

Ministry of Economics

Republic of Latvia

**ECONOMIC
DEVELOPMENT
OF LATVIA**

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Commentaries, questions or proposals are to be sent to:

Ministry of Economics, Republic of Latvia
Brīvības ielā 55, Rīga, LV-1519

Phone: 371-67013119

Fax: 371-67280882

E-mail: macro@em.gov.lv

Homepage: <http://www.em.gov.lv>

The Report was prepared by: O.Barānovs (overall compiling, 1., 4.1.1., 4.4.1., 4.4.2., 6.1.), G.Piņķe (3.1., 3.2.1., 3.2.2., 3.3.1., 3.3.2., 3.5., 4.1.2., 4.1.3., 4.3., 5.1.), E.Gergelevičs (2., 3.2.4.), I.Skribāne (3.2.3., 4.3., 5.2.), D.Dravnieks (3.3.3.), J.Salmiņš (3.3.2., 4.1.1., 4.1.2., 4.4.3.), L.Stelmaka (4.2.), Č.Grībovskis (5.1.), J.Ušpelis (5.3.), A.Jansons (6.2.1.), A.Gulbis, D.Klinsone, L.Stauvere, S.Pizika, M.Paņkova, G.Ābele, (6.2.2.), I. Tērauda (6.2.3.), T.Grīnfelds (6.3.1.), D.Merirands, D.Eberšteina (6.3.2.), A.Liepa (6.3.3.), I.Kalniņa, M.Paņkova (6.3.4.), I.Beināre, L.Dūda (6.4.), U.Vanaga (6.5.), L.Neiders, I.Eglītis, R.Bērziņš (6.6.), K.Šuste (6.7.), M.Stenders, I.Kabanova (6.8.), M.Purviņa (6.9.), I.Ozoliņa (6.10.), L.Zemīte, B.Vītoliņa (6.11.), E.Skribnovska, J.Strīpnieks, J.Maurāns, M.Ozoliņš (6.12.), D.Jirgena, D.Nestarenko, K.Lore, I.Mūrniece (6.13.), I.Lipovska (6.14.), I.Bērziņa (6.14., 6.15.3.) D.Kalnāre (6.15.1., 6.15.2.).

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Dear reader,

Experts of the Ministry of Economics have prepared the 29th **Report on Economic Development of Latvia**. The first Report was published in September 1994 and the following Reports since 1995 were published traditionally twice a year in June and December. The present Report, just like the previous ones, provides evaluation of the economic situation in Latvia and shows the progress of reforms, as well as offers economic development forecasts.

Considerable growth has been observed in Latvia for several years and it was the most rapid in the European Union. Within the period of 2005–2007 GDP annually grew by 11% on average. Since the mid-2007, the growth rates started to decrease and in the 3rd quarter of 2008 they became negative. Upon development of the global financial crisis, the recession rates in Latvia have accelerated in the second half of 2008 and negative growth rates are forecasted also for 2009.

Taking into consideration the current economic recession trends in the world and Latvia, the government is taking steps in order to prevent further decrease of the economic activity.

In April 2008, the government approved the Action Plan developed by the Ministry of Economics for the next two years envisaging stabilisation of national economy and paying the main attention to increasing and raising budget efficiency, improving the tax policy, increasing productive capacity, especially in tradable sectors, as well as to the implementation of the policy focused on the development of the knowledge-based economy. In October 2008, the plan was supplemented with new measures in the fields of tax policy, distribution of the financing of EU structural funds and decrease of the administrative burden. The goal of the measures in the conditions of decreasing availability of credit resources and poor external demand is to expand access to the financing for enterprises, promote investment in the private sector and continue decreasing the barriers for entrepreneurship.

In order to implement the re-investment stimulus, substantial amendments to the Law on Corporate Income Tax have been made becoming effective on January 1, 2009. The Holding fund has been established by support of the EU Structural Funds with a total amount of financing reaching LVL 128 million, which will provide aid to the small and medium-sized enterprises (SMEs) for receiving guarantees, export credits, risk capital and other financial instruments. The government has approved the *Support Programme for Improving Competitiveness of Enterprises*, which will facilitate the access to finances for SMEs. The amount of loans supported in the framework of the Programme is envisaged in the amount of up to LVL 200 million within the period of 2008–2009.

Upon attracting EU Structural Funds, financing in the amount of more than LVL 200 million, implementation of several programmes, such as *Introduction of New Products and Technologies into Production*, *Competence Centre Programmes*, *Support to Technology Transfer Contact Points*, *Development Programme for Innovation Centres and Business Incubators* have been started or planned to be started in the next months. These programmes are aimed at promotion of knowledge-based economy, i.e., to facilitate knowledge and technology transfer in production in order to ensure production of the products with higher value added.

In order to provide higher stability of Latvian financial system, in November 2008 the government has taken the step already approbated in the world, by overtaking the second largest commercial bank “Parex banka”. Latvian government will enter into negotiations with the potential strategic investors as soon as possible regarding the sale of this commercial bank.

In co-operation with the European Commission and International Monetary Fund the government has developed the *Economic Stabilisation and Growth Revival Programme of Latvia*, approved by the Saeima on December 12, 2008. The Programme is aimed at providing structural changes for sustainable economic development. The agreement with the European Commission and International Monetary Fund envisages also attracting appropriate financial resources in the amount of EUR 7.5 billion in order to solve the potential liquidity problems.

The Programme envisages to continue provision of a fixed exchange rate of the lats to the euro (EUR 1 = LVL 0.702804). The government will observe a strict fiscal policy in order to reach the Maastricht convergence criteria by 2011, as well as to receive an invitation to join the Eurozone. Within the next two years substantial optimisation and decrease of budget expenditures is planned. The public administration staff will be decreased by at least 15%, as well as such sectors as education and health will be reformed. In order to stabilise the financial sector, the state is ready to provide support to credit institutions and supervision of the credit institutions will be improved at the same time. The Programme envisages several measures for improving economic competitiveness, including providing financing opportunities for economic restructuring measures, especially for the programmes of EU Structural Funds in the conditions of a ceased credit resource market.

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

In the Report you will find information about both, the development of main economic and social indicators, growth of national economy sectors, external economic environment, and government's

economic policy for promotion of growth and employment, foreign trade policy, utilisation of the EU Structural Funds and the Cohesion Fund, innovation and entrepreneurship policy and other economic reforms. In the conclusion, the authors of the Report give recommendations for 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 to economists and entrepreneurs as well as to everyone interested in the issues of the economic development of Latvia and that it will encourage exchange of opinions between the public institutions, various organisations and interest groups, as well as other stakeholders.

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

December 2008



Kaspars Gerhards,
Minister of Economics

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ABBREVIATIONS

Abbreviations

ACTA	Anti-Counterfeiting Trade Agreement	RSE	Riga Stock Exchange
CF	Cohesion Fund	SJSC	State Joint Stock Company
CIS	Commonwealth of Independent States	SME	Small and medium-sized enterprises
CRPC	Consumer Rights Protection Centre	SOLVIT	Efficient Solving of Internal Market Problems
CSB	Central Statistical Bureau	SPD	Single Programming Document
CSMEC	Council of the Small and Medium-Sized Enterprises and Crafts	SRS	State Revenue Service
EC	European Commission	USA	United States of America
EEA	European Economic Area	WTO	World Trade Organisation
ERDF	European Regional Development Fund	ĀIPL	Ārvalstu investoru padome Latvijā
ESF	European Social Fund	DP	darbības programma
EU	European Union	EIV	Eiropas Investīciju fonds
EU-15	European Union before enlargement on May 1, 2004	EVP	Eksporta veicināšanas programma
EU-27	European Union after enlargement on January 1, 2007	IIN	iedzīvotāju ienākuma nodoklis
EU SF	European Union Structural Funds	KP	Konkurences padome
FCMC	Financial and Capital Market Commission	LATAK	Latvijas Nacionālais akreditācijas birojs
FDI	Foreign Direct Investment	LHB	Latvijas Hipotēku banka
FTA	Free Trade Agreement	LM	Labklājības ministrija
GDP	Gross domestic product	MK	Ministru kabinets
HPS	Hydroelectric power station	NSID	Nacionālais stratēģiskais ietvardokuments
ICT	Information and communication technologies	NVA	Nodarbinātības valsts aģentūra
IMF	International Monetary Fund	NVO	nevalstiskās organizācijas
ISPA	Instrument for the Structural Policies for Pre-accession	PCI	patēriņa cenu indekss
JSC	Joint stock company	PVN	pievienotās vērtības nodoklis
LGA	Latvian Guarantee Agency	ULC	produkcijas vienības darbaspēka izmaksas
LIDA	Latvian Investment and Development Agency		
LLC	Limited liability company		
LVS	Limited liability company "Latvijas standarts"		
ME	Ministry of Economics of Latvia		
NEC	National Economy Council		
PPP	Public and private partnership		

State Abbreviations

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

Measures

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

Conventional designations

–	Magnitude zero / absent	...	Data not available or too uncertain
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1. ECONOMIC SITUATION: BRIEF OVERVIEW

Rapid growth had been observed in Latvia during the period of 2005-2007, when GDP grew annually by 10.9% on average, but in 2007 – by 10%. The high growth rates were mainly ensured by the domestic demand. Both, private consumption and investment increased considerably. Increase of exports played a less significant role in the growth. Contribution of the net exports to the growth was negative.

Since 2007, the growth rates started to decrease and in the 2nd quarter of 2008 became negative. Deterioration of the economic situation in Latvia is determined by the processes of global financial crisis, which substantially decreases both, domestic and external demand. By intensifying of global financial problems, the recession rates in Latvia accelerated in the second half of 2008, and negative growth rates are forecasted also for 2009.

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

In 9 months of 2008, the volume of GDP has decreased by 2.4% as compared to the respective period of 2007, and by 5.2% in the 3rd quarter of 2008. At the beginning of 2008, the decrease of the domestic demand affected development of trade, construction and real estate market to a most considerable extent, but in the 3rd quarter of 2008 negative growth was observed in almost all basic economic sectors, excluding primary sectors and commercial services. Public services were provided at the level of the previous year.

The overall decline of GDP in the 3rd quarter of 2008 was most substantially determined by the decrease of the trade services, as well as decrease of production volumes in manufacturing. Production volumes in construction have also decreased considerably.

According to the conjuncture survey results, optimism of entrepreneurs decreases in relation to assessment of the economic situation and further

growth opportunities. The industry confidence indicator continues to decrease. On the whole, the economic sentiment indicator has reached the lowest value in the EU member states during the last 20 years.

The production volumes in the 3rd quarter of 2008 have also decreased in the EU in general, amounting to 0.2% according to the seasonally adjusted data of the *Eurostat*, of which, by 0.5% in Germany, Italy and United Kingdom. It should be noted that Estonia has had negative growth already for the third quarter – in the 1st quarter of 2008 GDP fell by 0.9%, in the 2nd quarter – by 0.8% and in the 3rd quarter – by 1%, while the growth still continues in Lithuania, but at a slower pace than in the previous year.

After stagnation in the end of 2007 in the USA, the increase of the growth rates from 0.2% in the 1st quarter of 2008 to 0.7% in the 2nd quarter of 2008 has been observed, however, in the 3rd quarter of 2008, the GDP decreased by 0.1%.

The main growth risks are related to instability of the global financial market, as well as the situation in the Latvian export markets. Rapid decrease of the availability to credit resources and necessity of the government to reduce its expenditures deepens the decline of investment and private consumption.

Taking into account the abovementioned, **the Ministry of Economics forecasts decrease of GDP in the amount of 4.6% in 2008, but in 2009 – by 10%.**

Due to decrease of domestic demand, the external balance has improved. The current account deficit of Latvia's balance of payments has fallen from 25% of GDP in the 3rd quarter of 2007 to 11.8% in the 3rd quarter of 2008. It should be noted that comparatively good growth rates of Latvian exports of goods and services are observed. Although the overall economic growth rate decreases, in 9 months of 2008 export volumes were by 3.5% higher than in the respective period of 2007.

The consumer price inflation in the first half of 2008 remained at a high level, which was affected by strong supply-side factors – increase in the administratively regulated prices (electricity, natural gas and heating), increase in fuel prices, increase in the excise taxes on tobacco and fuel, as well as increase in prices for food products. The total consumer price increase in May 2008 in comparison with May 2007 amounted to 17.9%, which was twice more rapid than a year ago (8.2%). However, since June 2008 due to decrease of supply-side factors, inflation has started to fall and in December 2008 the annual inflation amounted to 10.5%. It is expected that inflation will continue to decrease also in the next years.

Decrease of the growth rates starts to influence the employment indicators stronger. The number of employed persons in the 3rd quarter of 2008 decreased by 0.8% compared to the previous quarter. The number of employed persons decreased more rapidly in hotels and restaurants, various commercial services, as well as construction and manufacturing. The unemployment rate has considerably increased

from 5.3% in the 4th quarter of 2007 to 7.2% in the 3rd quarter of 2008. The data of the Central Statistical Bureau shows that at the end of the 3rd quarter of 2008 there were 9.6 thousand free vacancies. In comparison with the end of the 2nd quarter, its number has decreased by 3.1 thousand vacancies, but in comparison with the end of the 3rd quarter of 2007 – by 11.2 thousand vacancies.

Table 1.1

Latvia: Key Indicators of Economic Development

	2005	2006	2007	2008e	2009f
(changes over the previous year, %)					
Gross domestic product	10.6	12.2	10.0	-4.6	-10.0
Private consumption	11.2	21.2	14.8	-10.4	-11.2
Public consumption	2.7	4.9	3.7	-1.1	-9.6
Gross fixed capital formation	23.6	16.4	7.5	-13.6	-18.2
Exports	20.3	6.5	10.0	-2.8	-8.4
Imports	14.8	19.3	14.7	-13.4	-21.2
Consumer prices	6.7	6.5	10.1	15.4	4.0
(% of GDP, unless indicated otherwise)					
Central government budget fiscal balance	-0.4	-0.2	0.1	-3.5	-7.0
Central government debt	12.4	10.7	9.0	16.7	25.0
Current account balance	-12.5	-22.5	-22.5	-14.0	-5.0
Foreign direct investments in Latvia received during the year	4.5	8.1	7.0	5.0	3.0
Employment rate (share of economically active persons in the total population aged 15-64 years, %)	63.4	66.3	68.4	68.5	64.0
Unemployment rate (share of job-seekers in the number of economically active persons aged 15-74 years, %)	8.7	6.8	6.0	7.3	12.3

e – estimation; f – forecasts

Taking into account the current economic recession in the world and in Latvia, **the government acts in order to prevent further decrease of economic activities**, stabilise and recover the financial system, improve efficiency of public administration by reducing its expenditures and restructure Latvian economy by increasing its competitiveness.

The government has developed the *Economic Stabilisation and Growth Revival Programme of Latvia* (approved by the Saeima on December 12, 2008) in co-operation with the European Commission (EC) and International Monetary Fund (IMF), which will provide structural changes for sustainable economic development in the future. The agreement with the EC and IMF also envisages appropriate attraction of financial resources in the amount of EUR 7.5 billion, in order to solve the potential liquidity problems.

The Programme foresees to continue provision of a fixed exchange rate of the lats against the euro

(EUR 1 = LVL 0.702804). The government will observe a strict fiscal policy aimed at fulfilment of the Maastricht criteria by 2011, in order to receive an invitation in 2012 to join the euro zone. During the next two years substantial measures concerning optimisation and reduction of the state budget costs are foreseen. The public administration staff will be reduced by at least 15%, as well as the education and health sectors reformed. To stabilise the financial sector, the state is ready to provide aid to credit institutions by intensifying their supervision at the same time. The Programme foresees several measures related to improvement of competitiveness of the economy including provision of the opportunities for financing economic restructuring measures, especially under the conditions of limited availability of credit resources for the implementation of the EU structural fund programmes.

2. DEVELOPMENT OF WORLD ECONOMY¹

Under conditions of the financial crisis the global economic growth rates have been decreasing for a longer period of time. The International Monetary Fund (IMF) reduced the forecasts considerably concerning the development rates of almost all countries and regions in its report of October 2008 on the global economic development. However, it should be noted that under the influence of the financial crisis IMF repeatedly reduced these forecasts already in November 2008.

In 2008, the growth rate of the developed countries may decrease to 1%, but already in 2009 the growth could have a negative mark, which takes place for the first time during the post-war period. At present, the growth in the USA is mostly affected by the decrease in value of real and financial assets, as well as limited access to finances, which negatively influences households. The developed European countries suffer the most from the limited access to finances mentioned already above, as well as deterioration of the private confidence. Decrease of export opportunities negatively influences development of Japan.

goods, as well as the countries having considerable external financial and liquidity problems.

Decrease of the global demand affects commodity prices. Oil prices have decreased by 50-70% in comparison with its highest value, by returning at the level of at least 2007 regardless the decision of the OPEC on reducing petroleum extraction. Similar declines are also observed for metal products and food products, which may positively influence several developed and developing countries in Europe and Asia. However, such decline in prices negatively influences the growth perspectives of exporting countries.

Such price stabilisation and slowdown of economies help to hinder the inflation pressure. In 2009 inflation in the developed countries might decrease below 1.5%. It might decrease more rapidly in the developing countries remaining at a relatively higher level.

The global financial markets have entered the stage of a cycle of limited access to finances, which characterizes with the decline of the values for assets and outflow of investor resources. In October 2008 the prices of the main shares decreased by approximately 25%. Particularly high pressure has been experienced exactly by developing countries. The disparities between loan and deposit rates have considerably increased.

To prevent the main causes of financial crisis, as well as foster demand, complex policy measures are taken, however, a certain period of time should pass until complete influence of these measures is seen. These measures contain programmes on the purchase of bad assets, utilisation of the state resources for bank recapitalisation, allocation of complex guarantees, as well as reduction of the loan rates of central banks.

The financial markets respond to implementation of these policies, however, even by successful and quick implementation of these policies the financial crisis is likely to be deeper and longer than it was expected some months ago.

In addition to the direct influence of the financial crisis, economic activities are negatively influenced also by the decrease of consumer confidence. By the deepening financial crisis, households negatively assess increase of the further income and soon economic recovery. In the result, consumption declines by more rapid decrease of purchase of durable goods and investment.

By decreasing inflation risks an opportunity has currently appeared for the central banks to reduce the interest rates on loans. At the end of 2008 the interest rates in the USA and developed European countries decreased practically to zero, as well as it is expected

Table 2.1

GDP Growth (percentage over the previous year)				
	2006	2007	2008 f	2009 f
World	5.1	5.0	3.7	2.2
of which:				
USA	2.8	2.0	1.4	-0.7
Japan	2.4	2.1	0.5	-0.2
EU	3.3	3.1	1.5	-0.2
of which:				
Euro zone	2.8	2.6	1.2	-0.5
United Kingdom	2.8	3.0	0.8	-1.3
CIS	8.2	8.6	6.9	3.2
China	11.6	11.9	9.7	8.5

Source: "The World Economic Outlook", November 2008, International Monetary Fund; f – forecast

Upon reviewing the forecasts for 2009, the most considerable growth rate corrections have been made with regard to developing countries reducing their growth rate by 1 percentage point on average (in November as compared to the forecasts of October), however, the growth of 5% during such crisis period may be considered as relatively high. The growth rate forecasts have been substantially corrected for consumer goods exporting countries, taking into account the rapid decline in prices exactly for these

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

that they will not increase in 2009. This tendency is not so characteristic in the developing countries. The interest rates were increased in some countries in order to limit the outflow of capital, whereas in other countries they were reduced in order to promote economic activities.

The governments of several countries have informed of the use of fiscal policy instruments for promoting demand, which will cause additional pressures on the fiscal balances of these countries. At present, the further economic development perspectives are particularly unclear. Financial conditions continue to cause the risk of the slowdown of economic growth rates. The strict policy measures taken in the financial sector have prevented the crash of the financial system in several countries, although financial conditions remain unfavourable for the growth. Furthermore, several risks still exist regarding potentially deeper influence of the financial crisis on the economic activities. Insufficient access to borrowing resources may turn out to be much deeper and long lasting. Considerable decrease of these resources may increase risks of radical and voluminous changes of capital flow directions and uncontrollable changes of exchange rates in several developing countries. Another risk is related to the deflation, which may appear in the developed countries thus decreasing opportunities for faster economic recovery.

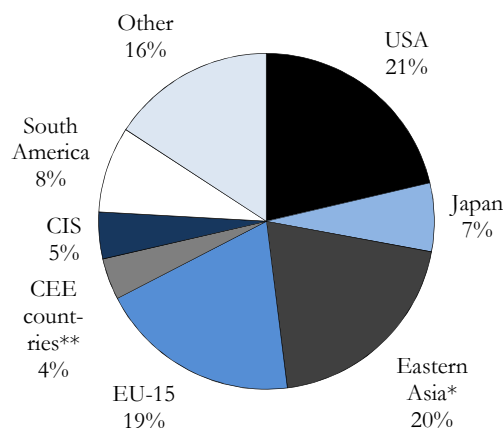
Taking into account the abovementioned, it is clear that additional macroeconomic incentives are necessary in order to promote growth and establish conditions for the financial sector recovery, including the opportunities to liberalise the crediting policy. However, further weakening of the conditions is restricted in several countries, because the interest

rates on loans are already close to zero. Broad fiscal incentives may be developed in such conditions, which may turn out to be sufficiently efficient, if they are precisely and smartly applied in the countries having appropriate budget opportunities.

Figure 2.1

Breakdown of the World's GDP by Groups of Countries in 2007

(structure, GDP by purchasing power units)



Source: "The World Economic Outlook", October 2008, International Monetary Fund.

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

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

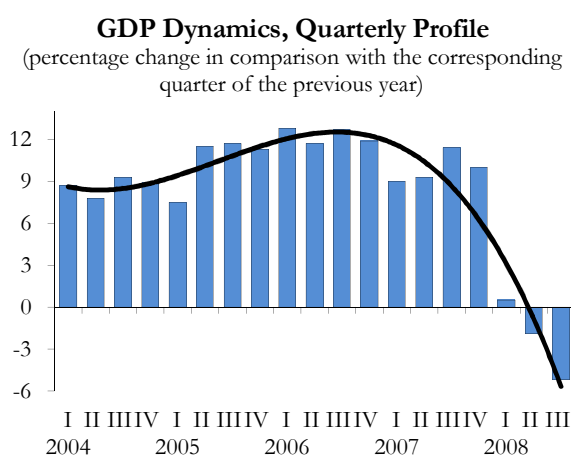
During the last months the global economic growth perspectives have been decreasing, because the real depth and duration of the financial market crisis is not clear, and it is also foreseen that the consumer and producer confidence will continue to decrease. Against this background, the global growth in 2009 is currently forecasted by 2.2%, which is by 1.6 percentage points lower than it was mentioned in the report of June 2008. According to the IMF forecasts, the developed countries will have recession by 0.3%, whereas the developing countries will experience growth by 5%. However, it should be taken into account that these forecasts are also very approximate and based on the current state policies, while global measures for stimulation of financial markets and softening of crediting policy may help to renew the global growth.

3. GROWTH AND PRODUCTIVITY

3.1. GDP Dynamics and Productivity

After the period of rapid economic growth, which has lasted for several years and characterised with the annual GDP growth rates exceeding even 10%, recession has started in the economy of Latvia.

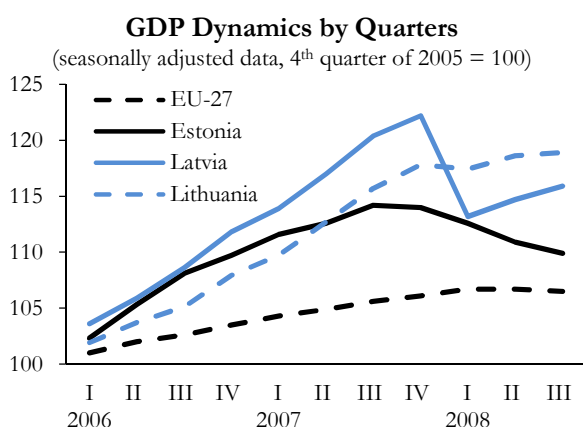
Figure 3.1



A rapid decrease of the economic activities started in 2008. The GDP decreased by 7.4% in the 1st quarter of 2008 in comparison with the previous quarter (according to the seasonally adjusted data), but still slightly exceeded the level of the respective quarter of the previous year (by 0.5%). The GDP did not decrease anymore in the next two quarters, but taking into account the continuous growth in 2007, its volume was already below the level of the 2nd and 3rd quarter of 2007 (by 1.9% and 5.2% respectively).

Recession of the Latvian economy is increasingly more affected by the processes of the global financial crisis, which substantially decrease both, Latvian domestic and external demand (see Chapter 3.2).

Figure 3.2



In 2008, economic activities have decreased within the entire EU. In general, GDP has decreased by 0.2% within the EU in the 3rd quarter of 2008 (according to the *Eurostat* seasonally adjusted data against the previous quarter), but in Germany, Italy and Great Britain by 0.5%.

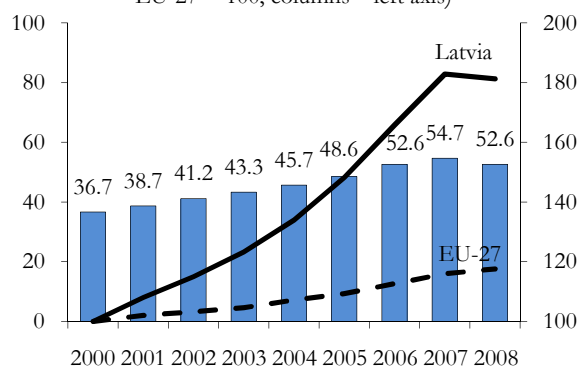
It should be noted, that negative economic growth in Estonia has lasted for the third quarter already – in the 1st quarter of 2008 GDP decreased by 0.9%, in the 2nd quarter – by 0.8% and in the 3rd quarter – by 1%. At the same time economic growth still continues in Lithuania, but at a slower pace than in the previous year.

GDP per capita in Latvia calculated in purchasing power parity standards was 52.6% of the EU-27 average in 2008 according to the estimation of the *Eurostat*. In comparison with 2000, the backwardness from the average EU level has been reduced by 15.9 percentage points.

Figure 3.3

GDP Dynamics and Level in Comparison with the EU average (according to the purchasing power parity standards)

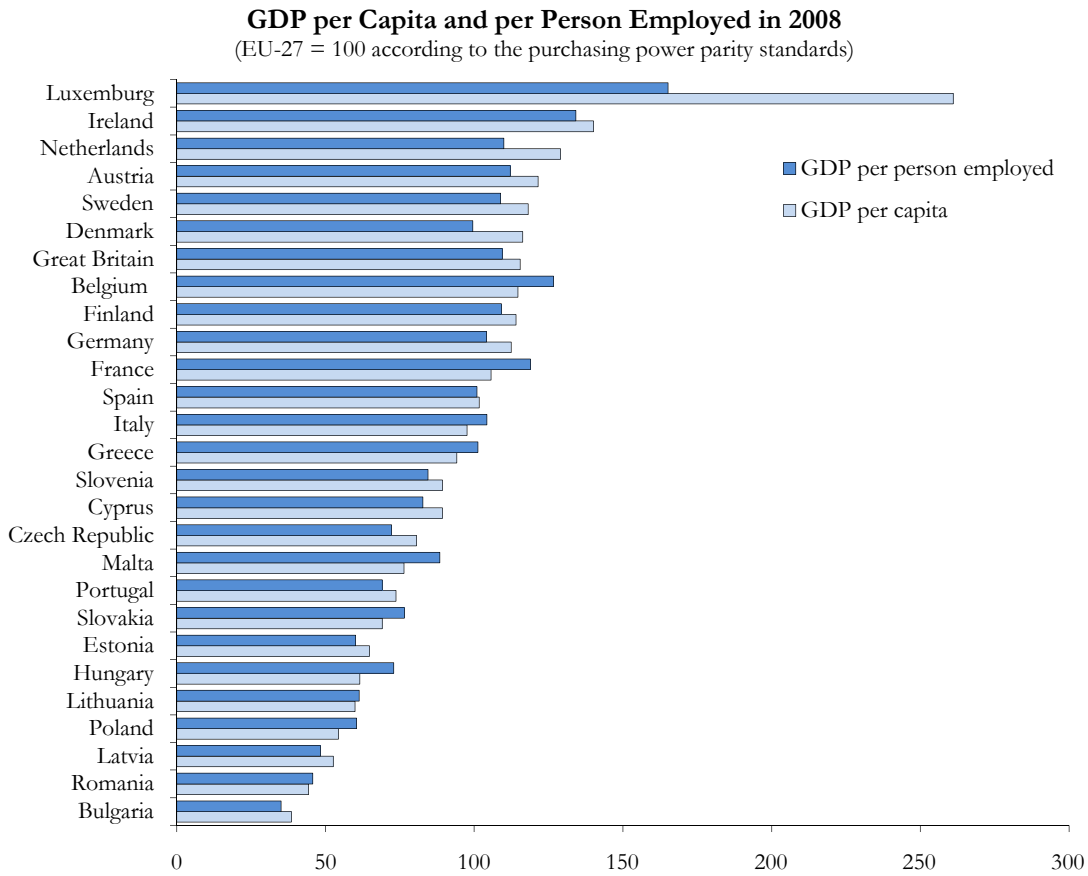
(2000 = 100%, curves – right axis;
EU-27 = 100, columns – left axis)



Source: *Eurostat, forecast of the Eurostat for 2008*

The comparatively low income level of Latvian economy is mainly related to its low productivity level. In 2008, GDP per capita level of Latvia in comparison with the EU average according to the purchasing power parity standards was the fourth lowest in the EU, but the productivity level – the third lowest.

Figure 3.4

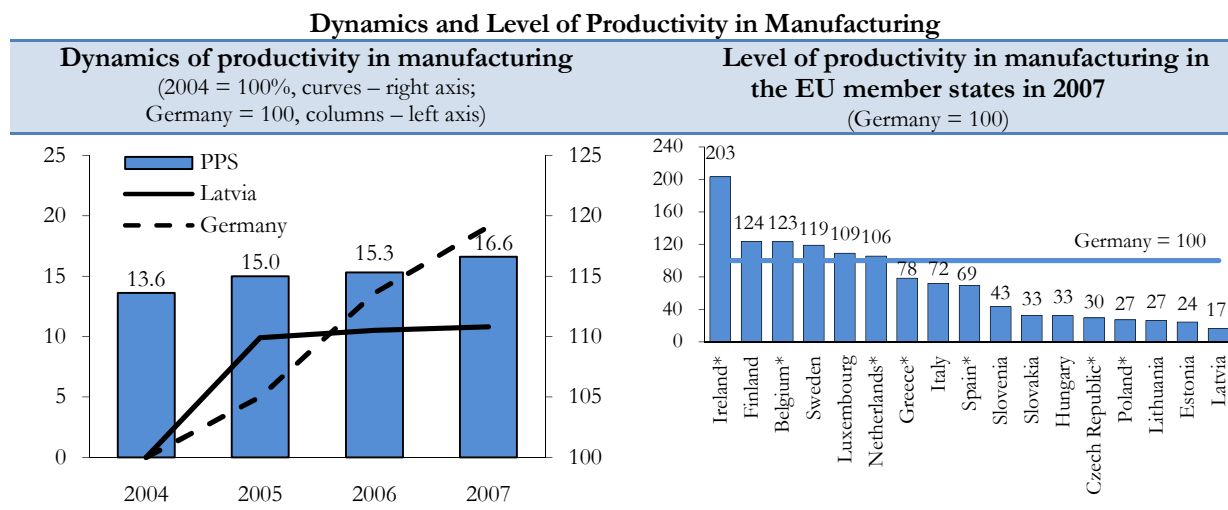


Source: estimation of the Eurostat

It should be noted that according to the productivity level Latvia's approaching to the EU average level takes place slower than according to the GDP per capita level. GDP per person employed (productivity), calculated in purchasing power parity

standards according to the Eurostat forecasts in 2008 in Latvia was 48.3% of the EU average level. In comparison with 2000, the backwardness from the average EU level has been reduced by 8.3 percentage points.

Figure 3.5



The fact that the productivity level in Latvia is still one of the lowest within the EU may partially be explained by the low productivity level in manufacturing, which is related to the fact that the low

and medium-low technology sectors dominate in the manufacturing structure. According to the estimation of the Eurostat, the productivity level of Latvia in manufacturing in 2007 was only 16.6% of the average

level of Germany. In comparison with 2000, the backwardness has decreased only by 4.9 percentage points.

Productivity is increasing faster in agriculture and fishing, electricity, gas and water supply sector, as well as in trade and commercial services sectors. However, productivity increases poorly in manufacturing and construction, due to the fact that within the last two years GDP growth was mainly facilitated by the increase in employment only. It should be noted that the productivity level of these sectors still lags behind the indicators of several service sectors. For example, the productivity level in the financial services is 4 times higher than in manufacturing.

In the coming years, the convergence process of Latvia towards the average EU level will slow down. The data of three quarters of 2008 testifies that the economic growth has decreased almost in all EU member states, however, in Latvia it has shrunk relatively more.

