit their projects for participation in the tender to the Investment and Development Agency of Latvia from 31 August–1 October 2009. In total, 109 projects were submitted for the project tender from which 13 projects were approved.

In 2009, the Investment and Development Agency of Latvia launched implementation of the EU Structural Funds programme activity *Measures to encourage innovations and business start-ups* with the aim of informing the society and raise awareness about innovations. The goal of the programme is to inform and to encourage a maximum number of individuals, especially youth, to start business activities, raise the prestige of business, as well as to foster understanding of the society about the role of innovations for promoting competitiveness, inform the society about events related to innovations and potential thereof, thus encouraging as large part of the society and businessmen as possible to turn to development and use of innovative solutions. In the second half of 2009, in the framework of the programme, debate competitions for pupils, Technical Creation Days, training courses *Become an Entrepreneur in 5 Days*, competition of business ideas *Idea Cup 09*, workshops for authors of innovative ideas in Riga in the regions of Latvia, and the programme *Pupils' Training Enterprises*, as well as a mentoring programme have been organised. In the framework of the innovative business motivation programme, in 2010, it is planned to implement the following measures:

- practical training measures for starting an innovative business;
- increasing the understanding of teachers with respect to the opportunities of innovative businesses by promoting practical training;
- implementation of the training programme *Pupils' Training Enterprises*;
- organisation of workshops for authors of innovative ideas and providing mentoring programmes;
- organisation of debate competitions on issues of innovative business;
- organisation of competitions for business plans and ideas for starting innovative business and development of innovations in business.

In 2009, the Ministry of Economics continued the development of the state aid programme *Competence Centres* with the main goal of implementing cooperation of scientists and businesses and increase competitiveness of businesses by promoting cooperation of the research and industry sectors to implement industrial research, new product manufacturing, and technology development projects. The programme will be financed from resources of the European Regional Development Fund. The total public funding for the programme is LVL 36 million and it will ensure the attraction of private sector funding for research and development measures of LVL 12.1 million. It is envisaged to launch the programme implementation in the 1st quarter of 2010.

## 6.6. Information Society

Information society is a social development phase based on free mutual exchange of information, developing a knowledge-based economy. Information society consists of the technological base (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 telecommunications technologies, information and knowledge are increasingly 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 expansion of ICT[1] 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 internet and to develop and ensure an efficient e-government.

According to the CSB data, the share of ICT[1] sector within GDP reached 4.2% in 2008. In 2008, 3078 companies operated in the ICT sector in Latvia, employing 24 947 persons, company turnover reached LVL 2.6 billion, staff costs – LVL 200 million. The value added of ICT production reached LVL 45 million, provision of ICT services – LVL 562 million. The external trade balance of ICT was negative: LVL 242.1 million, because the imports exceeded exports considerably, which were LVL 444.3 million and LVL 202.2 million, respectively.

**Box 6.16**

**Use of computers and Internet in Latvia**

According to the data of the CSB survey *Computer and Internet Usage in Households*, 60% of all households (households with at least one person in the age group of 16–74 years) had computers and 58% of households had Internet connection in 2009. The best situation with accessibility to Internet was for households in the regions around Riga (computers – 69%, Internet – 65%) and in the Riga region (computers – 66%, Internet – 64%), while in the other regions the situation was worse – in Zemgale region (computers – 59%, Internet – 61%), Kurzeme region (computers – 54%, Internet – 54%), Latgale region (computers – 51%, Internet – 44%), and Vidzeme region (computers – 50%, Internet – 48%). 61% of inhabitants used a computer and Internet on a regular basis (at least once a week). 50% of all households had broadband Internet connection.

At the beginning of 2009, 93% of all companies having 10 and more employees had computers, 86% of such companies had Internet connection, and 42% of companies had their own Internet website. In 2008, 62% of companies having 10 and more employees used Internet for communications with the public and local government institutions. 29% of all employees of companies used computer on a regular basis, while computer connected to the Internet was used regularly by 25% of employees.

At the beginning of the 2008/2009 academic year, the number of computers per 100 full-time students at higher education institutions and colleges was 14, 10 computers per 100 students at professional education institutions, but 9.4 computers at general education schools. From the total number of all educational institutions, all higher education institutions and colleges, 87% of professional education institutions, and 99.7% of general education schools had Internet connection.

Along with accession to the EU, the EU initiatives have become binding to Latvia (see Box 6.17), which refer to development of the information society. [1]

[1] The ICT sector is established 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, checking, testing, navigation, and other purposes; designing and mounting 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 databases and Internet portals; repair and maintenance of computers and office equipment; other actions related to computers).

**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 obtain 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 procurement, etc.

In April 2008, the European Commission published a medium-term report for establishment of *i2010*, which includes a comparison of the progress of EU Member States in the implementation of the initiative. The rapid progress of Latvia in establishment of broadband Internet in 2007 is marked in the report, as well as the good knowledge level of ICT specialists. Latvia considerably lagged behind from the EU average indicators in such sectors as e-government, e-business, and e-health in 2007. The main reason was the small investment volume of both public and private sector into the ICT sector.

In the European Digital Competitiveness Report 2009, which analyses the progress of *i2010* strategy during 2005–2009, it is pointed out that the development of the information society in Latvia is still lagging behind the EU average indicators, although Internet use and user skills are comparatively good. The Internet users are active users of the newest services on the Internet. In terms of broadband Internet speed, in 2008, Latvia was 6th among the EU Member States. However, in terms of broadband Internet accessibility and the number of Internet connections in households in rural areas, Latvia significantly lagged behind the average EU indicators. The number of businesses with broadband Internet connections was also low (62%), leaving Latvia as 23rd among the EU Member States. This was one of the reasons why e-commerce and e-business in Latvia lags behind the average EU indicators.

In fall 2009, discussions were launched on the development of the ICT sector in the EU after 2010. During its EU presidency, in September 2009, Sweden published its vision on development of the ICT sector in the EU until 2015 *Green Knowledge Society*. This document outlines 3 main subjects: development of knowledge-based society; development of the ICT sector, overcoming the current economic crisis; and ICT role in the fight against the climate change. 10 policies are proposed for the following 5 years: 1) knowledge economy: driver of future wealth; 2) knowledge society: participation for all; 3) green ICT: support for an eco-efficient economy; 4) next generation infrastructure: balancing investment with competition; 5) soft infrastructure: investing in social capital; 6) SMEs and ICT: supporting the small firms of Europe; 7) a single information market: enabling cohesion and growth; 8) revolutionising eGovernment: rethinking delivery of public services; 9) online trust: a safe and secure digital world; 10) clear leadership: rethinking the EU policy making process.

On 18 July 2006, the Cabinet of Ministers approved *Development Guidelines of the Information Society for 2006–2013*, which set the lines of action for development of the information society in Latvia.

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.

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 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* as of 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 Decree No. 689 of 10 November 2008 of the Cabinet of Ministers stipulated that the Electronic Procurement State Agency shall be merged with the Secretariat of Special Assignments Minister for Electronic Government Affairs as of 1 January 2009. Pursuant to the Decree of the Cabinet of Ministers of 1 April 2009 No. 220 *On reorganization of the Secretariat of Special Assignments Minister for Electronic Government Affairs*, as of 1 June 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. Information on e-procurement and development of e-services now is available on the website of State Regional Development Agency (*www.vraa.gov.lv*), while the information on e-government and the policy of information society – on the website of Ministry of Regional Development and Local Government (*www.raplm.gov.lv*).

According to the data of the State Regional Development Agency, the total sum of general agreements on procurement in 2008 reached LVL 6.2 million which ensured savings of about LVL 1 million. 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, SJSC "Latvijas Pasts" introduced the e-signature service and started the issue of e-signature smart cards. 30 thousand e-signature smart cards were issued until the end of 2008. Since the further purchase of smart cards will be performed by institutions at their own budget expenses, it is anticipated that at the end of 2010, the number of smart card holders will decrease to 5 thousand.

Taking into account the small amount of available electronic services and financial loss caused by introduction and maintenance of e-signature, on 1 June 2009, SJSC "Latvijas Pasts" transferred the provision of certification services function to the JCS Latvia State Radio and Television centre.

On 12 January 2010, the Cabinet of Ministers supported the *identification cards concept* developed by the Ministry of Regional Development and Local Governments, envisaging introduction of electronic identification cards. The card will be a person's identification and travel document in the EU, as well as the means for a person's electronic identification and authentication for electronic services, and also an e-signature carrier. The cards will be issued by the Office of Citizenship and Migration Affairs. The functions of reliable certification services provider will be carried out by a service provider selected in the framework of a tender procedure.

Considering the small number of e-signature smartcards users and budgetary restrictions, on 12 January 2010, the Cabinet of Ministers repealed the Order No. 810 of 17 December 2007 *On concept of establishing an electronic election system.*

According to the *Eurostat* data, Latvia in 2007 had introduced 6 basic services or 30% (average in the EU – 58%) of the 20 basic electronic services. Introduction of new e-services took place in 2008 and 2009 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 the broadband Internet connections reached 17.4% in the beginning of 2009 in Latvia (EU average – 22.9%) of all Internet connections. Owing 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, an 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 a 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 Employment.*

**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-Commerce**[1]

15.9% of all companies in 2008 having 10 and more employees had made purchases over the Internet, but 5.2% of companies had sold services and goods over the Internet. The turnover of the goods and services purchased over the Internet in Latvia constituted 4% of the total purchases in 2008, but the turnover of the goods sold over the Internet amounted to 4.4% of the total net turnover. According to *Eurostat*, the total turnover of e-commerce of EU companies amounted to 12% in 2008.

In the 1st quarter of 2009, 26% of all the population or 38% of Internet users had made purchases or ordered goods or services over the Internet for own needs at least once in a life. Purchases over the Internet are mainly made by the

[1] Data source on Latvia: CSB; data source on EU: *Eurostat*

users in the age group from 25 to 34 years (51% of Internet users).

On 28 June 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 the industry by facilitating growth of production volumes of high value added products.

In the framework of the programme, in order to promote development of e-commerce, on 16 June 2009, the Ministry of Economics, in cooperation with LDAL, organised a workshop *How to prepare for e-commerce?*. At the workshop, CD *E-commerce for Beginners – Guide to E-commerce* was presented, developed by the Ministry of Economics in cooperation with LLC "RIDemo".

## 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 6.18).

**Box 6.18**

**The number of small and medium-sized enterprises in Latvia**

There were 69 863 economically active individual enterprises and commercial companies (provisional information) in Latvia in 2008 (excluding agricultural and fishing farms and self-employed persons, who perform economic activities), of which 99.3% belonged to the category of SMEs. The distribution of economically active SMEs in Latvia is the following: micro enterprises – 78.6%, small enterprises – 17.3%, medium-sized enterprises – 3.5%, large enterprises – 0.6%.

An important indicator characterising the economic activity is the number of economically active enterprises and commercial companies per 1000 inhabitants. This indicator in Latvia has grown constantly over the last 7 years from 17 in 2001 to 31 in 2008.

However, it is of the same importance to emphasize the number of performers of individual work at piece rate (self-employed persons) (provisional information), which amounted to 42 769 in 2008 (19 per 1000 inhabitants), and the number of agricultural and fishing farms, which equalled to 13 276 in 2008 (6 per 1000 inhabitants). Taking into account the fact that there is no single methodological practice among the EU Member States for calculating the indicator characterising the economic activity as the number of enterprises per 1000 inhabitants, it is difficult to conduct objective comparative analysis of this indicator. The current practice of the responsible EU institutions shows that calculation of the number of enterprises per 1000 inhabitants includes not only businesses and commercial companies, but also self-employed, agricultural and fishing farms, etc. Therefore, applying an analogous practice accordingly, it has been calculated that, in 2008, Latvia had 56 performers of economic activity per 1000 inhabitants.

According to statistical data of "Lursoft" and the Register of Enterprises of the Republic of Latvia, 11 347 individual enterprises and commercial companies were registered in 2008, while 4764 were liquidated. In 11 months of 2009, 8540 individual enterprises and commercial companies have been registered, while 5396 have been liquidated.

Aid to SMEs in Latvia is regulated by the ***Law on Control of Aid to Commercial Activity***, which came into force on 1 January 2003.

On 27 January 2004, the Cabinet of Ministers approved the ***Policy Guidelines for Development of Small and Medium-Sized Enterprises in Latvia*** establishing the basic principles of activity of the government, long-term objectives, and sub-objectives, as well as the main directions of activity of the SMEs development policy. The goal of the guidelines is to promote favourable business environment, encourage initiatives of entrepreneurs and lessen the general risk, prevent obstacles to entrepreneurship, and foster stability and efficiency of the financial system and of the capital market in order to improve competitiveness of enterprises in the market.

The guidelines foresee implementation of a policy based on the best practices of the developed countries in accordance with the directions of activity outlined in the *European Charter for Small Enterprises* and other EU documents, at the same time taking into account the specifics of SME development problems in Latvia.

On 28 June 2007, the Cabinet of Ministers approved the ***Programme on Promotion of Entrepreneurship Competitiveness and Innovation for 2007–2013*** developed by the Ministry of Economics.

The programme includes policy actions for promotion of business competitiveness, innovative activities and industrial development, describing the vision for the next 7 years of competitiveness, innovation and industry development. The main goals of the programme are to provide favourable conditions for business development, to promote increased capacity and efficiency of the National Innovation System, to achieve substantial growth of industrial competitiveness and productivity, fostering increased volumes of manufacturing products with high added value.

**Box 6.19**

**Definition of SMEs**

***Law on Control of Aid to Commercial Activity*** establishes the definition of SMEs (according to the European Commission Regulation No. 70/2001 and amendments by the European Commission Regulation No. 364/2004, as well as pursuant to the European Commission Recommendation No. 361 of 6 May 2003):

medium-sized enterprises:
- number of employees: 50–249;
- annual turnover does not exceed EUR 50 million;
- total annual balance sheet value is under EUR 43 million;

small enterprises:
- number of employees: 10–49;
- annual turnover does not exceed EUR 10 million;
- total annual balance sheet value is under EUR 10 million;

micro enterprises:
- number of employees: 1–9;
- annual turnover does not exceed EUR 2 million;
- total annual balance sheet value is under EUR 2 million.

On 30 October 2009, by the order No 748 of the Cabinet of Ministers *Conception of support activities of the micro-enterprises* was approved. Activities included are referable to physical persons – performers of economic activities, individual merchants, owners of individual enterprises, farms and fishermen's farms, as well as legal entities – in a form of limited liability companies, which comply with the following criteria:
- net turnover (incomes from economic activities) is less or equal with LVL 70 000;
- number of employees not more than 5 (all LLC shareholders are considered to be employees);
- if micro-enterprise is registered in commercial register as LLC , it's owners in the same time are also members of the board;
- founders and participants of the micro-enterprise are just physical persons.

By defining privileges of registration, tax or receipt of financing in special laws and regulations additional restrictions to the criteria of micro-enterprises might be determined.

The programme defines specific measures to be implemented for improvement of the business environment, promotion of the availability of finances, development of new entrepreneurship initiatives and fostering their competitiveness, promoting awareness of the society about the role of innovation in promotion of competitiveness, for contribution to cooperation of industrial, educational and scientific sectors, transfer and commercialisation of knowledge, as well as for promotion of industrial development and improving productivity thereof.