Table 3.1

Productivity by National Economy Sectors – Value Added per Person Employed

	Annual average real changes in the period of 2004–2007, (%)	Level in current prices, 2007 (LVL per person employed)
Primary sectors	9.9	4531
Manufacturing	5.1	8960
Electricity, gas and water supply	7.1	22800
Construction	1.2	9194
Trade, hotels and restaurants	8.6	12806
Transport and communications	7.1	13082
Other services	7.7	21687
Public services*	3.4	9445
Total	7.3	11755

* Public administration including healthcare and education

3.2. GDP Expenditure

3.2.1. Aggregate Demand

The considerable increase of the domestic demand was the main growth stimuli during the last years. In 2007, however, a gradual decrease of the domestic demand rates has been observed.

As it has been mentioned before, the economic recession of Latvia is increasingly more influenced by the processes of global financial crisis, which considerably reduces both, the external and domestic demand of Latvia.

Table 3.2

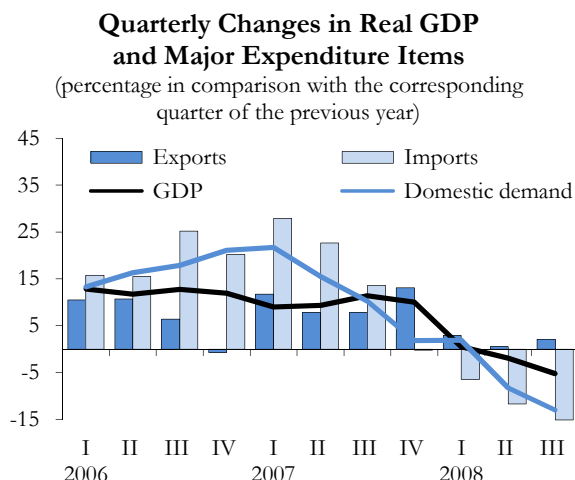
GDP of Latvia by Expenditure Items (percentage change over the previous year)

	2007			3 quarters of 2008 against 3 quarters of 2007		
	structure	growth rates	contribution to growth	structure	growth rates	contribution to growth
Gross domestic product	100	10.0	10.0	100	-2.4	-2.4
Private consumption	62.3	14.8	10.2	60.1	-7.7	-5.7
Public consumption	17.4	3.7	0.05	19.2	1.8	0.2
Gross fixed capital formation	32.7	7.5	2.8	29.6	-12.5	-4.4
Inventories	6.8	–	0.1	5.1	–	0.1
Net exports	-20.2	–	-5.1	-14.0	–	-7.5
– exports	42.2	10.0	4.2	42.8	0.4	0.2
– imports	-62.4	14.7	-9.3	-56.8	-11.2	-7.7

The depth of the financial crisis is strengthened by the markedly unbalanced position of the external sector of Latvia, which established within the previous years of the rapid growth. The considerable growth of private consumption and investment which occurred at more rapid rates than the overall economic growth was largely based on substantial inflow of foreign capital. It has also determined the development of a high current account deficit of the balance of

payments and, in the result, increased the vulnerability of the economy of Latvia. A rapid decline in private consumption and investment is currently taking place due to the decreasing financial inflow, 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.

Figure 3.6



The domestic demand (private consumption + public consumption + gross capital formation) was by 8.1% lower in three quarters of 2008 than in the respective period of the previous year. Along with the decline of the growth rates of private consumption and investment, decrease of imports is also observed, while the growth of exports is maintained. As a result, the share of contribution of the net exports to the overall growth is relatively high.

3.2.2. Private and Public Consumption

In the 1st quarter of 2008, the private consumption was by 0.5% lower than in the respective quarter of the previous year, but in the 2nd quarter it was already by 8.4% lower and in the 3rd quarter the decrease already amounted to 13.3%. The tendency of the retail trade decrease indicates that the private consumption will continue to decline also in the 4th quarter of 2008.

Within the recent years, the disposable income of households of Latvia¹ amounted to approximately 60% of GDP (in 2007 approximately 61% of GDP), while the private consumption expenditure level is higher – approximately 65% of GDP in 2007, therefore the net savings are negative (see Table 3.3).

Due to the rapid increase of wages in 2007, the disposable income of households grew more rapidly than the private consumption, therefore the negative balance of net savings decreased. In 2008 (and particularly at the beginning of 2008), the disposable income continued to grow to a rather considerable extent, but expenditures started to decline due to the decreasing capacity of loan financing. As a result, the net savings of households should be positive in 2008.

¹ Disposable income – income in cash and the cash value of goods and services obtained in kind, received in a form of wages and salary, other income for work (after deduction of taxes), transfers, net income (income after deduction of production costs) from business activity and agricultural production, income from property, rent, etc.

Table 3.3

Disposable Incomes and Final Consumption Expenditures of Households, Net Savings

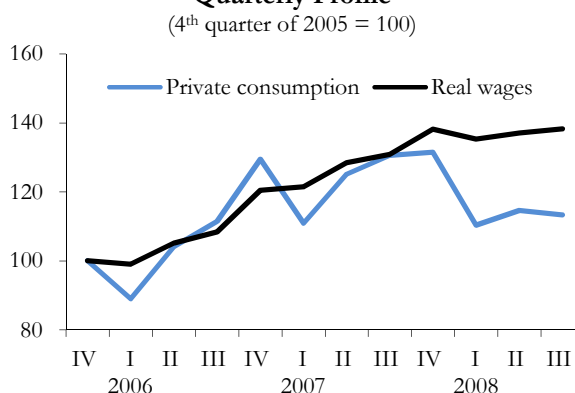
	2005	2006	2007 ^e	2008 ^e
Disposable incomes of households (changes in % compared to the previous year)	17.2	23.1	29.0	15.8
Final consumption expenditures of households (changes in % compared to the previous year)	20.9	28.5	26.5	4.3
Net savings in % of disposable incomes	-3.7	-8.2	-6.1	+4.5
Net savings in % of GDP	-2.2	-4.9	-3.6	+2.7

e – estimation of the Ministry of Economics

Contrary to the previous years, when households afforded to increase consumption more rapidly than the increase of real wages, the private consumption growth in 2007 was approximately equal to the growth of real wages, but in 2008 private consumption decreased despite the growth of real wages (see Figure 3.7).

Figure 3.7

Growth of Real Wages and Private Consumption, Quarterly Profile



Public consumption or public services, the value of which is determined by the volume of the provided public services, amounts to approximately one fifth of the aggregate domestic demand. Within the years of the rapid growth, the volume of public services increased at a slower pace than the private consumption. In three quarters of 2008, the volume of public consumption remained at a high level and comprised 19% of GDP. It should be noted that it was 16.6% in 2006 and 17.4% in 2007. In three quarters of 2008, its volume was by 1.8% higher than in three quarters 2007. In the period of economic recession cycle, especially if it is related to the decline of domestic demand, it is important not to reduce the public consumption too rapidly, therefore maintaining the domestic demand.

3.2.3. Investments

Accession of Latvia to the EU became a significant factor for accelerating the investment process. The rapid investment dynamics were fostered by the availability of cheap financial resources determined by both, the intensified foreign capital inflow and improvement of the financial situation of enterprises due to the relatively low tax burden and high domestic demand. During the period of 2004–2007 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 almost four times. Latvia's lagging behind other EU member states also considerably decreased regarding the volume of investment per employed person: in 2004 investment per employed person amounted to EUR 3 thousand (30% of the EU average level), in 2007 – EUR 6 thousand (50% of the EU average level).

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

Table 3.4

Gross Capital Formation				
	2004–2007 (average per year)	2006	2007	2008 I–III
Real growth (%)				
GDP	10.4	12.2	10.0	-2.4
Gross capital formation	15.3	18.3	11.6	-12.5
– gross fixed capital formation	17.5	16.4	7.5	-12.5
% of GDP				
Gross capital formation	37.6	39.7	40.4	34.6
– gross fixed capital formation	31.7	32.6	33.7	29.6
– changes in inventories	5.9	7.1	6.7	5.0

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.

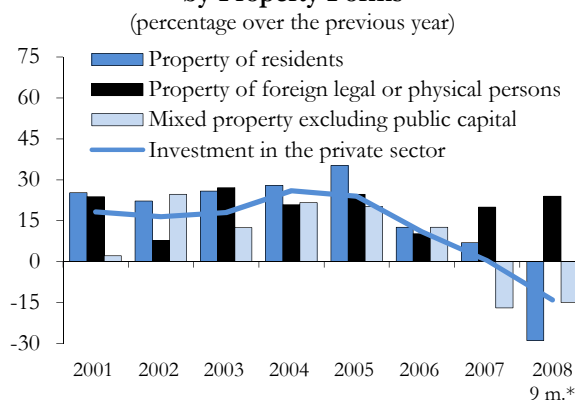
In 2007, investment dynamics became slower. In comparison with 2006, investment increased by 7.5%, which is by 8 percentage points slower than in 2006. Within 9 months of 2008, the investment volumes

decreased by 12.5% in comparison with 9 months of the previous year.

Since 2004, rapid dynamics of investment could be observed in both, public¹ and private sector. Over the last four years, investment in the private sector grew on average by 15% annually and amounted to almost 70% of the total investment. At the same time, investment in the public sector grew on average by 18% annually. It should be noted that in 2007 investment volumes in the public sector increased by almost 23%, but the investment rates in the private sector were more moderate than in the previous years (0.4%). During 9 months of 2008, investment in the private sector decreased by 14%. In 2008, the positive dynamics of investment still remained in the public sector. In comparison with the respective period of 2007, investment volumes increased by 12%.

Figure 3.8

Investment Dynamics in the Private Sector by Property Forms



* estimated using the quarterly data

Sectoral structure of investments². Rapid growth of investments during the period of 2004–2007 was observed in such sectors as construction, hotels and restaurants, operations with real estate, financial intermediation, health protection and education.

In general, the investment growth rates in national economy were two times lower in 2007 compared to 2006, which was determined by both, slower investment dynamics in several sectors and also decrease of investment volumes in the trade sector, as well as transport and communications sector by 16.6% and 15.5% respectively, testifying sensitivity of investors against fluctuations of domestic and foreign demand. According to provisional data, during 9 months of 2008 investment volumes decreased in almost all sectors. The biggest decrease of investment was in financial intermediation (-41%), as well as in the

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

² Investments in breakdown by sectors are presented according to the non-financial investment statistics that does not include all investments in fixed assets.

sectors, closely connected with real estate market. During 9 months of 2008 investment in construction decreased by 15.1% in comparison with the respective period of the previous year, while it decreased by 21.4% in operations with real estate. It should be

noted that deterioration of the investment environment did not affect such sectors as education and health protection. During 3 quarters of 2008 investment in these sectors grew by almost 30%.

Table 3.5

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

	Growth			Structure		
	2004–2007 (average per year)	2007	2008 I–IX*	2004–2007 (average per year)	2007	2008 I–IX*
Primary sectors	7.6	-17.8	4.9	4.5	3.6	4.5
Manufacturing	17.9	10.5	-5.3	16.7	17.4	16.4
Electricity, gas and water supply	13.2	51.6	-18.8	8.0	8.8	9.6
Construction	27.0	8.8	-15.1	4.3	4.7	4.4
Trade	5.0	-16.6	0.3	13.6	11.0	14.0
Transport and communications	3.0	-15.6	-5.1	13.6	11.5	13.2
Other commercial services	22.8	15.5	-17.5	24.2	27.3	17.9
Public services	19.5	16.5	19.0	15.2	15.8	20.0
Total	17.6	7.5	-12.5	100	100	100

* estimated using the quarterly data

During 3 quarters of 2008, the investment in commodity production sectors was by 9.6% less than in the respective period of the previous year, which is related to lower investment volumes in almost all sectors, except agriculture and fishing.

Since accession of Latvia to the EU, the annual investment volumes in manufacturing have almost

doubled, however, since 2006 the slowdown of investment dynamics has been observed. In 2006 and 2007 investment in manufacturing grew by 9.4% and 10.5% respectively or almost two times slower than in the first years after accession to the EU.

Table 3.6

Dynamics and Structure of Investment in Manufacturing (%)

	Growth rates			Structure		
	2004–2007 (average per year)	2007	2008 I–IX*	2004–2007 (average per year)	2007	2008 I–IX*
Food industry	-1.8	-37.0	-21.9	21.8	13.7	17.9
Light industry	-13.3	-3.5	-51.3	2.7	2.1	1.5
Wood processing	18.2	19.1	-4.6	26.4	28.3	19.4
Paper industry and publishing	20.2	4.9	-54.5	7.2	7.3	4.9
Chemical industry and related industries	24.3	1.1	-8.7	7.6	8.2	10.3
Production of other non-metallic mineral products	79.0	63.8	117.2	14.4	21.6	31.4
Production of metals and metal articles	20.5	46.4	-11.9	7.1	7.8	6.8
Production of machinery and equipment	9.0	31.0	-31.9	2.1	1.8	1.9
Production of electrical and optical equipment	7.1	-15.7	3.1	2.5	1.9	2.2
Production of vehicles	25.0	5.9	-18.9	2.3	2.0	1.5
Other industries	20.9	-6.1	-73.9	5.8	5.3	2.1

* estimated using the quarterly data

It should be noted that since 2006 investment has 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 indicate to decrease of competitiveness of these sectors.

At the same time, investment volumes in the light industry have decreased already since 2003. In 2003 investment in the light industry amounted to 7.1% of the total investment volume in manufacturing, in 2007 – only 2.9%. In 2007, investment in this sector decreased by 19%, but in the 1st quarter of 2008 – by 34%. Such dynamics of investment testify substantial decrease of competitiveness of the light industry.

Since 2004, the positive dynamics of investment 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 as 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 three quarters of 2008 have decreased also in the wood processing sector, while the investment increased in the sector of production of construction materials.

Since 2004, on the whole, the investment in manufacturing sectors of high and medium technologies grow the fastest: by 41.6% on average per year in high technology sectors, by 62.4% in medium technology sectors and by 19.2% in low technology sectors. In 2007, the investment in high technology sectors grew by 79.1% and constituted 11% of the total investment in manufacturing. Such trends may indicate to certain capital saturation in low technology sectors and drain of their development potential, which is also greatly affected by producer price competition pressure of the cheap labour force countries. Furthermore, dynamics of investment in 2008 indicates that the low technology sectors are very sensitive against the negative demand shock, due to which investors have substantially decreased the investment volumes.

3.2.4. Exports and Imports

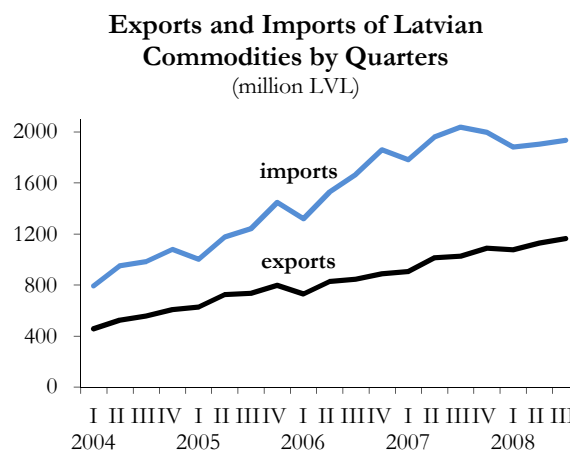
Exports and imports of commodities

Exports of Latvian commodities in 2007 were by 22.7% higher than in 2006 in current prices, while in constant prices – by 8.3%. Exports of commodities exceeded the level of the corresponding period of the preceding year also in 2008 (January-November) (by 10.5% in current prices and approximately by 3.5% in constant prices).

In 2007, the commodity imports grew at a more moderate pace in current prices (by 22%), but import prices increased considerably less, therefore volumes of imports in constant prices increased by 15.4%, which is much faster than the volumes of exports. Already in the second half of 2007, imports started to decrease considerably and in January-November of 2008 the imports were by 3.4% less (in current prices) than in the corresponding period of the

previous year, while they were less by at least 10% in constant prices.

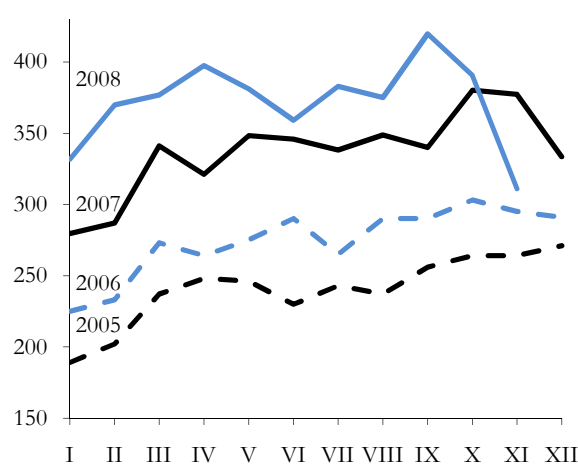
Figure 3.9



During three quarters of 2008, the **commodity exports** were favourably influenced by changes of trade conditions and the exports unit value index increased by 10.1%, but the imports unit value index – by 9.2%. Increase of exports unit value index was most substantially influenced by the rise of export prices for agricultural and food products, as well as the groups of products of chemical industry and metal-working products.

Figure 3.10

Dynamics of Latvian Commodity Exports by Months (million LVL)



In the period of January-November of 2008, exports went up in almost all groups of goods, especially metal-working products, which accounted for almost a half of the total growth of exports, as well as growth of exports of agricultural and food products (approximately one third of the total growth of exports), however, it should be noted that exports of wood and wood products rapidly decreased during this period and at present it has returned to the level of 2005.

Exports to EU-27 in the period of January-November of 2008 have increased by 5.9% in comparison with the previous year. Like the total Latvian exports, also exports to the EU-27 increased in almost all groups of commodities. The biggest growth

in exports to the EU-27 was provided by metal-working products (56% of the total exports to the EU-27), machinery (49%), as well as agricultural and food products (31%).

Table 3.7

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

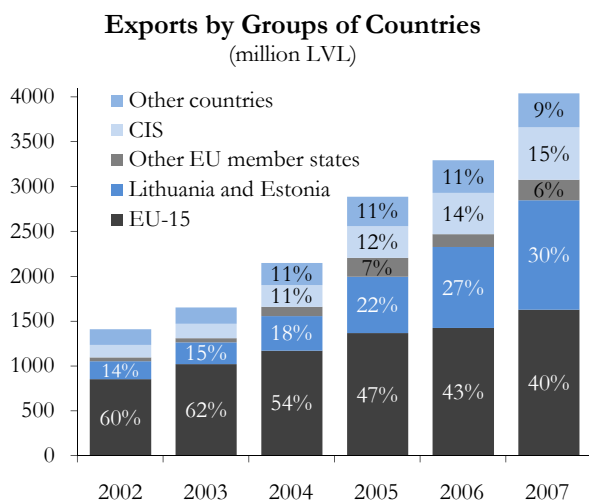
	2007		January-November 2008	
	structure	change compared to the previous year	structure	change compared to the corresponding period of the previous year
Total including:	100	22.7	100	10.5
wood and wood products (IX)	22.5	22.8	17.0	-17.8
metals and metal articles (XV)	14.6	20.8	17.3	32.4
light industry products (VIII; XI-XII)	7.3	1.1	6.2	-8.3
agricultural and food products (I-IV)	14.4	33.6	16.2	25.8
products of chemical industry and allied industries, plastics (VI-VII)	10.4	29.8	11.2	18.7
machinery (XVI)	11.0	37.1	12.2	22.9
mineral products (V)	4.1	-9.2	4.3	17.7
transport vehicles (XVII)	7.0	41.7	7.3	16.3
other commodities (X; XIII-XIV; XVIII-XXII)	8.7	14.2	8.3	5.6

Exports to the CIS countries in January-October of 2008 continued increasing at usual rapid pace of 16%. The biggest increases were observed for exports of food products, as well as chemical products.

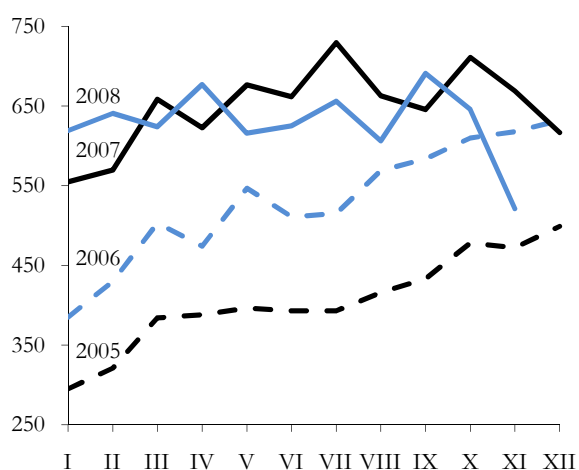
biggest decrease in the volumes was observed in the groups of transport vehicles, machinery, as well as wood and wood products.

Figure 3.12

Figure 3.11



Commodity Imports by Months
(million LVL)



Increase of **commodity imports** in the period of January-November of 2008 was observed in the groups of mineral products, agricultural and food products, as well as the products of chemical industry, while the

Table 3.8

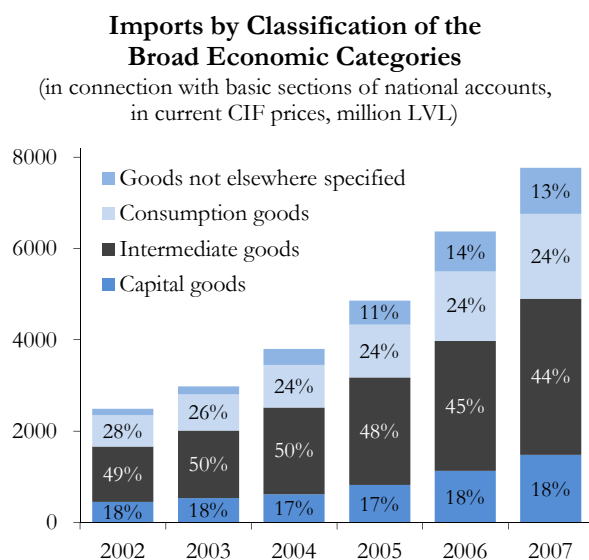
Imports by Main Groups of Commodities

(%, in current FOB prices)

	2007		January-November 2008	
	structure	change compared to the previous year	structure	change compared to the corresponding period of the previous year
Total	100	22.0	100	-3.4
including:				
wood and wood products (IX)	3.4	62.9	1.9	-45.9
metals and metal articles (XV)	9.6	23.3	10.4	4.0
light industry products (VIII; XI-XII)	5.5	16.0	5.4	-7.8
agricultural and food products (I-IV)	11.2	23.4	13.4	18.1
products of chemical industry and allied industries, plastics (VI-VII)	12.9	17.6	14.4	7.6
machinery (XVI)	20.8	28.8	17.8	-17.4
mineral products (V)	11.5	4.9	15.8	35.5
transport vehicles (XVII)	14.6	30.8	10.9	-28.4
other commodities (X; XIII-XIV; XVIII-XXII)	10.5	16.3	10.0	-8.9

As viewed by classification of the broad economic categories, the imports have been almost unchanged in the last years – the imports of consumption and intermediate consumption goods have increased a little slower than the total imports of goods (see Figure 3.13).

Figure 3.13



The biggest **trading partners** of Latvia in the period of January-November of 2008 were Lithuania (16.6% of the total foreign trade turnover), Germany (11.1%), Russia (10.4%), Estonia (9.7%), Poland (5.8%), as well as Sweden (5.3%).

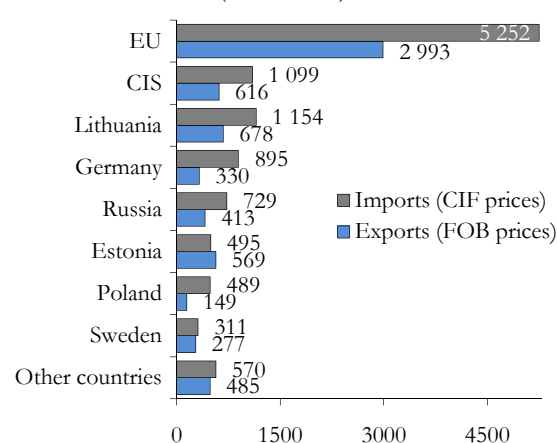
After Latvia's accession to the EU, foreign trade of Latvia with **Lithuania** and **Estonia** still continues to grow rapidly. In comparison with 2003, foreign trade with these countries has increased three times and

already amounts to more than 30% of the total trade with the EU member states.

Figure 3.14

Foreign Trade Turnover of Latvia* in January-November 2008

(million LVL)

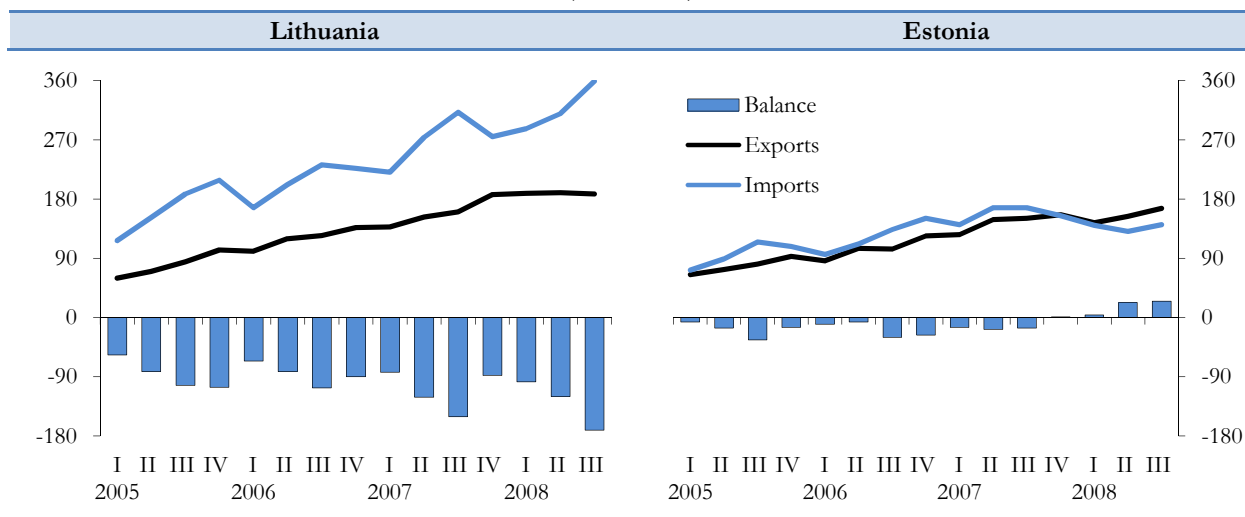


* with countries where foreign trade turnover with Latvia is not less than 5%.

As Figure 3.15 shows, the foreign trade balance with Estonia is positive in the last quarters, while it is negative with Lithuania and it continues to grow. In January-November of 2008 the imports from Lithuania exceeded exports by 70%. The main groups of commodities exported to Estonia are food products, machinery and products of chemical industry, while the same products of chemical industry and food products are imported from Estonia. Food products and products of chemical industry are mainly exported to Lithuania and Estonia, but mineral and food products are imported from these countries.

Figure 3.15

Latvian Foreign Trade Turnover with Lithuania and Estonia by Quarters
(million LVL)



Exports and imports of services

The clearly negative trade balance of commodities of Latvia is partly covered by the positive balance of services. The data of the balance of payments of three

quarters of 2008 testifies that the balance of services has slightly improved, as exports of services grow a little more rapidly than imports (see Table 3.9).

Table 3.9

Exports and Imports of Services in January-September 2008

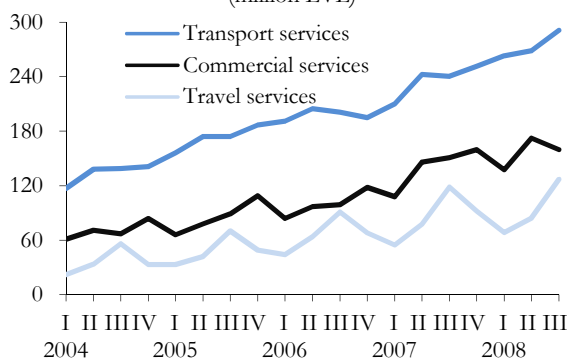
	Million LVL			Structure (%)		Changes compared to the corresponding period of the previous year (%)	
	exports	imports	balance	exports	imports	exports	imports
Services – total	1592.4	1126.1	466.3	100	100	16.4	12.7
including:							
Transport services	823.3	297.5	525.8	51.7	26.4	18.8	-3.0
– sea transport	281.9	64.3	217.6	17.7	5.7	4.2	-11.1
– air transport	134.6	98.6	36.0	8.5	8.8	33.4	-5.6
– other transport	406.8	134.6	272.2	25.5	12.0	26.4	3.7
Travel	279.6	402.4	-122.8	17.6	35.7	11.5	16.6
Commercial services	469.9	405.9	64.0	29.5	36.0	16.0	22.2
Other services	19.6	20.3	-0.7	1.2	1.8	3.2	28.5

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

Growth of revenues from incoming tourists and increase of commercial and other services are significant. It should be noted that although the amount of expenses by foreign tourists in Latvia is higher than the amount of expenses by Latvian travellers abroad, these amounts still continue to approach.

Figure 3.16

Exports of Services by Quarters
(million LVL)



3.3. Contribution of Sectors

3.3.1. Structure of Economy

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

In 2007, the share of services sectors in terms of value added has increased to 74.7% compared to 71.8% in 2000. According to the employment rate, the structure of national economy considerably differs from that, which is shown by the value added due to the markedly different levels of productivity in different economic sectors.

Table 3.10

Structure of Economy
(%)

	By value added		By number of employees	
	2000	2007	2000	2007
Primary sectors	4.8	3.6	14.5	10.4
Manufacturing	13.7	10.8	17.9	14.9
Electricity, gas and water supply	3.6	2.4	1.9	1.3
Construction	6.1	8.4	5.9	11.5
Trade, hotels and restaurants	17.9	22.2	17.7	19.8
Transport and communications	14.0	10.8	8.3	9.2
Other commercial services	23.0	27.8	12.4	14.3
Public services	16.9	13.8	21.4	18.6
Total	100	100	100	100

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

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.

Table 3.11

GDP Growth
(%)

	Growth rates			Contribution to growth		
	Average 2004–2007	2007	3 Q 2008	Average 2004–2007	2007	3 Q 2008
Primary sectors	4.8	8.7	-0.8	0.9	0.3	-0.1
Manufacturing	4.6	-0.3	-6.2	2.8	0.0	-1.4
Electricity, gas and water supply	3.7	4.9	-1.7	0.5	0.1	-0.1
Construction	16.2	14.4	0.7	5.6	1.2	0.1
Trade, hotels and restaurants	14.9	12.3	-5.2	15.1	3.0	-2.4
Transport and communications	9.8	9.8	3.2	6.5	1.5	0.9
Other commercial services	4.3	4.6	3.5	2.8	0.6	1.7
Public services	12.8	13.5	2.8	14.6	3.5	0.6
GDP	10.5	10.3	-0.6	48.8	10.3	-0.6

The rapid development rate of services sectors, which is based on attraction of external financial resources, may not replace more export-capable sectors – a relatively slow growth of manufacturing. 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 mentioned, at the end of 2007 the growth rates started to decrease due to the domestic demand remaining at the same level, and in 2008 the growth was already negative. Decrease of the domestic demand directly affected economic activities of the sectors – retail trade has declined, construction growth rates as well as activities in the real estate market have decreased.

The second factor of economic recession is decrease of the main export sector – decrease of the manufacturing output, which was not only determined by lower domestic demand and weakening of demand in the trade partner countries, but also by gradual decrease of competitiveness of Latvian industry in relation to the high inflation and rapid increase of labour costs.

3.3.2. Manufacturing

The decline of manufacturing has continued in 2008. Production volumes of the sector have

decreased by 8% within 11 months of 2008 in comparison with the respective period of 2007. The decrease of output was observed for most sectors, including production of non-metallic minerals, wood processing and light industry. The production output of metals and metal products has remained close to the level of the previous year, while production of electrical and optical equipment and production of transport vehicles has increased substantially, which may be explained by the considerable growth of the volumes of new orders in the first three quarters of 2008.

Figure 3.17

Monthly Growth Dynamics of Manufacturing

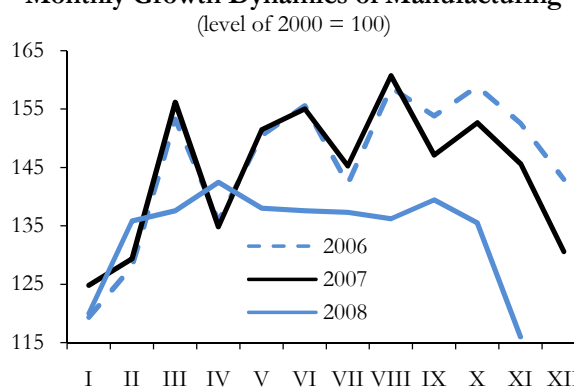


Table 3.12

Growth of Manufacturing*
(%)

	Average annual growth 2004–2007	Growth in 2007 compared to 2006	January–November 2008 against January–November 2007
Manufacturing – total	4.1	-1.0	-8.0
Food industry	3.8	-1.1	-6.6
Light industry	3.8	-1.2	-16.1
Wood processing	0.2	-5.8	-10.2
Paper industry and publishing	5.8	-0.3	-6.2
Chemical, rubber and plastic industry	14.6	2.7	-6.3
Production of other non-metallic mineral products	9.6	-1.5	-10.7
Production of metals and metal articles	6.6	9.1	-3.2
Production of machinery and equipment	1.0	-6.8	-15.0
Production of electrical and optical equipment	7.6	6.7	14.1
Production of transport vehicles	1.6	0.4	31.8
Other industry sectors	3.7	-5.2	-28.2

* according to operational data

Deterioration of the situation in manufacturing in 2008 was determined by several factors. The most substantial factor is the rapid decline in the domestic demand, as a result of which the sales volumes decreased considerably. In 2007, sales volumes in the local market grew by 2.6%, but fell by 9.4% in 11 months of 2008. The rapid decline of domestic demand was partially compensated by the increase of export sales volumes (by 2.5%). However, the

processes in the global financial markets have affected the growth of the main export markets of Latvia – Lithuania, Estonia, the rest of the EU and Russia, therefore it can be expected that it will be not possible to maintain the previous export volumes of manufacturing in the next year. The growth of the sector in the previous year was also affected by the slowdown of crediting and high prices of production resources (rise in price of electricity and natural gas, as

well as increase of the global oil prices, which reached the highest level in the second half of 2008). The increase of the labour costs in the beginning of 2008

has played negative role on the competitiveness of various industrial sectors.

Table 3.13

Structure of Manufacturing in 2008*
(%)

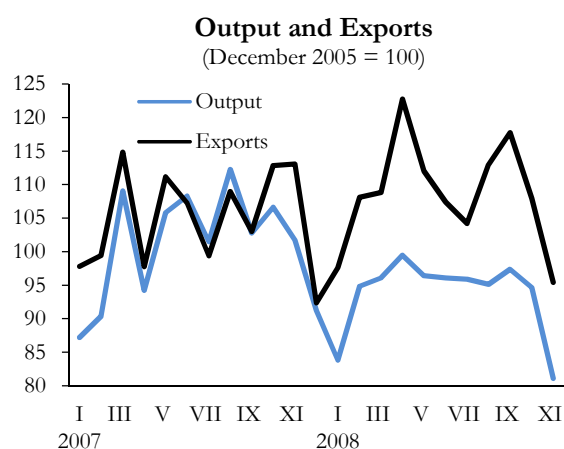
	By value added	By number of employees	Share of exports in sector's sales
Manufacturing – total	100.0	100.0	50.4
Food industry	22.4	21.4	24.3
Light industry	5.9	11.4	76.4
Wood processing	14.3	17.8	65.7
Paper production and publishing	8.2	7.4	25.8
Chemical, rubber and plastic industry	7.7	5.9	64.6
Production of other non-metallic mineral products	7.0	4.7	23.9
Production of metals and metal articles	12.4	10.0	70.6
Production of machinery and equipment	3.8	4.1	75.1
Production of electrical and optical equipment	6.9	4.5	63.5
Production of transport vehicles	7.5	5.5	74.7
Other industry sectors	3.8	7.4	52.8

* estimation of the Ministry of Economics according to operational data

In comparison with 2007, the share of manufacturing exports in realisation of the sector in 11 months of 2008 has increased from 48.4% to 50.4%, which is related to compensation of the decline in domestic demand with the gain of new export markets. However, not all sectors have managed to successfully re-orient their operations under the new economic conditions. For example, the share of wood processing has considerably decreased in manufacturing both, in terms of the value added and the number of employed persons, because the demand for wood processing products in the global markets decreased. The share of production of metals and metal products has increased due to the increase of export volumes of the sector, however, it has also started to decrease in the second half of the year. The overall increase rates of export volumes in manufacturing were more rapid than the dynamics of the total output of the sector.

Until the mid-2007, the price dynamics was similar in the domestic market and for the exported products, but in the second half of the year producer prices started to rise more rapidly in the domestic market, while the price dynamics of the exported products became slower. In 2008, price increase continued both for the products sold in the domestic market and those sold in the export markets, however, deflation of the producer prices was observed in September–November. The increase of producer prices of manufacturing amounted to only 2.7% in November 2008 as compared to November of 2007, which is considerably lower than in November of 2006 (12.6%) and also by 7.5 percentage points lower than in September 2008.

Figure 3.18



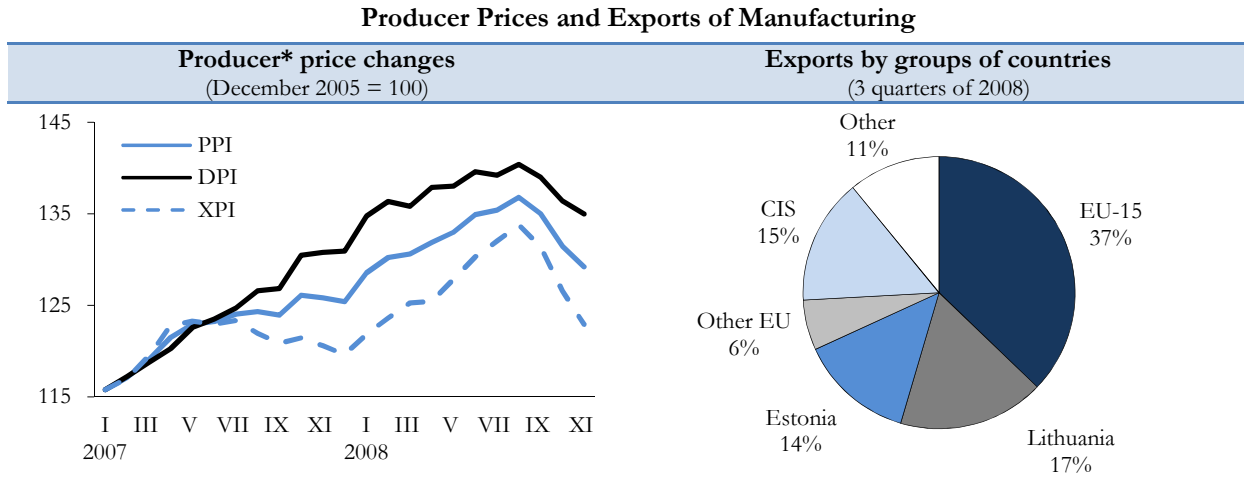
The dynamics of the producer price index in manufacturing in Latvia slightly differs from the total price dynamics within the EU. In autumn 2007 the manufacturing prices within the EU started to rise rapidly, while in Latvia their growth rates started to decrease. Increased producer price indices in the EU remained also in the beginning of 2008. However, the various price change dynamics actually does not improve competitiveness of Latvian producers, because changes in prices of Latvian producers are more rapid than the average EU prices. At the end of the year the producer price increase rates also decreased considerably on average in the EU.

Manufacturing export structure remains almost unchangeable in the recent years. Almost 4/5 of the export of products are related to EU member states, a half of which to EU-15 member states and 31% to

Lithuania and Estonia. The share of exports of the sector has slightly increased to CIS in 2008,

constituting 15% of the total exports of manufacturing products.

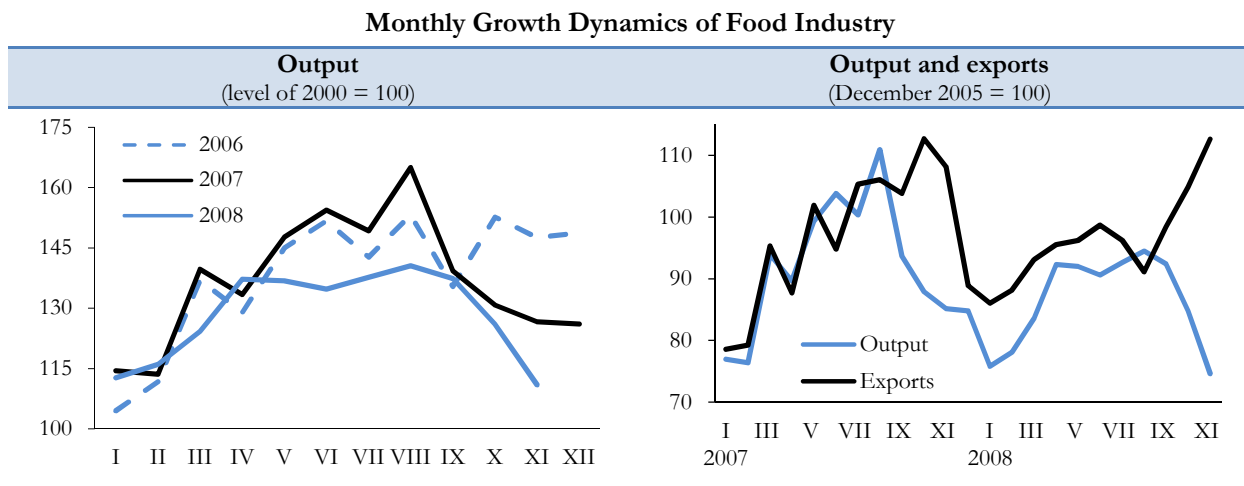
Figure 3.19



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

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

Figure 3.20



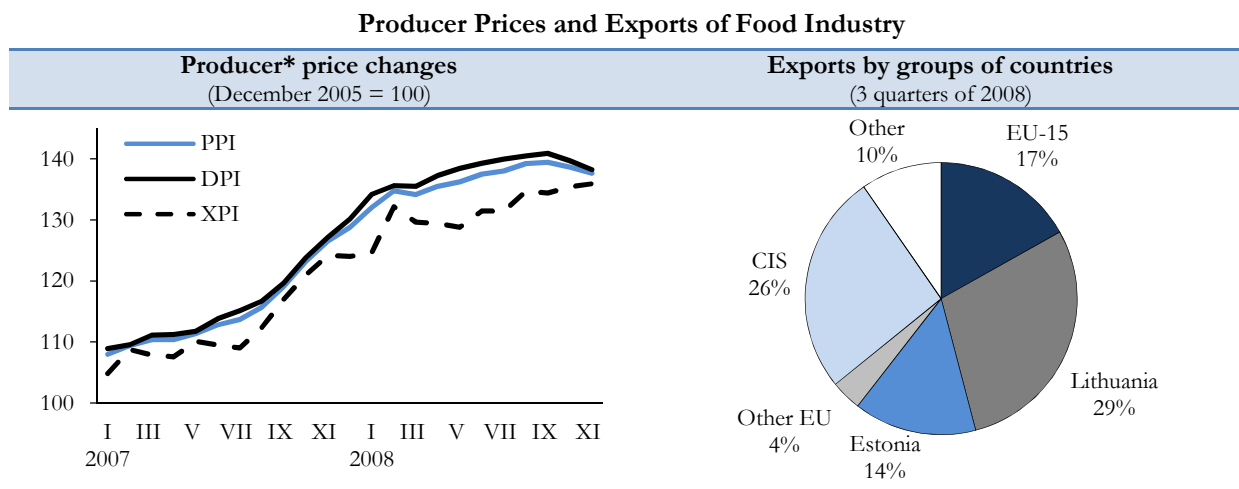
In 11 months of 2008, output of the sector has decreased by 6.6%. The decline in the food processing sector has been observed already since the mid-2007, which is determined by both, decrease of the domestic and external demand. In November 2008, the sales volumes had decreased for both, the products sold in the domestic market and exported products (by 7.2% and by 4.2% respectively during a year).

In 11 months of 2008 the total sales proceeds in food industry grew by 11.4% in comparison with January-November of 2007, which was determined by the high growth of prices of food products which has

been observed already since 2006. In November 2008 compared to November 2007, the producer prices grew by 8.8% (for the products sold in the domestic market – by 8.6%, but for the exported products – by 9.4%).

Approximately 75% of the products produced in the sector are consumed in the domestic market, the rest products are exported, mainly to Estonia, Lithuania and Russia. Moreover, exports of food products to Lithuania and Estonia constitute 70% of exports of Latvian food products to the EU member states.

Figure 3.21

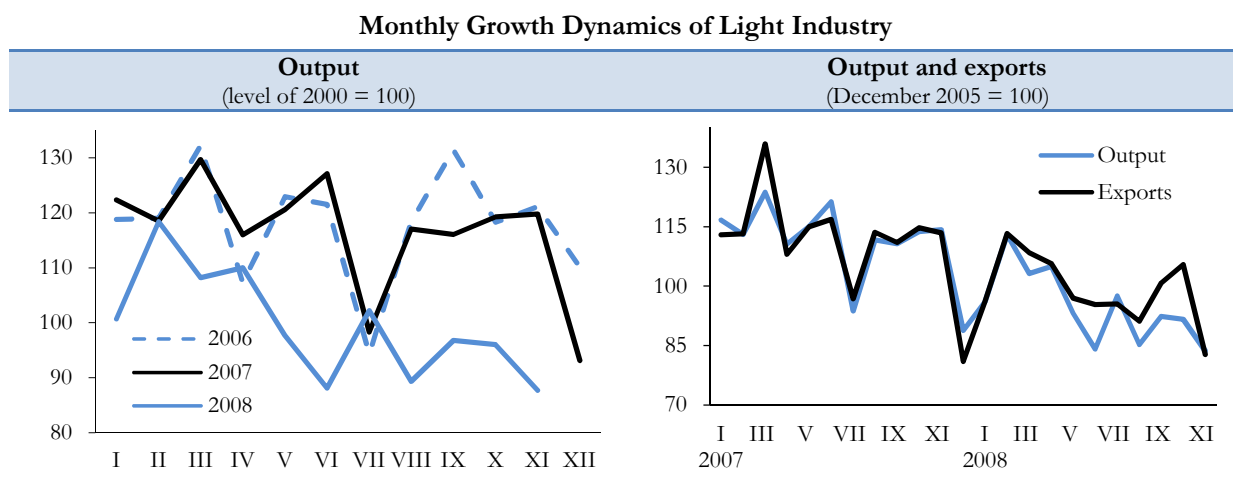


* PPI – producer price index, DPI – producer price index for products sold in the domestic market, XPI – producer price index for exported products

The share of the *light industry* sector continued to decrease in terms of the value added of manufacturing in 2008 and amounted to 5.9%. The

sector is mainly oriented to exports (76% of the produced output is exported abroad).

Figure 3.22



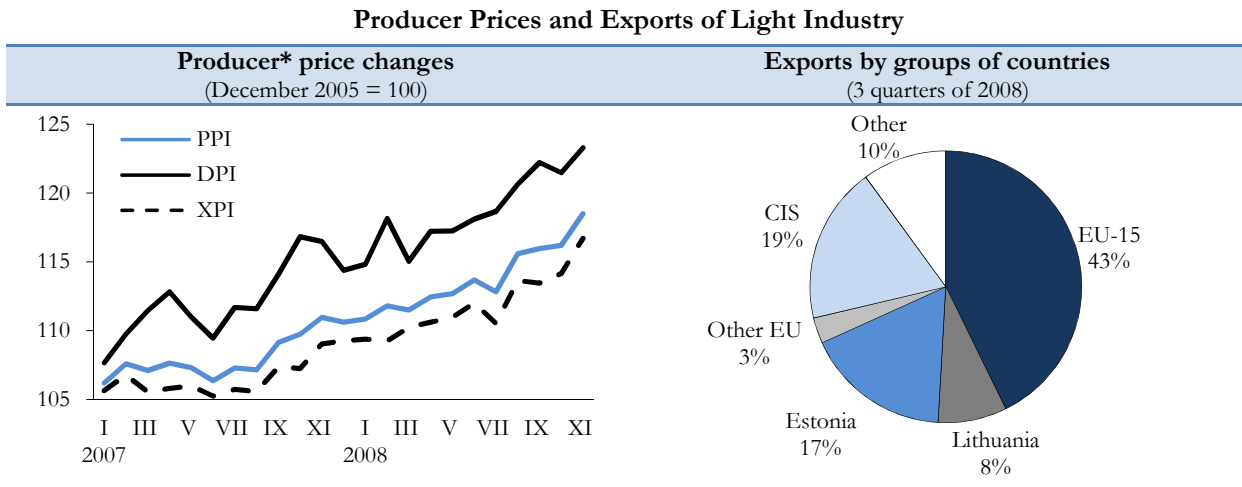
The main sales markets of Latvian textile industry are in the old EU member states. Due to the poor demand in the EU member states and high competition in the sector, it is hard for Latvian producers to expand production volumes.

In January-November 2008, the output volumes of the sector decreased by 16.1% in comparison with 11 months of 2007. Although export volumes to Lithuania, Estonia and CIS countries increased, they still did not compensate decline of export volumes to EU-15 countries, which is the most important export market of Latvian light industry. The rise of producer

prices did not manage to compensate decline of the production volumes. As a result, sales proceeds of the sector decreased by 8.1% in 11 months of 2008.

The rise in light industry producer prices was 6.8% in November 2008 compared to November 2007. It should be noted that the rise of the prices for textiles has been more moderate (2.2%) within 12 months than the price increase in production of wearing apparel and processing of furs (12%). Furthermore, the price increase for exported products in light industry sector is considerably lower than for the products sold in the domestic market.

Figure 3.23

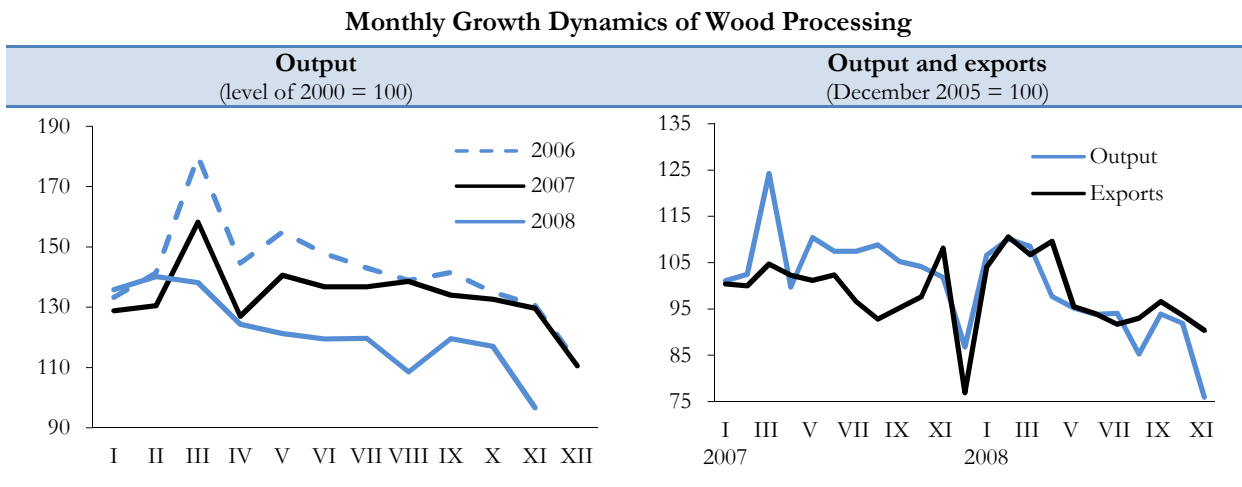


* PPI – producer price index, DPI – producer price index for products sold in the domestic market, XPI – producer price index for exported products

Wood processing is one of the biggest sectors of Latvian industry. Its value added makes up more than 14% of the manufacturing output. High share of

exported products (65% of the output) is characteristic for the wood processing sector.

Figure 3.24



The decline of production volumes of the sector started already in the mid-2006, when the demand for wood processing products considerably decreased in Europe. In January-November 2008, the sector output decreased by 10.2% in comparison with the respective period of the previous year. Within 11 months of 2008, sales volumes of products sold in the domestic market decreased by 10.4%, while for exported products – by 1.9%.

The wood processing sector faces difficulties also in Lithuania and Estonia. Approximately one-fourth of the wood processing companies might be closed down in Estonia due to the increase of the price for raw materials and the lost competitiveness of the domestic companies in the foreign markets, whereas Lithuanian entrepreneurs search for solutions to decrease the rapidly rising prices for raw materials by differentiating the access to domestic wood resources and selling raw

materials only to those entrepreneurs, who have declared the production capacities.

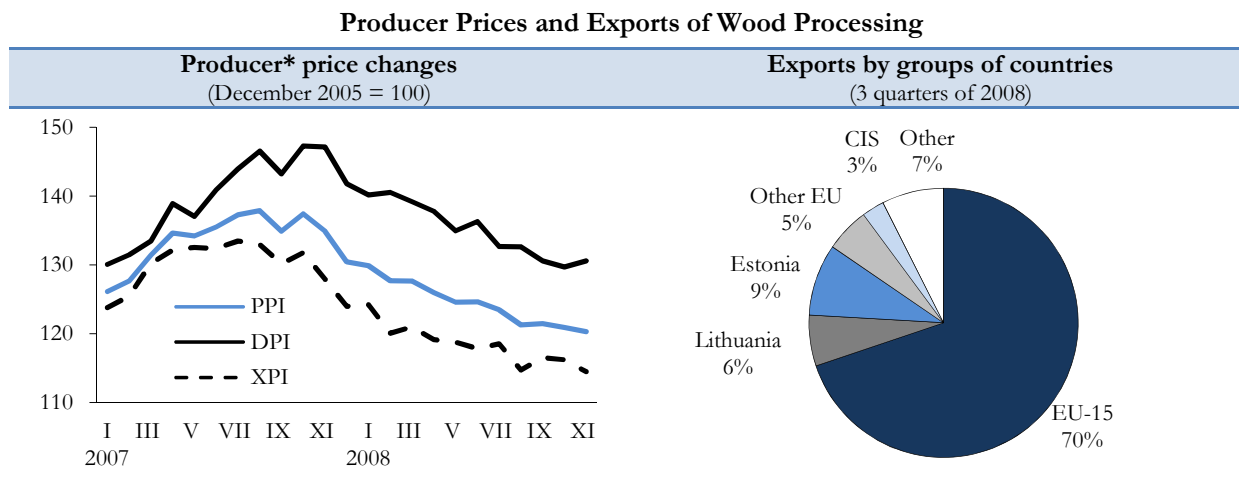
Almost 3/4 of the exported products are sold in the old EU member states. The decrease in exports of wood products to EU-15 countries was partially compensated by its growth to Estonia and Lithuania, as well as to other new EU member states.

The producer prices of wood processing increased equally rapidly for both, the products sold in the domestic market and exported products in the period of 2005-2006. In the beginning of 2007, the prices of products sold in the domestic market rose more rapidly. Since the end of 2007, the producer prices started to decrease rapidly which was affected by decrease of the domestic and external demand, as well as remaining amount of the supply of products established as a result of action of such large wood processing countries as Sweden and Germany, where

high production volumes remained despite the decrease of the aggregate demand in the world. In

November 2008 the prices decreased by 10.8% compared to November 2007.

Figure 3.25



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

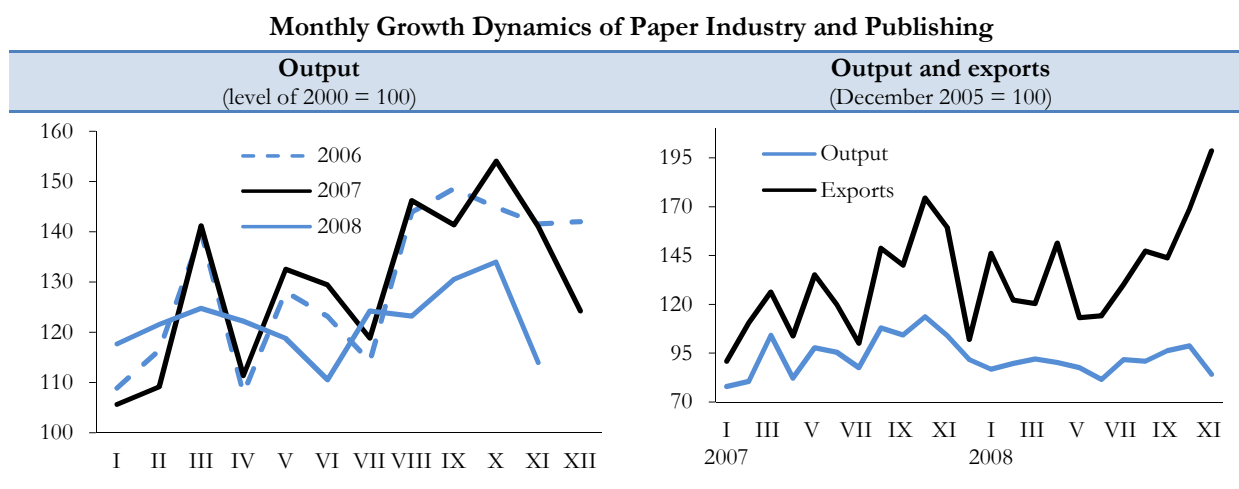
In 2009, the small processing companies which purchase sawn timber from the big Latvian producers may remain without raw materials, because development of the sector in 2008 was influenced by the change of the bank policy in relation to financing of mutual payments of the producer and buyer in Latvia. Hitherto, factoring was frequently used for the internal payments between the domestic companies of Latvia, which was very widely implemented by the Scandinavian banks. The banks do not grant credit limits anymore in the current economic situation, and the producers have to decide, whether to undertake risk themselves and provide material to the small producers. Recently, other economic sectors started to face such a problem more often. Latvian timber exporters will lose their competitiveness in the international market, but the domestic market may scale down due to inaccessibility to financial resources. Further growth of Latvian wood processing sector is

related to modernisation of production technologies and more efficient production methods.

In 2007, the growth of **paper industry and publishing** after comparatively good growth indicators in 2006 (increase by 8.4%) remained at the level of the previous year (decline by 0.3%), whereas in 11 months of 2008 the total output of the sector fell by 6.2% as a result of rapid decrease of the domestic demand. Both, production of cellulose, paper and paper products, as well as publishing and polygraphy decrease at similar rates. In November 2008 compared to November 2007, the production volumes decreased by 13.7% and 12.2% respectively.

Approximately 1/4 of sales of the sector is made by exports, the volumes of which grew by 6.2% in January-November 2008 compared to 11 months of 2007. The sale of exported products slightly increased (by 1.1%) also in 2007, however, the total output of the sector remained at the same level.

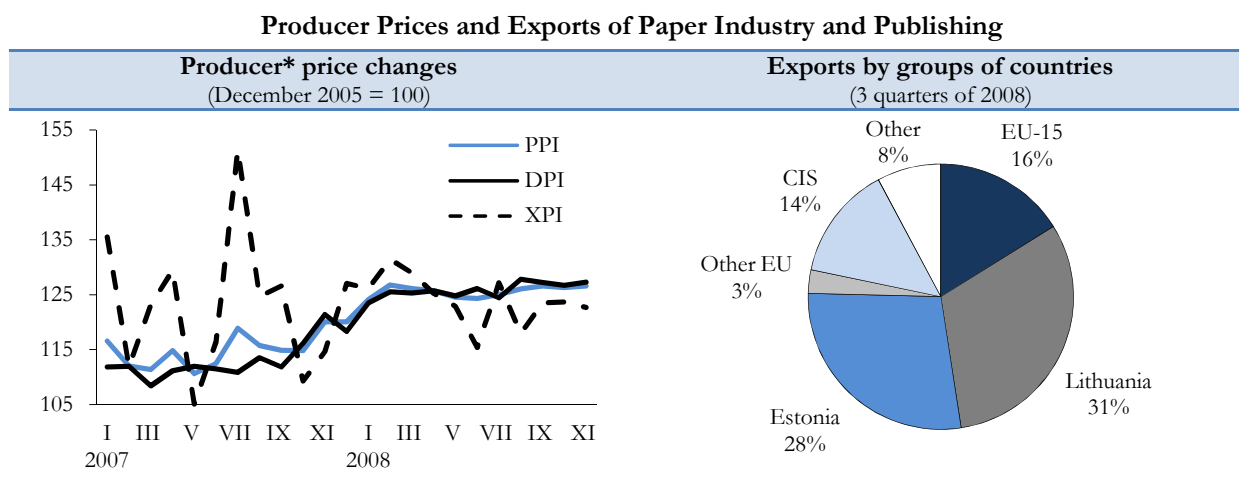
Figure 3.26



Although the sales markets of the sector are not related to the export opportunities to a great extent, increase of export volumes is still a substantial

incentive for the growth of the sector. The exported products are mainly sold in Lithuania and Estonia. Exports to EU-15 countries grew substantially in 2008.

Figure 3.27



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

The producer prices of the sector considerably rose in 2007, when they increased by 14.7% mainly due to the price increase for exported products (by 19.9%). In 11 months of 2008, the rate of the price increase has decreased substantially (the increase by 5.4%). Besides, the prices for exported products in January-November 2008 have grown by only 1.3% in comparison with 11 months of 2007, while the prices for the products sold in the domestic market have increased by 11.5% within the same period of time.

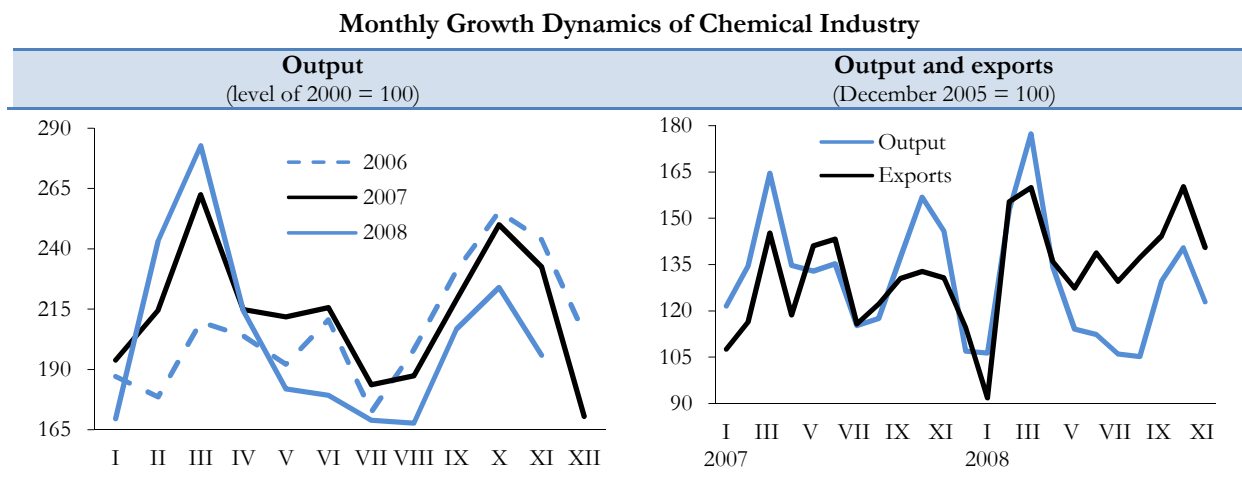
The forecasts of the previous years regarding rapid decrease of the paper demand in the world due to expanding electronic environment have not fulfilled, while several large producers decided to restructure or expand their production units resulting in the situation that paper production capacities are not capable to satisfy the demand. The rapid growth of paper consumption and inability of producers to produce paper in the required amount may cause a lot of unfavourable consequences. It may facilitate the increase of the price for paper, paper producers may delay fulfillment of orders, which will negatively affect development of several business sectors.

Chemical industry in Latvia has stable traditions, producing a wide range of products for a long period of time for both, the final consumption and the

intermediate consumption. The share of chemical industry in 2008 amounts to 7.7% of the total value added of manufacturing. In 11 months of 2008, output of the sector has decreased by 14.6% compared to the respective period of the previous year. In 2007, moderate growth was observed in the sector (increase by 2.7%). Due to the decrease of the domestic demand, the sales volumes had decreased by 24.3% in the domestic market in January-November 2008, whereas the sale of exported products in the same period of time has grown by 8.3%. It should be noted that production volumes of chemical substances, their products and chemical fibres in 11 months of 2008 have remained close to the level of the previous year, while production of rubber and plastic products has decreased considerably (by more than 30%).

Slightly more than 60% of the production output in 2008 was exported and it was by almost 10 percentage points more than in 2007. The exports of chemical industry products is almost equally distributed by the main export partners of Latvia: EU, Lithuania, Estonia and CIS. The markets in the old EU member states do not expand. The sector has poor competitiveness in the markets of the developed countries.