On 30 October 2009, the Cabinet of Ministers approved the ***Conception on Support Measures for Micro Enterprises*** with the aim of:
- reducing the costs related with launching commercial activity of micro enterprises;
- implementing a tax policy, which is friendly for micro enterprises;
- ensuring that the micro entrepreneur is able to do his own accounting;
- ensuring the availability of funding for micro enterprises;
- ensuring availability of complete information for micro enterprises.

***The Mortgage Bank of Latvia*** (hereinafter – Mortgage Bank), which is the only 100% state owned bank in Latvia and fulfils the functions characteristic for a development bank, has a substantial role in trading support instruments[1].

At the moment, the most significant support programme implemented by the Mortgage Bank is the *Support Programme on Improvement of Competitiveness of Enterprises* approved by the Cabinet of Ministers on 13 May 2008. By approving this programme, the government intended to support enterprises oriented towards the international market, manufacturing products or providing services with a high added value, technologically intensive manufacturing enterprises, as well as establishment of new enterprises, providing investments and liquid assets loans. The Mortgage Bank started implementation of the programme in June 2008, using the funds attracted from deposits for granting loans. Financial market crash in the fall of 2008 stopped the attraction of the financial resources for the programme needs, thus the granting of new loans was restricted. In the framework of the programme, by the end of 2008, 32 loans were granted for a total of LVL 9.9 million, including LVL 7.2 million for investment loans and LVL 2.7 million for loans for current assets.

In February 2009, the Cabinet of Ministers adopted regulations *On Loans for the Improvement of Enterprise*

[1] In October 2006, the Cabinet of Ministers accepted the conception *On Development of the State Joint Stock Company "Mortgage and Land Bank of Latvia" for 2007–2013* envisaging a gradual transformation of the Mortgage Bank to a full-spectrum development bank. In fall 2009, a new conception has been drafted updating the tasks of the bank for transforming its operations into development bank functions.

*Competitiveness*, envisaging that until December 2013, the Mortgage Bank will grant loans for improvement of enterprise competitiveness in the amount of LVL 210 million[1]. In the framework of these regulations, the range of enterprises eligible for support was extended – together with the small and medium-sized enterprises, also large enterprises with economically substantiated action plans and without access to financing from the crediting institutions due to increased risk, may receive the support. These regulations stipulate that, in the framework of the programme, loans for investment and current assets will be granted with a maximum loan amount for each enterprise not exceeding LVL 6 million. The loans are mainly envisaged for implementation of projects of enterprises operating in the manufacturing sector and for enterprises which are attracting funding of the EU Structural Funds grant programmes.

Since the beginning of the programme for improvement of enterprise competitiveness, 230 loans have been funded with the total amount of LVL 84.4 million, including for current asset financing – 139 loans in total of LVL 27.4 million, and for investments – 91 loans in total of LVL 57 million. Sectors receiving most funding are timber processing, electricity production, food and beverages production, as well as construction, iron and its product manufacturing, chemical industry, and accommodation services.

In December 2008, the Cabinet of Ministers approved the ***Latvian Small and Medium-Sized Enterprises Micro Crediting Programme*** delegating its implementation to the Mortgage Bank. The programme is aimed at introducing a mechanism of micro crediting small and medium-sized enterprises and self-employed persons, as well as at promoting access to micro credits for starting business activity or its development. The micro credits are intended for implementation of business projects – loans for investments and current assets – for enterprises with up to 10 employees, as well as for self-employed persons operating outside Riga. The Mortgage Bank grants micro credits in the amount of up to LVL 3000, attracting, if necessary, cooperative credit unions, established by territorial principle and operating outside the territory of Riga City, in granting and monitoring the micro credits. 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 thousand[2] and financing from the Mortgage Bank in the amount of LVL 113 thousand. It is planned that in the framework of the programme micro loans will granted to 300 entrepreneurs. Since February 2009, when the implementation of the programme was launched, until now, the Mortgage Bank has already granted 87 loans for the total amount of LVL 244.3 thousand, including 49 loans for investments of 135.5 thousand in total and 38 loans for current assets in the total amount of LVL 108.8 thousand. Judging from the loan amounts, every fourth micro loan is related with retail sales, while other more represented sectors are light industry, social services, scientific and technical services, as well as car trade and repair services. So far during the implementation of the programme, interest in the loans has been shown by both newly established enterprises (for current assets or small investments) and existing SMEs for small investments or compensation of necessary current assets, thus gaining the possibility to continue and develop the economic activity.

In September 2009, the Cabinet of Ministers adopted regulations *On Loans for Promotion of Development of Micro, Small and Medium-Sized Enterprises and Agricultural Services Cooperatives*. In accordance with these regulations, the Mortgage Bank has to implement a new loan programme with the aim of improving the access to funding of persons performing economic activity and registered in Latvia, thus fostering economic development. It is envisaged that, in the framework of the programme, until 2013, for the promotion of development of micro, small, and medium-sized enterprises and agricultural services cooperatives, loans current assets and investments of LVL 142 million will be available. The maximum loan amount per person performing economic activity will be no more than LVL 300 thousand. At the moment, the programme is in the preparation stage. In October 2009, for implementation of the programme the Mortgage Bank concluded a loan agreement with the EIB for the amount of EUR 100 million, which will come into force after signing the state guarantee agreement.

Together with the Mortgage Bank and its branches, the ***Support Programme Department ALTUM*** (ALTUM) is also providing 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 start-ups, which are not financed by commercial banks due to insufficient collaterals and other risks of the project. In October 2008, ALTUM completed the implementation of two EU Structural Funds programmes: 1) In the framework of *ERDF*

[1] In November 2009, financial resources in the amount of LVL 130 million were at the disposal of the Mortgage Bank for implementation of the programme, including the loan of the Northern Investment Bank (NIB) in the amount of LVL 71 million, ERDF and state contribution in the amount of LVL 43 million, as well as crediting resources of the Mortgage Bank in the amount of LVL 16 million. By the end of 2009, the Mortgage Bank is planning to receive an additional loan from the European Investment Bank (EIB) of LVL 71 million, which also will be used for the implementation of the programme.

[2] Contribution from the Ministry of Finance consists of funding from the EU PHARE Programme LE9201 *First SME Financing Programme*, which, by the means of a letter from the European Commission dated 21 May 2007, is granted to the government of the Republic of Latvia for SME crediting.

*Crediting Programme for Business Start-ups*, 291 loans have been granted to business beginners in the amount of LVL 22.8 million; 2) in the framework of *ESF Training, Consulting and Financial Support Programme*, almost a thousand of potential business start-ups have been trained; loans for implementation of 327 start-up projects have been granted amounting to LVL 5.8 million; the start-ups also received grants for company establishment, consulting services costs, providing subsistence in the amount of about LVL 2.2 million.

On 31 March 2009, the Cabinet of Ministers approved regulations establishing the procedure of implementation of the programme ***Support to Starting Self-Employment and Entrepreneurship*** co-financed by the ESF. The implementing authority of the programme as in the case of previous ESF's programmes is the Mortgage Bank (ALTUM). The programme is aimed at increasing economic activity in the country, developing business knowledge and skills of start-ups, as well as providing financial support. It envisages a complete support to business start-ups and newly established companies, i.e. consultations, training, and financial loans (up to LVL 54 thousand) and grants[1] for starting an economic activity. Support may be granted to the working-age persons, including unemployed persons who have expressed the wish to start commercial activity or self-employment, as well as to the newly established companies. For the purposes of this programme, newly established companies are companies that have lawfully registered their activity not earlier than 3 years before requesting the support in the framework of the programme. The project amount envisaged in the business plan may not exceed LVL 60 thousand, and the beneficiary must at the same time provide co-financing for the implementation of the business plan of at least 10% from the total amount of the plan.

Total funding for the programme is LVL 23 million, including funding from the ESF's and the state budget – LVL 14 million, and co-financing of the Mortgage Bank of LVL 9 million. In the framework of the total funding of the programme, LVL 17.5 million is envisaged for loans, while LVL 4 million – for grants, training and consultations. It is planned that in the framework of the programme scope, by 2013, 1200 start-ups will be trained, while funding (loans and grants) will be received by 600 persons. The practical implementation of the programme has been launched in August 2009. Since launching of the programme until November, 819 potential entrepreneurs have showed interest in it, while cooperation agreements have been concluded with 291 entrepreneurs. 33 customers have submitted business plans, and 4 persons have been granted funding amounting to LVL 71 thousand in total. In November 2009, the tender for training providers has been concluded. In the framework of the programme, these persons will be providing training to the programme participants who have insufficient theoretical and practical knowledge for performing commercial activity and preparation of a business plan[2]. The training will be available for persons wishing to start an economic activity or having started it during last year.

The **"Latvian Guarantee Agency"** (LGA) is a state-owned company with the aim of supporting the accessibility to funding for small and medium-sized enterprises in Latvia, by issuing:

- **loan guarantees** as the necessary additional security for receiving a loan from a commercial bank;
- **financial leasing guarantees** as an additional security for receiving industrial leasing;
- **co-financing investments in Latvian small and medium-sized enterprises by specifically 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 beginning of the programme, the LGA has developed and introduced guarantee products of investment loan, current assets loan, and financial leasing. The LGA has also taken extensive informative measures, in order to inform the entrepreneurs and credit institutions about the guarantee products and procedure of their receipt. Results of the programme are summarized in the Table 6.5.

Table 6.5

**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, the LGA published a tender in 2005 for selection of managing companies of the risk capital funds. Eight applications were received of which the following companies were selected as winners: LLC "Zalas gaismas investicijas", JSC "Eko Investors", and

[1] A grant for starting of an economic activity (up to LVL 3.6 thousand, but not exceeding 35% from the amount of the loan); a grant for repayment of a loan (up to LVL 2 thousand, but not exceeding 20% from the amount of the loan).

[2] In the region of Riga, training will be provided by association of "College of Accounting and Finance" and "Biznesa komplekss"; in Vidzeme and Latgale regions – by association of LLC "Macibu un konsultaciju centrs ABC" and LLC "Mensarius"; in Kurzeme and Zemgale regions – by association of LLC "Stockholm School of Economics in Riga".

LLC "TechVentures Fondu Vadibas Kompanija" with which contracts were concluded establishing 3 risk capital funds – respectively limited partnerships: LP "ZGI fonds", LP "Otrais Eko fonds", and LP "INVENTO". By the end of 2006, the risk capital funds attracted private investors, among them several institutional investors of Latvia: JSC "Atklatais pensiju fonds SEB Unipensija" and JSC "Pirmais Slegtais Pensiju Fonds". The total signed capital of the risk capital funds in Latvian enterprises reached LVL 21.8 million. The risk capital funds started their investment activity at the beginning of 2007, by ending the year with investment in 15 enterprises with the total amount of LVL 3.5 million. After the conclusion of the programme in 2008, the number of enterprises having received support has increased to 28 and the total amount of investment – to LVL 11.7 million.

On 10 March 2009, the Cabinet of Ministers adopted Regulations No. 237 On activity 2.2.1.3. ***Guarantees for the Improvement of Enterprise Competitiveness*** of the Operational Programme *Entrepreneurship and Innovation*. The goal of the regulations is to provide the enterprises with access to funding for development of commercial activities and for implementation of the EU projects via ensuring guarantees in situations when the guarantee at the disposal of the enterprise is not sufficient to attract the credit resources in the necessary amount and when the banks evaluate the enterprise as too risky, as well as to facilitate competitiveness of businesses, promote absorption of new markets and consolidation in existing ones. The LGA guarantees are provided for such financial services as investment loans, current assets loans, financial leasing, and local factoring. The guarantees cover up to 80% of the principal amount of the financial service, but no more than EUR 3 million to one enterprise. The maximum term of a guarantee to loans investments and financial leasing is ten years, but it is three years for the current assets loans and local factoring.

On 20 April 2009, the LGA and the Ministry of Economics signed a contract on implementation of OP project *Guarantees for the Improvement of Enterprise Competitiveness* of activity 2.2.1.3 *Guarantees for the Improvement of Enterprise Competitiveness* of measure 2.2.1 *Access to Financial Resources* of priority 2.2 *Access to Finances* of Supplement *Entrepreneurship and Innovations*. The ERDF financing accessible in the framework of the activity is LVL 33.8 million.

Since the beginning of the programme, there is a considerable activity of businesses, as of October 31 2009, the LGA had received applications for guarantees from 209 companies – 117 of them have been approved and 85 are already issued.

The guarantees issued by 31 October 2009 and amounts thereof are shown in Table 6.6.

Table 6.6

**Guarantees issued by LGA in the framework of activity 2.2.1.3 *Guarantees for the Improvement of Enterprise Competitiveness* (02.04.2009–31.10.2009)**

| | 31 October 2009 |
|---|---|
| Number of applications (enterprises) | 209 |
| Amount of applications (million) | 88.8 |
| Number of the issued guarantees (enterprises) | 85 |
| Amount of the issued guarantees (million LVL) | 30.2 |
| Amount of the guaranteed credits (million LVL) | 58.5 |

Besides the guarantees, on 12 May 2009, aiming at improving the competiveness of enterprises, the Cabinet of Ministers adopted regulations *On Short-term Export Credit* defining coverage of short-term export credit guarantees, beneficiaries, as well as the procedure for granting of guarantees and the procedure under which the guarantor covers loss. The LGA's export credit guarantee covers up to 90 % from the deferred payment amount, but not exceeding EUR 1 million or an equivalent amount of another currency. The deadline of the deferred payment may not exceed 2 years.

In accordance with the Decree No. 571 of 24 August 2009 of the Cabinet of Ministers On Distribution of Funds of the Ministry of Finances Sub-programme *Funding for the Implementation of Projects and Measures Co-financed by Financial Aid of the European Union Policy Instruments and Other Foreign States*, in 2009 funding was granted to the Ministry of Economics sub-programme 27.06.00 *Implementation of the European Regional Development Fund Projects (2007–2013)* for activity 2.2.1.3 *Guarantees for the Improvement of Enterprise Competitiveness* of ERDF programming period 2007–2013 in the amount of LVL 13.8 million from which LVL 5 million were allocated for the implementation of the export credit instrument.

The guarantees issued by 31 October 2009 and amounts thereof are shown in Table 6.7.

Table 6.7

**Guarantees issued by LGA in the framework of activity 2.2.1.3 *Guarantees for the Improvement of Enterprise Competitiveness* (01.06.2009 – 31.10.2009)**

| | 31 October 2009 |
|---|---|
| Number of applications (enterprises) | 20 |
| Amount of applications (million) | 14.0 |
| Number of the issued guarantees | 5 |
| Amount of the issued guarantees (million LVL) | 0.2 |

## 6.8. Competition Policy

The Competition Council (hereinafter – CC) is responsible for the 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 free and fair competition, as well as to facilitate the development of competition within the public interests in all economic sectors.

The CC acts in compliance with the *Competition Law* and three directions of activity defined in the Operational Strategy of the CC for 2007–2009 – protecting competition, promoting competition and strengthening the role of the CC in development and implementation of EU legal acts, and in international organisations and networks.