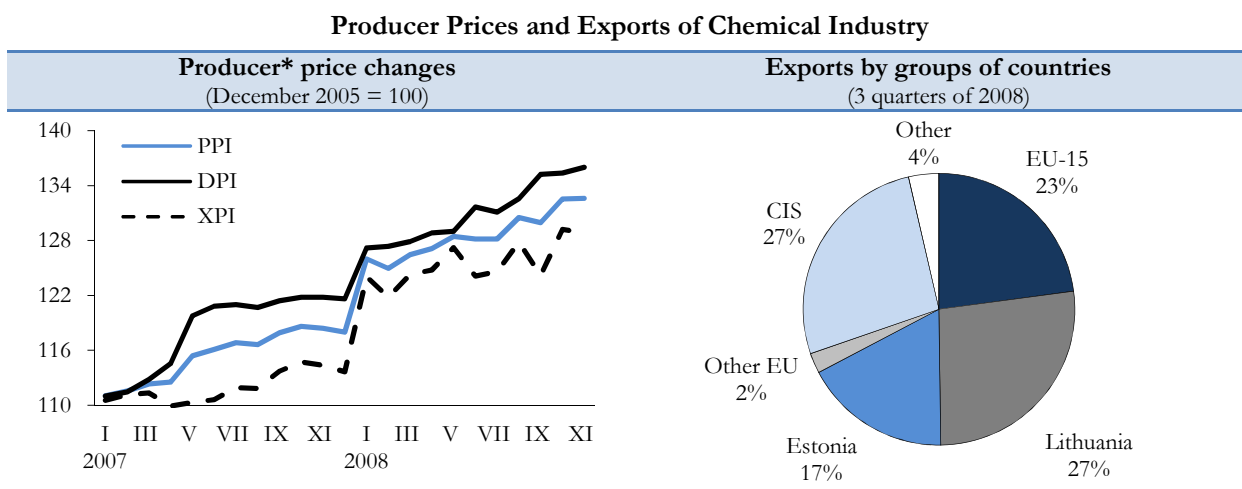
Figure 3.28



The producer prices continued to grow on a gradual basis, whereas the prices for exported products increased slightly faster. The producer prices grew by 12% in November 2008 in comparison with

November 2007. The prices for rubber and plastic products rise at a more moderate pace, but the price increase for chemical products is higher due to relatively high demand remaining in foreign countries.

Figure 3.29



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

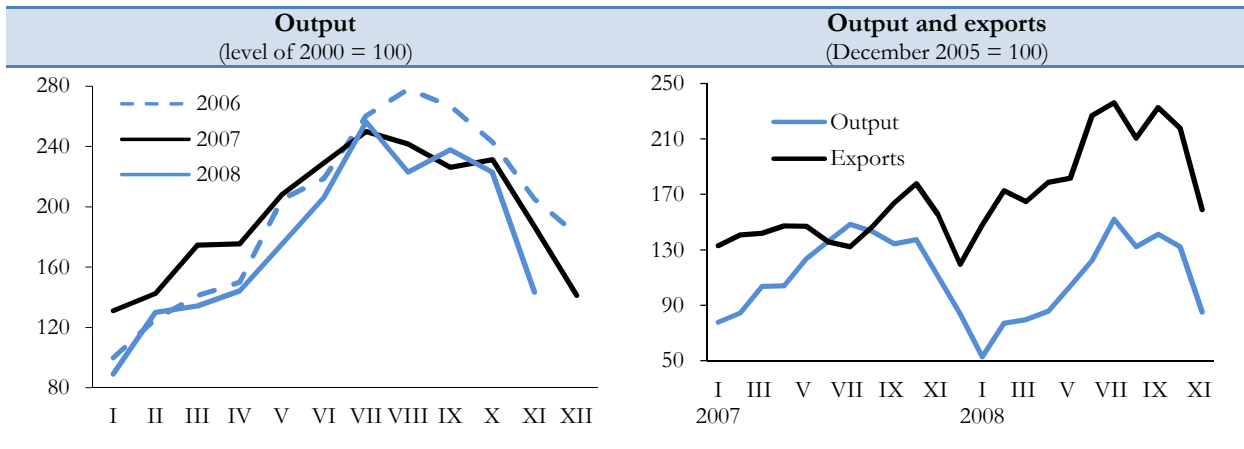
The growth rates of the *production of other non-metallic mineral products* depend on the fluctuations of the domestic demand to a great extent, mainly in relation to the demand for construction materials. Due to the decline of the growth rates of construction in 2008, the sector output has also decreased substantially, which is by 10.7% lower in 11 months of 2008 than in January-November 2007.

Production of non-metallic mineral products is negatively influenced by the slower development and decline in the real estate markets and construction. The volume of products sold in the domestic market fell by 11.2%, while the export volumes of the sold products increased by 31.3% in 11 months of 2008.

Almost ¼ of the produced products of the sector is exported. The main export market is EU, where 77% of the exported products are sold.

Figure 3.30

Monthly Growth Dynamics of the Production of Other Non-Metallic Mineral Products

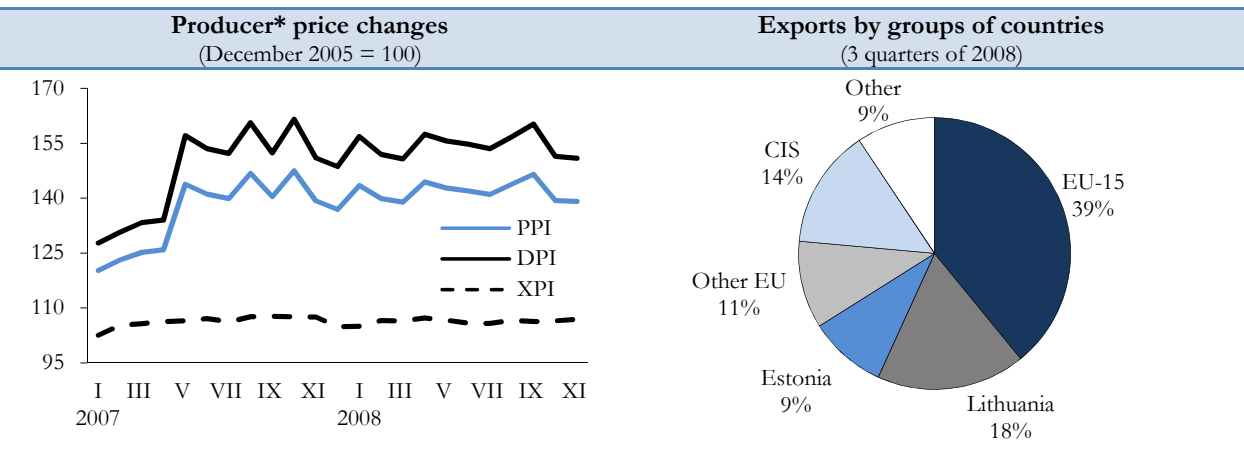


In order to compensate the rapid increase in wages and taking into account the good conjuncture in the domestic market, the producer prices of the sector rapidly rose in May 2007, but afterwards remained practically unchanged. Regardless of the fact that

production of construction materials is a very energy-intensive sector, the price increase for energy resources in 2008 did not affect the producer prices substantially. In 11 months of 2008 the producer prices decreased by 0.1%.

Figure 3.31

Producer Prices and Exports of Other Non-Metallic Mineral Products



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

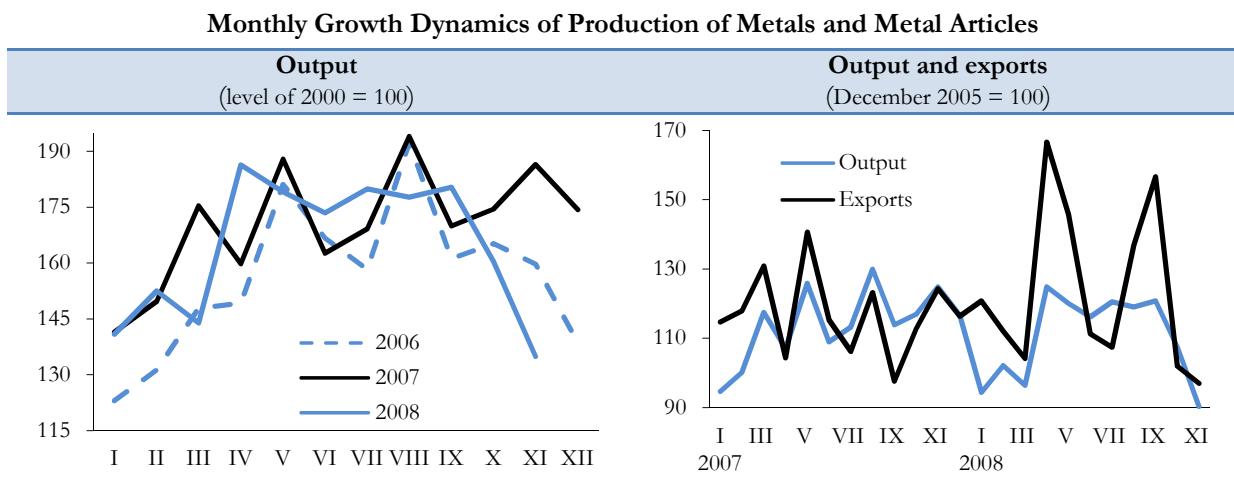
The sector of *production of metals and metal articles* has rapidly developed in recent years and currently it is one of the biggest industry sectors of Latvia constituting 12.4% of the value added of manufacturing. In the first half of 2008 output of the sector has remained at the level of the previous year, however, in 11 months of 2008 the output volumes of the sector are by 3.2% lower than in the respective period of the previous year due to considerable decrease in both, domestic and external demand in the second half of the year.

Exports amount to 71% of the sold products of these sectors. In comparison with 2007, the share of exports in the sale of the sector has increased, because during the period of the rapid development of construction in 2006 and 2007 the share of the domestic market grew, which started to rapidly shrink

due to decreasing domestic economic activities in 2008. In 2007, the volumes of the products sold in the domestic market grew by 22.4%, but in January-November 2008 they shrank by 11.8%. The volumes of the exported products maintain stable growth rates (the growth by 7.1% in 2007 and by 5.7% in 11 months of 2008 in comparison with the respective period of the previous year). As the sector of metals and metal articles is mainly oriented to exports, development of the sector is mainly determined by development tendencies of the external market.

Metals and metal articles produced in Latvia have high competitiveness around the world. More than 70% of the products are exported to EU member states, besides the most part is exported to the old EU member states.

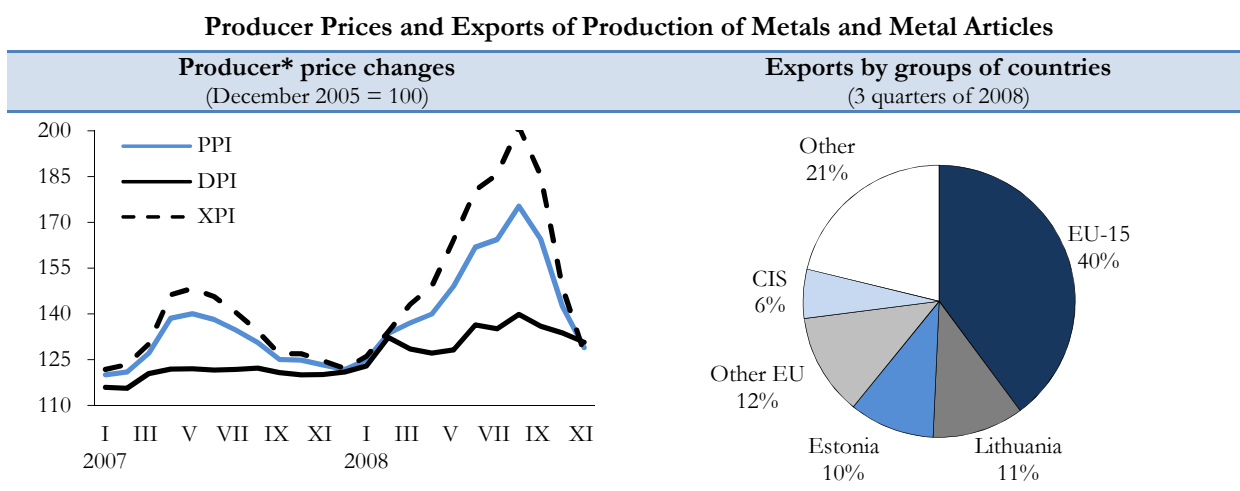
Figure 3.32



The price increase for not only the production volumes but also for products played a comparatively important role in the growth of the sales income of the metal processing sector in the beginning of 2007. Since the end of 2007 and in six months of 2008 the sales

proceeds were determined by the decrease of the production volumes, which was compensated by the increase of the producer prices. Such a tendency was observed for both, the products sold in the domestic market and exported products.

Figure 3.33



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

Producer prices of the sector grew substantially in the beginning of 2008 for both, the products sold in the domestic market and exported products. Moreover, the price increase was considerably more rapid for exported products which enabled to compensate the increasing production costs to a great extent, including increase in labour costs.

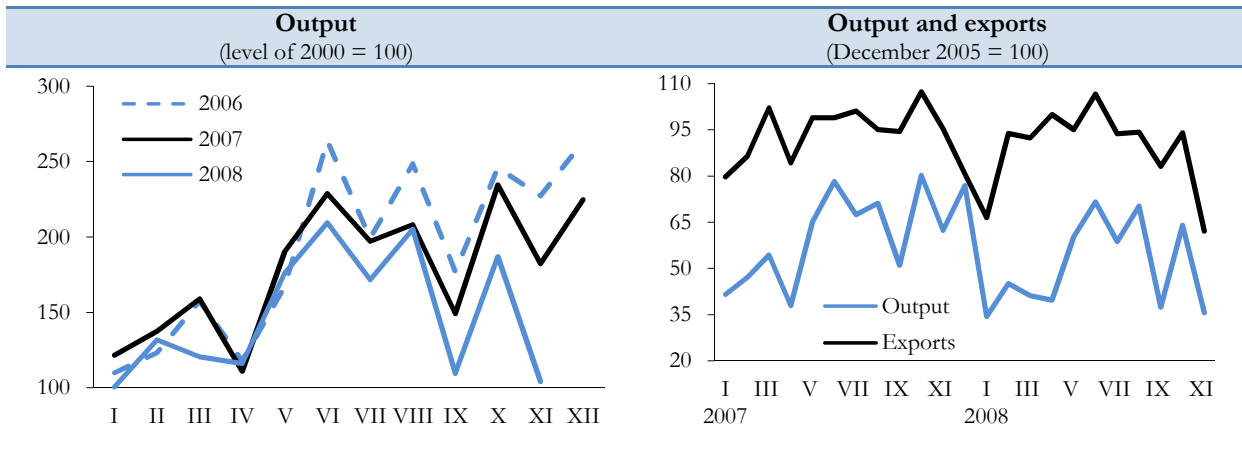
In November 2008, producer prices fell rapidly due to considerable decrease of both, the domestic and external demand. In August 2008 the price increase of 12 months for the products sold in the domestic market amounted to 14.5% and 49.8% for exported products, but in November 2008 – only 8.8% and 2% respectively. The considerable decrease in prices, especially for the exported products, is closely related to price fluctuations of metals and metal articles in the global market.

The sector of *production of machinery and equipment* is basically a supplier of the means of production and technologies to other sectors. During the recent years the production and export volumes of the sector have grown for several times in Latvia, mainly due to the financing of EU structural funds, which has been invested in improvement of production units.

In January-November of 2008, output of the sector shrank by 15% in comparison with the output of 11 months of 2007. The decrease of production volumes of the sector has been observed already since 2006. The sales volumes of the sector decreased by 24.4% in the domestic market, whereas the decrease of the volumes of exported products constituted 5.9% in 11 months of 2008.

Figure 3.34

Monthly Growth Dynamics of Production of Machinery and Equipment

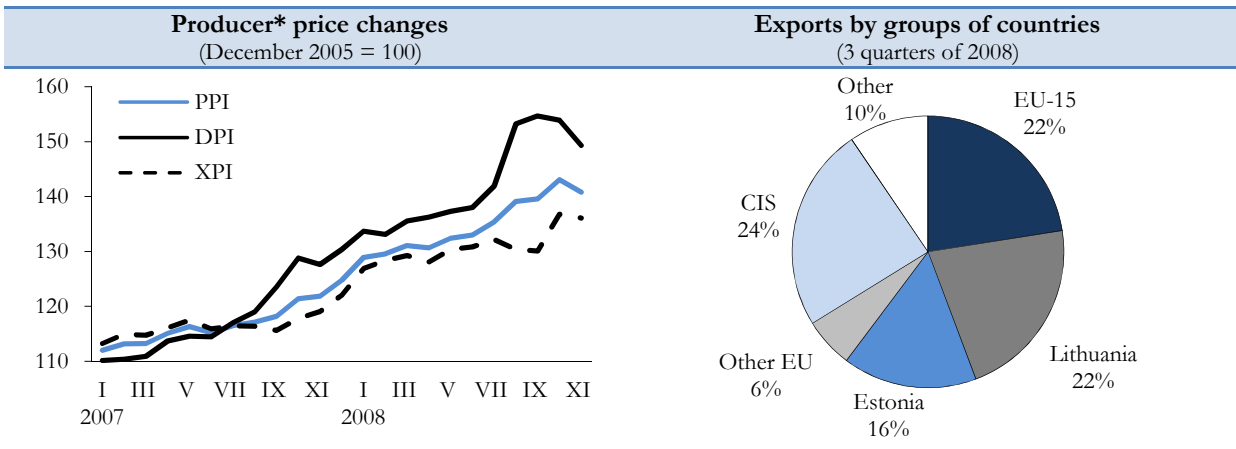


The main sales markets of the sector are EU member states, besides more than a half of the products of the sector exported to EU is sold in Lithuania and Estonia. A relatively big part of exports of the sector is related to the markets of CIS and other countries.

The prices for the products sold in the domestic market have rapidly grown due to increasing demand in the domestic market. The prices for exported products increased to a more moderate extent.

Figure 3.35

Producer Prices and Exports of Production of Machinery and Equipment

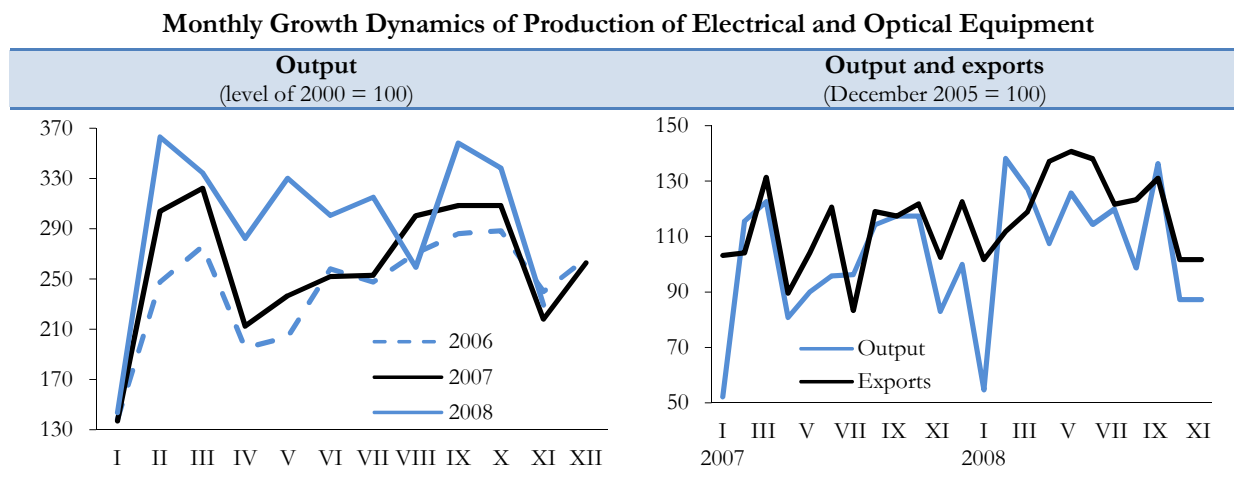


* PPI – producer price index, DPI – producer price index for products sold in the domestic market, XPI – producer price index for exported products

In November 2008 producer prices grew by 15.5% in comparison with November 2007. After a more rapid price increase in the beginning of the year producer prices started to fall gradually. The sector and the national economy in general has been seriously affected by the rapid price increase for energy resources, but the relatively small price increase and the tendency of decrease in prices still indicate decrease in profit of enterprises. The growth of the sector in the last year was influenced by the still rapidly increasing labour costs, which partially determined gradual decrease of production volumes of the sector.

Production of electrical and optical equipment has developed rapidly in the recent years, and output of the sector exceeds the level of 2000 for more than three times. After accession to the EU, the growth rates of the sector slightly slowed down, but remained at a stable level. In 11 months of 2008, the output volumes of the sector grew by 14.1%. During the same period of time the sales volumes of the exported products increased by 13.8%, while the sales volumes fell by 5.7% in the domestic market due to the decreasing demand. Regardless of the comparatively rapid growth of the sector, its share of the total value added of manufacturing is still small (7%).

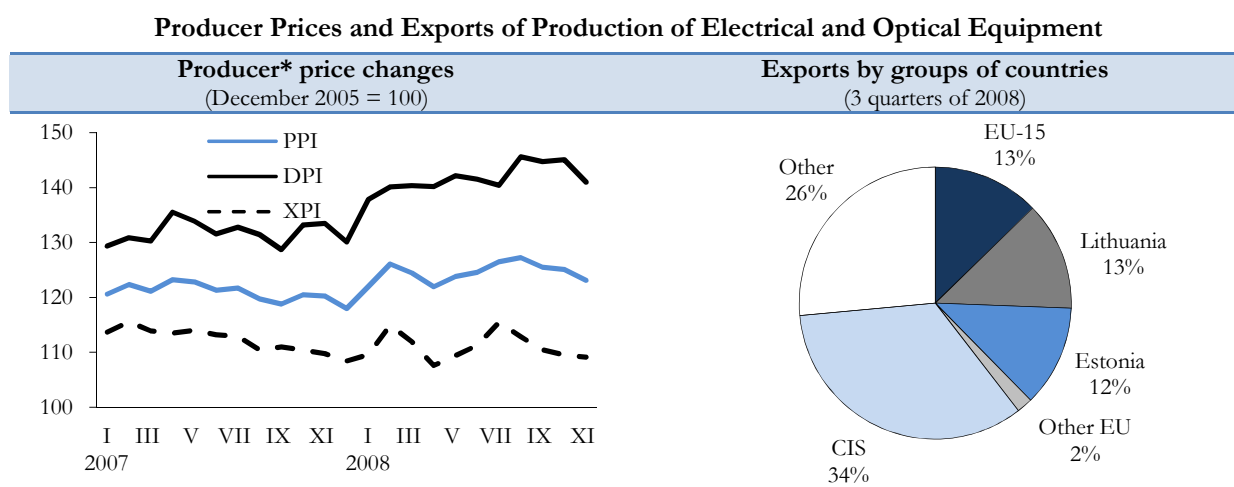
Figure 3.36



The sector exports slightly more than 60% of its products, besides, the share of exports in 2008 has increased due to decreasing sales in the domestic market. Stable partners in trade of products of the

sector are CIS countries, Lithuania and Estonia, where almost 60% of the total exports of the sector are realized.

Figure 3.37



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

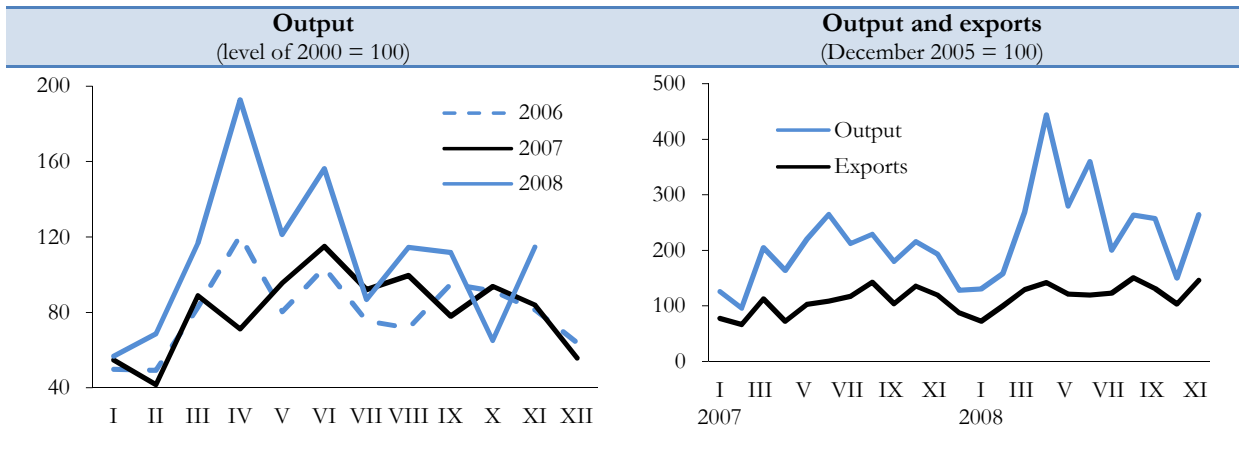
In the beginning of 2008, a small increase of producer prices was observed in the sector, which was determined by the price increase for the products sold in the domestic market, while the prices for the exported products fell. Due to both, the decreasing external and domestic demand, in November 2008 the prices for the products sold in the domestic market had grown by 5.6%, while they decreased by 0.7% for the exported goods as compared to November 2007.

Production of transport vehicles is the other manufacturing sector, which managed to increase production volumes in 2008. Within 11 months they

exceeded the level of the respective period of 2007 by 31.8%. It should be noted, that in 2007 the decrease of the output (by 5.2%) has been observed in this sector. The rapid growth of production of transport vehicles was determined by the considerable increase of new orders within three quarters of 2008 both, in the domestic and foreign markets. As a result, sales volumes increased at similar rates both, in the domestic market (by 13.5%), and exported products (by 15.4%) in January-November 2008 compared to the respective period of 2007.

Figure 3.38

Monthly Growth Dynamics of Production of Transport Vehicles

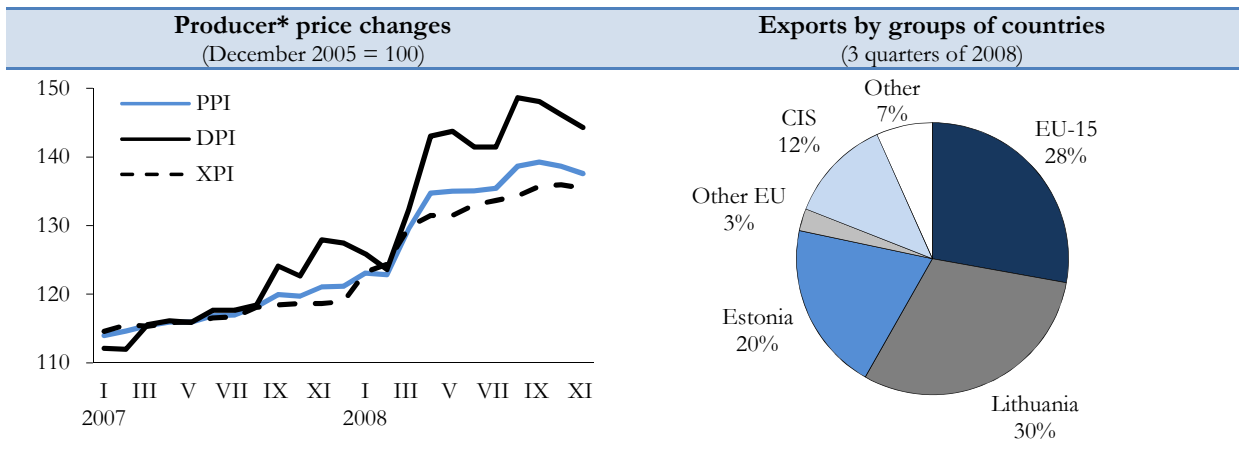


Almost ¾ of the production of this sector is being exported. Export markets are rather evenly distributed in various directions – both to the EU

member states, including Lithuania and Estonia, and to the CIS countries and other countries of the world.

Figure 3.39

Producer Prices and Exports of Production of Transport Vehicles



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

The producer prices for the products sold in the domestic market and in the foreign markets increased almost equally, except the second half of 2007 and beginning of 2008, when the prices for domestically sold products increased more rapidly. Regardless of the producer price tendencies of other manufacturing sectors, producer prices for transport vehicles remained high also at the end of 2008. In November 2008 the prices for domestically sold products grew by 12.7%, but for exported products – by 14.2%.

3.3.3. Energy Sector

Both, the imported (natural and liquefied gas, oil products, coal) and local energy resources (firewood and peat) are used in Latvia to ensure fuel, electricity and heat to national economy sectors, commercial consumers and population. Part of electricity is generated by Latvian HPPs and CHPs, whereas other

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

In 2007, the total energy consumption of Latvia was 211.2 PJ, and 70.9% of this consumption was ensured by imports of energy resources mostly from Russia (natural gas – 29%, heavy fuel oil – 2.3%, other oil products – 35.7%, coal – 1.9%). Among local energy resources, wood was used the most (firewood, remainders from woodprocessing, woodchip, wood briquettes and granules), comprising 23.1% of the total energy consumption. Share of the electricity generated by Latvian HPPs and wind power stations in the total energy consumption was 4.7%.

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

Table 3.14

Consumption of Energy Resources in Latvia¹
(thousand tons of equivalent fuel – ktce²)

	2002	2003	2004	2005	2006	2007
Energy resource consumption – total	6226	6514	6648	6770	7021	7206
of which:						
natural gas	2050	2138	2114	2155	2233	2158
light fuel products and other oil products	1717	1857	1950	1995	2225	2442
heavy fuel oil, oil shale	230	166	132	113	77	59
firewood, peat, coke and other types of fuel	1537	1655	1719	1722	1725	1691
coal	99	90	87	107	116	145
electricity (HPPs, wind generators and imported from abroad)	593	608	646	678	645	711

¹ Source: CSB and the Ministry of Economics.

² 1 ktce = 0.02931 PJ.

In 2007, the SJSC “Latvenergo” generated 53% of the required electricity, 39% was supplied by other countries and 8% was purchased from small producers

of electricity. In comparison with the respective period of the previous year, the electricity consumption has increased by approximately 5%.

Table 3.15

Electricity Supply in Latvia¹
(billion kWh)

	2002	2003	2004	2005	2006	2007
Total electricity supply	6.323	6.608	6.786	7.053	7.399	7.771
Electricity generation – total	3.975	3.975	4.689	4.905	4.891	4.771
of which:						
HPPs ²	2.433	2.216	3.044	3.267	2.661	2.668
CHPs ³	1.238	1.363	1.225	1.278	1.740	1.452
other CHPs	0.263	0.298	0.306	0.255	0.407	0.532
small HPPs	0.030	0.050	0.065	0.058	0.037	0.066
wind generators	0.011	0.048	0.049	0.047	0.046	0.053
Imports of electricity	2.348	2.633	2.097	2.148	2.508	3.000

¹ Source: SJSC “Latvenergo”, Ministry of Economics, CSB

² Daugava cascade and Aiviekste HPP (HPP of SJSC “Latvenergo”)

³ CHP of SJSC “Latvenergo”

Consumption structure of the *centralised heat supply* has not changed in the recent years, with central heating comprising 65-70% and hot water supply making 30-35%. Of the total amount of sold heat energy, 2.3% was sold to industry, 73.4% to households and 24.3% to other consumers.

The biggest consumers of natural gas are CHPs and heat supply enterprises of “Latvenergo” (57.3%), industry (20.8%) and other consumers (~21%). Rīga region accounts for 80% of the total natural gas consumption in Latvia. Natural gas is not used at all in Latgale region, with the exception of Daugavpils and Rēzekne cities and Preiļi district. In Kurzeme region natural gas consumption is the biggest in Liepāja and reaches ~11% (by JSC “Liepājas siltums” and JSC “Liepājas metalurģis”), while in Zemgale region it amounts to ~4% (in Jelgava city and Bauska district).

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

Oil products have an important place in Latvian market of energy resources. Their market share is slightly higher than 30%, including the share of heavy fuel oil in the oil fuel balance amounting to approximately 4%. The biggest consumers of heavy fuel oil are heat supply (65%) and industry (27.5%). Complying with the abovementioned requirements of the EU Directive 1999/32/EC, the Cabinet of Ministers adopted Regulations No. 125 “On the Limitation of Sulphur Content in Certain Liquid Fuels” on March 2, 2004. 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 and peat). The forecast of firewood consumption depends on the extent to which regions will manage to change from the extensive use of firewood to its rational use. In the total fuel consumption, the share of firewood is

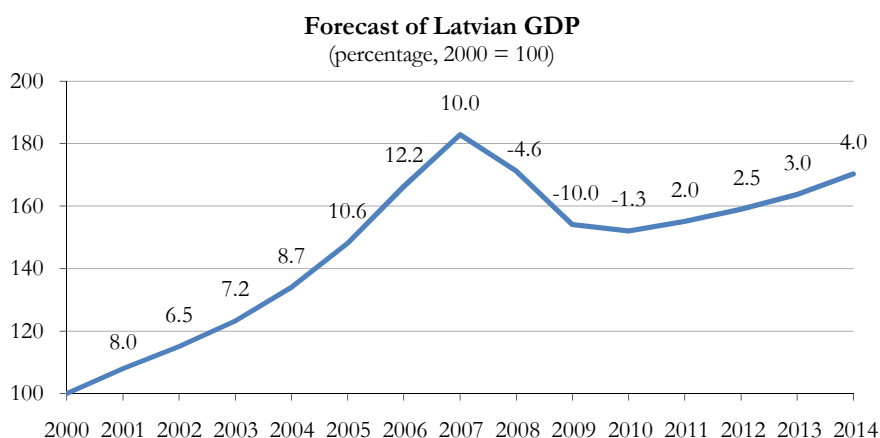
already quite substantial and has reached 29-30%. The biggest consumers of firewood are households (62.3%), heat supply companies (14.7%), industry (mainly woodprocessing enterprises) and other consumers (23%). Firewood and coal are used evenly across all regions of Latvia. The usage of peat in the energy sector continues to decrease.