**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 merge of enterprises. Since 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 – the CC does not implement the supervision of unfair competition anymore, while it examines the violations of the *Advertising Law* only in cases when the misleading or comparable advertisements significantly affect the competition in general. On September 1, 2009 the amendments to the *Competition Law* adopted on June 18, 2009 came into force ensuring supervision of merging in cases when the total market share of the player exceeds 40%, as well as clarifying the concept of dominant position in retail (see Box 6.20).

**Box 6.20**

**On September 1, 2009 new amendments to the *Competition Law* came into force**

The most significant changes envisaged by the amendments adopted on June 18, 2009 refer to controlling the merging of enterprises – these amendments stipulate that as from September 1, 2009 the permit from the Competition Council prior to merging must be received not only by the enterprises with the total turnover in the previous financial year in the territory of Latvia exceeding LVL 25 million, but also the enterprises with the total market share in the respective market exceeding 40%. Along with the incorporation of the 40% criterion, the Competition Council is provided with the possibility to prevent the creation or strengthening of dominant position in those economy sectors of Latvia that have small turnovers, thus the condition about the LVL 25 million turnover in the previous financial year may not be applied.

Several editorial clarifications have been made in relation with dominant position in retail, incl. a precise definition that the retailers must settle payments for fast circulation of food products, i.e. goods with the expiration date not exceeding 20 days, no later than within 30 days, thus implementing the protection of interests of fresh food manufacturers and in general clarifying this provision and simplifying its application.

In 10 months of 2009, the CC has in total adopted 28 final decisions from which 6 decisions concern breaches with respect to prohibited agreements, 13 – abuse of dominant position, 8 – in relation with the merge of enterprises and 1 decision concerning unfair competition.

The priorities of the CC relate to the identification and prevention of breaches of the *Competition Law* – prohibited agreements and dominant position abuse. In four cases examined in January – October 2009, the CC has identified violations in relation with prohibited agreements, while in three cases it has found abuse of dominant position. The most significant of these is the breach of the *Competition Law* and, at the same time, of Article 81 of the Treaty Establishing the European Community – a prohibited agreement among five enterprises distributing appliances manufactured by LLC Samsung Electronics Co. This violation entails not only competition distortion, but also an extended negative impact on consumers, who have been overcharged for the respective household appliances (see Box 6.21).

**Box 6.21**

**The CC inflicts penalty on the dealers of Samsung appliances for a prohibited agreement**

On October 30, 2009 the CC adopted a decision, where it identifies a prohibited agreement among five enterprises, which distribute appliances manufactured by LLC Samsung Electronics Co. The CC has found out that in 2007 and 2008 the dealer of Samsung appliances manufacturer in the Baltic States – LLC "Samsung Electronics Baltics" – and the largest distributors of its goods in the territory of Latvia – LLC "RD Elektroniks", LLC "PROKS", LLC "ELKOR TRADE" and LLC "ROTA un K" (which was then the owner of "Tehnoland" chain) – have participated in prohibited operations directed towards the division of the market, restricting free trade and implementing and maintaining a certain price level for Samsung goods.

The abovementioned enterprises have deliberately taken part in price fixing for Samsung goods at a desirable level, guaranteeing higher revenues at the expense of consumers, who paid more for these goods than they would have paid under conditions of fair competition. By introducing control measures and implementing or threatening to implement sanctions, the enterprises also made Internet shops to accept these prices, thus eliminating or significantly restricting the mutual competition among distributors and Internet shops.

**Box 6.21 continued**

The CC has also found out that, in the sales agreements with appliances wholesalers, the LLC "Samsung Electronics Baltics" has incorporated territorial restrictions for trading goods by prohibiting the sale of certain goods outside of the territory defined in the agreement without the permission of the LLC "Samsung Electronics Baltics". Competition, which could have reduced prices, was eliminated by preventing parallel imports into the Baltic States. The LLC "Samsung Electronics Baltics" strengthened its influence in the market by introducing a condition that the warranty repair for the appliances sold by it is available only in the region, where they have been purchased.

Therefore, the established prohibited agreement was present both at the vertical level between the LLC "Samsung Electronics Baltics" and the distributors of its goods, and at the horizontal level – among wholesalers LLC "RD Elektroniks", LLC "PROKS", LLC "ELKOR TRADE" and LLC "ROTA un K", which were also direct competitors.

A fine will be applied on the enterprises, as well as a legal obligation to develop and implement corporative competition rights compliance regulations. As the initiator of the breach, the LLC "Samsung Electronics Baltics" has been applied a fine of LVL 4.1 million, while the wholesalers involved in the breach have been applied fines of LVL 1.4 million (LLC "RD Elektroniks"), LVL 0.27 million (LLC "PROKS"), LVL 0.54 million (LLC "ELKOR TRADE") and LVL 0.27 million (LLC "ROTA un K").

In 2009, several important court decisions have been adopted strengthening the understanding of application of competition legislation. The decision of the Senatorial Board of the Department of Administrative Cases of the Supreme Court Senate to repeal the unfavourable sentence for the CC of the Administrative District Court set clear and evident frameworks from the competition rights perspective for incompliant action of enterprises during tenders (price polling) (see Box 6.22).

**Box 6.22**

**The Senate repeals the unfavourable sentence for the CC of the Administrative District Court in the case of building contractor cartel agreement**

On June 29, 2009 the Senatorial Board of the Department of Administrative Cases of the Supreme Court Senate repealed the unfavourable sentence for the CC of the Administrative District Court and the case, which concerns a cartel agreement among building contractors LLC "Stats", LLC "Info Serviss" and LLC "Alti A" and handed it to the District Court for re-consideration.

In the decision of September 14, 2005 the CC had established that the building contractors LLC "Stats", LLC "Info Serviss" and LLC "Alti A", when taking part in price polling for refurbishing of premises in the social care centre in Jurmala, had exchanged information about prices, as well as coordinated the participation in the tender and the conditions of this participation (the enterprises had submitted equally wrongly designed technical specifications while, in the technical proposal, the same material types had been chosen, the description of the technical characteristics had not been provided and the same grammatical errors appeared; the enterprises had also exchanged information regarding the planned estimates). The CC established that the construction enterprises were involved in the creation of a horizontal cartel agreement and had violated the agreement prohibition as defined in the Article 11 of the *Competition Law*.

Applications regarding the appeal of the CC's decision were presented to the court by all three enterprises and both the Administrative Regional Court and the Administrative District Court had satisfied these applications pointing out that the breach with respect to the prohibited agreement may not be proven without specifically proving information exchange about the proposals to be submitted for the price polling expressed in financial terms. Holding the view that the District Court had misinterpreted the provisions of the *Competition Law*, which lead to the wrong consideration of the case altogether, the CC appealed the sentence of the District Court to the Senate.

The Senate fully repealed the sentence of the Administrative District Court and adjudged that in the case of the price poll, free and fair competition is distorted or impeded by the exchange of any information related to the poll among the respective market players if this information allows forecasting the participation and activity of another market player in the price polling allowing to plan one's action accordingly. Thus, the assumption that the distortion of competition may only be achieved by exchanging information about the price to be offered to the customer is untrue.

In compliance with the European Community case law, the existence of actions or agreements directed against competition may be established from a certain number of concurrences and references, which in the absence of another logical explanation, when interlinked, may form evidence of breaches of competition regulations. In this case, the Senate directly referred to the necessity to see the findings of the CC regarding the coordinated action of the market players all together.

In terms of strengthening the investigation powers of the CC, the opinion of the Senate is essential stating that the refusal of the market players to allow in compliance with the procedure provided for in the legislative acts the employees of the CC to become acquainted with the information at the disposal of the market player, may be considered a breach irrespective of whether the CC can prove that the market player had the information necessary for the CC.

Also, in 2009 the legal proceedings in the case regarding the unfair discounts applied by the JSC "Starptautiska lidosta "Riga"" have been completed (see Box 6.23).

In order to explore market distortions timely and to prevent the risks of their potential existence, the CC, within the accounting period and in the framework of **competition promotion**, has carried out a number of market supervision and competition development support measures (*competition advocacy*). With the reduced number of applications by market players regarding the potential violations of the *Competition Law*, self-initiated market supervision is becoming an important research tool, which allows the CC to identify and prevent significant damages to the competition and the public.

In the framework of the market supervision, the CC has analysed the competition situation, searching for violations of the *Competition Law*, and, in several cases, has developed and submitted proposals for the improvement of the situation to the responsible institutions.

**Box 6.23**

**<u>The legal proceedings in the case of the unfair discounts applied by the JSC "Starptautiska lidosta "Riga"" have been completed</u>**

On September 29, 2009, taking into account the conclusion of the administrative agreement between the CC and the JSC "Starptautiska lidosta "Riga"", the legal proceedings were completed with respect to the CC's decision of November 22, 2006 where the discount system applied by the JSC "Starptautiska lidosta "Riga"" was recognised as unfair and incompliant with the Article 82 of the Treaty Establishing the European Community.

Following the adoption of amendments on May 5, 2009 by the Cabinet of Ministers in Regulations No. 911 of December 5, 2006 *Procedure for defining charges for air navigation and services of the State Joint Stock Company "Starptautiska lidosta "Riga"" and procedure for charge distribution* providing for the withdrawal of the discounts recognised as unfair, the Competition Council agreed to the settlement offered by the airport. The administrative agreement on the dismissal of the legal dispute, where the airport undertook to apply an equal service charge to all air carriers, was signed on July 20, 2009.

In 10 months of 2009, the Competition Council has implemented supervision in such market sectors as sworn auditor services, water management infrastructure construction, payment cards services, eggs trade, wholesale trade of electronic household appliances, progeny and veterinary services, beer trade, and on-line book sales. In three of these sectors – supervision of payment cards services, electronic household appliances wholesales and eggs trade – possible breaches of the *Competition Law* have been found and relevant cases have been initiated regarding the abuse of a dominant position or using prohibited agreements, some of which have already been completed (see Box 6.21) or are still under investigation.

Due to several market supervision measures, certain shortcomings have been discovered in the actions of the sector players. Upon implementing supervision of the veterinary services market, the Competition Council drew the attention of the Latvian Association of Veterinarians to the provisions restricting the price competition as provided for by its *Code of Conduct*, as well as of the Ministry of Agriculture to the low level of competition and the restricted availability of veterinary services in the field of reproductive animals, especially in remote rural areas. Due to some of the market supervision measures, the CC has gained a deeper insight in the situation of competition, paying attention also to such markets where there is seemingly no development. The Competition Council supervised the on-line book sales market and established that although there are no obstacles for entering the respective market the number of on-line bookshops in Latvia is small and, during the last half of the year, two of four shops have terminated their economic activity. The sales volume of books purchased on-line is small in comparison with regular bookshops and it may be concluded that in Latvia this market is not developing. Although the books in the Internet are slightly cheaper than in the regular bookshops, there is no consumer demand for sales in the Internet. Besides, the market players have recognised that trading books in the Internet as an independent economic activity (without a regular bookshop) is not profitable. In the future just like now, insufficiently developed markets, as well as vertical relations among suppliers and buyers, horizontal aspects of market players cooperation in the context of the *Competition Law* and abuse of market power by large enterprises will be among the scope of activity of the CC, which will be initiating supervisory measures in different market segments.

**Box 6.24**

**<u>Proposals for the improvement of competition in the land surveying services market</u>**

Having analysed the competition situation in the land surveying services market, the Competition Council has established that along with private persons surveying services are also provided by such state companies as the State Limited Liability Company "Latvijas valsts mernieks" and the State Joint Stock Company "Latvijas Juras administracija". The Competition Council pointed out that in such a market as the land surveying services market, where efficient competition exists and offers may also be provided by private persons, indirect (with state company mediation) business activities of public persons may create competition impediments and the risk of unequal treatment.

With respect to the activity of the JSC "Latvijas Juras administracija" in the land surveying services market, taking into account that its activity in the provision of surveying services is not stipulated in the legislative acts providing for the delegated (state administrative) tasks and that it conflicts with the cases when a public entity may perform business activity as provided for in the State Administration Structure Law, the Competition Council made a proposal for the JSC "Latvijas Juras administracija" to terminate its activities in land surveying services market, defining a respective transition period or transferring the existing company's obligations (and the respective assets) via tender procedure to other market players.

Considering that state LLC "Latvijas valsts mernieks" implements certain delegated tasks of public administration in the framework of the land reform works, the Competition Council supported several solutions for narrowing its activity in the land surveying services market, at the same time pointing out the positive and negative effects.

During the accounting period, the CC has provided a number of assessments or opinions, incl. on the situation in the land surveying services market with the aim of promoting competition (see Box 6.24).

**In the context of the international cooperation**, applying the best practice of other countries in the field of competition law application, in summer of 2009, the CC organised the Sixth Annual Competition Conference of the Baltic States which is organised by one of the Baltic States every three years. The agenda of the conference was dedicated to the assessment of the competition policy implementation. In the framework of the conference, representatives of competition authorities in Latvia, Lithuania, Estonia, as well as Germany, Austria, Czech Republic and Sweden studied such issues as the political and economic outcome of competition policy implementation, use of economic analysis in the investigation of violations, important aspects of the application of competition legislation and market research methodology.

In 2009, the CC in cooperation with the Federal Ministry of Economics and Technologies of Germany and the federal competition institution *Bundeskartellamt*, implemented the Project No. LV/2006/EC-01TL *Further economic research and analysis capacity strengthening of the Competition Council* in the framework of the Transition Facility Programme *Twinning Light*. In the framework of this project, the CC's economic analysis capacity is being strengthened. Several missions of German experts took place in the institution, workshops and trainings were organised in relation with the application of economic analysis methods in the activities of investigation and market supervision, a pilot project has been carried out – supervision of beer sector; sample methodology and guidelines/recommendations have been developed for the supervision, monitoring and analysis of certain sectors of the economy. On the basis of these recommendations, a list of markets to be supervised in 2010 and an action plan have been developed.

In September 2009, in the framework of the abovementioned cooperation project, the CC organised a conference *Implementation and Efficiency Assessment of the Competition Policy: Expertise, Experience and Expected Results*. In the framework of the conference, its participants – representatives of entrepreneurs and their professional associations, as well as law offices, academic environment and public administration institutions – had the opportunity to gain an insight in the competition policy issues in Latvia, Germany and Switzerland. Additionally, in the framework of the conference, the project results were presented, placing particular emphasis on the expertise gained by the CC regarding the planning of the market supervision as a tool to find violations. In this respect, recognising the effects of the economic crisis on the entrepreneurship, the CC has initiated several activities with the aim of examining and eliminating factors impeding fair activities of entrepreneurs in the market.

## 6.9. Regulation of Public Utilities

The Public Utilities Commission (hereinafter – the Commission) is a multi-sector regulator performing regulatory functions in the sectors of energy, electronic communications, postal services and railway transport, water management and municipal waste management. The task of the Commission is to ensure the opportunity to receive uninterrupted and safe services to all users for economically reasonable prices and to ensure the possibility for enterprises to develop providing public services with profitability according to the economic situation. The Commission adopts its decisions independently and is not subject to decisions of the government or other public institutions. The members of the Commission's Board are appointed by the Saeima, and only a court may declare decisions taken by the Commission substantively unlawful and cancel them. Activities of the Commission are financed from the state duty paid by enterprises for regulation of public utilities on the basis of the annual net turnover of the regulated public utilities.