3.4. Forecasts

The Ministry of Economics has developed medium-term economic development forecasts for the period until 2014. It is forecasted that the started recession in 2008 will continue in 2009 and in 2010.

Economic recovery may start in the mid-2010, when the annual average growth rate will be still negative. The growth by 2% is forecasted for 2011, which will increase in the following years and reach 4% by 2014.

Figure 3.40



Development of national economy for 2009-2010

It is forecasted that in 2009 the GDP may decrease by 10%, but in 2010 – by 1.3%. Investments and private consumption will decline the most substantially, but with regard to sectors the decrease will be in manufacturing, construction and trade.

The main basic assumptions for the forecasts of 2009 and 2010 is the poor external and shrinking domestic demand, as well as consequences of the global financial crisis.

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

The decrease of the private consumption in 2009 is determined by the practical stop of household crediting process, decrease of wages and increase of unemployment. In 2010 the private consumption may continue to decrease, because employment and wages will not increase.

The decrease of investment in the private sector will be mainly affected by deterioration of the access conditions to financial resources (loans become more expensive and profits are decreasing), as well as pessimistic future expectations of entrepreneurs. The decrease in the investment will be partially compensated by the public investment in road construction and repair and the policy implemented by the government for improvement of the access to financial resources.

Table 3.16

Forecast of Latvian GDP by Expenditure Items				
	2008	2009	2010	2011-2014*
growth rates, % over the previous year				
Gross domestic product	-4.6	-10.0	-1.3	2.9
Private consumption	-10.4	-11.2	-1.0	1.9
Public consumption	-1.1	-9.6	-2.0	0.9
Gross fixed capital formation	-13.6	-18.2	0.0	3.9
Exports	-2.8	-8.4	-3.0	5.4
Imports	-13.4	-21.2	-0.9	4.6
structure, %				
Gross domestic product	100.0	100.0	100.0	100.0
Private consumption	59.2	62.7	62.8	62.0
Public consumption	19.7	18.4	18.3	16.7
Gross fixed capital formation	29.8	22.8	22.4	22.5
Changes in inventories	4.8	-1.1	0.3	3.0
Exports	41.9	43.7	43.2	47.9
Imports	-55.5	-46.6	-47.0	-52.1
Export-import balance	-13.6	-2.9	-3.8	-4.2

* annual average growth, structure in 2014

The net exports will improve, i.e. the deficit of export–import will decrease, because as a result of reduction of the domestic demand the imports will continue to decrease. Taking into account the poor

demand of the export partners of Latvia, there will be also a slight decrease of exports in 2009. Exports may start to increase in 2010, while imports will continue to decrease.

Table 3.17

Forecast of Latvian GDP by Sectors				
(real growth in % over the previous year)				
	2008	2009	2010	2011-2014 (average annually)
Gross domestic product	-4.6	-10.0	-1.3	2.9
Primary sectors	-0.7	-15.0	-2.1	2.5
Manufacturing	-6.8	-18.7	-1.8	4.7
Electricity, gas and water supply	0.0	-1.1	-0.6	1.5
Construction	-3.3	-17.1	0.6	3.7
Trade, hotels and restaurants	-6.9	-16.5	-1.2	2.8
Transport and communications	-0.1	-4.4	-2.6	5.2
Other commercial services	-0.6	-2.0	-0.8	2.1
Public services	-0.7	-5.2	-1.7	0.9

Economic development in 2009 and 2010 may be influenced by several risks. The possibility exists that decrease of the external demand as the consequence of the global financial crisis is even bigger than it is currently forecasted by the European Commission and other international organisations, because high uncertainty dominates in the world regarding further development, as well as intensity of influence of the financial crisis on the real sector. Both, the European

Commission and other international organisations constantly reduce the growth forecasts.

The possibility that the financial crisis in Latvia will deepen should be noted as well. A more radical decrease of the access to loans and the necessity of the government to reduce its expenditures to a greater extent may foster the decline of investments and private consumption.

In case of simultaneous fulfilment of the abovementioned risks, the decline of GDP may reach 13-15% in 2009 and the deflation may start, which will deepen the crisis even more.

Development perspectives for 2011-2014

As it was mentioned, the growth may revive in 2011, if the financial markets start to recover at least in the second half of 2010, which will provide a positive incentive for local entrepreneurs and improve the situation in our export markets, especially in the EU.

The main growth stimulus for Latvia in the future periods must be related with the expansion of export opportunities. Therefore, competitiveness of our key export-oriented industry sectors both in international and local markets has a determinant role for ensuring growth. It should be taken into account that intensifying of price competition is observed in the global markets for goods and services. Previously, the

competitiveness of Latvian industry was largely based on relatively cheap labour force and low general costs. Due to the growth of labour costs these advantages are partially lost, therefore appropriate increase of productivity and growth of complexity of the export products will have a determinant role, which will let to compete in the international markets more successfully.

In order to provide the average growth in 2011-2014 by 2.9%, the production volumes of manufacturing should increase by at least 4.7% plus it is foreseen in the forecasts that the external balance of Latvian services should also improve, where the major contribution has been provided by transport services.

The main risk for further growth is inefficiently implemented structural policy for improving the competitiveness of 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

Taking into account that the economic growth in Latvia has stopped in 2008 and even decreased and it is forecasted that negative growth will continue also in the next two years, the main task of the fiscal policy in 2009 is not to allow budget deficit (excluding the possible financial system support measures) above 5% of GDP. At the same time, the government keeps the commitment to aim at achieving a balanced budget as soon as possible as it is determined by the *Economic Stabilisation and Growth Revival Programme of Latvia* (adopted on December 12, 2008).

In order to implement the fiscal responsibility constantly and create the basis for establishment of the sustainable economic stabilisation reserve, the

Programme envisages that the Cabinet of Ministers will set clear and responsible fiscal policy targets for inclusion in the legislation, by setting the goal to form a balanced budget and channel at least a half of the growth of annual budget revenues to the stabilisation reserve, if the GDP growth forecasted for the budget formation is higher than 2%.

As it is shown in Table 4.1, the general government sector deficit¹ in Latvia in recent years has been lower than 3% of GDP allowed by the Maastricht Treaty. In 2003, the general government budget had a deficit in the amount of 1.6% of GDP, but upon gradual improvement of the financial situation, the general government budget had a surplus amounting to 0.1% of GDP in 2007.

Table 4.1

General Government Budget

	2003	2004	2005	2006	2007	2008*	2009*
Revenues							
(million LVL)	2120.2	2583.2	3191.7	4213.0	5251.1	5361.6	4948.0
(% of GDP)	33.2	34.7	35.2	37.7	35.53	32.9	32.2
Expenditures							
(million LVL)	2223.6	2659.6	3224.4	4237.1	5242.5	5889.0	5696.7
(% of GDP)	34.8	35.8	35.6	37.9	35.47	36.1	37.1
Balance							
(million LVL)	-103.5	-76.5	-32.6	-24.1	8.6	-527.4	-748.7
(% of GDP)	-1.6	-1.0	-0.4	-0.2	0.06	-3.2	-4.9

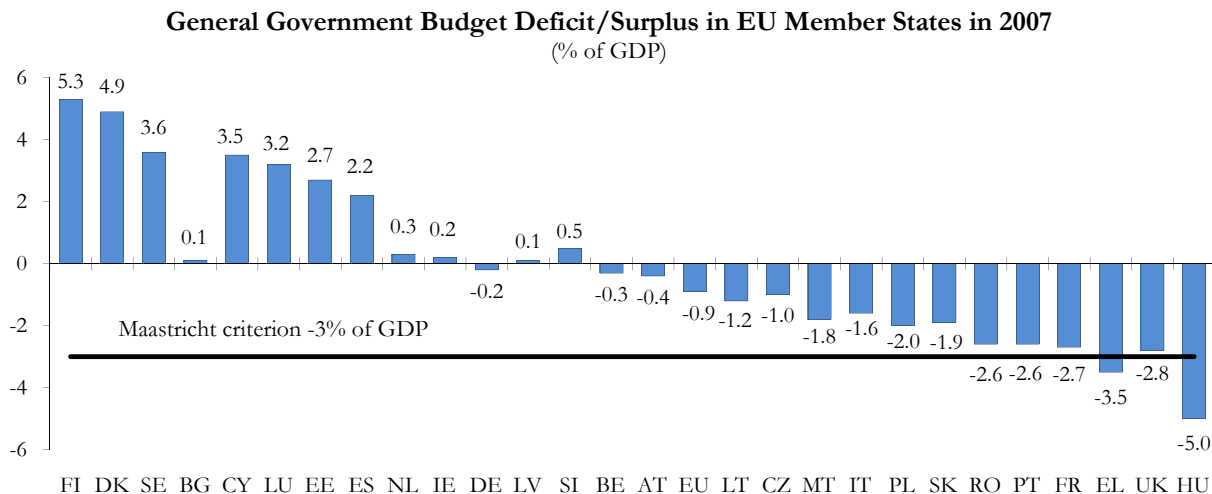
* forecast

As it can be seen from the Figure 4.1, the average level of the budget deficit in the EU member states was 0.9% of GDP in 2007 (1.4% of GDP in 2006, 2.4% of GDP in 2005). Fiscal balances improved in all EU member states having a budget deficit (except Belgium, Greece, France, Lithuania, Romania and United Kingdom) in 2007. In 2007, the highest general government budget deficit as a percentage of GDP was

observed in Hungary (-5%), Greece (-3.5%), United Kingdom (-2.8%), France (-2.7%) and Portugal (-2.6%). Twelve EU member states had general government budget surplus in 2007, of which the highest surpluses as a percentage of GDP were in Finland (+5.3%), Denmark (+4.9%), Sweden (+3.6%) and Cyprus (+3.5%).

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

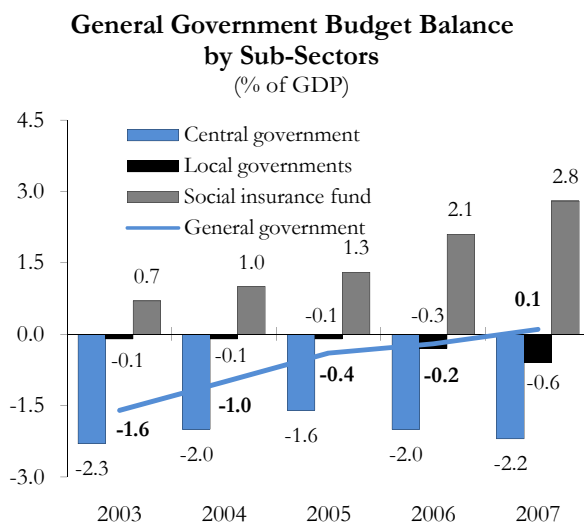
Figure 4.1



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

The general government budget deficit has been determined mainly by the deficit of the central government budget, which has a tendency to increase (see Figure 4.2). The financial situation of the social insurance budget has substantially improved within recent years: in 2003 it had a surplus in the amount of 0.7% of GDP, but in 2007 it reached already 2.8% of GDP. The local government budget balance has been substantially influenced by the construction of the Southern Bridge in Riga within recent years.

Figure 4.2



In autumn 2007, the Saeima approved the **budget of 2008** with a surplus in the amount of 1% of GDP. However, taking into account the macroeconomic situation in the country and assessing the state budget revenue forecasts, in summer 2008 amendments to the state budget of 2008 were made envisaging to provide a budget surplus in the amount of 0.05% of GDP or LVL 8 million. In order to ensure fulfilment of the

state budget with a surplus, ministries and other central public institutions reduced the budget expenditures for 2008 by reducing current expenses.

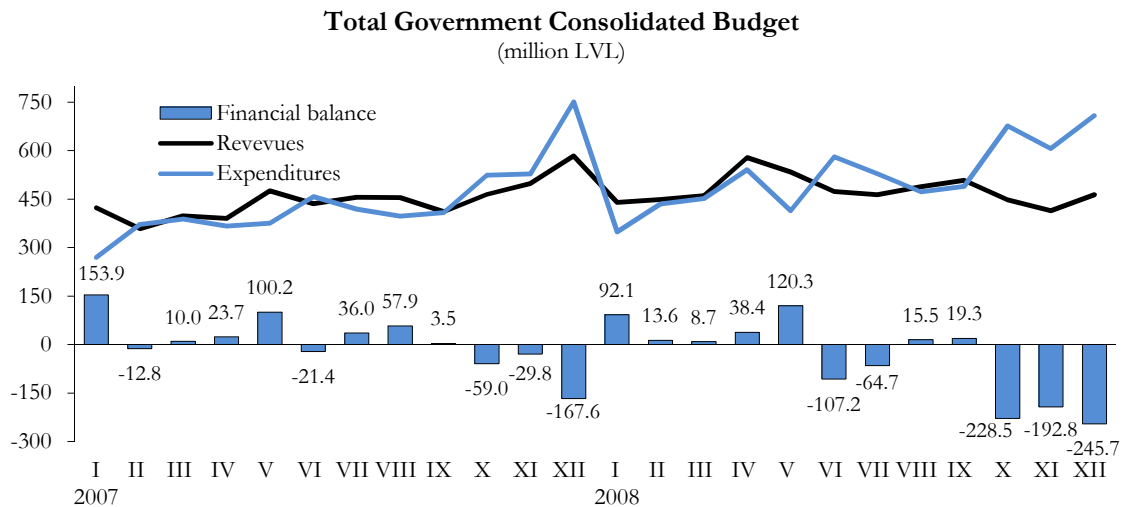
In 9 months of 2008, a spare surplus of LVL 135.9 million of the general consolidated budget had established, however, in the last three months of 2008 budget expenditures exceeded budget revenues considerably and lagged behind from the planned. Therefore, there was a deficit in the amount of LVL 527.4 million or 3.3% of GDP in the general consolidated budget in 2008, which was by 3.4 percentage points higher than in 2007.

In November 2008, the Saeima approved the **state budget of 2009** with a deficit in the amount of 1.8% of GDP. However, in the beginning of December 2008 the government decreased the forecasts for 2009 related to the growth and revenues due to the deterioration of the economic situation in Latvia and in the world. Taking into account the revised forecasts, the Saeima approved the amendments to the budget of 2009 in December 2008, foreseeing a budget deficit in the amount of 4.9% of GDP, as well as several reductions of public expenditures.

The main cost optimisation and reduction measures included in the amendments of the budget for 2009 are as follows:

- reduction of the number of employed persons and nominal wages by 15% in the public administration institutions and structures providing public services financed by the state budget;
- reduction of costs related to the purchase of goods and services needed for the state by 25%;
- reduction of the public expenditures by 25% on average for the subsidies of programmes, with exception of health care programmes, for financing of which more resources have to be retained.

Figure 4.3



In 2009, several amendments to the tax legislation became effective, which will facilitate distribution of tax accent from the direct taxes related to production to the indirect taxes related to consumption in order to increase economic competitiveness and promote investments in production:

- amendments to the Law “On Corporate Income Tax” (see Box 4.1), in order to introduce a reinvestment stimulus;
- reduction of the personal income tax rate by 2 percentage points from 25% to 23%; increase of the untaxed minimum from LVL 80 to LVL 90;
- increase of the basic rate of VAT from 18% to 21%; increase of the reduced rate of VAT from

5% to 10% and its abolition for particular groups of goods and services, except child’s food, medicine, supply of heat energy, electricity supply, public transport services;

- increase of the excise tax on fuel, coffee, alcohol and soft drinks to the tax level dominating in the Baltic market space.

In 2010, it is planned to extend the real estate tax base by adding housing and at the same time setting substantial allowances for the housing of the registered place of residence. In addition, extension of the personal income tax base is planned in 2010 by including also the income gained from capital and from increase of capital.

Box 4.1

Amendments to the Law “On Corporate Income Tax”

Amendments to the Law “On Corporate Income Tax”, which have come into force on January 1, 2009, foresee several reinvestment stimuli:

- increase of equity capital;

The amendment is aimed at provision of an incentive for the owners of an enterprise not to divide the profit in dividends, but invest in development of the enterprise, therefore increasing the equity capital. The law envisages decrease of taxable income by a particular amount of interest, which the taxpayer would have paid for a loan of a similar amount (in the amount of the increase of the share of equity capital);

- increase of the cost of fixed assets for the needs of writing-off depreciation;

The goal of the amendments envisages promotion of manufacturing, which is the main export-oriented sector, continuing to apply a substantial tax incentive to the taxpayers performing production and acquiring new technological equipment for production within the period of up to 2013. The amendments to the law envisage extension of the special procedure for writing-off fixed assets for new production technologies for five years (from 2009 to 2013), therefore, raising the increasing ratio of the cost of fixed assets to 1.5 during this period;

- replacement of fixed assets;

The goal envisages provision of an incentive for the taxpayers to replace inefficient and out-of-date technological equipment with new and efficient equipment and postponing the tax payment for the alienated fixed asset at the moment of replacement, facilitating transfer of production complexes from the territories with high cadastral value and real estate tax burden to more favourable territories in terms of taxes in rural areas of Latvia. The law prescribes to dispose the profit obtained from the sale of fixed assets (including technological equipment) from imposing a corporate income tax, if a new similar fixed asset is acquired instead within 12 months;

- incentive to register patents and trademarks;

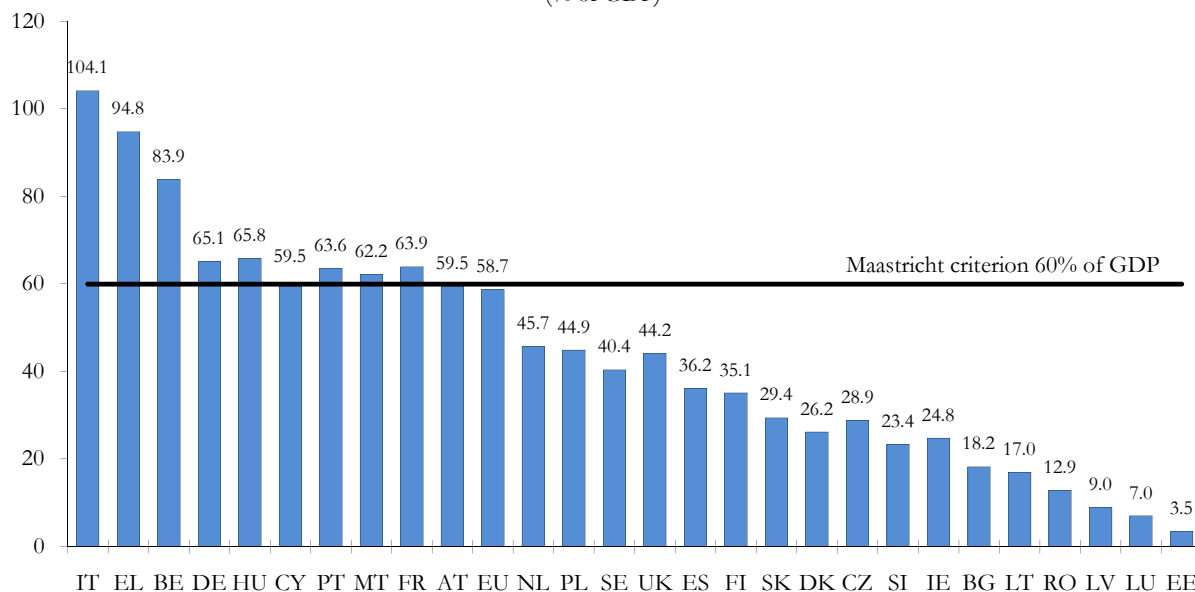
The amendments are aimed at promotion of patent and trademark registration, therefore increasing the private sector investments in research and development (R&D), facilitating the achievement of EU average indicators regarding expenditures on research and development in terms of the percentage of GDP. The law specifies that the ratio of 1.5 increasing the value of depreciation will be introduced for such intangible investments, as a result of which the patents and trademarks are registered (the same as for the new production equipment).

The level of the **general government debt**¹ in Latvia is the third lowest in the EU (see Figure 4.4). In 2007, the EU average level of the general government debt was 58.7% of GDP (61.3% of GDP in 2006, 62.7% of GDP in 2005). General government debt exceeded the Maastricht criterion (60% of GDP) in

8 EU member states in 2007. In 2007, the highest general government debt in percentage of GDP was observed in Italy (104.1%), Greece (94.8%), Belgium (83.9%), while the lowest general government debt in percentage of GDP was registered in Estonia (3.5%), Luxembourg (7%) and Latvia (9%).

Figure 4.4

Public Debt in EU Member States in 2007
(% of GDP)



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

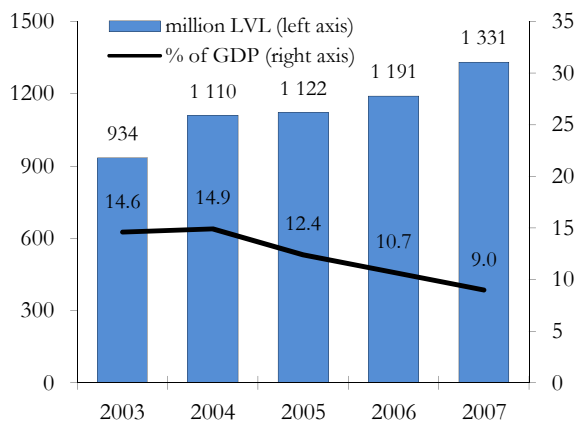
In the recent years, the general government debt in Latvia has increased from LVL 933.9 million at the end of 2003 to LVL 1331.3 million at the end of 2007, while it has decreased in percentage of GDP from 14.6% to 9% of GDP respectively (see Figure 4.5). At the end of June 2008, the general government debt reached LVL 1739 million.

In order to ensure financing for fulfilment of the state budget and refinancing of the debt, the resources are attracted both, from the domestic and foreign capital markets using a variety of financial instruments.

The biggest share in the structure of public debt is constituted by the Eurobonds and domestic borrowing bonds (50.8% and 26.7% respectively of the total amount of the central government debt at the end of August 2008) the remaining part of the public debt obligations consists of the short-term domestic borrowing promissory notes and loans from the international financial institutions.

Figure 4.5

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



Issuing Eurobonds³ is the most efficient instrument for attraction of large resources, by increasing the volumes of the current issues or issuing the new ones. On February 29, 2008, Latvia issued

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

² According to the methodology of the ESA 95 European System of National Accounts.

³ Up to now, Latvia has issued Eurobonds in the international capital market in 1999, 2001 and 2004. In 2004, Latvia issued the largest amount of Eurobonds so far, namely, EUR 400 million and with the longest maturity (10 years).

Eurobonds in the amount of EUR 400 million with the maturity in 2018.

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 considerably below the public debt criterion set in the Maastricht Treaty.

4.1.2. Budget Revenues

Total revenues of the state consolidated budget in 2008 amounted to LVL 5723 million (according to the cash revenue principle), which was by 6.4% more than

in 2007 and were by LVL 830.6 million less than it was planned. During the years of the rapid growth, the budget revenues grew almost by 30% annually. Although in the beginning of 2008, the revenues increased at the same rate, however, due to substantial decrease of the economic activities, especially domestic demand, the combined budget revenues also decreased in the second half of the year, which were even lower in the 4th quarter than at the end of 2007. It should be noted that the budget revenues decreased at higher rates than GDP in 2008 and in the result the share of the state consolidated budget revenues in GDP decreased to 35.1%.

Table 4.2

Budget Revenues*				
<i>(% of GDP)</i>				
	2005	2006	2007	2008
General government sector revenues	35.3	35.9	36.4	35.1
I Tax revenues	28.1	29.9	29.5	29.1
1. Indirect taxes	11.2	11.8	11.4	10.3
– value added tax	7.5	8.3	8.1	6.9
– excise tax	3.5	3.3	3.0	3.3
– customs duties	0.2	0.2	0.2	0.2
2. Income taxes and property taxes	8.3	8.7	9.2	9.8
– corporate income tax	2.0	2.3	2.7	3.1
– personal income tax	5.6	5.9	6.0	6.3
– real estate tax	0.7	0.6	0.5	0.4
3. Social security contributions	8.3	9.0	8.6	8.6
4. Other taxes	0.3	0.4	0.4	0.3
II Non-tax revenues	7.2	6.0	6.9	6.1

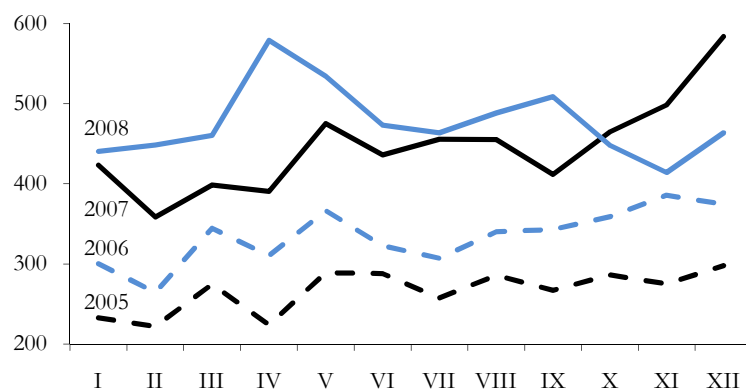
* according to the official data of the Treasury

Deterioration of the economic situation in Latvia has influenced tax collection substantially. In 2008, the tax revenues constituted LVL 4736.6 million of the state consolidated budget, which exceeded the tax revenues of 2007 by 8.6%, but lagged behind from the planned amount by 7.7%. The highest contribution to the tax revenues in recent years was provided by the

growth of consumption taxes, and especially the value added tax, but in 2008 the increase in taxes was mainly ensured by labour taxes (state social insurance contributions and personal income tax). The main factors, affecting the increase of tax revenues in 2008 were still high inflation and increase in wages.

Figure 4.6

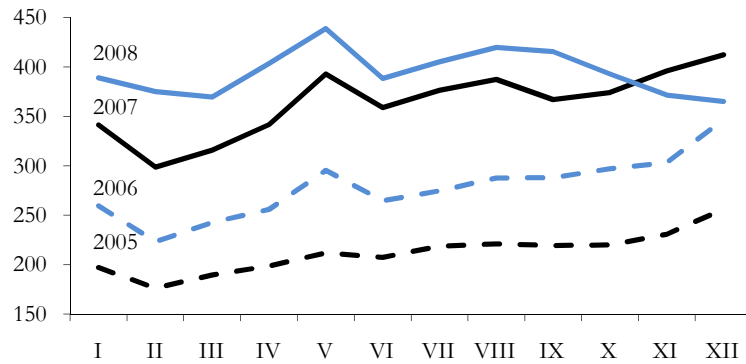
General Government Consolidated Budget Revenues by Months*
(million LVL)



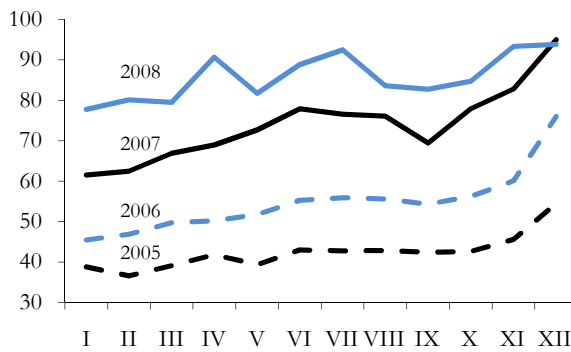
* according to official data of monthly reports of the Treasury

Figure 4.7

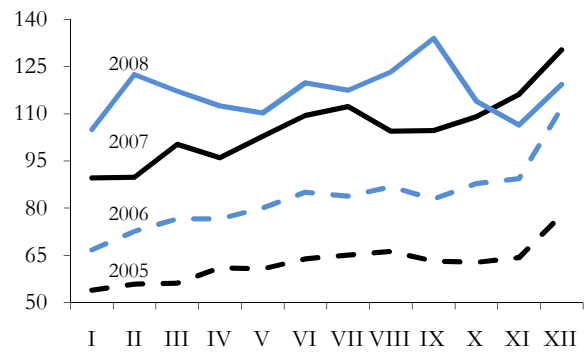
Tax Revenues by Months*
(million LVL)



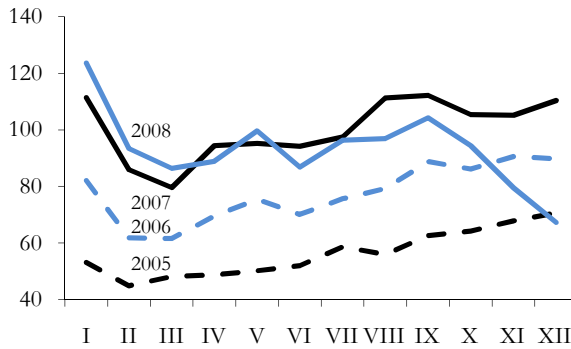
Personal Income Tax



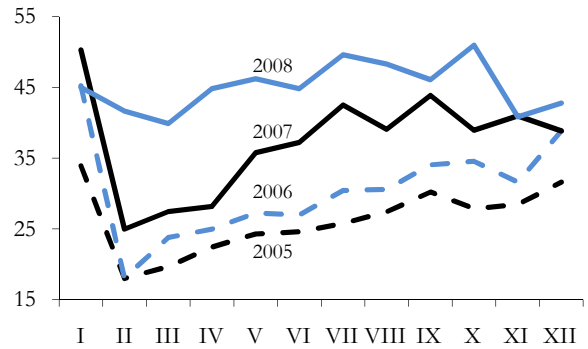
State Social Security Contributions
(excluding state-funded pension scheme resources)



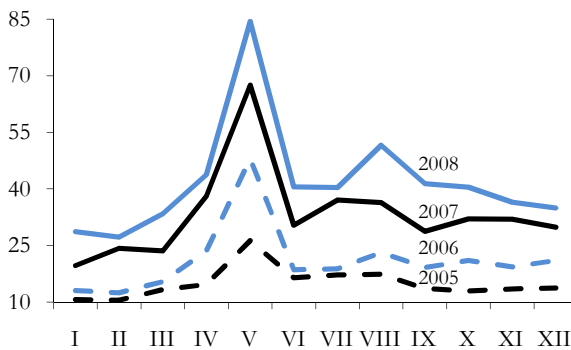
Value Added Tax



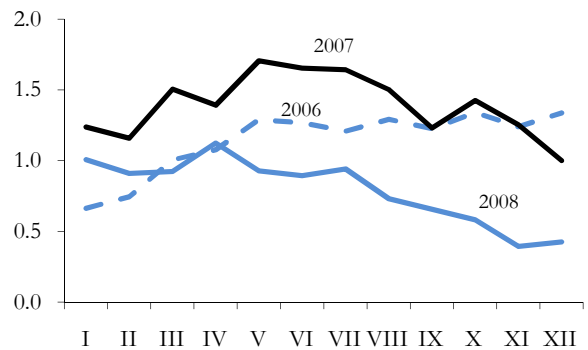
Excise Tax



Corporate Income Tax



Tax on Cars and Motorcycles



* according to official data of monthly reports of the Treasury

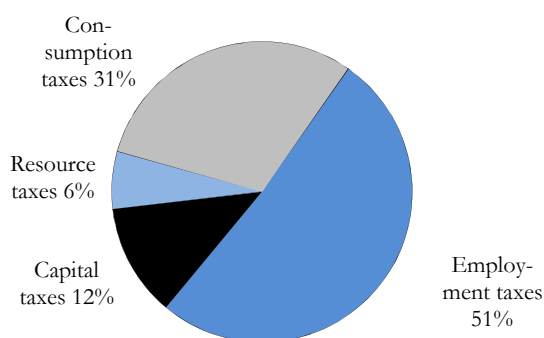
In 2008, the share of **employment taxes** in the total tax revenues grew to 51.3%. The increasing wages and continuously high employment rate

determined the growth of labour tax revenues (state mandatory social insurance contributions grew by 10.8%, personal income tax collection increased by

15.9%). The total contribution of these taxes to the total increase of tax revenues constituted 6.4% or more than 3/4 of the increase in total tax collection. Taking into account the tax legislation changes, which came into force in January 2009, and the expected decrease in the number of employed persons, it is expected that the tax revenues from this group of taxes will decrease in 2009.

Figure 4.8

**General Government Consolidated Budget
Tax Revenues by Tax Groups
in 2008**
(%)



The share of **consumption taxes** in the tax structure has decreased by 3.1 percentage points in 2008 compared to 2007. Consumption taxes ensured the most rapidly growing tax revenues in the previous years, which was fostered by the increasing domestic demand and high inflation. However, in 2008 the growth of collection from the consumption taxes decreased due to the shrinking domestic consumption and also decreasing inflation in the second half of the year.

The most substantial decrease is observed in the value added tax revenues, which amounted to LVL 1117.2 million in 2008 or by 7.1% less than in 2007. The increase of the consumption share of excise tax revenues by 32.6% in 2007 was affected by increasing excise tax rates, especially for tobacco products. If the forecasts on decrease in domestic consumption come true, the further consumption tax revenues will also shrink substantially, which will be slightly compensated by the tax rate increase.