Functions of the Commission include regulation of the regulated sectors and enterprises that operate therein, protecting 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, carrying out extrajudicial settlement of disputes, and supervising compliance of the provided services with license and general authorisation conditions and specified quality requirements.

**Changes in the legislative acts**

On June 11, 2009, amendments were implemented to the *Law on Regulators of Public Utilities* envisaging the creation of a single regulator. In accordance with these amendments, the Commission, by November 1, 2009, took over the regulatory functions from the local government regulators or local government councils (boards) in the sectors regulated by the local governments (heating, municipal waste management and water management).

Until the entry into force of the Commission's methodology for the sectors of energy, municipal waste management and water management, the Regulations No. 281 of June 26, 2001 of the Cabinet of Ministers *Methodology for Calculation of Public Utilities Tariffs in Sectors Regulated by Local Governments* are applied. In autumn 2009, the Commission developed new methodologies for tariff calculation for sectors of waste management and water management, as well as, according to the amendments to the *Law on Regulators of Public Utilities*, established regional structural units.

Taking into account the amendments to the *Law on Regulators of Public Utilities*, as well as entry into force of the *Law on Postal Services* in which the list of types of postal services has been supplemented, on October 27, 2009 the Cabinet of Ministers adopted Regulations No. 1227 *On the Types of Regulated Public Utilities.*

**Situation and policies of the regulated sectors**

**Electricity and gas supply (see also Chapters 3.2.3 and 6.3.2)**

The dominant role in electricity supply is held by the JSC "Latvenergo", which generates more than 90% of electricity produced in Latvia and ensures the supply of electricity, as well as the 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 tikls" 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 tikls" fully owned by the JSC "Latvenergo".

Electricity is also generated by about 150 small hydropower stations with the total capacity of 25.2 MW, 15 wind power stations with the total capacity of 27.2 MW, and 43 cogeneration plants with the total capacity of about 130 MW. About 20 other enterprises have received licences to carry out distribution and sale of electricity.

Latvian electricity market is fully opened to competition as of July 1, 2007 and since the second half of 2008, the largest electricity users buy electric energy at an agreed price, several electricity users have changed their power 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 affiliated users. Tariffs for affiliated users were last set in April 2008 and in 2009 the market price is close to the price set by the tariffs, therefore, at the moment, it is unlikely that the public marketer could reduce the electricity tariff.

As of 2010, the Ignalina nuclear power plant will terminate its operation. At the moment, it is a cheap electricity source and until 2010 it formed a significant part from the total capacity gained in the region. With decrease of the available capacity, the electricity price fluctuations may increase; if oil and gas price or electricity consumption grows, it may affect the electricity price more than before. It is expected that, in 2010 the tariffs for affiliated users will remain unchanged.

Supply of natural gas in Latvia is ensured by a vertically integrated enterprise JSC "Latvijas Gaze".

Natural gas tariffs change automatically depending on the price fluctuations of purchased gas. The fact that the gas price is pegged to the average nine months price for oil products is very advantageous to the users. Although, since March 2009, the oil prices have been growing, this average index is more stable and reached the lowest level only in September. It may be expected that on January 1, 2010 the tariff for residents will decrease slightly more in comparison to the tariff applied since July 1, 2009: for users who use gas for cookers and water heaters, it will be reduced by 5%, while for users who use gas for heating it will be reduced by 9%.

A large part of the gas pumped into Incukalns Gas Storage has been purchased at such a rather profitable price, therefore until the end of 2009–2010 heating season the applicable natural gas price will remain low. The natural gas price in summer 2010 and during the next winter will fully depend on tendencies of oil product prices and changes of US dollar exchange rate.

**Electronic communications and postal services**

417 companies were registered and actively operated in the sector of electronic communications as of November 17, 2009. In the postal sector, the state JSC "Latvijas Pasts" provides general postal services, while approximately 50 service providers operate actively in the sector of express mail.

In the field of electronic communications market analysis, several measures have been carried out for the conclusion of the 2nd analysis round – Reports on Market Analysis have been drafted and published, as well as the so-called national and community consultations have taken place. The peculiarity of the market analysis procedures is that before adopting a decision on the application of regulatory measures the Commission must consult with both the market players and the international cooperation partners – regulators of other countries and the European Commission. While performing the market supervision, information on the development of the electronic communications market was collected.

On July 3, 2009 the new *Law on Postal Services* came into force, which stipulates a single legal framework in the field of postal services provision for all players of the postal services market, in order to ensure a universal accessibility of postal services and the continuity of their provision, promote competition, by applying transparent, non-discriminatory and proportionate regulatory procedures, ensure free provision of postal services, as well as to protect the interests of postal services users. Terminology has been clarified in the new law, as well as concepts absent until now have been defined and a new regulatory framework has been included for certain issues.

In order to create the regulatory framework of the sectors to the full extent, the Cabinet of Ministers and the Commission must develop and issue several regulations, orders, procedures, and methodologies within half a year after enforcement of the law.

**Railway**

In the railway sector, the state JSC "Latvijas Dzelzcels" ensures maintenance of public railway infrastructure. Domestic passenger transportation is carried out by the JSC "Pasazieru vilciens" and the LLC "Gulbenes – Aluksnes banitis". In the sector of cargo transportation there are also several operators, such as the LLC "LDz Cargo", JSC "Baltijas ekspresis" and JSC "Baltijas tranzita serviss".

By December 1, 2009 the Commission must set a charge for using the public railway infrastructure for transport in 2010 on the basis of data submitted by the state JSC "Latvijas Dzelzcels" and auditors' opinion. It may be expected that the railway infrastructure charge for 2010 will decrease a little in comparison with 2009.

**Heating, water supply and sewerage, waste management and disposal**

In accordance with amendments of June 11, 2009 to the *Law on Regulators of Public Utilities*, the Commission shall take over the regulatory functions in the sectors of heating, municipal waste management and water management from local government regulators or local government councils (boards) by November 1, 2009.

By November 2009, the Commission has taken over documents of 433 enterprises, incl. 182 enterprises in the heat delivery sector, 164 enterprises in the water management sector, 87 enterprises in the waste management sector. In accordance with the *Waste Management Law*, the Commission carries out full regulatory functions with respect to the disposal of municipal waste, while with respect to collection, transport, loading and storing, it only sets the tariffs until the conclusion of an agreement between the local government and the enterprise selected according to the procedure provided for in the legislative acts regulating public procurement.

The Commission has developed tariff calculation methodology for sectors which were regulated by the local government regulators until November 1, 2009. After discussing of the draft methodologies with representatives of sector associations, updating of the draft methodologies will continue.

## 6.10. Export Promotion Policy

*Guidelines for export promotion of Latvian goods and services and attraction of foreign investment in 2010–2016* define the basic principles, aims, and results to be achieved of the export promotion policy.

The guidelines define three main directions of action:

- increasing competiveness;
- contractual security;
- support instruments.

Concrete measures in these directions of action are envisaged in the framework of *Action plan for export promotion of Latvian goods and services and attraction of foreign investment in 2010–2011*.

Promotion of export and investments is implemented via **direct export promotion measures**. A wide range of support services is available to the Latvian exporters in order to increase the export capacities and promote exports of Latvian goods and services. In 9 months of 2009, various export support services have been provided, including 2610 consultations to enterprises on issues related to exports, also about foreign markets, organisation of 21 informative seminars on export skills, foreign markets and specific marketing requirements, organisation of 22 trade missions of Latvian enterprises, as well as of 96 individual business visits to the potential cooperation partners abroad. Identification and implementation of export and investment projects continues.

At the moment, ten **external economic representations 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 establishing and maintaining business contacts, providing information about the requirements of the respective foreign market, implementing the marketing measures of export promotion and attracting investment abroad, as well as the measures of finding cooperation partners by identifying the potential investors and business partners.

In accordance with the order of the Minister of Economic Affairs of 25 September 2009, the Coordination Council of External Economic Representations of Latvia was established, functioning as a collegiate, coordinating, and consultative institution to ensure the coordination of operations of External Economic Representations of Latvia and to supervise execution of the tasks.

The function of the council is to submit operative proposals to the Ministry of Economics in relation to the operations of External Economic Representations of Latvia, ensuring efficient representation of Latvian enterprises in foreign countries.

The main tasks of the council are the following: to examine advisability of opening or closing representations in certain countries, to examine and to submit proposals with respect to delegating employees for work at a representation, to monitor and assess operational results and financial indicators, to submit proposals with respect to distribution of representation resources and competencies, as well as to examine and to submit proposals with respect to other issues related to the operation of the representation network.

The council consists of four representatives with voting rights from large Latvian exporting enterprises, four representatives with voting rights from small and medium-sized exporting enterprises, two representatives with voting rights from the Ministry of Economics, one representative with voting rights from the Ministry of Foreign Affairs, and one representative with voting rights from the Investment and Development Agency of Latvia. The functions of the secretariat of the council are performed by the Ministry of Economics.

In the framework of the measure *Business Support Activities* of the EU Structural funds Operational Programme of 2008–2013 *Entrepreneurship and Innovations*, activity 2.3.1.1 *Access to International Trade Markets – External Marketing* is being implemented and the operation of export credit insurance system is ensured.

In the framework of the activity ***Access to International Trade Markets – External Marketing***, wide support is envisaged for the enterprises in implementation of external marketing measures – participation in exhibitions, contact exchanges, trade missions, organisation of seminars and conferences. External marketing in foreign countries is being supported, 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. In total, by November 2009, 161 projects had been approved amounting to LVL 2.3 million.

**In 2010, the financing available in the framework of the sub-activity *Access to International Trade Markets – External Marketing* will be LVL 6 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 allows increasing the total export volume (particularly to countries with high risk degree), extending the export markets (CIS region, economies with rapid economic growth etc.), as well as consolidation in existing markets. The export credit guaranties are available to enterprises in all sectors of economy.

On 12 May 2009, the Cabinet of Ministers Regulations *On Short-term Export Credit Guarantees* were adopted forming normative base for short-term insurance of export transactions. Regulations determine coverage for short-term export credit guarantees, beneficiaries, procedure for granting guarantees and for recovering losses by the guarantor. In accordance with the regulations, as of 1 June 2009, short-term export credit guarantees are granted by LLC "Latvian Guarantee Agency". Since the launch of the programme until December 2009, 48 export credit guarantee applications had been received from 20 enterprises for the total amount of requested deferred payment of EUR 15.5 million:

– 23 guarantee projects have been approved for the total amount of LVL 1.2 million;
– 12 contracts have been signed for the total amount of LVL 587.1 thousand (to Russia, Belarus, Azerbaijan, Somalia, and Georgia).

In order to simplify the criteria for guarantees for exports to third countries, on 14 December 2009, the Cabinet of Ministers approved amendments to Regulations *On Short-term Export Credit Guarantees*. The amendments envisage repealing two main guarantee criteria (export turnover of the enterprises – EUR 500 thousand; and export activities of the enterprises for at least two years), maintaining the condition that the goods must be produced in Latvia.

# 6.11. Protection of Consumer Rights and Market Surveillance

The consumer rights protection system in Latvia is in a constant process of strengthening and development in order to ensure efficient market surveillance and protection of the consumer rights.

<u>**Improving the Normative Base**</u>

On 15 January 2008, *the Consumer Rights Protection and Market Surveillance Programme for 2008–2010* was approved by the Cabinet of Ministers, which develops the existing consumer rights protection system, as well as prescribes the priorities in this field. The following main directions of activity are set in the programme:

– improvement of the normative base concerning the consumer rights protection;
– creating favourable business environment by implementing adequate and efficient market surveillance and supervision of the legislative acts concerning consumer rights protection;
– informing the consumers and entrepreneurs about consumer rights protection issues, as well as promotion of consumer education;
– improvement of domestic and cross-border extrajudicial dispute settlement procedures;
– facilitating the activity of consumer rights protection associations.

In order to eliminate some deficiencies in relation to the implementation of *Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees* and of *Directive 2002/65/EC of the European Parliament and of the Council concerning the distance marketing* *of consumer financial services,* on 26 November 2009, the Saeima adopted the law *On Amendments to the Consumer Rights Protection Law*. The amendments to the law clarify the consumer rights in case of purchase of goods noncompliant with the consumer rights contract provisions, by defining that the goods must be exchanged or noncompliance thereof with the contract provisions must be eliminated without a charge, including free shipping of the goods, work, material, and other expenses. In accordance with the requirements of Directive 2002/65/EC, the law also stipulates that in cases when the contracting parties have agreed that the applicable legal regulations are legal regulations of a country, which is not the European Economic Area Member State, the *Consumer Rights Protection Law* will be applicable if it provides for a higher level of consumer protection than the legal regulations agreed upon by the contracting parties if the contract is closely connected with the territory of the Member State.

In order to improve application of the regulatory framework provided for in the Regulations No. 207 of 28 May 2002 of the Cabinet of Ministers *On Distance Contracts* regarding the information to be included in the distance agreement and provided in the offer proposed to the consumer, as well as enjoying the rights of refusal, on 10 November 2009, the Regulations of the Cabinet of Ministers On Amendments to the Regulations No. 207 of 28 May 2002 of the Cabinet of Ministers *On Distance Contracts* were adopted. The regulations, *inter alia*, in accordance with the court practice of the European Communities (see, e.g. *the European Court of Justice Case C-489/07*), provide that a consumer, when applying the rights of refusal, is liable for any decrease in value of the goods, if the goods have been used in a way that is noncompliant with the good faith principle, including its use for other purposes apart from trying to establish its properties or operation.

In 2009, the work continued on the Proposal for the *Directive of the European Parliament and of the Council on Consumer Rights* approved in the European Commission on 30 October 2008. The proposal has been drafted after the revision of the consumer *acquis*, which was started in 2004 in order to simplify and improve the applicable regulations by establishing a real and functional EU internal market for commercial transactions among the entrepreneurs and consumers, and finding the right balance between the high level of consumer protection and competitiveness of enterprises. The proposal envisages revision of four directives in the field of consumer contractual rights. 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, the right of withdrawal (term of validity, application procedures, and consequences), regulates the seller's responsibility for goods that are noncompliant with the agreement provisions, as well as a new regulation of unfair provisions of the agreement is set, namely, the proposal envisages introduction of the lists of unfair contractual obligations of two types: "the black list" – provisions considered as unfair under any conditions and "the grey list" – provisions considered as unfair unless the seller proves the contrary. At the moment, the discussion continues regarding the application of the full harmonisation principle on the provisions of the directive. The European Parliament could take its opinion regarding the draft regulation in the first reading at the end of 2010.

**Supervision of Consumer Rights**

The Consumer Rights Protection Centre (hereinafter – CRPC) is the main coordinating institution in the field of consumer rights protection and supervision. Within 10 months of 2009, CRPC:

- provided 47 348 consultations, from which 42 946 were provided to consumers, and 4402 to legal persons;
- examined 2514 consumer complaints and applications (hereinafter – complaints).