In 2008, the growth of tax revenues continued in the **group of capital taxes** (by 21.1%). Despite the general economic tendencies, the corporate income tax revenues increased at a relatively rapid rate in 2008 (by 25.9%), while the real estate tax revenues amounted to LVL 70.7 million only, which is by 4.7% less than in the previous year despite the high activity in the real estate market in the previous years. It is expected that in 2009 the enterprise profits will fall due to decreasing overall business activities, and therefore the tax revenues will decrease as well.

Changes in the group of **resource taxes** are mainly related to the excise tax on oil products, the share of which in this tax group constitutes 97%. In comparison

with the previous years, the share of the resource tax group has slightly increased and amounts to 6.2% of the total tax revenues. In 2008, the excise tax on oil products was collected in the amount of LVL 283.4 million, which exceeded the collection of the previous year by 11.6%. It is largely related to increase of the excise tax rate on oil products, as well as the high demand for oil products. The natural resources tax was collected in the amount of LVL 9.6 million in 2008, which was by 6.4% less than in 2007 and basically related to decrease of business activities.

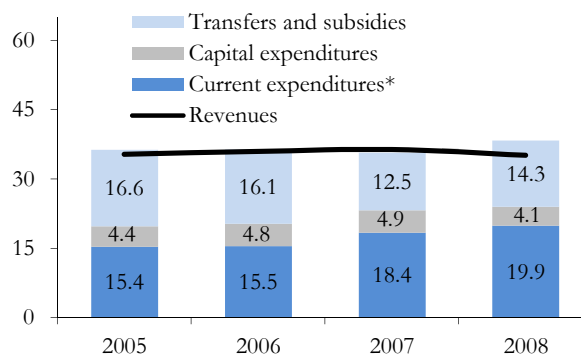
4.1.3. Budget Expenditures

In 2008, the consolidated budget expenditures comprised 38.4% of GDP, but the consolidated budget deficit constituted 3.3% of GDP.

Despite the strict budget discipline and substantial reduction of the public administration expenditures, the budget expenditures exceeded the revenues by LVL 531.1 million in 2008. The state consolidated budget expenditures were LVL 6254.1 million, which exceeded the level of the previous year by 18.4% despite the substantial reduction of expenditures at the end of the year.

Figure 4.9

**Revenues and Expenditures
of the General Government Consolidated Budget**
(% of GDP)



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

In 2008, current expenditures constituted the highest share amounting to 51.9% in the state consolidated budget and transfers for the private sector constituted 37.3%, while capital expenditures comprised only 10.8%. In comparison with the previous years, the share of current expenditures, as well as transfers, subsidies and grants has increased in the structure of budget expenditures. In comparison with 2007, current expenditures have increased by 21.3%, transfers to the private sector – by 26.9%, while capital expenditures have decreased by 1.7%. Moreover, the capital expenditures financed from the state budget decreased more rapidly, which was partially compensated by the increase in capital expenditures of local governments.

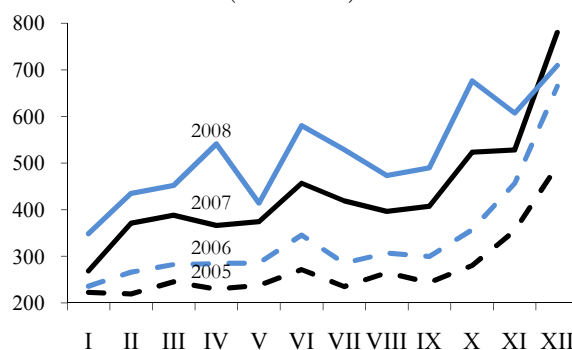
The highest share in the total expenditures regarding government functions in 2008 was made up by social security (21.5%), education (20.2%) and economic activity (18.1%). A rapid growth of expenditures was observed in almost all groups of expenditures, except public order and security, where LVL 357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

Despite a substantial decrease in the growth of budget revenues, the main budget priorities were consistently implemented in 2008, namely, improvement, arrangement and provision of functions of health care by improving the quality of medical services and its availability to society (increase in the expenditures by 9.6%), improvement of the education system (by 22.9%), modernisation of the social protection system (by 25.8%), strengthening the state defence (by 14.8%), as well as improvement of administrative and institutional capacity of law enforcement institutions. Implementation of the

programmes co-financed by the EU has been realized successfully as well.

Figure 4.10

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



* according to official data of monthly reports of the Treasury

Table 4.3

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

	2007		2008	
	structure	of GDP	structure	of GDP
Expenditures – total	100	35.8	100	38.4
General government services	14.3	5.1	13.6	5.2
Defence	3.7	1.3	3.5	1.3
Public order and safety	6.1	2.2	5.0	1.9
Economic activity	16.4	5.9	18.1	6.9
Environmental protection	2.5	0.9	2.4	0.9
Management of municipal areas and housing	3.8	1.3	3.6	1.4
Health	9.0	3.2	8.1	3.1
Recreation, culture and religion	4.3	1.5	4.0	1.5
Education	19.7	7.1	20.2	7.8
Social security	20.3	7.3	21.5	8.3

* according to the official data of the Treasury

The public demand is made up by the public consumption or public services (their value is determined by the volume of provided public services) and public investment that is the capital investment using budget resources. The public demand constitutes approximately 1/4 of the aggregate domestic demand.

During the years of the rapid growth, the volume of public services increased at a slower rate than the private consumption. In the three quarters of 2008, the volume of the public demand remained at a high level amounting to 24% of GDP. It should be noted that it constituted 21.3% of GDP in 2006, 22.8% of GDP in 2007. In the three quarters of 2008, its volume was by 5.2% higher than in the three quarters of 2007. During the recession period of the economic cycle, especially if it is related to the decline of the domestic demand, it is important not to reduce public consumption rapidly, thereby maintaining the domestic demand.

Table 4.4

Public Demand

	2005	2006	2007	3 rd quarter of 2008
% of GDP				
Public demand	20.8	21.3	22.8	24.0
Public consumption	17.4	16.6	17.4	19.2
Gross fixed capital formation	3.4	4.7	5.4	4.8
Growth over the previous year (%)				
Public demand	5.9	13.5	7.6	5.2
Public consumption	2.7	4.6	3.7	1.8
Gross fixed capital formation	21.2	49.1	18.7	15.6

In 2007, the public expenditures on the gross fixed capital formation amounted to LVL 790 million or 5.4% of GDP, which was one of the highest levels in the EU. Like in the previous years, the highest expenditures on the gross fixed capital formation in percentage of GDP were in the new EU member states (in Romania 5.7% of GDP, in Estonia 5.4% of

GDP, in Lithuania 5.2% of GDP). Governments spend 2.5% of GDP on average on the gross fixed capital formation in the EU-27. Economically developed countries have a lower share of government expenditures on investments in percentage of GDP, for example, 1.5% of GDP in Germany and 1.7% of GDP in Denmark.

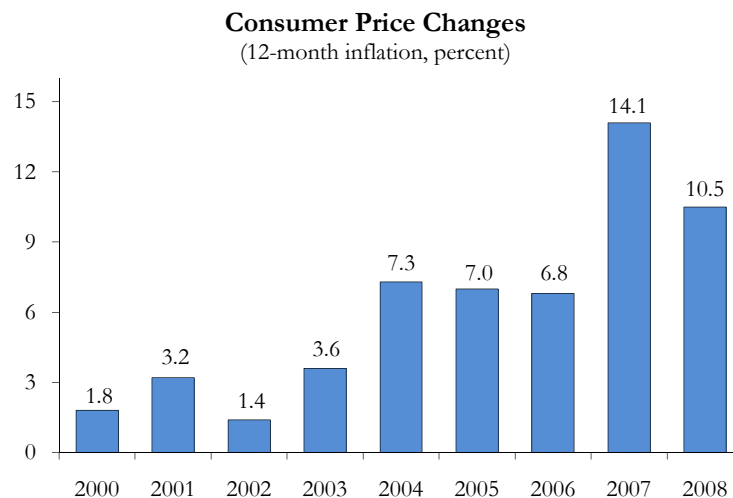
4.2. Prices

4.2.1. Consumer Prices

Increase in consumer prices in Latvia in the period of 1998-2003 was close to the inflation rate in the developed countries and one of the lowest among the Central and Eastern European countries.

However, since 2004 inflation rate has increased rapidly and it is one of the highest among the EU member states. The prices increased particularly rapidly in 2007, when the inflation rate doubled. The inflation rate has increased also in the beginning of 2008, but since June 2008 it started to decrease.

Figure 4.11



The rapid growth of prices in 2007 was determined by both, demand-side and supply-side factors. The high mortgage loan volumes, as well as substantial increase of wages facilitated demand-pull inflation. At the same time, considerably rapid growth of food prices, rise in the administratively regulated prices and rise of the world prices for oil, which substantially affected the rise of the domestic prices for fuel, should be noted as the most important factors fostering cost-push inflation.

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

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

Consumer Price Changes by Months
(December of the previous year = 100)

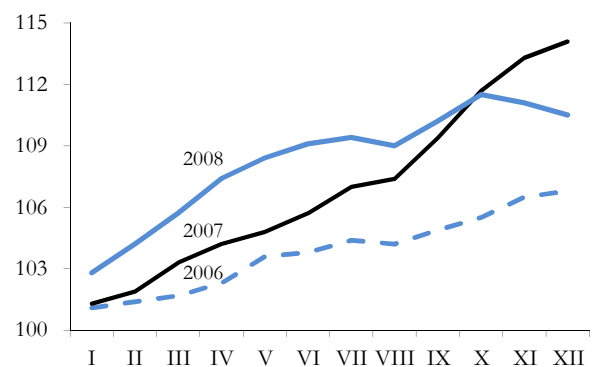


Figure 4.12

In 2008 the total price level increased by 10.5%, which is by 3.6 percentage points lower than the price increase of the previous year.

Figure 4.13

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

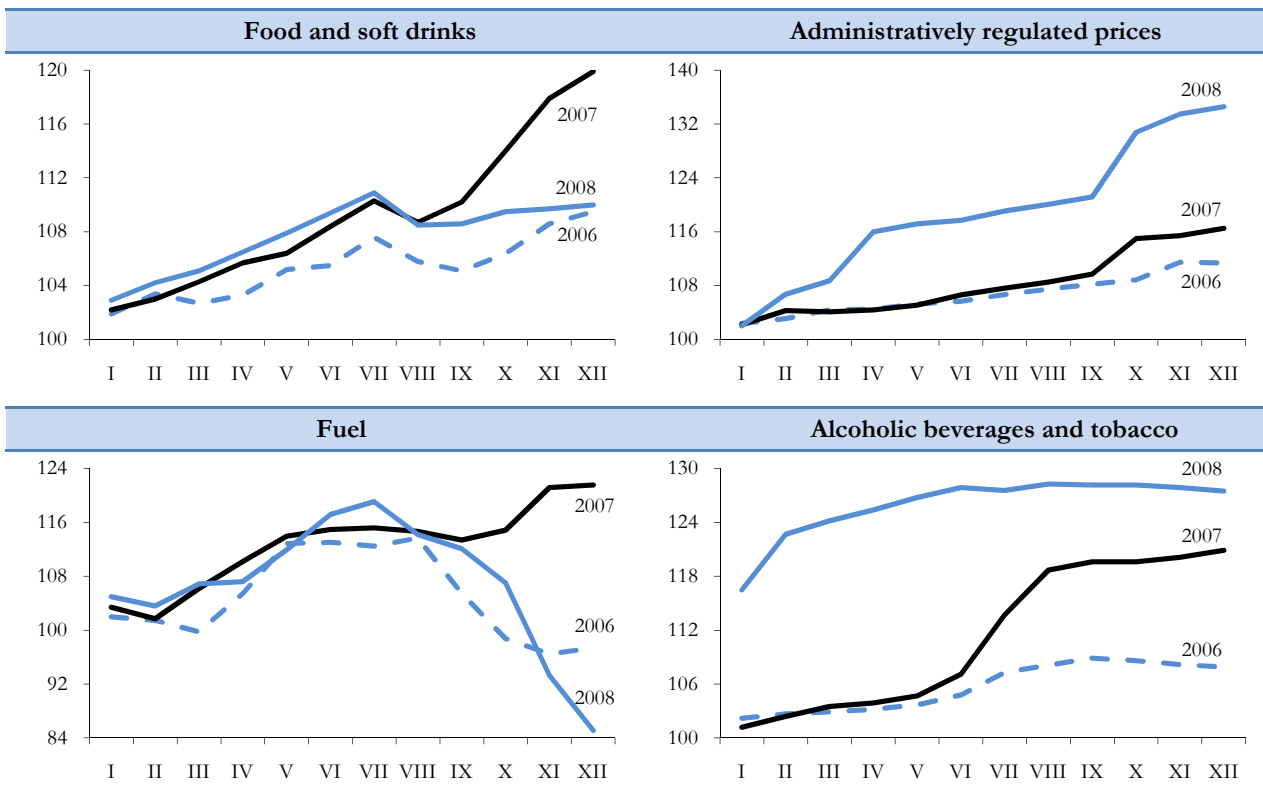
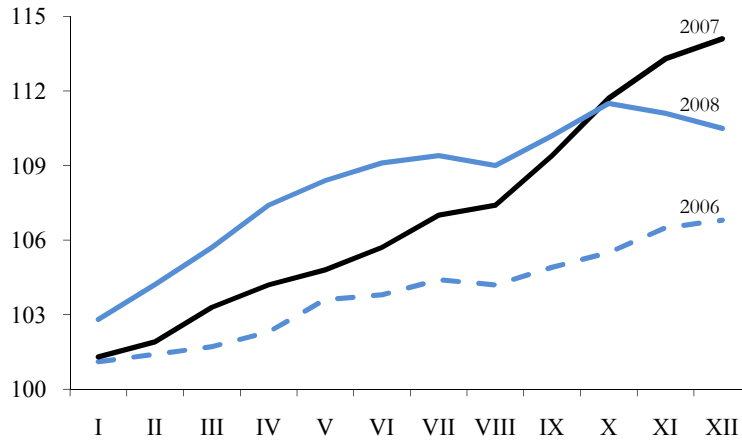
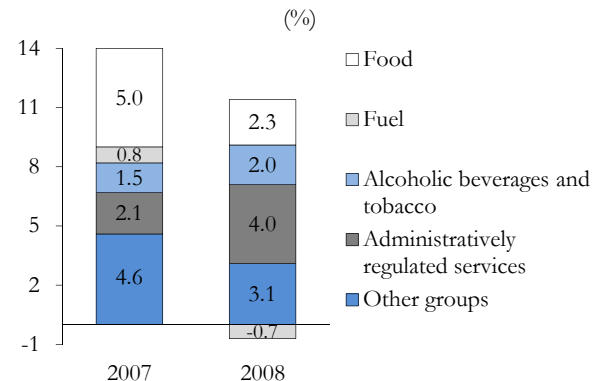


Figure 4.14

The Impact of Different Consumer Price Groups on 12-Month Inflation

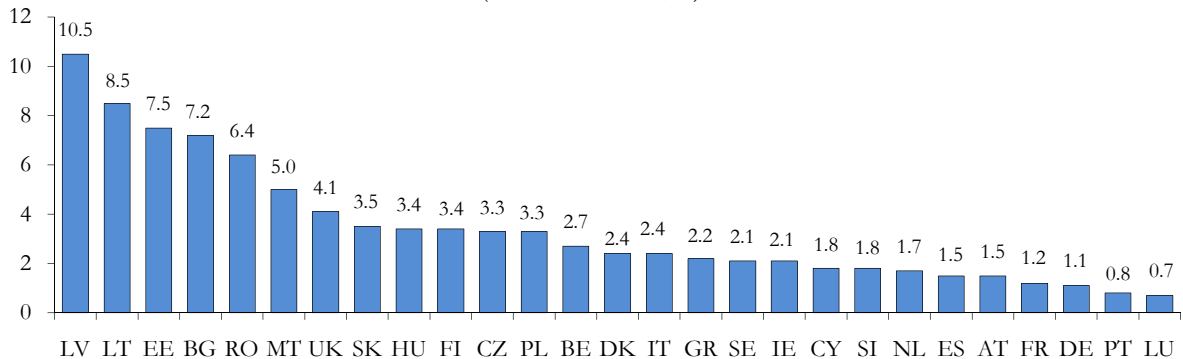


The rise of prices was mainly determined by the increase of the administratively regulated prices, which increased the total level of consumer prices by 4 percentage points. The increase of prices of food raised the total price level by 2.3 percentage points, but of alcoholic beverages and tobacco –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

As of March 2007, a substantial rise of prices can be observed within the entire European Union. However, similar to the previous periods, Latvia had the highest consumer price inflation in the EU in 2008, as well.

Figure 4.15

Changes of Harmonized Indices of Consumer Prices in the EU Member States in December 2008 as Compared to December 2007*
(12-month inflation, %)

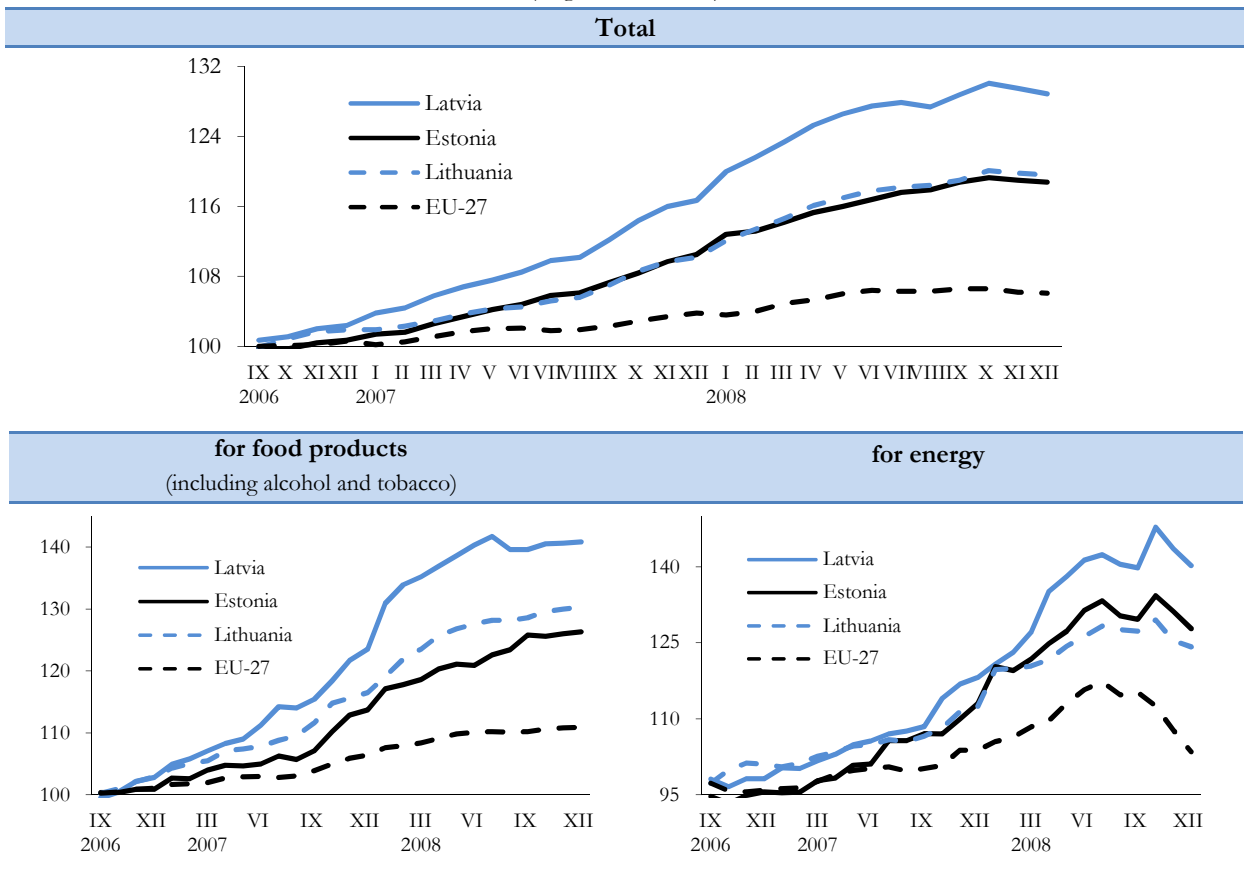


AT – Austria, BE – Belgium, BG – Bulgaria, CZ – Czech Republic, CY – Cyprus, DE – Germany, DK – Denmark, EE – Estonia, GR – Greece, ES – Spain, FI – Finland, FR – France, HU – Hungary, IE – Ireland, IT – Italy, LT – Lithuania, LU – Luxembourg, LV – Latvia, MT – Malta, NL – Netherlands, PL – Poland, PT – Portugal, RO – Romania, SE – Sweden, SI – Slovenia, SK – Slovakia, UK – United Kingdom
* IE and UK – November 2008 compared to November 2007
Source: Eurostat

In 2008 inflation in the closest neighbouring countries was also on a comparatively high level, but lower than in Latvia (10.5%) – Estonia – 7.5%, Lithuania – 8.5%.

Figure 4.16

Harmonised Consumer Price Index by Months
(August 2006 = 100)



The increase of prices in Latvia in 2008 was the most rapid almost in all groups of goods and services in comparison with other Baltic States. The most rapid increase of prices in Latvia was observed for goods,

services and especially energy. Its price in Latvia increased by nearly 18.7%, in Estonia – by 13.1%, but in Lithuania by 10.5%. A rapid increase of prices in Latvia was observed also for food, where the prices

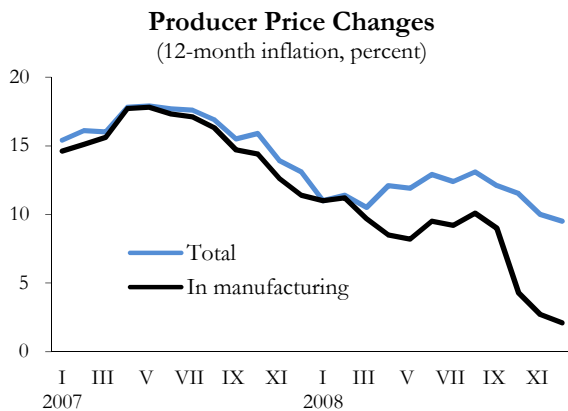
increased by 14% (in Lithuania – by 11.9% and in Estonia – by 11.1%).

4.2.2. Producer Prices

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

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

Figure 4.17



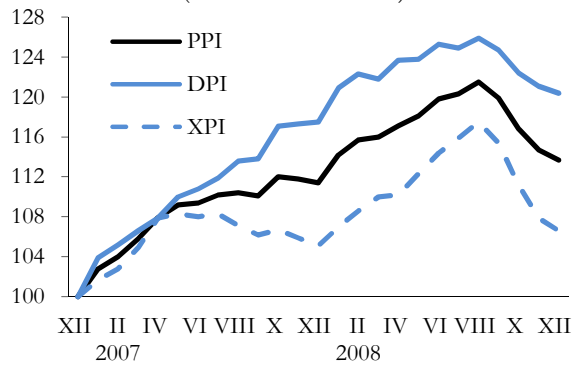
The total increase of producer prices in 2008 (by 9.5%) was by 3.6 percentage points slower than in the

previous year (by 13.1%). The increase of producer prices in manufacturing was observed until August 2008, when it was followed by a substantial decrease in producer prices.

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

Figure 4.18

Producer Price Dynamics in Manufacturing (December 2006 = 100)

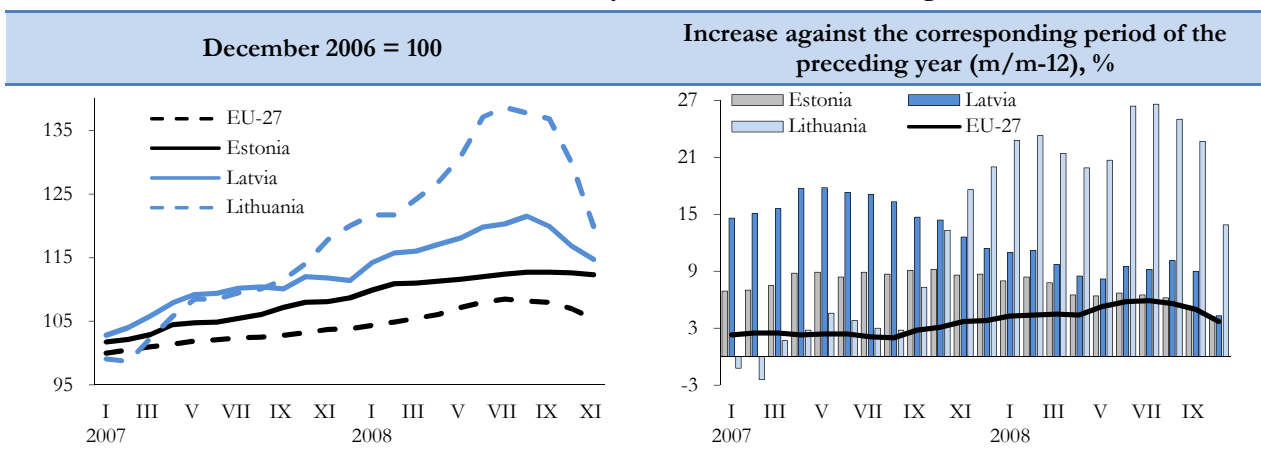


PPI – Producer Price Index
DPI – producer price index for products sold in the domestic market
XPI – producer price index for exported products

Dynamics of producer price index in manufacturing in Latvia differs a little from the total EU dynamics. EU manufacturing prices began to grow faster in autumn 2007, when their growth rates in Latvia began to fall. High producer price indices in the EU remained also in 2008.

Figure 4.19

Producer Price Index by Months in Manufacturing



However, the different dynamics of the price changes does not improve competitiveness of Latvian

producers, because the increase of producer prices in Latvia is still more rapid than in the EU on average.

4.3. Balance of Payments

4.3.1. Current Account

Latvia typically has a relatively high current account deficit of the balance of payments. The main cause of the high deficit is the markedly negative trade balance. About one seventh of this balance is covered by the positive balance of services. Mostly negative current account balance is covered by foreign direct investment and other long-term capital flows. The reserve assets of the Bank of Latvia are increasing.

Along with the rapid growth of the domestic demand, since 2006, a substantial increase of the current account deficit of the balance of payments started, as well. It increased from 12.5% of GDP in 2005 to 25% of GDP in 2007.

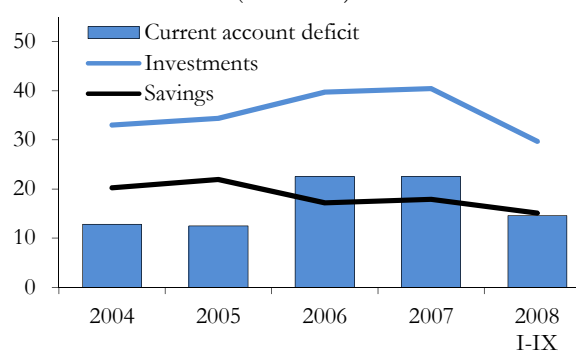
In the second half of 2007, a new tendency appeared due to the slowdown of the domestic demand: exports of goods increased more rapidly than imports, as a result of which the current account deficit of the balance of payments decreased to 18.3% of GDP in the 4th quarter of 2007. In 2008, the current account deficit continued to decrease almost by three percentage points each quarter. In the 3rd quarter of 2008, the current account deficit was 11.8%. Decrease in the current account deficit was largely determined by improvement of the trade balance due to the decline of imports, while at the same time the exports dynamics remained positive.

The rapid inflow of foreign capital positively affected investment on the one hand, but on the other hand became a substantial factor for decreasing the level

of savings, i.e., the investment level in the national economy substantially increased from 27.5% of GDP in 2004 to 40.4% of GDP in 2007, while savings decreased from 20.4% to 17.9% respectively.

Figure 4.20

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



In 2007, the dynamics of investments slowed down, but in 2008 the level of investments was almost by 10 percentage points lower than in 2007. The level of national savings remained relatively stable confirming a substantial adjustment of domestic consumption in the conditions of decreasing income. Such consumers' behaviour may be explained by the low level of savings. In general, the decrease of the current account deficit was determined by a substantial decline of investments in 2008.

Table 4.5

Balance of Payments of Latvia
(% of GDP)

	2005	2006	2007	2007 I-IX	2008 I-IX
A. Current account	-12.5	-22.5	-22.5	-24.2	-14.6
Trade balance	-18.9	-25.6	-23.9	-25.3	-18.0
<i>exports</i>	33.5	30.7	28.5	29.3	30.0
<i>imports</i>	-52.4	-56.3	-52.4	-54.6	-48.0
Balance of services	3.8	3.3	3.4	3.5	4.0
Net income	-1.1	-2.7	-3.3	-3.6	-3.3
Current transfers, net	3.7	2.4	1.3	1.1	2.7
B. Capital account	1.3	1.2	1.9	1.0	1.6
C. Financial account*	16.3	30.5	24.7	28.8	17.1
Direct investment	3.6	7.5	6.7	8.5	5.2
<i>abroad</i>	-0.8	-0.9	-1.1	-0.7	-1.1
<i>in Latvia</i>	4.4	8.3	7.8	9.2	6.3
Portfolio investment**	-1.3	0.2	-1.6	-2.9	1.9
<i>assets</i>	-1.3	-1.3	-1.0	-2.6	0.7
<i>liabilities</i>	0.0	1.5	-0.5	-0.4	1.2
Other investments	14.0	22.6	19.5	23.3	9.9
<i>assets</i>	-2.7	-9.7	-21.0	-19.6	-0.1
<i>liabilities</i>	16.7	32.2	40.5	42.9	10.0
D. Net errors and omissions	-1.9	0.6	-0.7	-2.0	-2.2
E. Reserves	-3.2	-9.9	-3.4	-3.7	-1.9

* without reserve assets

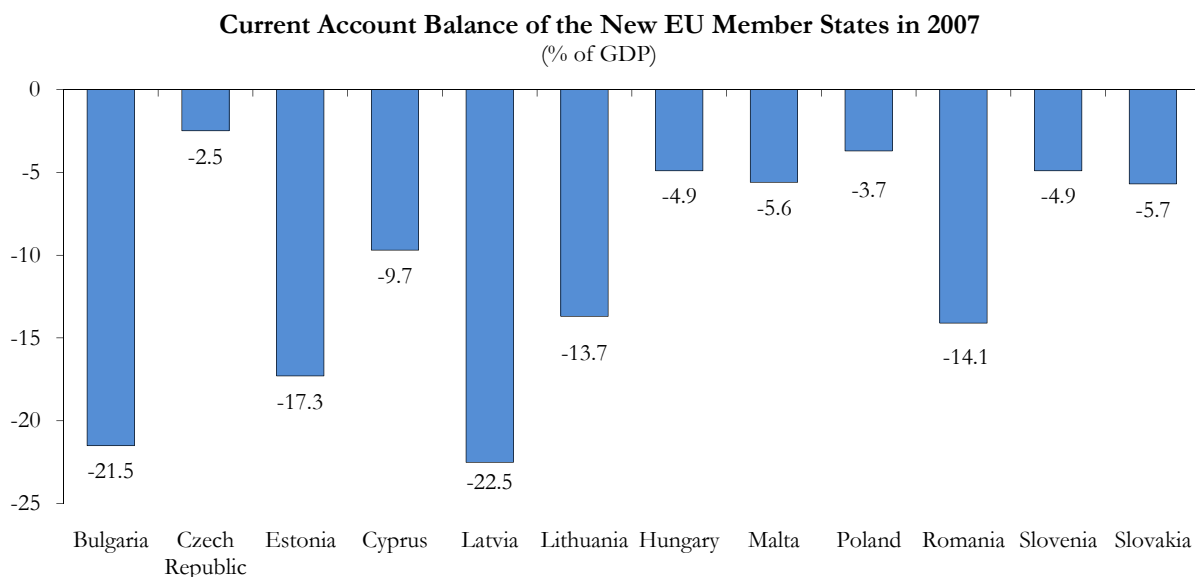
** portfolio investment and derived financial instruments

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

too low in order to implement restructuring and modernisation of the national economy.

In 2007, the level of the current account deficit of Latvia was still the highest among the new EU member states (see Figure 4.21).

Figure 4.21



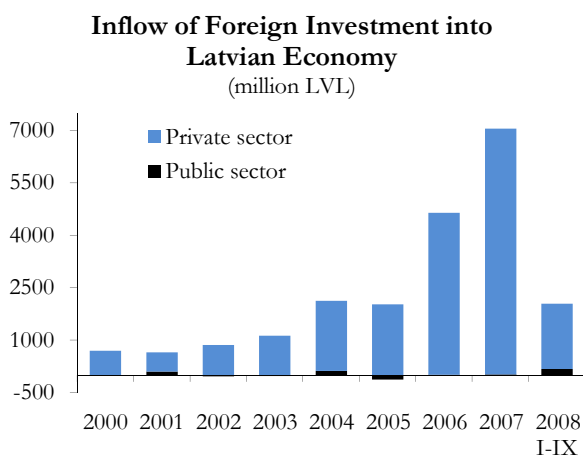
Source: estimation of the *Eurostat*

4.3.2. Financial Flows

In order to balance the external sector in case of a high current account deficit, it is important to look at the nature of coverage of the current account deficit and character of financial flows.

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

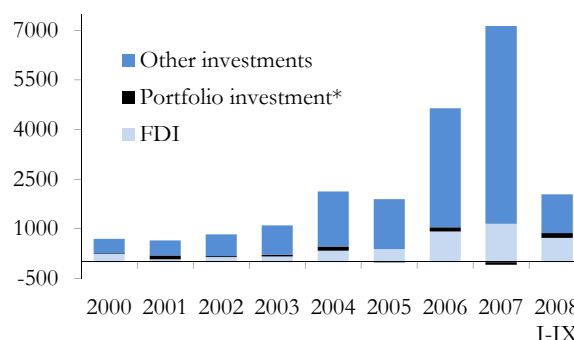
Figure 4.22



Foreign investment is mainly attracted by the private sector. As from 2004, foreign investments increased rapidly and their volume increased by 1.5 times in 2007 compared to the previous year, but in 2007 compared to 2004 – increased by almost 3.5 times. In 2008, a much slower inflow intensity of investments has been observed, which is mainly determined by the unfavourable conditions in the global financial markets.

Figure 4.23

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



* portfolio investment and derived financial instruments

Within three years (2005–2007) the volume of investment has tripled and it covered 35–37% of the negative balance of the current account. The foreign direct investment (FDI) flows increased in 2006 and 2007. In 9 months of 2008 FDI decreased by 23.3% in comparison with the respective period of the previous

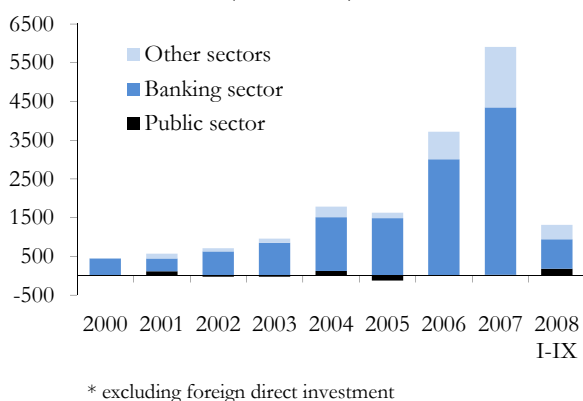
year and covered 43.4% of the negative balance of the current account.

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

“Other investments¹” comprise the majority of total foreign investments. These are trade loans, other credits and borrowings, cash and deposits, etc. In 2006 and 2007, the volume of the foreign financial resources attracted by the private sector (including commercial banks) substantially increased in the form of loans. Within three years it grew by 4.4 times. In 9 months of 2008, a negative flow of “other investments” has been observed for the first time within the last four years. It was mainly determined by the decrease of non-resident deposits in monetary financial institutions and decline in the level of borrowings of the private sector. In the 2nd and 3rd quarter of 2008, the flows of other investments were positive, however, within 9 months of 2008 they were almost four times smaller than within 9 months of the previous year, which was mainly determined by the decrease in the short-term flows.

Figure 4.24

Net Foreign Investment Flows by Sectors* (million LVL)



The capital attracted in 2007 exceeded the volume of GDP by 54%, but the debt of Latvia to the rest of the world amounted to 127%, including the government debt of 5%. The amount of the debt of the rest of the world to Latvia reaches 78% of GDP.

4.3.3. Foreign Direct Investment

Since the restoration of independence, the foreign direct investments (FDI) have had an important role in the growth of Latvian economy. According to the data of 2006, the range of the goods and services produced by companies by using foreign capital amounted to

54.5% of GDP, constituted 55.4% of the volume of Latvian exports and employed 12.5% of the total number of employed persons. Thus, successful attraction of foreign direct investment has direct positive influence on macroeconomic stability and competitiveness of Latvia.

With Latvia's accession to the EU, the intensity of FDI has increased considerably. In the period of 2004–2007, investments of the foreign entrepreneurs into Latvian economy in the form of direct investments were almost three times higher than in the period of 2000–2003. Such tendencies are typical for all Baltic States indicating to the importance of the geopolitical situation regarding attraction of the FDI.

Figure 4.25

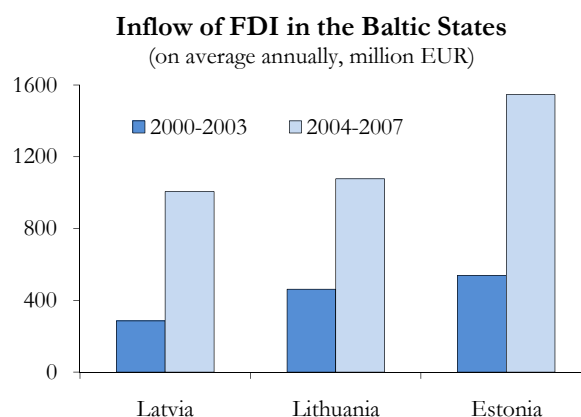
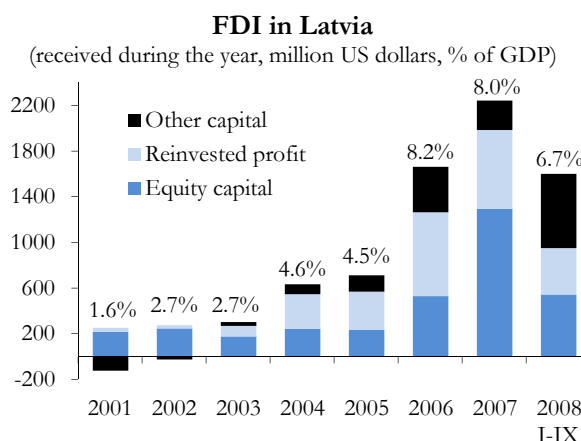


Figure 4.26



Latvian investors have also become more active abroad. Since 2004, Latvian entrepreneurs have invested EUR 124 million on average annually in the form of direct investments, i.e., almost six times more than before the accession to the EU. At the end of September 2008, the FDI stock accumulated by Latvia in foreign countries reached LVL 550.4 million, and in comparison with the respective period of the previous year, it has increased by 66%. Almost half of Latvian investments have been made in Switzerland (mainly in the trade sector) and Lithuania (in trade and financial intermediation). Latvian entrepreneurs have become recently more active also in Russia. Latvian investments into Russian economy at the end of

¹ Financial transactions, which are not included in the direct and portfolio investments.

September 2008 amounted to 8.4% of the total FDI stock accumulated by Latvia abroad.

The volume of incoming FDI reached LVL 1158.1 million (USD 2172.5 million) in 2007, but in three quarters of 2008, the FDI flows (mainly in the form of equity capital and reinvested profit) were by 23.6% lower than the flows of the respective period of the previous year.

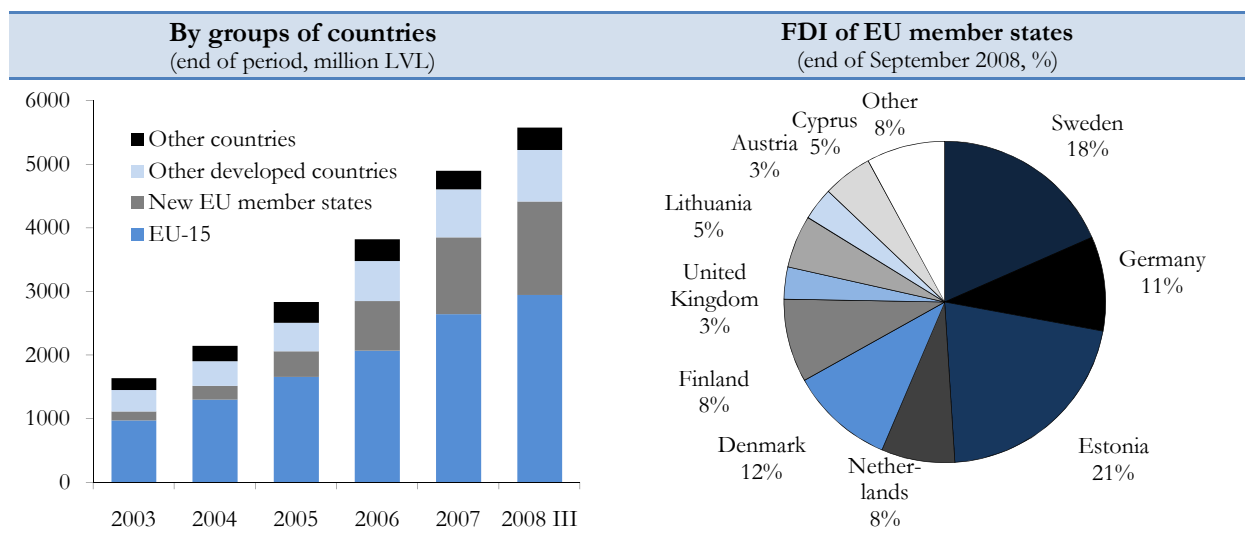
According to the international investment balance of Latvia, the FDI stock in Latvian economy at the end of September 2008 reached LVL 5862.4 million or almost 38.8% of GDP. The share of FDI in the structure of the accumulated foreign capital has slightly

increased and amounted to 23.5% at the end of September 2008, which was determined by a more rapid inflow of foreign capital in the form of direct investment instead of other investments (mainly bank loans).

Geopolitical structure of the FDI stock in Latvia has not changed substantially since 2004: it is mainly investment of the EU member states. At the end of September 2008, investments of the EU member states amounted to 79.2% of the total FDI stock, and one-third of it are related to investments of the new EU member states.

Figure 4.27

FDI Stock



The biggest investor countries are Sweden, Estonia, Germany and Denmark. At the end of September 2008, the FDI stock of these four countries comprised almost 59.4% of the total FDI stock in Latvia. Typically dominant sectors exist in all abovementioned countries. Swedish FDI are concentrated in the sectors of financial services (68%), 63% of Estonian FDI are also concentrated in the financial services sector. German entrepreneurs have

mainly invested in the energy sector and real estate (57% of German FDI stock in Latvia).

Since Latvia's accession to the EU, the FDI stock more than doubled in both, goods and services. As concerns production of goods, a particularly rapid increase of the FDI has been observed in the energy sector (by almost 5 times), and more than 5 times in the construction sector. The dynamics of FDI was not so rapid in the manufacturing sector (increased by 1.5 times).

Table 4.6

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

	2004	2005	2006	2007	3 rd quarter of 2008
Primary sectors	49.8	59.5	71.6	112.9	146.1
Manufacturing	276.1	376	395.3	465.2	501.9
Energy	164.7	327.6	348.1	270.7	278.5
Construction	36.5	49.7	67.6	86.0	112.5
Trade	395.7	437.8	562.3	681.9	900.3
Transport and communications	333.3	336.4	347.0	398.0	454.5
Financial mediation	375.9	625.4	964.6	1434.7	1610.6
Other services	439.2	529	795.3	1214.5	1352.6

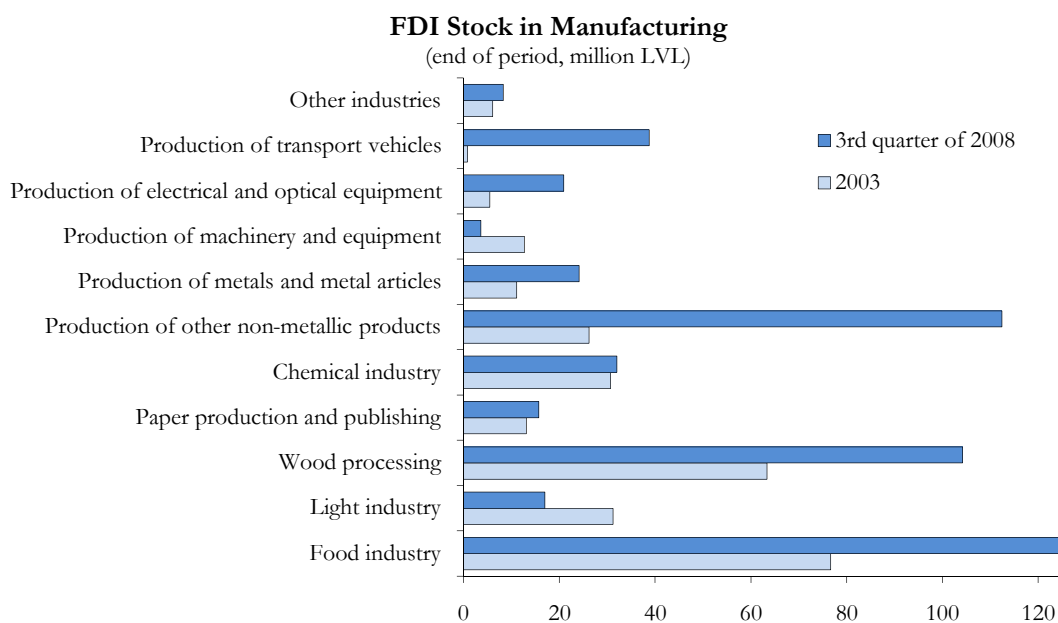
By the end of 2004, the commercial services sector had the biggest share in the sectoral structure of the FDI stock, but already from 2005, financial services took the leading positions in attraction of FDI. The share of financial services sector in the structure of FDI stock in 2008 remained at the level of the previous year and reached 30% at the end of September 2008.

The overall level of FDI stock has increased in all sectors in 2008, indicating that investors have not substantially adjusted their plans regardless of the decrease in economic activities. However, the growth rates of FDI have slowed down, especially in the services sector. The FDI stock in the services sectors in 9 months of 2007 increased by 35.3% (including by 38% in financial intermediation) and by 56.6% in the sector “operations with real estate”, but in the respective period of 2008 it grew almost two times slower – by 16%. It was largely determined by a much lower investment in the mentioned sectors. The decrease in the growth rates of the FDI stock in the production of goods was small. It should be noted that the biggest volumes of foreign investments are still attracted by two sectors: financial intermediation and operations with real estate. In 2007, the FDI in these

sectors constituted almost 70% of the FDI received within a year. High investments were in the trade sector, where the FDI stock grew by 17.7% in 2007 and by 38.2% in 9 months of 2008. The FDI growth rates remained high in the construction sector (38% in 2007 and 30.8% in 9 months of 2008).

The FDI growth rates in manufacturing are relatively moderate. In general, there is no pronounced difference between the FDI dynamics before and after Latvia’s accession to the EU. At the same time, 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 by almost a half in light industry and chemical industry, but by more than five times in production of machinery and equipment. However, the FDI has substantially grown in such sectors as production of electrical and optical equipment (by 4 times), production of other non-metallic products (by 4 times). In 2008, high investments were made in production of transport vehicles. In comparison with the end of 2007, the FDI stock increased by 2.4 times in this sector.

Figure 4.28



The most attractive manufacturing sectors for foreign investors are food industry, wood processing and production of other non-metallic mineral products. FDI stock in these sectors made up 70% of the total FDI stock in manufacturing at the end of September 2008. It should be noted that these are low and medium-low technology sectors indicating that the relatively low labour costs and access to natural resources are still important regarding attraction of the foreign capital in Latvia. The investors from Denmark, Finland, Germany, Sweden and the Netherlands have made higher investments in manufacturing within the last four years.

A lot is being done in Latvia in order to improve the investment environment. A big role in this process is played by the Investment and Development Agency of Latvia, which was founded as the non-profit organisation state JSC “Development Agency of Latvia” in 1993 and reorganised as the state agency “Investment and Development Agency of Latvia” (IDAL) in 2003. One of the most important priorities for operations of the IDAL in the sphere of investment attraction is attraction of such projects that are based on knowledge and technologies. The investment attraction strategy of the IDAL is focused on qualitative maintenance of

the projects of incoming investments and proactive operation related to attraction of investment projects when addressing the potential investors in accordance with the priorities set in the Economic Development Strategy of Latvia.

The FDI dynamics show that foreign investors still consider Latvia's business environment as a comparatively favourable location for starting business activity, which is attractive for foreign investments, despite the global economic crisis.

The production unit of household objects opened by the Dutch company Brabantia (EUR 8 million) in Ģibuļi parish near Talsi and employing more than 70 persons may be mentioned as one of the successfully implemented FDI projects in 2008. Another good example is already the second production unit of vehicle spare parts of the Swedish

company Leax in Latvia, which serves Volvo and Scania. Leax Baltix invested EUR 5 million in Rēzekne and provided 120 job places. This project is particularly important for the region, taking into account the recent closure of the Rebir.

In general, 2008 may be characterised as the period of cooling down. On the background of the global financial and economic crisis, enterprises increasingly focus on appropriate use of already existing capacities, as a result the deadlines for investment projects are extended or postponed. It is necessary to concentrate more not only on the maintenance of the incoming potential projects, but also on qualitative maintenance of the already implemented projects. Therefore, a confidence is strengthened that the foreign investors having already entered do not consider the possibilities to cancel their activities in Latvia.

4.4. Financial and Capital Markets

4.4.1. Monetary Policy and the Exchange Rate¹

The Law "On the Bank of Latvia"² 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 decisions or instructions of the government or governmental institutions. The Bank of Latvia performs its functions under the supervision of the Saeima.

Since the mid-February 1994, the Bank of Latvia had unofficially pegged the exchange rate of the lats (LVL) to the SDR³ basket of currencies (1 SDR = LVL 0.7997) thus *de facto* implementing the fixed exchange rate policy. As from January 1, 2005, the peg of the lat to the SDR basket is replaced with the peg to the euro (1 EUR = LVL 0.702804). The change of the lat's peg was determined by Latvia's plans to join the European Exchange Rate Mechanism II (ERM II) and, after fulfilment of the required criteria, to join the Economic and Monetary Union (EMU)⁴. The *Economic Stabilisation and Growth Revival Programme of Latvia* (approved by the Saeima on December 12, 2008) contains a decision that the Cabinet of Ministers and the responsible public administration institutions will take all the necessary measures in order to fulfil the Maastricht Convergence criteria, which would ensure introduction of the euro as soon as possible (in 2012).

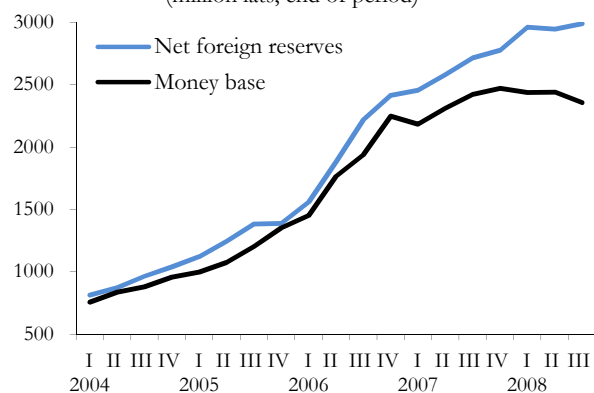
As from May 2, 2005, Latvia joined the ERM II with the already existing exchange rate of the lat against the euro, namely, 1 EUR = LVL 0.702804. The

ERM II allows standard fluctuations of the exchange rate within +/-15% around the central or peg rate. However, Latvia commits to unilaterally keep the exchange rate fluctuations margin within +/-1%, retaining the former width of the corridor of lat's fluctuations, which was habitual to the financial market since 1994, when the lats was fixed to the SDR, and was kept when the lats was re-pegged to the euro on January 1, 2005.

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

Figure 4.29

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



In order to keep a fixed exchange rate, it is necessary to have a sufficient amount of foreign

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

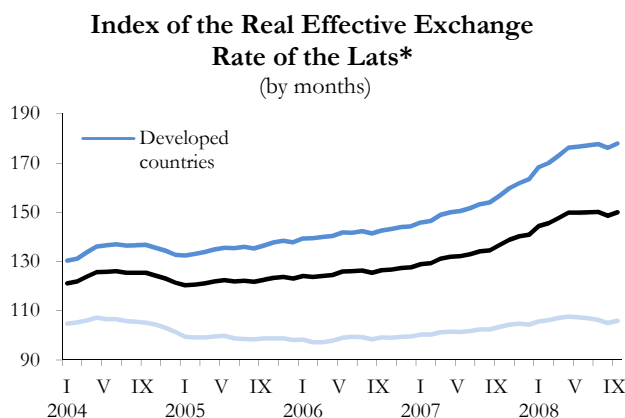
reserves. Up to now, no problems have been experienced with this regard in Latvia. Net foreign reserves of the Bank of Latvia constantly cover the money base of Latvia, and their amount equals to the amount of goods and non-factorial services imported by the country within several months (see Figure 4.29).

The coverage of money base (currency in circulation and deposits in the Bank of Latvia) with net foreign assets was 121% at the end of October 2008. Net foreign assets of the Bank of Latvia have increased by 6% in comparison with the end of October 2007.

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 5592 million at the end of October 2008 (USD 5758 million at the end of 2007, USD 1535 million at the end of 2003).

The Bank of Latvia calculates the real effective exchange rate of the lats¹ against the currencies of 13 countries, which are the main trading partners of Latvia². It shows the relative export competitiveness of Latvia in global markets (see Figure 4.30).

Figure 4.30



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

Since 2005, the real exchange rate of the lats has been experiencing a trend of increase with regard to currencies of the developed countries due to the relatively high inflation, however, since the mid-2006 – also with regard to currencies of the developing countries. In the mid-2008, the real exchange rate of the lats has stabilized.

The increase of the real effective exchange rate of the lats is not favourable for Latvian exporters.

4.4.2. Market Structure and Development

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

At the end of 2008, 21 banks and five branches of foreign banks operated in Latvia. Moreover, credit institutions or their branches, which are registered in the European Economic Area (EEA) countries and which have submitted applications to the *Financial and Capital Market Commission* (hereinafter FCMC)³ may provide banking services in Latvia.

The total amount of bank assets reached LVL 23.4 billion at the end of November 2008 (LVL 21.9 billion at the end of 2007, LVL 15.9 billion at the end of 2006). 78% of the total paid up capital of banks is owned by foreign shareholders.

The Latvian banking system has stabilized, as a result of the most bank mergers and takeovers taking place in the period of 1998–2001. Almost all banks are privately owned. Only the *Mortgage Bank of Latvia* is fully owned by the state.

The global financial market turmoil has also affected the Latvian banking system. In autumn 2008, a significant outflow of deposits has been observed in JSC “Parex banka”, therefore the government of Latvia had to partially nationalize this bank⁴ and provide liquidity support to it. Other local banks and companies have experienced difficulties to restructure their international obligations.

The *Economic Stabilisation and Growth Revival Programme of Latvia* envisages implementation of several measures in order to stabilise the financial sector. The Programme specifies that:

- the state retains guarantees for all deposits in Latvian banks to EUR 50 000;
- the state will provide guarantees to the syndicated bank loans to be repaid in 2009 by adopting a separate decision in each case;
- the Cabinet of Ministers will determine the possible framework, as well as the required internal procedures for fast provision of public financial resources for the financial institutions having financial difficulties under the influence of the global financial crisis;
- although the legal acts in force in Latvia related to financial services and surveillance practice comply with the *acquis communautaire* and the international standards, the recent events showed the necessity for both, to improve application of the regulating requirements in practice, and review the

¹ Real exchange rate of the lats includes changes of the nominal exchange rate of the lats against the currency of a trade partner of Latvia as well as consumer price changes in Latvia compared with consumer price changes in the trade partner country. The real exchange rate is calculated by dividing the nominal exchange rate index with the ratio of foreign and domestic price indices.

² USA, Denmark, France, Italy, the United Kingdom, the Netherlands, Finland, Germany and Sweden are included in the group of developed countries, while Estonia, Russia, Lithuania and Poland are included in the group of developing countries.

³ 227 notifications from the EEA countries about willingness of banks of these countries to start providing financial services in Latvia without opening a branch were received by December 31, 2008.

⁴ JSC “Parex banka” has become a subsidiary company of the state JSC “Mortgage Bank of Latvia”.

existing legislation intensifying supervision of institutions operating within the financial market, which will be also performed by preparing a special financial sector supervision intensifying programme.

Taking into account the situation in the international financial markets, affecting access to the resources and their prices, the banking sector liquidity indicator tends to decrease by still exceeding the standard, which is 30% (it amounted to 48.7% at the end of November 2008; 55.7% at the end of 2007). Along with the increasing expenditures for establishing reserves, as well as the resources becoming more expensive and decreasing growth rates of crediting, the bank profitability also decreases. In 11 months of 2008 the bank profits amounted to LVL 208 million, which is by 36% lower than in the respective period of 2007.

The average capital adequacy ratio of the banking sector has not decreased since the end of September 2008, and at the end of November 2008 it still constituted 12.3%, which considerably exceeded the minimum prescribed by the law (8%). Return on assets (ROA)¹ was 1.2% at the end of September 2008, while return on equity (ROE)² amounted to 14.7% (2% and 24.2% at the end of 2007 respectively).

15 **insurance companies**, four of which provided life insurance and 11 provided non-life insurance, as well as 9 branches of foreign insurance companies operated in Latvia at the end of 2008. In Latvian financial and capital market, the share of insurance companies in the total assets is slightly below 2%.

The total amount of gross premiums signed in the insurance market reached LVL 259.7 million in the three quarters of 2008, which was by 13.6% more than in the three quarters of 2007, while the volume of paid gross rewards was LVL 137.9 million or by 46.9% more than in the three quarters of 2007.

Accession to the EU has fostered competition in this sector. Since May 1, 2004 non-bank financial institutions of EU member states no longer need to receive a licence or open a branch in Latvia in order to offer their services. Foreign companies now are allowed to insure assets of their subsidiaries in Latvia not only with local insurers, which has reduced the growth of real estate insurance volumes in the Latvian market. 359 notifications by insurance supervision bodies of the European Economic Area countries on the intention of insurers licensed in these countries to use the principle of service provision freedom in Latvia were received as of December 31, 2008.

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

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

The situation in the global financial markets substantially affects the Latvian securities market. At the end of 2008, market capitalisation of Latvian companies at the RSE was LVL 820 million (LVL 1475 million at the end of 2008). At the end of 2008, the RSE index *OMX Riga* (January 1, 2000 = 100) had decreased to 271 points (it was already 595 points at the end of 2007).

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

4.4.3. Deposits and Loans

In the second half of 2007, decrease in the growth rate of monetary indicators started, which continued also within the three quarters of 2008. It was mainly determined by the situation in the global financial markets, as well as in the economy of Latvia.

¹ ROA – ratio of profit/losses to assets.

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

Table 4.7

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

	2005	2006	2007	2008*
<i>(million LVL)</i>				
Net foreign assets	-1326.6	-2634.7	-4482.8	-5692.1
Net domestic assets	5311.2	8114.6	10654.1	11840.8
Domestic loans	6441.3	9877.4	13018.2	14274.0
to government (net)	266.3	100.5	-87.4	-383.1
to companies and individuals	6175.0	9776.9	13105.6	14657.1
Other assets (net)	-1130.1	-1762.8	-2364.2	-2433.2
Broad money M2X	3984.7	5479.9	6171.3	6148.8
Currency in circulation (less vault cash balance)	786.4	969.3	900.0	876.9
Deposits of individuals and companies	3198.3	4510.6	5271.3	5271.9
of which:				
demand deposits	2020.2	2974.5	2864.9	2531.5
time deposits	1178.1	1536.1	2406.4	2740.4
<i>(changes against the respective period of the previous year, %)</i>				
Domestic loans	63.1	53.3	31.8	17.1
of which:				
to companies and individuals	63.6	58.3	34.0	17.6
Broad money M2X	38.9	37.5	12.6	5.3
Currency in circulation (less vault cash balance)	21.8	23.3	-7.1	-4.1
Deposits of individuals and companies	43.9	41.0	16.9	7.0
GDP (in current prices)	21.8	23.3	32.3	14.0

* in 3 quarters of 2008

The **share of deposits** of companies and individuals withdrawn by residents increased by 16.9% at the end of 2007 in comparison to the end of 2006, while the share of deposits has grown by only 7% in September 2008 in comparison with the respective month of the previous year.

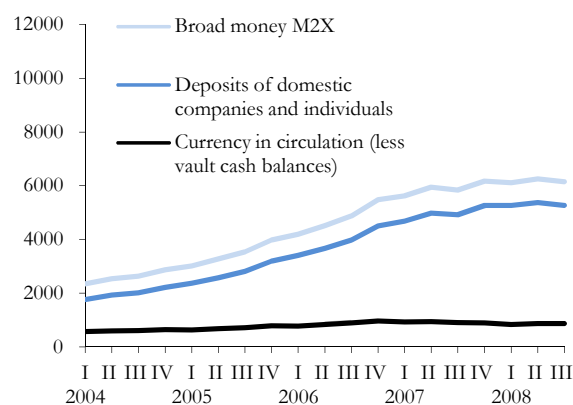
The dominant role in deposits is played by term deposits, the share of which in the total structure of deposits was 52% at the end of September 2008. It should be noted that the demand deposits had a bigger share within the preceding years. At the end of 2007, they amounted to 54% of all resident non-financial companies and deposits of households, but at the end of 2006 – even 66% of all the deposits.

The biggest share of all resident deposits was formed by the deposits of households (55%), as well as the deposits of private non-financial companies at the end of September (25%).

The share of deposits of non-residents in the total volume of deposits is relatively high in Latvia, it amounted to 44% of the total volume of deposits (at the end of September 2008), and its volume had increased by 11.4% within a year. However, taking into consideration the latest events in the Latvian banking system, the growth rates of non-resident deposits considerably shrank in the following months, and the growth rate in November was already only 5.3% as compared to November of the previous year.

Figure 4.31

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



A little more than half of the total volume of the deposits drawn by residents consists of deposits in lats, whereas the deposits in Euro constitute approximately one third of all the deposits. The biggest share of non-resident deposits was traditionally made by deposits of the private non-financial companies, of which more than half were deposits in US dollars.

In the period of 2004–2006, the volume of **loans** granted to companies and individuals increased by

50–60% annually, and it was promoted by the inflow of foreign capital, increase of economic activity, as well as easy access to financial resources. From the second half of 2007, decrease in the crediting growth rates was observed, which was related to more cautious crediting policy of the biggest Latvian commercial banks affected by deterioration of the situation in the global financial markets, as well as slowdown of economic growth.

The growth rates of loans granted in 2008 against the respective month of the previous year decreased gradually: in January the growth amounted to 31.8%, whereas in November it was only 14.3% in comparison with November of the previous year. Furthermore, the balance of loans in November decreased by LVL 25.9 compared to October.

Figure 4.32

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

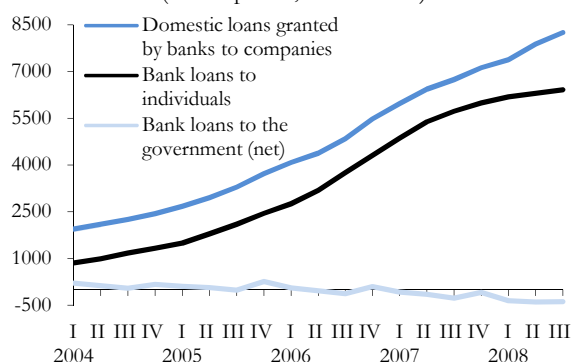
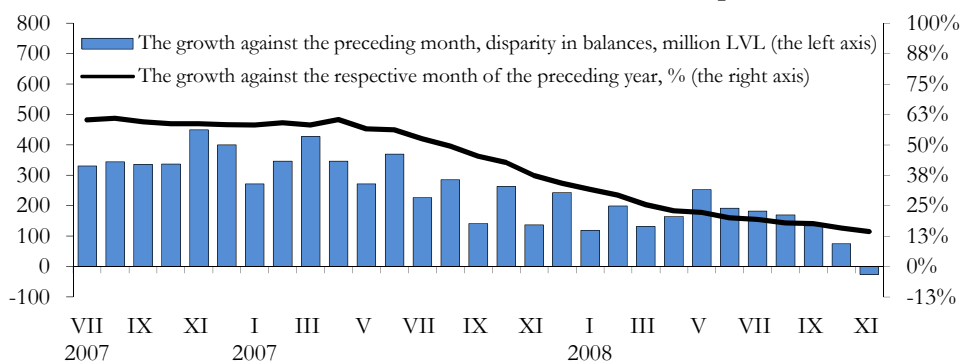


Figure 4.33

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



Due to the growing domestic demand, the Bank of Latvia also increased the refinancing rate and reserve ratio by several times in order to hinder the growth rate of loans since March 2004. However, the influence of these measures in Latvia is restricted by the fixed exchange rate regime, as well as several specific factors, such as the comparatively easy access of banks to foreign resources and comparatively high share of loans granted in foreign currencies in the total loan structure.