Over the last 5 years, the number of complaints still tends to grow. Within 10 months of 2005 CRPC received 810 complaints, in 2006 – 1002 complaints, in 2007 – 1764 complaints, in 2008 – 2187 complaints, while in 2009 – 2514 complaints.

Out of all complaints examined within 10 months of 2009, in 381 cases the solution was favourable to the consumer and in 162 cases a decision favourable to the consumer has been adopted. 195 cases concerning goods that are noncompliant with the provisions of the agreement corresponding to the value of LVL 250.3 thousand have been found a positive solution and in 50 cases corresponding to the value of LVL 57.7 thousand a decision favourable to the consumer has been adopted, while in 74 cases concerning services noncompliant with the provisions of the agreement in total corresponding to the value of LVL 26.1 thousand have been found a positive solution and in 52 cases in total corresponding to the value of LVL 25.7 thousand a decision favourable to the consumer has been adopted. 81 complaints were unjustified; regarding 1154 complaints, an explanation has been provided to the consumer; 144 complaints have been forwarded in accordance to their jurisdiction for examination in other institutions; 43 complaints have been withdrawn by consumers requesting termination of the examination; in 151 cases CRPC has refused to examine the complaint, while in 398 cases from all the complaints submitted are currently under examination.

In the complaints, the consumers complained about:

- negligence of the contracting party legal equality principle – in 568 cases;
- provision of incomplete information – in 21 cases;

- incorrectly defined payment for the purchase and weight or size – in 30 cases;
- breaches with respect to examination of claims – in 128 cases;
- services noncompliant with the provisions of the agreement – in 491 cases;
- goods that are noncompliant with the provisions of the agreement – in 643 cases;
- other complaints – in 806 cases.

Among 643 complaints concerning the purchase of goods that are noncompliant with the provisions of the agreement in total corresponding to LVL 755 thousand, the majority of complaints has been about shoes, mobile phones, electric goods, apartments and houses, followed by complaints about furniture, cars, textiles and other various goods.

491 complaints have been received regarding services that are noncompliant with the provisions of the agreement in total corresponding to LVL 196.7 thousand, from which the majority concerns electronic communications, rent and public utilities, air transport, building, individual furniture orders, distance contracts and tourism services, followed by complaints regarding dry cleaners, vehicle repairs and other services.

The consumers have asked the CRPC for consultations concerning:

- consumer rights in case of food products that are noncompliant with the provisions of the agreement – in 9238 cases;
- rights and procedures stipulated in the legislative acts – in 24 448 cases;
- consumer rights in case of services that are noncompliant with the provisions of the agreement – in 6436 cases;
- issues within the competence of other institutions – in 4046 cases;
- contract provisions – in 2345 cases;
- choice of experts – in 1798 cases.

**Supervision of Unfair Commercial Practice, Advertisements, and E-commerce**

Within 10 months of 2009, CRPC has commenced examination of 158 cases concerning commercial practice and advertising, including 77 cases upon individual applications.

**Box 6.25**

**Aggressive commercial practice offering the consumers to sign an additional agreement with mortgage agreements**

At the beginning of 2009, JSC "Aizkraukles banka" (hereinafter – AB) sent letters to its customers requesting them to submit a number of documents concerning their and their family members' financial situation, also informing them that AB is planning to introduce a monthly charge of LVL 5.00 for the servicing of current accounts. In the letters AB pointed out that, in case the customers do not want to use the current account which is applied a servicing charge, they may contact the bank and sign an additional agreement thus opening a free of charge mortgage repayment account, while a part of the customers at the bank were offered by AB to sign additional agreements with essentially changed agreement provisions, including unfair and less favourable agreement provisions for the consumers.

After the examination of case materials at CRPC's disposal, CRPC concluded that the bank has engaged in:

1) Aggressive commercial practice implemented through use of disproportionate influence, creating the impression of a potential contractual penalty, which is not provided for in the agreements concluded with the consumers, and through making the consumers to make a forced choice offering a part of the consumers to sign an additional agreement incorporating unfair agreement provisions, or to pay the monthly account servicing charge of LVL 5.00, or to submit all documents requested in the letters sent by the bank.

2) Misleading commercial practice implemented through holding back information that for a part of the consumers, when concluding the certain additional agreement regarding the change of the account, also the mortgage agreement provisions will change becoming less favourable for the consumers.

3) Commercial practice noncompliant with the professional diligence principle implemented through offering unfair and unequal provisions to the consumers, incorporating these provisions in certain additional agreements. It must be noted that the bank has signed a written resolution not to apply a part of the unfair agreement provisions.

After analysing the given facts, CRPC declared the practice of AB as unfair commercial practice and applied a fine of LVL 8000, as well as imposed a legal duty to terminate the unfair commercial practice, prohibiting AB to offer its consumers wishing to use the free of charge mortgage repayment account to conclude additional agreements where not only the mortgage provisions concerning the account to be used for the mortgage liabilities have been changed, but also other mortgage agreement provisions.

**Misleading commercial practice providing the consumers with untrue information regarding the offer of electronic communications service**

Various mass media sources were publishing the following advertisement: "*Still wasting money with another operator? Do not wait until the end of the agreement and join Bite! We will cover the contractual penalty of the previous operator! You will always be able to send text messages within Bite network for 0.00 santims! This is offered by Bite only*".

CRPC recognised these advertisements as misleading as, in fact, the contractual penalty was not covered. The covering of the contractual penalty as claimed in the advertisement was implemented by offering the consumers a monthly discount of up to LVL 5.00 and in total not exceeding LVL 50.00.

CRPC's decision applied a legal duty on LLC "BITE Latvija" to terminate the unfair commercial practice by discontinuing the advertisement, as well as other similar advertisements and/or informative materials where LLC "BITE Latvija" is untruly claiming that will cover the consumers' contractual penalties applied to them by other mobile communications operators. CRPC also applied an administrative fine of LVL 2000 taking into account the mitigating circumstances, e.g., that fact the LLC "BITE Latvija" recognised and regretted its breaches.

Within 10 months of 2009, CRPC has examined 106 cases regarding unfair commercial practice, including 103 cases when examination has been launched with respect to misleading commercial practice, 3 cases – with respect to aggressive commercial practice, and 3 cases concerning commercial practice that is noncompliant with the professional diligence.

CRPC has examined 55 cases related with breaches of the advertising law, including examination of 6 cases on breaches concerning advertising alcoholic beverages, 2 cases on breaches concerning advertising tobacco products, 2 cases concerning fuel consumption and $CO_2$ emissions, while the remaining 45 cases have been examined in relation with other advertising breaches.

The majority of cases have been launched with respect to implementation of commercial practice in the field of electronic communications services, financial services, consumer crediting advertising, and advertising food supplements and other products that are attributed with therapeutic effects, as well as tourism services.

Within 10 months of 2009, in 30 cases breaches with respect to unfair commercial practice or advertising have been eliminated upon CRPC's request, while in 7 cases a written determination to eliminate voluntarily the breaches found by CRPC has been received.

With respect to the breaches found in the field of advertising and commercial practice within 10 months of 2009, the persons implementing the commercial practices have been imposed with administrative fines by CRPC in 26 cases amounting to LVL 27 thousand. In several cases, decisions have been made regarding a temporary adjustment, while in 1 case additional information has been requested, in 1 case it has been requested to exclude certain advertising elements, in 7 cases communication of the advertisement and implementation of the commercial practice has been prohibited, while in 3 cases it has been requested to terminate the unfair commercial practice.

Within 10 months of 2009, examination of 45 cases in the field of e-commerce has been launched. The majority of breaches have been found in relation with failure to provide information or incorrect provision of information regarding the rights of refusal (in 29 cases). In 39 cases a request has been sent to eliminate voluntarily the breaches found, and these requests have been satisfied.

In accordance with the priorities defined in CRPC's annual plan, in 2009, the following **supervision projects** were implemented:

1) Examining the commercial practice of tourism service providers.

In the framework of the project, in total 30 offers were examined – in 20 cases inspections were performed at the location of service provision and, in 10 cases, publicly provided offers were examined. From these cases, in 21 cases (70%) no breaches were found. In 9 cases CRPC initiated examination of the case. In 3 cases the examinations were terminated. The main breaches found – misleading commercial practice and providing untrue information regarding the price. CRPC developed recommendations for the tourism service providers concerning their commercial practice (available on CRPC's website), as well as organised a meeting where the main breaches and their prevention possibilities were discussed together with the tourism service providers.

2) Examining the consumer crediting services advertisements.

In total, CRPC initiated 34 case examinations in the field of consumer crediting services advertisements. In 22 cases, the breaches found with respect to the advertisements were eliminated upon CRPC's request. In 5 cases, CRPC initiated and adopted decisions regarding administrative breaches and applied administrative fines, as well as adopted 1 decision imposing a legal duty to terminate the circulation of an advertisement until ensuring its compliance with the requirements of legislative acts. The main breaches found: failure to provide or partly provided statutory information regarding liability, implementing misleading commercial practice or commercial practice noncompliant with the professional diligence principles.

3) Examining Internet websites selling electric goods.

The project is implemented in the framework of a joint measure of the European Union Member States – *Sweep Days 2009*. The examination of 11 websites has been initiated assessing the compliance of information therein with the regulatory legislative acts on information society services, commercial practice and advertisements, from which in 7 cases non-compliances with the legislative acts requirements have been found and requests have been sent to eliminate the breaches within a defined deadline. The breaches were eliminated voluntarily in all cases.

4) Examining Internet websites offering to purchase consumer crediting services.

The project is implemented in the framework of the cooperation network of the Member States within the International Consumer Protection and Enforcement Network (hereinafter – ICPEN). Examination of 10 websites has been initiated where the consumers are offered to conclude distance agreements on crediting. In the framework of the project, the enterprises were sent letters with a request to eliminate the breaches voluntarily. In case of failure to eliminate breaches, the necessity to adopt binding decisions was considered.

**Protection of Collective Interests of Consumers and Supervision of Agreements**

During 1 January – 31 October 2009, 543 complaints have been received regarding allegations of unfair agreement provisions, and 130 complaints concerning other alleged consumer rights breaches.

The majority of complaints, i.e. 325, have been received on consumer crediting agreements and creditor actions, e.g., applying disproportionately large contractual penalties, increasing credit interest payments or unilaterally withdrawing from the agreement. 19 complaints have been received regarding insurance agreements, 18 complaints regarding agreements on provision of other financial services, 38 complaints regarding goods or services purchase agreements, 28 complaints regarding real estate purchase agreements (preliminary agreements), 22 complaints regarding management agreements, 1 complaint regarding building services agreement, and 58 complaints regarding other agreements. In comparison with the previous year, the number of complaints regarding unfair agreement provision has grown significantly (in 2008, within the same period, 444 complaints were received), especially with respect to consumer crediting agreements – in comparison with the same period in 2008 (69 complaints), within 10 months of 2009 almost 5 times more complaints have been received regarding consumer crediting agreements.

During 1 January–31 October 2009, 23 decisions have been adopted regarding unfair agreement provisions, requesting to terminate the application of the unfair provisions incorporated in the agreements concluded with consumers and to implement amendments in the draft agreements offered to the consumers.

The majority of agreements have been adopted in relation with preliminary real estate purchase agreements – 11 decisions; 6 decisions have been adopted with respect to consumer crediting agreements, which may be explained with the situation in the real estate market.

The most frequent unfair agreement provisions are the following: disproportionately high contractual penalties, unilateral rights to keep the prepayment made by the consumer, unjustifiably restricted liability of the seller or the service provider, overly extensive rights of the seller or the service provider to withdraw unilaterally from the agreement or to apply a contractual penalty, arbitrage clause.

In 13 cases, upon CRPC's request, the enterprises voluntarily implemented changes in the draft agreements offered to the consumers.

**Box 6.26**

**Unfair agreement provision requesting the consumer to undertake the risk of market situation changes**

Examining consumer complaints, CRPC concluded that the mortgage agreement of JSC "DnB Nord banka" stipulates that: "*The Bank may unilaterally withdraw from the Agreement and request full anticipatory execution of the Agreement obligations from the Mortgagor, if the value of any of the properties pledged in accordance with the security agreements decreases significantly and the Mortgagor has not executed the provisions of Paragraph 9.4 of Part II of the Agreement, or if the property has been destroyed*". *Another paragraph of the agreement provides that: "If, after assessing the property pledged to the Bank in accordance with the security agreements, it is concluded that its value has decreased significantly (i.e. by more than 25 % (twenty-five percent) in comparison with the market value on the basis of which the Mortgage was calculated, the Bank may request the Mortgagor to provide an additional security for the Agreement obligations*". From the above it may be concluded that, in case the value of the property pledged has decreased by more than 25 % in comparison with its initial (at the time of agreement conclusion) market value, the bank is entitled to request an additional security from the mortgagor, and, in case the consumer is not able to ensure an additional security, the bank is entitled to request the termination of the agreement and repayment of the amount due to the bank.

Considering that in fact with the provisions described above the bank requests the consumer to undertake the liability for market risks, i.e. the risk of decrease in value of the pledged property which does not depend on the consumer, CRPC recognised such provisions as unfair in accordance with its Decision No. 23-lg of 13 October 2009, and requested the bank to discontinue their application, as well as to redraft the agreements offered to the consumers.

**Cross-border Trade**

As the amount of population emigrating from Latvia and the amount of tourists visiting Latvia is increasing, a positive solution of the problems of consumers connected with the purchased low quality goods and services and cross-border consumer protection is becoming increasingly topical.

European Consumer Centre of Latvia (hereinafter – ECC Latvia) is established as a separate CRPC department co-financed by the European Commission.

In 2008, the consumers contacted the ECC Latvia 548 times of which 418 were consultations and 130 – complaints.

In 10 months of 2009, the ECC Latvia has examined 138 complaints, 204 simple complaints, and provided 206 consultations in relation with cross-border trade. In case of a cross-border trade complaint, support is provided to a consumer in order to find the responsible institution to solve the consumer's complaint, but no decisions are made against a foreign entrepreneur.

38% of the complaints received were related to air traffic services, 14% – e-commerce, 11% – clothes and shoes, 1% – low quality appliances, 32% – other goods and services.

In 2009, *ECC Latvia* cooperated with the extensive informative campaign *Speak up! This is your consumer right!* organised in Latvia by the European Commission and concerning consumer rights in the European Union. Banners with link to the website of this campaign (*www.pateretajiem.lv*) have been placed on *ECC Latvia's* website.

**Market Surveillance**

For 2009, in relation with market surveillance, CRPC set the following priority directions: toys, children goods, self-defence products, solariums, swimming pools, price indications, electronic goods, building products, recreational craft, wheeled transport the basic function whereof is not related with the participation in the road traffic.

Within 10 months of 2009, 891 inspections were performed and within the framework 2121 designs were assessed, incl. 264 electric goods, 106 toys, and 102 building products.

**Market surveillance projects implemented within 10 months of 2009**

**Electric goods**

CRPC carried out 194 checks and assessed the compliance of 749 electric goods designs with the set requirements. Breaches were found in 64 trade locations, and noncompliance of 179 designs was found. The trading of 35 designs (88 pieces) has been discontinued. Expertise of 8 electronic goods designs has been carried out. No non-compliances were found.

3 electronic goods projects were implemented:

1) In the framework of the air conditioner project, 16 inspections were performed and 33 air conditioner designs were assessed. For 20 designs noncompliance with the legislative acts requirements was found: 7 designs did not have the CE label, 5 designs did not have a warning with respect to the potential risks, 11 designs had deficient energy efficiency labelling.

2) In the framework of the information technology appliances project, 45 inspections were performed and 93 IT appliances designs were assessed. For 32 designs noncompliance with the legislative acts requirements was found.

3) In the framework of the electric heaters and air humidifiers project, 59 inspections were performed and 177 heater designs were assessed. For 30 designs noncompliance with the legislative acts requirements was found.

**Wheeled vehicles and their parts (quadracycles, the basic function of which is not related with participation in the road traffic)**

The aim of the project was, considering the growing popularity of these products and the level of danger related with their use, especially among youngsters and children, to check whether quadracycles offered in the Latvian market conform to the legislative acts requirements.

In the framework of the project, 21 inspections were performed and 23 designs were assessed. For 15 designs (65%) noncompliance was found.

6 enterprises have implemented voluntary measures and eliminated the noncompliance of the products with the legislative acts requirements. 2 enterprises have been applied a fine for the breaches.

**Building products**

1) The aim of the laminate project is to check the compliance of the laminate flooring with the legislative acts requirements by assessing compliance of the labels, conformity documentation, attached instructions, and information included in the technical documents of the products.

In the framework of the project, 17 inspections were performed at trading and manufacturing locations. In total, 54 designs were assessed. For 29 designs (54%) noncompliance was found.

2) The aim of the chimney project is to check compliance of stainless steel chimneys, iron linings, and chimney channel connecting tubes with the legislative acts requirements. 10 inspections were performed, 9 designs were assessed, no non-compliances were found.

**Machinery (power hand tools)**

The aim of the project is to check the compliance of the machinery sold in the Latvian market with the legislative acts requirements by assessing compliance of the labels, conformity documentation, attached instructions, and information included in the technical documents of the products. 11 inspections were performed, 31 designs were assessed, no non-compliances were found.

**Recreational water transportation: inflatable rubber and PVC boats, water jets**

The aim of the project is to check the compliance of inflatable rubber and PVC boats, and water jets with the legislative acts requirements by assessing compliance of the labels, conformance documentation, information intended for the users, attached instructions and information included in the technical documents of the products. In the framework of the project, 17 inspections were performed at trading and manufacturing locations. In total, 33 designs were assessed. For 6 designs (18%) non-compliance was found.

**Individual means of protection**

19 inspections were performed and 54 IAL designs were assessed. Breaches were found in 11 enterprises for 18 designs.

**Toys**

In the field of toys, 106 inspections were performed and 197 toy designs assessed. Breaches were found in 7 enterprises and for 39 designs.

In the framework of the project, 30 toy designs were removed for the purposes of expertise to examine their mechanical and physical properties and they were forwarded for testing to the SGS CTS laboratory in France. After the expertise, 19 toy designs were recognised as unsafe. 31 toy designs were removed for the purposes of expertise to examine the noncompliance of their chemical and acoustic properties.

**Procedure for price indication**

In 2009, 122 inspections were performed in the field of price indication procedure, and breaches were found in 13 trading locations.

**Solariums**

66 inspections were performed and 68 solarium facilities were assessed. Breaches were found in all 66 service provision locations and noncompliance was found in all 68 solarium facilities.

The testing results showed that for all tanning facilities assessed the UV radiation exceeds 0.3 $W/m^2$.

**Spray paint flasks**

8 spray paint flasks were removed for the purposes of expertise. As a result of the testing, the chemical substance – toluene – was found in the composition of the paint flasks in such amount, which exceeds the amount stipulated in the legislative acts, and therefore the use of such products creates a serious risk and significantly exposes consumer health. CRPC banned further trade in Latvia of the tested spray paint flasks and imposed a duty on the distributors to withdraw these products from retail sales and consumer use, and destroy them. The withdrawn and remaining spray paint flasks were destroyed in the presence of CRPC officials.

**Dangerous facilities**

As of 1 July 2009, CRPC launched surveillance of dangerous facilities, including investigation of an incident related with accidents of dangerous facilities. Market surveillance measures were also implemented with respect to shoes and textiles.

**State metrological supervision**

In 10 months of 2009, 10 244 thousand units of measurement equipment (hereinafter – UM) in 430 companies were subjected to metrological monitoring in order to establish **conformity of the units of measurement equipment with the normative requirements**, including:

– 5080 units of measurement equipment in 345 trading companies;
– 5039 units of measurement equipment in 79 production and service provision companies;
– 125 units of measurement equipment in 6 public administration institutions.

In 125 enterprises, breaches of legislative acts requirements were found, and, as a result of the checks, 270 units of measurement equipment or 2.6% from the total number assessed were recognised as noncompliant with the metrological requirements, including units of measurement equipment without the necessary conformity assessment certifications, labelled in a noncompliant manner, as well as used breaching the repeated verification deadlines stipulated by the normative requirements. For noncompliance with the normative requirements 30 physical and legal persons were issued an administrative protocol and decisions were adopted in accordance with Article 99 and 166[15] of the *Administrative Violations Code of Latvia*.

Upon implementing monitoring of the units of measurement equipment and fulfilling the functions specified in the *Law on Uniformity of Measurements*, the functions set by the CRPC in relation to supervision of correct implementation of measuring processes control measures (metrological tests) have been carried out in 2009 **in the locations of use of fuel filling equipment** in order to establish, whether the actual error of the units of measurement equipment corresponds to the maximum admissible operation error specified in the legislative acts. Control measurements have been taken – metrological tests to 54 fuel stations, in total checking 108 capacity meters. Non-compliances were found in 9 cases when the actual measurement error exceeded the threshold error of 0.5% specified in the normative acts.

The CRPC continued **market research of the units of measurement equipment** in the sectors regulated for use, assessing the **situation** with respect to the conformity of heat meters, gas meters and gas volume correctors distributed at trading locations and whole sale enterprises with the legislative acts on metrological requirements, as well as the observance of legislative acts requirements with respect to the installation of the afore mentioned meters at the locations of their use. 20 inspections have been performed, including checks in 7 enterprises operating in the field of heat production and supply to consumers, in 4 gas supply enterprises and 1 installation and technical maintenance service enterprise. At the trade enterprises, breaches were found with respect to the meter sets compliance with the manufacturer's conformity declaration and manufacturer's instructions for use.

The **measures planned within the control programme of pre-packed goods have been implemented** by carrying out conformity control of the amount and marking of pre-packed goods planned for distribution in production and wholesale companies, *inter alia* setting chemical products, coffee, and tea as a priority.

**Control of the pre-packed goods has been performed in 66 production companies**, 282 lots of goods have been inspected (a static control test has been performed). Non-compliances were established – 19 lots of goods or 7.3% of the total amount of inspected lots of goods did not conform to the normative requirements in relation to the actual amount of goods. Administrative protocols have been issued to 6 legal persons concerning non-conformity of the amount of pre-packed goods with the normative requirements, as well as decisions adopted in compliance with Article 99 of the *Latvian Administrative Violations Code.*

# 6.12. Quality Assurance

## 6.12.1. Quality Structural Policy

The main task in the area of quality assurance is to promote observance of requirements of the legislative acts in the regulated and non-regulated sphere, as well as to improve the base of legislative acts in accordance with the EU requirements, taking into account the needs of the national market and economy, hence ensuring compliance of the products placed on the market and of the provided services and encouraging increased competitiveness of the enterprises and reduction of obstacles to international trade.

National quality assurance system in Latvia is regulated by the *Law on Conformity Assessment*, the *Standardisation Law*, and the *Law on Uniformity of Measurements*, as well as by the regulations of the Cabinet of Ministers deriving from the above 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 Latvian economy in order to protect the consumers and environment from low-quality products and services, promote growth of competitiveness of enterprises and reliability of products and services provided by Latvian entrepreneurs;
– improvement of the informative and consultative base;
– participation of national institutions of accreditation, standardisation, and metrology in international organisations, ensuring international recognition thereof, and compliance of Latvian quality assurance system with international requirements;
– maintenance and international comparison of the national base of metrology standards in order to ensure the necessary traceability of measurements and protect society from inaccurately conducted measurements;
– encouraging introduction of a quality management system, environmental and other voluntary quality systems in enterprises in order to ensure manufacturing of higher-quality products and provision of higher-quality services, as well as competitiveness of Latvian companies in international markets;
– improvement of the market surveillance system in order to provide equal conditions to all market participants and protect consumers from potential unfair competition of companies.

As of 1 July 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 legislative acts and thus also the conformity assessment infrastructure, a draft law Amendments to the *Law on Conformity Assessment* (See Box 6.27) has been developed.

**Box 6.27**

**Draft law Amendments to the *Law on Conformity Assessment***

The draft law defines more clearly the terms used in the law, coordinating them with the policy documents of the EU coming into force in 2010: Regulation (EC) No 765/2008 of the European Parliament and of the Council of 9 July 2008 setting forth the requirements for accreditation and market surveillance relating to the marketing of products and repealing Regulation (EEC) No 339/93, and Regulation (EC) No 764/2008 of the European Parliament and of the Council of 9 July 2008 establishing procedures relating to application of certain national technical rules to products lawfully marketed in another Member State and repealing Decision No 3052/95/EC, as well as the term "competent authority for conformity assessment" has been defined more clearly.

The draft law envisages simplifying the procedures for notification and publishing by defining that the Latvian National Accreditation Bureau at LLC 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 forth 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 those competent authorities for conformity assessment, which operate in the regulated sphere.

The draft law defines more clearly the procedure for financing the accreditation system, 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 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 forth the requirements for accreditation and market surveillance relating to marketing of products and repealing Regulation (EEC) No 339/93, the draft law envisages that the decisions with respect to accreditation of the competent authorities for conformity assessment are taken by the Head of the Latvian National Accreditation Bureau of LLC Standardization, Accreditation, and Metrology Centre.

The draft law envisages authorising the Cabinet of Ministers to adopt regulations of the Cabinet of Ministers regarding the Latvian Quality Prize by supplementing the respective section of the law which lays down the operational principles of the national quality assurance system.

## 6.12.2. Accreditation, Standardisation, Metrology

Since 1 July 2009, LLC "Standardization, Accreditation and Metrology Centre" carries out the tasks in the field of standardization, accreditation, and metrology as stipulated in the *Standardization law*, *Law on Conformity Assessment*, *Law on Uniformity of Measurements*, as well as other related laws.

**Standardization.** Standardization Bureau (LVS) of LLC "Standardization, Accreditation, and Metrology Centre" manages and coordinates activities of businesses and organisations of Latvia in standardisation in accordance with the *Standardization Law*.

The main functions of the LVS are, in cooperation with international and European organisations of standardization, to set up Latvian fund of standards and issue Latvian standards.

Since 2004, LVS is a full-fledged member of the European Committee for Standardization (CEN) and of the European Committee for Electrotechnical Standardization (CENELEC). LVS is also a corresponding member of the International Organization for Standardization (ISO) and an associated member of the International Electrotechnical Commission (IEC).

Pursuant to the approved plans, the priority directions of activity of the LVS in 2009 were to publicise standardization information, to update and maintain the Latvian Standard Fund, to improve the electronic trading system of standards, to cooperate with international, European and national standardization organisations.

As of November 1 2009, 29 881 standardization documents have been registered in the LVS, including 28 430 European standards adopted in the status of a Latvian standard. In 10 months of 2009, 50 standardization technical committees and 3 working groups coordinated by the LVS have adapted 1539 European standards, and 39 mandatory applicable standards have been translated into Latvian. Standardization information services have been provided to 4175 legal and physical persons.

In 2009, improvement of the electronic trading system of standards continued. At the moment, already 36% of all standards are sold via e-shop.

The automatic electronic information notification system introduced by the LVS has provided free service to clients *Monthly Report on the Standards Registered in Latvian Status and Cancelled Latvian Standards* in the fields concerning the clients to 550 regular clients.

Standardization activity is popularised on the LVS website on regular basis. Eight articles about current standardization problems in Latvia have been placed in the regular column "Standardization" of the magazine "Kvalitate" (Quality).

The LVS participates in the development cooperation projects coordinated by the Ministry of Economics.

In the framework of the economic promotion programme based on business activity and knowledge, the LVS has launched the establishment of technical infrastructure in order to provide convenient access to standardization information for enterprises.

Pursuant to the approved plans, the priority directions of activity of the LVS in 2010 are the following:

- to supplement and update the Latvian standards fund;
- to improve the LVS's information technologies for improved quality of client service;
- to improve the electronic sale system of standards;
- cooperation with international, European and national standardization organisations.

**Accreditation.** The Latvian National Accreditation Bureau (hereinafter – LNAB) of LLC "Standardization, Accreditation, and Metrology Centre" ensures the operation of the national accreditation system. For the purpose of the European legislation, LNAB is a National Accreditation Institution.

According to the *Law on Conformity Assessment*, the main functions of the LNAB are:

- to evaluate, accredit, and supervise the testing and calibration laboratories and certification and inspection institutions for conformity to the prescribed requirements of the normative acts, Latvian national standards, 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 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 200 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) have been accredited. 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. LNAB continues provision of accreditation services in Ukraine, where 1 institution for personnel certification has been accredited.

LNAB has confirmed conformity of the accreditation system in 6 spheres of accreditation to the Multilateral Recognition Agreement (MLA) of European Co-Operation for Accreditation (EA). In order to constantly conform to these requirements, LNAB 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, collaboration is also developed with accreditation institutions of Belarus, Ukraine, and Uzbekistan. Cooperation with Georgian accreditation institution has been successfully initiated by providing assistance in implementation of the European and international requirements, and a cooperation agreement has been concluded.

LNAB has also encouraged participation of the national laboratories in the international inter-laboratory comparative testing programmes and organised examinations of skills.

**Metrology.** The Metrology Bureau (MB) of LLC "Standardization, Accreditation and Metrology Centre" is the national metrology institution of Latvia and the aim of its activities is to ensure unity of measurements in the country in accordance with the *Law on Conformity Assessment*.

In order to satisfy the needs of the economy of Latvia in the field of credibility and traceability of measurements:

- at the Finnish National Metrology Institution MIKES, another calibration of the national standards for linear measures, electric resistance measurements, direct voltage, alternating voltage and alternating current has been performed. Control of calibration results and drift of these standards, as well as an update of the uncertainty budget have been implemented;
- stability analysis and drift assessment during inter-calibration period of the national mass measurement standard has been performed.

In the framework of the mutual recognition agreement of Latvia and the International Bureau of Weights and Measures, the time standard data supply to BIPM and exchange of time data with 15 laboratories in Poland and Lithuania has continued. A permanent authorised access to the comparative result database has been established.

Pursuant to the memorandum signed by Latvia and the European Association of National Metrology Institutes (EURAMET), as well as EURAMET action plans, an analysis has been performed with respect to the following projects *Polyhedral Prism Calibration*, *Bar Measurements Calibration*, and *Mass Kilogram Standard with Replacement*. The national project *Mass Standard (Weight) Calibration* among laboratories accredited in Latvia has been completed. The work continues in the EURAMET project *Time Definition and Regulation in the European Countries*.

Consultations have been provided in the field of regulated metrology to JSC LATVENERGO, GKPP Road Traffic Surveillance Bureau of the Ministry of Internal Affairs, LLC "KJS", LLC "SKAILOKS", LLC "Tek Know Baltic", LLC "ECSYSTEMS", and a Lithuanian company UAB "Cesius Baltic".

13 conformity certificates for measurement equipment types have been repeatedly issued, and the list of approved types has been updated. One unit of measurement equipment has been certified.

On 7–8 September 2009, the National Metrology Institute of Estonia "Metrosert" performed an audit of the MB technical capabilities and quality management system, and approved MB's competence to perform the maintenance and calibration of standards in accordance with the requirements of Standard EN ISO/IEC 17025:2005.

## 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 is basically achieved, the Saeima adopted the *Law on Completion of 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 of completing the privatisation process and land reform and ensuring completion of the use of privatisation certificates (see Box 6.28).

**Privatisation of state-owned property units and land**

Privatisation of state-owned property units or land is carried out and privatisation proposals are summed up by the state joint stock company Latvian Privatization Agency (hereinafter – Privatisation Agency) under the *Law on Privatisation of Property Units Owned by State and Local Governments*.

A decision to bring a state-owned property unit (including capital shares) or vacant land lot to privatisation is taken by the Cabinet of Ministers, while a decision to bring a built-up land lot (on which there are buildings owned by another person) to privatisation is taken by the Privatisation Agency. The decision is taken on the basis of a privatisation proposal submitted by any natural or legal person.

626 proposals for privatisation or privatisation continuation of real estate, 57 proposals for privatisation of state capital shares and 4302 proposals for privatisation of land lots have been registered by the *Register of Privatisation Proposals* of the Privatisation Agency from 1 September 2005 (when the *Privatisation Completion Law* came into force) till 1 October 2009. After 31 August 2006, the Register of Privatisation Proposals registered those privatisation proposals, which were submitted by mistake to other state and local government institutions by this date and transferred by pertinence to the Privatisation Agency later.

A natural or legal person eligible to acquire personal or real property in Latvia can be the subject in privatisation of state-owned property (real estate, capital shares, land). Payments for the property units have to be made in lats (LVL) and/or privatisation certificates.

**Box 6.28**

***Law on Completion of State and Local Government Property Privatisation and Use of Privatisation Certificates***

*The Privatisation Completion Law* prescribes:

– the deadline is 31 August 2006, by which every legal or natural person may propose to bring any state or local government property to privatisation;
– the procedure, by which a privatisation proposal submitted by a person is reviewed and a decision is adopted to bring the state or local government property to privatisation;
– that privatisation may be denied and the property remains in possession of the state or local government if the property is necessary to perform public administration functions or commercial activity of the state or local government;
– that the Cabinet of Ministers had to adopt decisions regarding the handing over of a property owned by the state or local government, if the private person has not submitted a privatisation proposal with regard to the respective property of state or local government by 30 December 2007;
– that the state joint stock companies "Latvenergo", "Latvijas pasts", "International airport "Riga"", "Latvijas dzelzcels", "Latvijas gaisa satiksme", and "Latvijas valsts mezi" will not be privatised or alienated;
– the deadlines, by which the persons willing to redeem land allocated for permanent use have to submit land redemption application (30 November 2007) or by which the land boundary plan or confirmation of the land redemption payment done in privatisation certificates before conclusion of the land redemption contract has to be submitted to the State Land Service (1 September 2008), as well as by which the application for decision with respect to the allocation of the property for payment has to be submitted (31 August 2010), and that the land purchase agreement has to be concluded by 30 December 2010;
– that 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 final deadline is 28 December 2007, by which persons 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 publicly available registers of privatisation proposals and land redemption.

From 17 April 1994 till 1 October 2009, the privatisation regulations had been approved in the statutory procedure for 2422 state property units (excluding land). 94 companies were transformed to public joint stock companies, thus releasing 439.1 million shares into public circulation. The income obtained from privatisation of state property units (with the exception of land, selling of shares emerged as a result of capitalisation of debts and alienation of capital shares) amounted to LVL 1.7 billion, of which LVL 394 million in cash and the nominal value of LVL 1.3 billion in privatisation certificates. New owners took over obligations of privatised state companies (enterprises) for more than LVL 186.7 million. The amount of the specified investments was LVL 145.4 million, while the amount of investments actually invested reached LVL 266.7 million.

The Privatisation Agency carries out privatisation of state-owned lands since 1997. 4796 state-owned land lots with the total area of 7090.4 ha were privatised (purchase agreements signed) by 1 October 2009. The total sales price for the privatised state lands reached LVL 196 million, of which LVL 93.3 million in cash and LVL 102.6 million in property compensation certificates. As of 1 October 2009 income from privatisation of these land lots amounted to LVL 174.6 million, of which LVL 80.5 million in cash and LVL 94.2 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 personal or real estate property in Latvia within the process of privatisation of local government properties can be the subject in privatisation of local government property (real estate, a deemed part of the real estate, enterprise, capital shares, land). Payments for local government property units have to be made in lats (LVL) and/or privatisation certificates.

Privatisation of local government property in the local government area is ensured by the property privatisation commission of the respective local government (rural municipality, city, district, region).

Compliance of privatisation projects, regulations, and announcements approved by a local government with the provisions of the *Law on Privatisation of Property Units Owned by State and Local Governments* and the *Privatisation Completion Law* is ensured by the Ministry of Economics.

From February 17, 1994 till October 1, 2009, the Ministry of Economics has reviewed and accepted for information 3239 privatisation projects for the total relative price of LVL 148.4 million (inter alia payments in certificates for the nominal value of LVL 57.4 million).

From 1 January 1997 till 1 October 2009, the Ministry of Economics has reviewed and accepted privatisation regulations in respect to 1671 built-up and vacant local government lands (announcements of privatisation of built-up land lots separately as from 1 September 2005) with the total value of land lots in the amount of LVL 26.4 million (of which LVL 13.3 million to be paid in property compensation certificates).

According to Item 7 of Article 5 of the *Privatisation Completion Law*, after 31 August 2006 the local governments shall submit quarterly data to the Ministry of Economics regarding the received privatisation proposals for municipal property units and built-up and vacant land lots, decisions on bringing these property units and land lots to privatisation, the sale price, and the amount of privatisation certificates to be used for payment.

**Privatisation of residential buildings**

Privatisation of residential buildings in Latvia was initiated in 1995. It was implemented by the Central Privatization Commission of Residential Buildings (since 1 January 2004 – State Agency "Housing Agency"; since 1 January 2008 – the Construction, Energy, and Housing State Agency; and since 1 July 2009, it is continued by the JSC "Latvian Privatisation Agency"), as well as by the residential building privatisation commissions of the local governments in compliance with the procedure stipulated by the *Law on Privatisation of State and Local Government Apartment Buildings*.

In accordance with information provided by the local governments and national statistics, there are 30 346 residential buildings with 502 181 apartments to be privatised in Latvia, including 25 152 local government residential buildings with 451 811 apartments and 5194 state residential buildings with 50 370 apartments.

**The privatisation process of the state residential buildings** – decisions on bringing 5092 apartment buildings to privatisation have been adopted until 1 October 2009, which amounts to 98% of the total amount of state owned apartment buildings. 5070 residential buildings 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 contracts have been sent to the persons, who have obtained apartments in possession until privatisation of an residential buildings. The possession of 22 977 apartments has been transferred by the decision until privatisation of an residential house. 44 227 state apartments have been privatised until 1 October 2009, which constitutes 87.8% of the total amount of state apartments. In the 3rd quarter of 2009, 11 apartments were privatised.

**The privatisation process of local government residential buildings** – 24 331 local government residential buildings 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 contract have been sent to the persons, who have obtained the apartments in possession until privatisation of the residential building. In the 1st and 2nd quarter of 2009, 41 residential buildings with 380 apartments were offered for privatisation. 171 589 apartments have been transferred to possession by local government decisions until privatisation of the residential building. Ownership relations have been arranged for 42 947 owners of the apartments privatised for the shares of agricultural enterprises, who live in 1705 apartment buildings privatised for shares. Until 1 July 2009, 399 822 local government apartments have been privatised, which constitute 88.5% of the total number of local government apartments.

By 1 October 2009, 9320 residential buildings were transferred to the **management of apartment owners**, including 5709 local government residential buildings and 3611 state residential buildings. As a result of this process, 417 apartment owner associations and unions have been established in Latvia, of which 307 are located in seven biggest cities, and 110 – in the regions of Latvia. Authorisation agreements for property management by apartment owners have been signed for 2892 residential buildings.

**Land reform**

The principal goal of the land reform is to rearrange the legal, social, and economic relations of land use and ownership from the planned economy to the market economy.

The state land reform includes allocation of free land pertaining to the state for permanent use, restoration of ownership rights, redemption of the land allocated for permanent use, and privatisation (alienation) of land owned by the state or local government. Redemption of land allocated for permanent use is being carried out in relation to the rural and urban land reform, which is under way in the country.

Allocation of urban land for the use to residential building owners or orchard users, who have received the land for establishing an orchard with building rights, has been completed. The urban land commissions have reviewed conclusions concerning the rights to acquire ownership of land for payment and have concluded their entry in the City Land Redemption Register. The decision-making regarding allocation of land property for payment has been concluded and the decision making process on the termination of rights to use land and termination of land rent agreements with persons who by 1 September 2008 had conducted the cadastral survey or pre-payment, but had not by 31 August 2009 submitted an application for the decision for allocating land property for payments, have has been launched. Until 30 December 2009, conclusion of contracts with persons, who had submitted applications for decisions and received positive decisions, continued, in accordance with the Regulations No. 686 of 25 August 2008 of the Cabinet of Ministers *Procedure for Signing Land Redemption (Purchase) Agreement*. Until 1 October 2009, SJSC "Latvijas Hipoteku banka" (Mortgage Bank of Latvia) had signed a total of 72 717 agreements, of which 289 agreements were signed during the 1st three quarters of 2009.

In accordance with the *Privatisation Completion Law*, the submission of rural area land redemption claims to the State Land Service (hereinafter – SLS) for rural land allocated for permanent use took place in two stages: from 1 September 2005 until 31 August 2006 and from 1 August 2007 until 30 November 2007.

After receiving the land redemption claim, the SLS verifies the person's entitlement to redeem the claimed land unit for payment. In case the person is entitled to redeem the land property, the SLS adopts a decision and enters the land property requested for redemption in the Rural Land Redemption Registry. For permanent users of land who due to legislative restrictions were not entitled to redeem the land at the moment of examination of the land redemption applications, but who might become entitled by the time of taking the decision on allocating land property for payments (by 31 August 2009), the land claimed for redemption was entered in the Rural Land Redemption Registry with a condition that by 31 August 2009 the persons will submit documents to the SLS confirming their rights to redeem the land.

In cases when land boundary plans had been registered in the information system of the Real Estate State Cadastre by 31 August 2009, the SLS entered the land units allocated for permanent use with cadastral survey without the person's request.

Persons, whose redeemable land unit, had already been performed and the cadastral survey and the land boundary plan had already been prepared, timely and not later than by 31 May 2009, had to submit an application to the SLS Regional Department for a decision regarding the allocation of land property for payment. Persons, whose land claimed for redemption had been conditionally entered into the Rural Land Redemption Registry, must submit additional documents confirming the entitlement to redeem the land (e.g. document confirming inheritance of land use or redemption rights).

Likewise, persons that are redeeming land and have by 1 September 2008 executed the pre-payment for the land, but the cadastral survey had not been performed for this land, must by 31 August 2010 submit an application to the SLS Regional Department for a decision regarding the allocation of land property for payment.

By 31 August 2009, on:

– 2600 land units conditionally entered into the Rural Land Redemption Registry documents had not been submitted confirming the rights to redeem land;
– 4610 land units pre-payment has been made, but the land boundary plan had not been submitted to the *National Real Estate Cadastre information system*;
– 11 070 land units entered into the Rural Land Redemption Registry and with cadastral survey application for decision regarding the allocation of land property for payment had not been submitted.

The 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 235 114 agreements, including 4496 agreements in the 1st three quarters of 2009 for the total land area of 1.7 million hectares, including 25 364 hectares in the 1st three quarters of 2009.

In accordance with Section 16 of the *Law on the Completion of Land Reform in Rural Areas*, until December 28, 2007 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 "Visparejas Lauksaimniecibas banka" (General Agricultural Bank) or the "Valsts zemes banka" (State Land Bank), as well as heirs of such persons (hereinafter redeemers of German lands) shall submit a request regarding the restoration of land ownership rights to the State Land Service. If the documentation confirming 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 State Land Service until September 1, 2008. As from 2 January 2009, after summarization of all the applications the State Land Service has to start taking decisions on restoration of land ownership rights to the land planned for finishing the land reform. Review of the applications and decision-making will be taking place by 30 December 2010. In accordance with the information provided by the State Land Service, 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 State Land Service and Service until 1 September 2008, from almost 2200 applications submitted 1155 have been provided with documentation confirming the land ownership and inheritance rights 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 National Real Estate Cadastre information system, by 1 October 2009, 8496 land units had been registered as the land planned for finishing the land reform in the area of almost 25 790 ha.

**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.

Privatisation certificates are issued and used according to the *Law on Privatisation Certificates*. By 1 October 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, 4896.2 thousand for land in rural areas, 969.3 thousand for property ownership, 814.4 thousand for urban land, 461 thousand for companies and other property units, 89.8 thousand for property taken away from politically repressed persons, and 84.4 thousand for property alienated in illegal manner.

2000 property compensation certificates have been granted to 15 former owners or their heirs in the 1st three quarters of 2009.

By 1 December 2007, in accordance with the provision set in Article 27 of the *Law on Completion of Privatisation*, 58 thousand persons lost their rights to transfer 1.6 million privatisation certificates to their accounts.

According to the *Law on Privatisation of Land in Rural Areas*, 11 076 decisions have been made by October 1, 2009 about payment of cash compensations for former land ownership in rural areas. Compensations in the total amount of LVL 17.5 million have been paid to 8411 persons, cancelling 0.6 million property compensation certificates.

Cash compensations in the total amount of LVL 4.6 million were paid to 26.2 thousand politically repressed persons as a payment for privatisation certificates by October 1, 2009. In compliance with the provision prescribed in Article 27 of the Law on the Completion of Privatisation of State and Municipal Asset units and the Use of Privatization Vouchers, 3.1 thousand persons have lost their rights to cancel 15 thousand privatization vouchers.

Table 6.8

**Use of Privatisation Certificates**
(by 1 October 2009)

| Type of property | Amount | Number of privatisation vouchers | including property compensation vouchers |
|---|---|---|---|
| | | (million) | (thousand) |
| Apartment buildings | 444 thousand privatised housing units | 37.9 | 589.8 |
| Enterprises and other properties | ... | 7.3 | 109.6 |
| Capital shares (stocks) | ... | 44.5 | 954.0 |
| including: | | | |
| in public offering | 128.7 million shares | 37.1 | 820.0 |
| Land | 300.8 thousand land lots | 16.6 | 5131.6 |
| **Total:** | | **106.1** | **6785.0** |
| % of total certificates issued | | 94.4 % | 84.7 % |

By 1 October 2009, 106.1 million privatization vouchers or 94.4% of the total number of issued vouchers have been used for privatisation of state and municipal asset units (see Table 6.8).

2.3 million privatisation vouchers or 2% of the total number of issued vouchers, including 0.1 million compensation vouchers were on the accounts of 389 thousand natural persons as of 1 October 2009.

Accounts of legal entities held 1.5 million privatisation vouchers or 1.3% of the total number of issued vouchers, including 11 thousand property compensation vouchers, as of 1 October 2009.

In October 2009, holders of privatisation vouchers could use services of 15 licensed intermediary capital companies for transactions in the market of privatisation vouchers. Total monthly transactions with privatisation vouchers (buying from natural persons and selling) performed by intermediary capital companies in 1st three quarters of 2009, fluctuated from 9.9 thousand privatisation vouchers in August to 109.2 thousand privatisation vouchers in July, and from 0.9 thousand property compensation vouchers in September to 2.7 thousand property compensation vouchers in March.

# 6.14. Advisory Councils of the Ministry of Economics

## 6.14.1. National Economy Council

National Economy Council of the Ministry of Economics (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 bylaws of the Ministry of Economics and *Agreement on Co-operation in the National Economy Council* concluded on February 17, 1999 and Bylaws of the NEC.

The NEC is an advisory institution that participates in settlement of issues referring to business 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 set by the *Lisbon Strategy* in Latvia and to involve public institutions, local governments and social partners in fulfilment of these goals.

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 development of Latvian economy. The NEC prepares proposals and adopts recommending decisions on these issues. The NEC carries out 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 on *Growth, competitiveness and employment*. The co-operation memorandum is aimed at co-operation and concerted action in implementation of objectives of *National Development Plan* and *Lisbon Strategy* – promotion of growth of the economy and employment of Latvia, as well as active participation in development and implementation of sustainable strategy of Latvia.

In order to ensure professional representation of the interests of economic sectors in an effective dialogue with the Ministry of Economics, the NEC and other business organisations and public institutions, the Ministry of Economics has set up a model of co-operation with the economic sectors.

**Box 6.29**

**NEC personnel**

In accordance with the decision of the Managing Authority, the NEC personnel are approved by the Minister of Economics.

The NEC Managing Authority is a consulting and co-ordinating institution that takes part in settlement of issues referring to the business policy and is responsible for assessment and approval of issues in the agenda of the NEC action plan and NEC meetings, as well as for ensuring and improvement of efficiency of the NEC operation.

Composition of the NEC Managing Authority is approved by the Minister of Economics. Managing Authority consists of five representatives of the NEC founders, who are NEC members at the same time:

- representative from the Ministry of Economics;
- representative from the Latvian Chamber of Commerce and Industry;
- representative from the Employers 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 designated by the NEC Managing Authority, among them the Minister of Economics, NEC Chairman and representatives of entrepreneur organisations, 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 composition of the NEC are taken by the NEC founders in meetings of the NEC Managing Authority.

The NEC is chaired by the Chairman elected by the members of the NEC Managing Authority from among the members in a rotation sequence for a term of office of one year.

The NEC meetings are held on average once per month.

Work of the NEC is organised by the Secretariat of the National Economy Council, operations of which are ensured by the Ministry of Economics.

In between the NEC meetings, recommending decisions of the NEC are taken by the NEC Managing Authority.

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 the programming documents, take measures towards implementation of the programmes on improvement of economic development and business environment adopted as part of the governmental declaration, and that the councils of experts will assess and give opinion on draft legislative acts elaborated by the ministries.

The NEC members and experts participate in:

- Consultative Board for Development Co-operation Policy Issues at the Ministry of Foreign Affairs;
- Supervisory Board of the Lisbon Strategy;
- Construction Council;
- Latvian Tourism Advisory Council;
- Export Promotion Council;
- National Standardisation Council;
- European Union Structural Funds Supervision Committee;
- Information Society National Council;
- Advisory Council of Investment and Development Agency of Latvia.

**Box 6.30**

**NEC on priorities of economic policy**

The NEC still considers taxation policy and administration, labour force education, macroeconomic stability and non-predictability of amendments to the legislative acts as one of the most problematic spheres.

At the same time, the normative acts must be assessed already during their drafting process, in order to identify and prevent the possible violations of the competition rights, technical barriers to trade and discriminating conditions within the sector of free movement of goods and services, as well as in the sphere of company law. State support and procurement supervision must be improved obtaining high transparency level for 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. Such 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 export promotion institutional base must be provided, as well as raising its capacity, development of external economic representations, accessibility of financial instruments and support to companies in export marketing.

In the 2nd half of 2009, 5 National Economy Council meetings have taken place in which the following most important issues have been reviewed regarding:

- *Economic Stabilisation and Growth Revival Programme of Latvia* in the context of amendments to the state budget 2009 and perspective for 2010–2012;
- Proposals for the recovery of the economy of Latvia;
- Proposals for the recovery of the economy of Latvia in medium term, including proposals to changes in tax policy;
- Implementation procedure of energy efficiency measures;
- Reorganisation of the State Revenue Service and tax collection tendencies in the 2nd half of 2009;
- *Insolvency Law*;
- Draft legislative acts developed by the Ministry of Finance with respect to increase of taxes comprised in the budget package of 2010;
- Follow-up actions for the economic recovery.

### 6.14.2. 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, *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 composition and statutes of the CSMEC is approved with a Decree No. 560 of the Ministry of Economics of December 11, 2007.

The goal of 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 prepare proposals and make recommending decisions on these issues; to carry out 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.

Meetings of the CSMEC are held once per month on average and are led by the Chairman elected by the Council. The Ministry of Economics ensures work of the Council and performs the functions of its secretariat.

In the 2nd half of 2009, 5 CSMEC meetings have taken place, in which the following most important issues have been reviewed regarding:

- proposals for the recovery of the economy of Latvia;
- support to Latvian enterprises;
- on Globalisation Adjustment Fund and support programmes for entrepreneurs under the responsibility of the Ministry of Welfare;
- topical issues in branches of risk capital in Latvia;
- *Business incubator programme* and other Structural Funds programmes administered by LIAA in the 2nd half of 2009;
- *Construction Law*;
- draft regulation of the European Parliament and the Council on consumer rights;
- Draft law *Insolvency Law*;
- Latvian Guarantee Agency information about guarantees granted;
- exhibition – fair *Made in Latvia* and related export opportunities;
- progress report on the action plan on improvement of the business environment for 2009;
- follow-up actions for the economic recovery.

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 improvement of Latvian business environment.

A positive trend to be noted is that through co-operative efforts with the Ministry of Economics businessmen are invited on a regular basis to assess SME development issues and draft programming documents shaping SME development policy before adoption thereof by the Cabinet of Ministers.

At the sittings, proposals for various legislative acts have been developed. The council believes that it is necessary to enhance the support to micro-enterprises, establish friendly tax policy, create single database of public administration and its subordinate bodies etc.

In order to strengthen the role of the CSMEC in improvement of the business environment, as well as in order for the non-governmental sector was competently represented in absorption of the EU Structural Funds and support programmes, members of CSMEC are delegated for participation in such councils, committees, and working groups:

- EU Structural Fund Steering Committee;
- Sub-committee of the European Regional Development Fund and the Cohesion Fund;
- Sub-committee of the European Social Fund;
- Drafting development guidelines for the state tax and duty system in the working group;
- Export Promotion Council;
- Advisory Council of the Investment and Development Agency of Latvia;
- Business Development Board of Riga City Council;
- Coordination Council of External Economic Representations of Latvia.

Participating in entrepreneur delegations beyond the borders of Latvia, the co-operation agreements of the Council have been concluded with similar organisations of the Republic of Azerbaijan and Republic of Israel.

# 7. Recommendations

The rapid economic recession has been brought to a halt, the slowdown rates are lower, and the situation is slowly stabilising. Positive growth could start again in the mid-2010. The main challenges for ensuring sustainable growth in a medium-term are related to ensuring competitiveness in open markets for goods and services and decreasing social risks. For ensuring long-term growth, however, the main challenges are related to the transition to a knowledge-based economy, solving the demographic issues, including ageing, and to the creation of a "green" economy.

**In the medium-term**, Latvia will have to adapt to the new economic conditions. Due to the global financial crisis, the paradigm of economic development is changing. In the previous years, the main driver for growth was the strong domestic consumption, which was based on voluminous inflow of capital. In the future, the determinant role will be played by the country's competitiveness in the open markets for goods and services. Thus, the main growth driver will be the expanding export opportunities. At the same time, a tense situation in the labour market should be taken into account. On the one hand, over the next few years, competitiveness of Latvia will be mainly based on the price competitiveness, incl. low labour costs, and, on the other hand, the future economic development will be to a larger extent determined by the growth in productivity and to lower extent – by the increase of employment (slow increase of employment rate). Thus, a high risk remains that social tension (poverty, exclusion) and labour force emigration will grow, and this time it may affect not only population with low qualification, which was characteristic in the previous years, but also highly qualified labour.

Therefore, the top-priority tasks in order to solve medium-term challenges are the following:

- **in securing macroeconomic stability:**
  - to ensure strict fiscal discipline in accordance with the deficit reduction timetable as prescribed by the *Economic Stabilisation and Growth Revival Programme of Latvia*;
  - to draft a fiscal responsibility law, which would determine medium-term fiscal policy objectives thus facilitating implementation of a responsible fiscal policy;
  - to ensure fulfilment of the Maastricht Convergence criteria by 2014, in order to join the Eurozone;
- **in improving the business environment and support:**
  - to reorganise the tax system, ensuring that it becomes more socially fair and friendlier to entrepreneurship;
  - to differentiate real estate tax, taking into account the value of residential buildings;
  - to assess thoroughly the overall influence of provisioned amendments on entrepreneurship and national economy, when making changes in the tax system, as well as to create preconditions to improve competitiveness of Latvian entrepreneurs in the domestic market;
  - to improve the process of entrepreneurship 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 drafting a new *Insolvency Law*;
  - to promote development of e-government and e-services in order to raise availability and efficiency of public services. The establishment of the state megasystem ("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 official statistical information of the state level, 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 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 the tax and fee systems related to registration of the real estate;
  - to simplify the administration process of construction, by reducing the number of days and procedures necessary for developing and approving a construction plan;
  - to assess the requirements for additional information and the related administrative burden, which has occurred or may occur during transposition of the EU directives, and to reduce additional or simplify the existing requirements on information provision set by the national laws and regulations;

  - to increase operation efficiency of the State Revenue Service by continuing reorganization of the SRS into an institution, which helps the entrepreneurs;
  - to introduce a fixed tax for microenterprises by combining the corporate income tax, personal income tax, state mandatory social insurance contributions and liquidity risk charges;
  - to allow the economically active residents, who have lost their jobs, to receive the calculated unemployment benefit for six months in case a microenterprise is being established;
  - to increase the VAT registration threshold up to LVL 35 000;
  - to revise tax declarations and maximally simplify them, repealing all unnecessary requirements so that the entrepreneur can fill them by himself/herself;
  - to establish a microcrediting programme for producers of agricultural products;

- **in ensuring competition and determining administratively regulated prices:**
  - to tackle the most significant competition breaches as efficient as possible, focusing on abuse of a dominant position in the retail trade sector;
  - to perform preventive and inspective measures for identifying prohibited agreements in the sectors important for the national economy by paying particular attention to public and local government procurements;
  - to continue the evaluation of the effect of legislative acts and their drafts on the competition situation in various markets for tackling administrative barriers;

- **in promotion of investment, business start-ups and access to finances:**
  - to support the enterprises having difficulties to receive a loan for the implementation of the EU Structural Funds projects with the help of specially established financial instruments;
  - to pay more attention to the allocation of financing to development of entrepreneurship in the early stage (measures for the access to the pre-seed and seed capital, opportunities to receive loans with preferential terms) and access to finances in the form of a risk capital;
  - to address the foreign enterprises more actively and inform them about the advantages of Latvia in order to attract productive long-term foreign investment which would have a positive financial influence also on Latvian enterprises – sub-suppliers, and promote creation of qualitative long-term jobs;
  - to promote exchange of information between Latvian companies looking for strategic investors and foreign companies willing to expand their business in the European market;

- **in the application of the EU funds:**
  - to reduce the time necessary for administrative procedures, simplifying the procedure of development and approval of implementation conditions;
  - to direct EU structural funds towards viable projects, taking into account priority sectors;

- **in promoting exports:**
  - to ensure access to export credit guarantees in order to increase access to the markets with higher risk degree and to promote exports of goods and services of Latvian origin;
  - to support the participation of entrepreneurs and their unions in international exhibitions and trade missions, in order to foster access to new markets;
  - to ensure representation of Latvia in negotiations on external economic interests, in order to improve the contractual conditions of international trade and reduce trade barriers encountered by entrepreneurs in export markets;
  - to promote participation of Latvian companies, entrepreneur organisations and public institutions in priority projects planned in the framework of the EU Baltic Sea Strategy, in order to use these projects for more effective co-operation between Latvian entrepreneurs and partners in the Baltic Sea region and raising competitiveness in the global market;

- **in establishing of flexible labour market:**
  - to review the regulation of labour legal relations, including obligations related to the payment of adjustments 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 force mobility;
  - 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 regulatory system of labour market demand and supply by ensuring preparation of medium and long term forecasts of labour market and to consider the population census of 2011 as an important data source for the improvement of this system;

– **in improving energy efficiency:**
  – to implement the *State Support Programme for Promoting Renovation of Multi-Apartment Buildings*, by allocating co-financing for energy audits of the buildings, for drafting technical survey opinions, for preparation of technical projects or simplified renovation documentation;
  – to 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 buildings and residential social buildings.

In order to ensure sustainable growth in the **long-term**, Latvia must create a knowledge-based economy where the growth is based on a generation of values using knowledge (education and research, innovation and creativity, digital economy), ensure a sustainable social budget, taking into account the issues related to the ageing of society, ensure diversification of energy supply, as well as create a more environmentally-friendly ("greener") economy.

The top-priority tasks to solve the long-term challenges are the following:
– **in establishing the knowledge-based economy:**
  – to facilitate cooperation of scientists and entrepreneurs by establishing competence centres in order to promote cooperation between the research and industrial sectors in the implementation of industrial research, new products and technologies, as well as to support the technology transfer contact points 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 industrial property rights;
  – to improve the normative acts regulating scientific activity by prescribing that scientific institutions may be the owners of the intellectual property developed as a result of the research financed by the state;
  – to promote digital economy;

– **in ensuring efficient, safe and sustainable energy supply:**
  – by utilising the co-financing of the EU structural funds and the support mechanism of mandatory procurement of electricity by promoting the 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 of energy;
  – to increase the level of energy supply security and energy efficiency;
  – to develop the energy infrastructure projects by implementing the *Baltic Interconnection Plan*, in the framework of the EU Baltic Sea Region Strategy.

**A consistently implemented structural policy will promote economic revival 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 in the conditions of mutual understanding and dialogue within the society.**