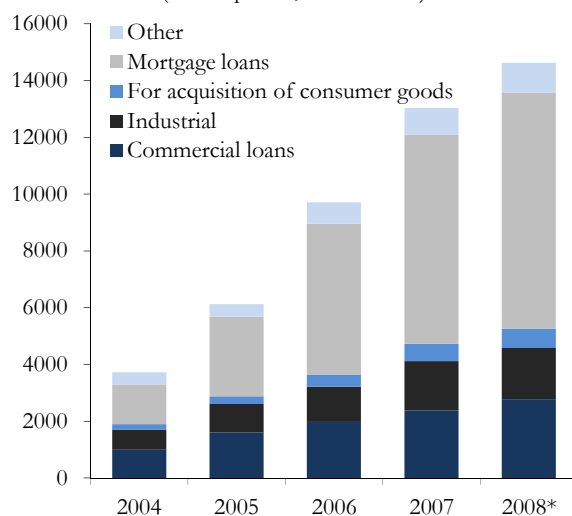
By the changing economic situation, on January 17 and April 24, the Bank of Latvia decided to decrease the reserve ratio for bank liabilities over 2 years, respectively, from 8% to 7% and from 7% to 6%. The government has also “mitigated” some of the measures set in March 2007, as well as approved the amendments to the *Credit Institution Law* and amendments to the *Consumer Rights Protection Law*, envisaging cancellation of the mandatory initial payment in the amount of 10% for receiving a loan.

Mortgage loans still have the highest share in the structure of loans granted to domestic companies and individuals. Their share in the bank loan portfolio has increased from 22% at the end of 2002 to 56.4% at the end of 2007. In November 2008, the share of mortgage loans has remained almost constant (56.7%). The share of commercial loans (in order to increase business assets of companies) of the total sum of bank

loan portfolio in November was 19% (18% at the end of 2007), but the share of industrial loans (for acquisition of fixed assets and financing of long-term investment projects) amounted to 12.4%, which is by 1 percentage point less than in December 2007.

Figure 4.34

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

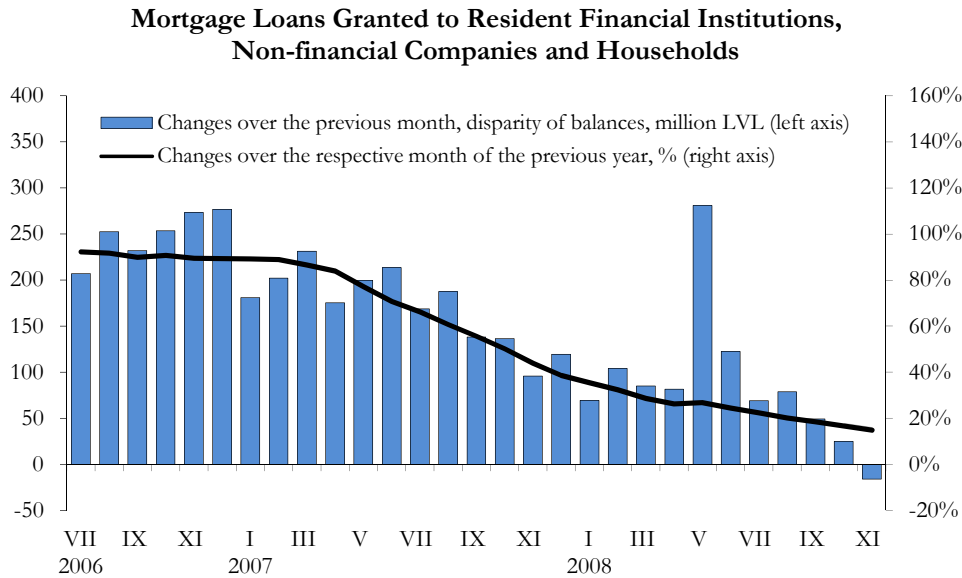


* the end of November

The amount of the granted mortgage loans grew very rapidly in the preceding years (by 89% in 2006 and by 39% in 2007). From the second half of 2007, decrease of the mortgage loan growth rates was observed. In November 2008, the growth of the mortgage loan volume against the respective month of

the previous year was only 15%. The most significant factors hindering the growth of the mortgage loans is a more careful attitude of households regarding their expenditures, decrease of income and the high debt burden largely affected by the high interest rates on loans.

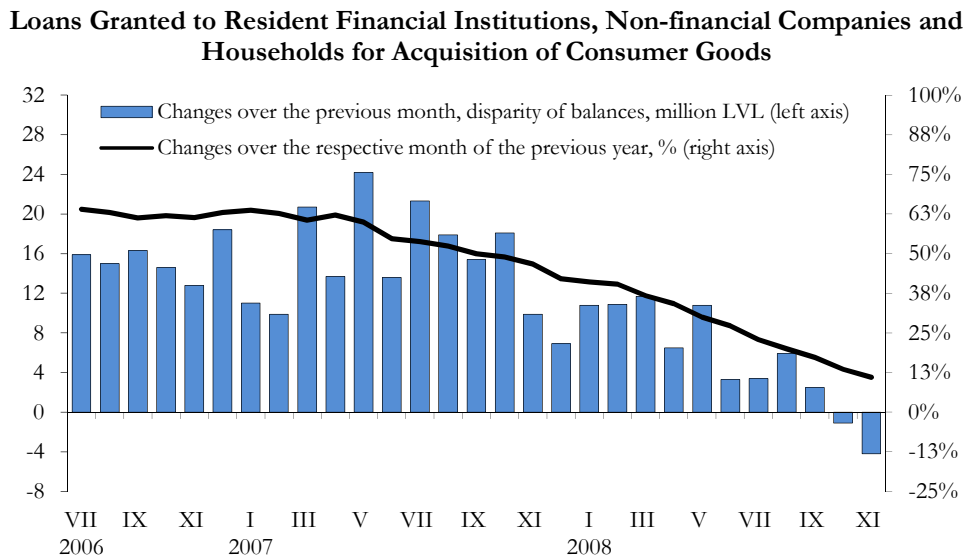
Figure 4.35



In 2008, the growth rate of loans for acquisition of consumer goods also decreased (the growth by 11%

against November 2007). The consumer loans amount to 4.6% of all the granted loans.

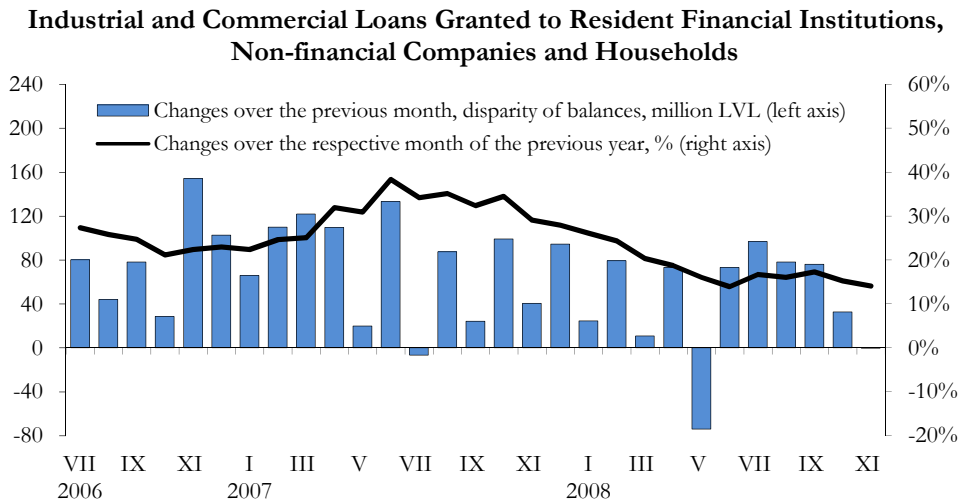
Figure 4.36



The total volume of industrial and commercial loans granted to resident financial institutions, non-financial companies and households amounts to 31.4% of the total loan structure. The balances of these loans

increased by 14.1% as compared to November 2007, which was mainly determined by the growth of balances of commercial loans by 18.5%.

Figure 4.37



The medium-term loans have decreased in the total loan structure, while the short-term and long-term loans have grown respectively. At the end of November 2008, the share of long-term loans amounted to 60.8% in the total loan portfolio (58.1% at the end of December 2007), whereas the share of short-term loans has increased from 10.8% at the end of 2007 to 12.1% in November 2008.

During the 3rd quarter of 2008, the share of loans with delay in payment continued to grow in the total loan portfolio of banks. At the end of September, the loans with the delay in payment to 30 days amounted to 6.7% (6.6% in the 2nd quarter) and 2.5% with the delay from 31 to 90 days (1.9% in the 2nd quarter), but 2.5% with the delay of above 90 days (6.6% in the 2nd quarter). A balance of loans with the delay in payment longer than 90 days reached LVL 414 million at the end of September 2008, but their share in the total loan portfolio increased to 2.5%. The highest share of these loans at the end of September was concentrated in the loans issued to the sectors of construction, real estate operations, hotels and restaurants, as well as

health and social care. Delay of the loan payments of households has also increased considerably.

Figure 4.38

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

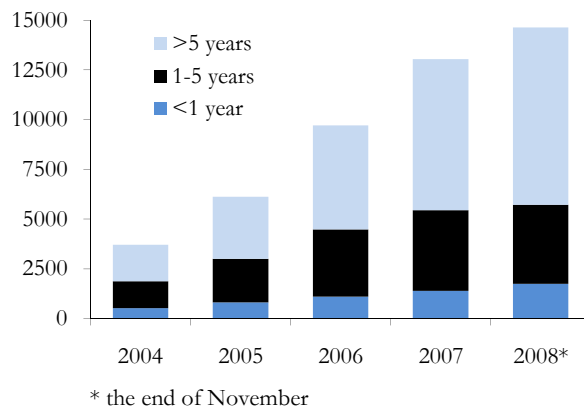
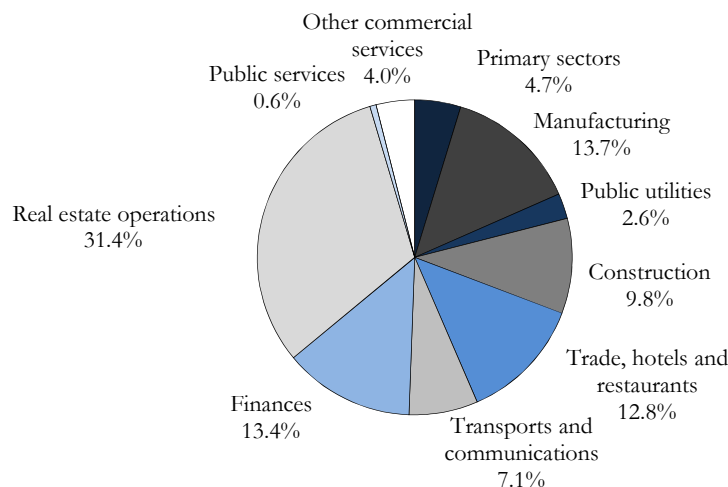


Figure 4.39

Balance of the Long-Term Loans Granted to Companies in the National Economy (at the end of the 2nd quarter of 2008, million LVL)



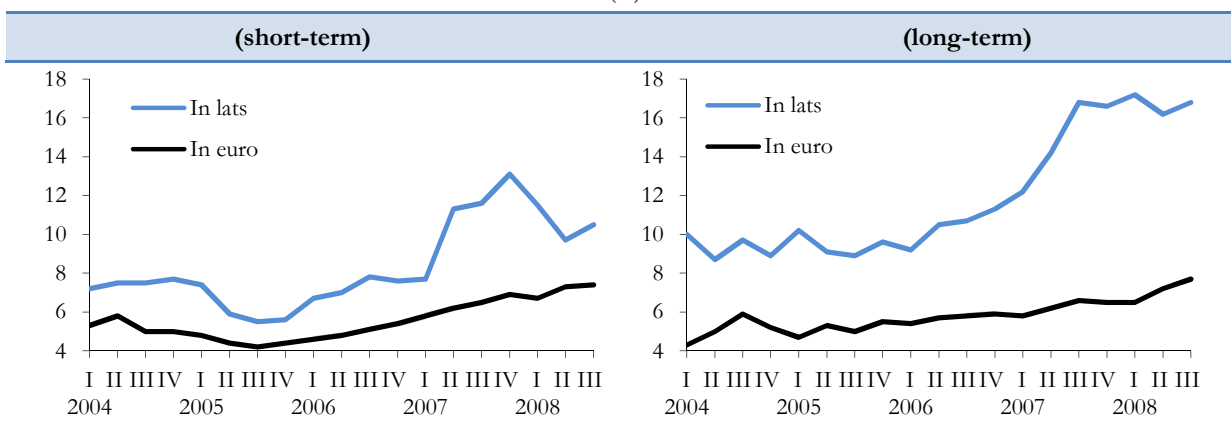
In the first half of 2008, the real estate operations had the most loan balances in the amount of LVL 2456.1 million, which made 31.4% of the total loans granted to economic sectors. It was followed by the sectors of manufacturing, financial services and trade, where the shares of each sector for the total loan balance is approximately 13%. 11.8% of all loans granted to the sectors are loans in lats.

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

1st quarter of 2008 was 11.5%, but the long-term loans amounted to 17.2%, where the interest rates of the loans granted in Euro were respectively 6.7% and 6.5%. The interest rates of the loans granted in lats slightly decreased in the 3rd quarter of 2008: 10.5% for short-term loans and 16.8% for long-term loans, whereas the interest rates of the loans granted in Euro increased: 7.4% for short-term loans and 7.7% for long-term loans.

Figure 4.40

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

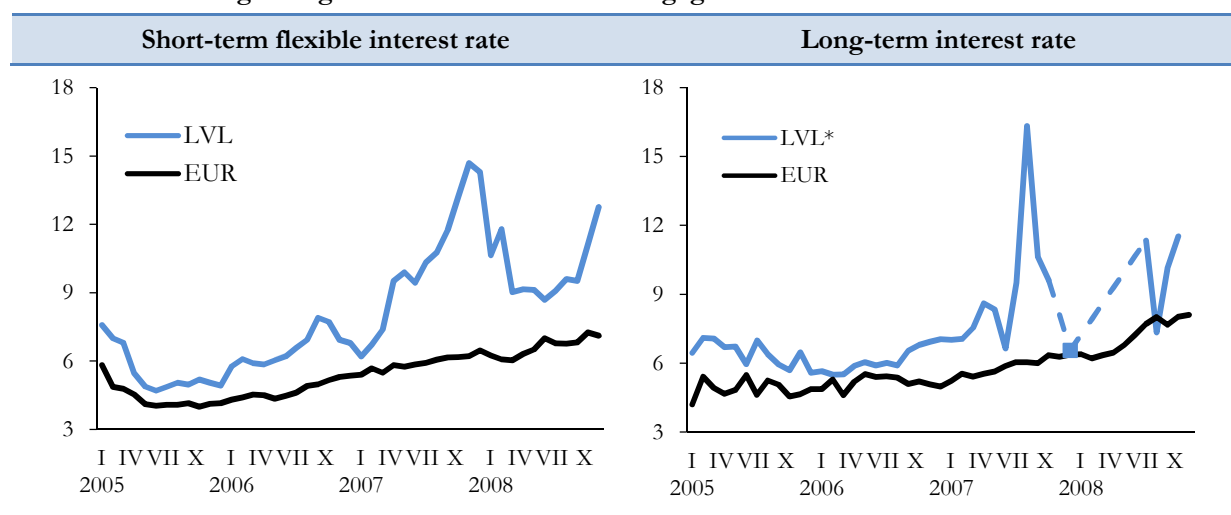


In 2008, the average weighted annual interest rates decreased for the long-term deposits in credit institutions attracted in lats from 10.1% in the 1st quarter to 8.9% in the 3rd quarter. The short-term interest rates also decreased, namely, from 6.6% in the

1st quarter to 5.2% in the 3rd quarter of 2008. The average weighted annual interest rates for the deposits attracted in Euro increased slightly. In the 3rd quarter of 2008 the short-term interest rate amounted to 4.4%, but the long-term interest rate – 5.7%.

Figure 4.41

Average Weighted Interest Rates on Mortgage Loans Granted to Households



* there is no data for November 2007, January-June 2008 and November 2008

Since 2007, the interest rates of loans granted to households in lats have rapidly grown, while the growth of the interest rate of the loans granted in Euro has been significantly more moderate. In the beginning of 2008, decrease in the short-term flexible interest

rate of loans granted to households in lats was observed. In the second half of the year, the interest rates of both, the loans granted in lats and the loans issued in Euro started to increase again.

5. LABOUR MARKET

5.1. Employment and Unemployment

Rapid economic development of Latvia in the period of 2004-2007 positively influenced the situation in the labour market – employment grew, the unemployment rate decreased and the number of economically active persons increased. The number of employed persons increased annually by 2.9% on average during the period of 2005-2007, while the unemployment rate has decreased from 10.4% in 2004 to 6% in 2007. As a result, the employment rate in Latvia reached 68.3% in 2007, which exceeds the EU-27 average by 2.9 percentage points.

Decrease of economic activities, which started at the end of 2007, are still weakly reflected in the employment indicators in the first half of 2008, because changes in the employment rate always slightly lag behind the changes in economic activities by 2-4 months on average.

During the first three quarters of 2008, employment did not practically decrease and its rate

even slightly exceeded the indicators of the respective period of the previous year.

However, it should be noted that changes have taken place at the level of unemployment – it has increased from 5.3% in the 4th quarter of 2007 to 6.5% in the 1st quarter of 2008 and increased further to 7.2% in the 3rd quarter of 2008. Such a situation has been caused by the reason that in the beginning of 2008 the number of economically active persons had increased considerably, which may be partially explained by the growth of motivation to be employed (rise of wages along with increase in the cost of living), as well as decrease of labour demand in Ireland and UK.

It is expected that the employment rate will further decrease and the unemployment rate will increase, because negative GDP growth rates have been observed since the 3rd quarter of 2008.

Table 5.1

Key Indicators of Employment and Unemployment*

Indicators	2000	2005	2007	3 quarters of 2008
Population in the age of 15-64 years (thousand)	1600.3	1583.8	1573.4	1567.8
Economically active persons in the age of 15-64 years (thousand)	1074.7	1100.8	1146.6	1168.5
Employed persons (thousand)	917.6	1003.6	1075.5	1087.4
Participation rate (%)	67.2	69.5	72.9	74.5
Employment rate (%)	57.3	63.4	68.4	69.4
Unemployed (job seekers) (thousand)	158.3	99.1	72.1	81.2
Unemployment rate (%)	14.4	8.7	6.0	6.7
Registered unemployed persons (end of period, thousand)	93.3	78.5	52.3	54.2
Registered unemployment (end of period, %)**	7.8	7.4	4.9	5.0

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

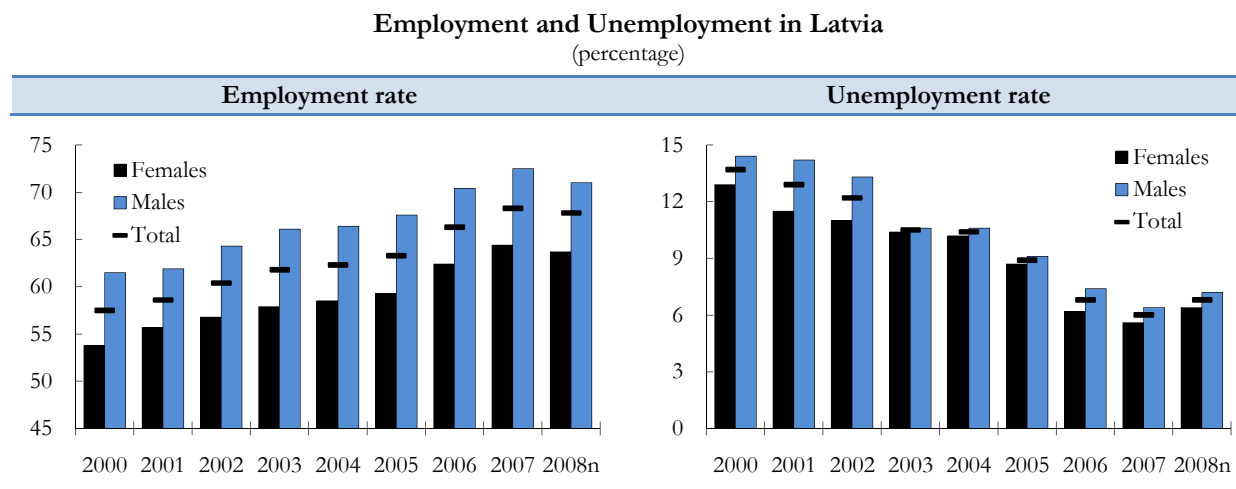
** Share of registered unemployed persons in the economically active population from 2002 according to the new methodology.

Upon comparing the employment rate by gender, it may be concluded that female employment in Latvia is higher than the EU average and this difference tends to grow, as the female employment rate exceeded the EU average by 3 percentage points in 2004, but in 2007 – by 6.1 percentage point. Male employment lagged behind the average EU level until 2007 (by 4 percentage points in 2004 and by 1.3 percentage

points in 2006), however, taking into account its annual growth, it reached the average EU level in 2007 (72.5%).

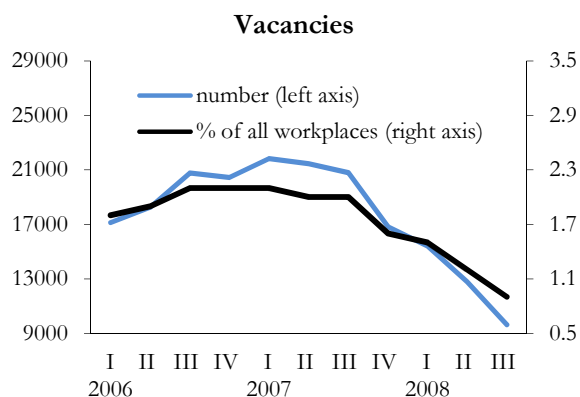
In the beginning of 2008, changes in the employment and unemployment indicators of female and male are homogenous without a marked difference.

Figure 5.1



e – estimation of the Ministry of Economics

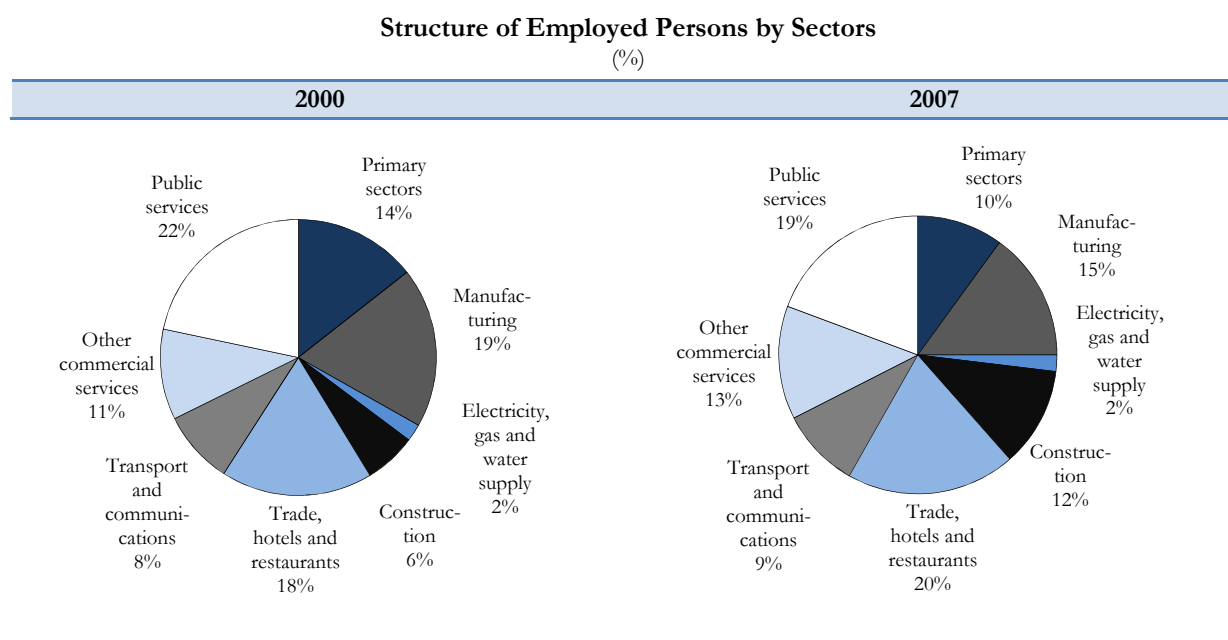
Figure 5.2



The number of vacant positions is rapidly decreasing (see Figure 5.2). The number of vacant positions started to decrease since the 2nd quarter of

2007. It means that already since the mid-2007 the majority of Latvian enterprises have not foreseen the increase of production volumes.

Figure 5.3



Source: Eurostat

According to the national economy sectors, the structure of employed persons in 2007 has slightly changed as compared to 2000 (see Figure 5.3). The number of the persons employed in the trade and construction sectors has increased more rapidly, whereas the number of the persons employed in the agriculture, industry and public service sectors has decreased.

As it has been mentioned, a notable decrease of the number of employed persons due to the decrease in economic activities has not been observed still, but in

particular sectors such as construction and manufacturing the number of employed has already decreased by 4-5% in the 3rd quarter of 2008. The decrease in other sectors is small or has not been observed yet.

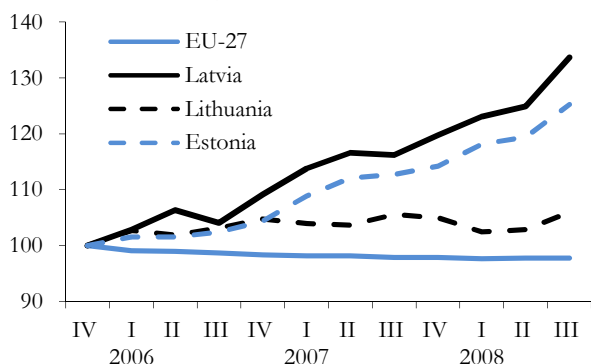
According to the quarterly survey of enterprises and institutions, the number of occupied positions has decreased by 1% in this period, but in such sectors as manufacturing and public administration up to 3%. The decrease in construction, as well as transport and communications sector has not been observed yet.

5.2. Labour Costs

Labour costs per production unit (unit labour costs – ULC)¹ is one of the indicators characterising competitiveness (both, for the country as the whole and for separate sectors). The dynamics of this indicator shows that competitiveness of Latvia, as well as other Baltic states with regard to other EU member states deteriorates.

Figure 5.4

Dynamics of Real ULC in the EU Member States
(4th quarter of 2005=100)



Source: Eurostat

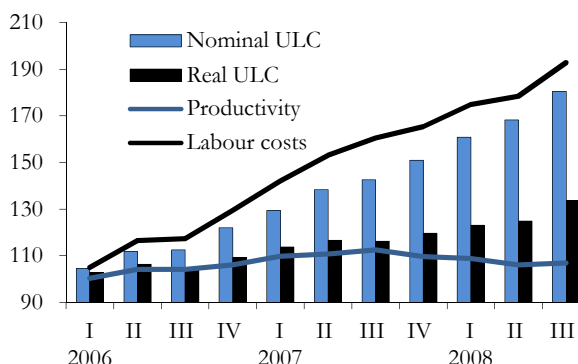
Both, in Latvia and also in Estonia the real ULC growth rates considerably increased as from 2006, while the dynamics of this indicator in Lithuania remained steady and comparatively moderate. The growth of labour costs is the consequence of the labour outflow from Latvia and capital inflow, which is the result of a deeper integration into the EU and global markets.

Since 2006, the real ULC grew by 33.6% in Latvia, 25% in Estonia, 6% in Lithuania, whereas in the EU member states it decreased on average by 2.3%. Until 2007 increase of the real ULC was mainly determined by the more rapid growth of labour costs on average than productivity growth. It should be noted that the slowdown tendencies of the productivity growth rates

were observed already as from 2006. In 2008 the real ULC growth rates in Latvia, as well as in other Baltic states increased. The decrease of demand in domestic and external markets has negatively influenced the situation in the commodity markets. During three quarters of 2008, GDP decreased by 2.4% in comparison with the respective period of the previous year, however, the appropriate adjustments in the labour markets did not happen at that time, which was the main reason for the growth of real ULC.

Figure 5.5

Changes of Labour Costs in Latvia
(4th quarter of 2005=100)



Source: Eurostat

On the whole, the nominal² ULC grow more rapidly than real³ ULC in the economy, which indicates that labour costs are partially compensated by producer prices. However, since 2007 the difference in dynamics of these indicators gradually decreases. It means that the compensatory effect of the rise in producer prices gradually wanes upon decreasing domestic demand and increasing competition. Therefore, it is only possible to maintain price competitiveness in international markets under conditions of the fixed exchange rate by increasing productivity, particularly in the export-oriented sectors.

¹ ULC are defined as the ratio between the labour costs and labour productivity. If productivity grows more rapidly than wages, the ULC will decrease showing that price competitiveness of the country increases and vice versa.

² adjusted by producer price index or deflator

³ unadjusted by producer price index or deflator

5.3. Employment Policy

The employment policy of Latvia is closely related to the EU employment policy. The member states and Community develop a co-ordinated strategy in the field of employment. Latvian employment policies are based on the EU employment strategy and long-term employment targets formulated by the European Council in Lisbon: to reach an overall employment rate of 70% in the EU by 2010 (including 60% for women and 50% for pre-pension age population of 55–64 years old).

In Spring 2008, the European Council approved the *Integrated Guidelines for Growth and Jobs for 2008–2010* and country-specific recommendations marking the new Lisbon strategy cycle. In the field of the employment policy Latvia is recommended to intensify efforts to increase labour supply and productivity within an integrated flexicurity approach, by improving activation and regional mobility, and enhancing the responsiveness of education and training systems to labour market needs by putting in place a lifelong learning system. The European Council specifies in its conclusions that in addition Latvia should focus on pursuing active labour market policies and improving access to childcare.

Implementation directions of the Integrated Guidelines are specified in the National Lisbon Programmes of the member states (see Chapter 6.1). In the framework of the New Lisbon Strategy Cycle, new tasks and measures are set for 2008–2010 in order to implement the Integrated Guidelines and country-specific recommendations. The priorities of the employment policy of Latvia for 2008–2010 are as follows:

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

The rapid economic growth during the last years is also reflected by dynamics of the labour market indicators. The employment rate has increased in all target groups. The increase of employment rate and decrease of unemployment rate has been observed in Latvia until 2008. However, as from the beginning of 2009 the influence of declining growth rates is starting to reflect also in the labour market indicators. Therefore, already at present new turning points must be faced in the employment policy upon beginning of deterioration of the labour market indicators.

The state policy in the areas of reduction of unemployment and support to unemployed persons and job-seekers is implemented by the State Employment Agency (SEA). In the framework of implementation of the policy, the SEA organises **active employment policy measures**. In

co-operation with local governments and social partners the SEA constantly expands the active employment policy measures in order to make them more available and appropriate to the needs of clients. Employer surveys in the framework of short-term forecasting of labour market are conducted twice a year on a regular basis in order to harmonise the active employment policy measures with the labour market requirements.

The SEA implements the following measures for reduction of unemployment:

- professional training, re-training and improving professional skills of the unemployed;
- measures to improve competitiveness;
- measures for certain groups of persons.

The co-financing of the European Social Fund has enabled to increase rapidly the number of unemployed persons involved in active employment policy measures in the previous years. In 2003, 54.6 thousand unemployed persons were involved therein, 179.6 thousand in 2005, 166.4 thousand in 2006 and 64.6 thousand in 2007 (one unemployed person may be involved in several activities). As a result of changes of the unemployment rate, the structure of the measures changes by focusing on improvement of their efficiency.

Most participants have been involved in the measures in order to increase competitiveness (48.6 thousand job-seekers in 2007 and 145.7 thousand in 2008). The other measures have been implemented into the following extent: 3.9 thousand unemployed persons are involved in the professional training, re-training and raising skills of the unemployed, 10.3 thousand in temporary paid employment and 1.8 thousand unemployed persons involved in the measures for certain groups of persons.

Career consultation services have been provided to 44.3 thousand persons, 12.2 thousand of whom were unemployed persons and job-seekers.

In the framework of the measures for certain groups of persons, subsidized employment for the unemployed is implemented by providing an opportunity for the unemployed persons to acquire and improve professional skills in the workplaces established for a specific period. Subsidized employment of the disabled/unemployed persons and unemployed persons of the target groups is implemented by helping to find a permanent job for the unemployed persons of these groups. The measure “Acquirement of Working Skills” provides an opportunity for the unemployed persons to try their professional adequacy within 3 months in a particular workplace, as well as to obtain the necessary skills, which would facilitate finding a permanent job.

Since 2007, separate target groups have been divided (economically inactive population – alcohol or drug addicted persons, as well as persons addicted from toxic substances or other intoxicating substances, persons taking care of a family member, etc.) in order

to facilitate inclusive labour market and for the integration of these persons in the labour market, particular methods and measures are necessary. It is a substantial step to provide systematic support to these target groups within a long-term.

In 2007, the SEA and Professional Career Counselling State Agency (PCCSA) were merged in order to ensure more efficient provision of services available to the clients pursuant to the principle of one-stop shop. Therefore, the SEA has also undertaken implementation of the preventive measures, such as group and individual consultations regarding choosing and planning a career, determination of professional adequacy in relation to the issues of seeking employment and staying at work for both youth and adults, including the employed persons, particularly the population with high social exclusion risk.

Promotion of **employment of young people** is implemented in the framework of several projects. Several projects for raising competitiveness of young people are being implemented by support of the European Social Fund, for example, the measure “Ensuring Work Practices for Unemployed Young People”.

The project “Employment Measure during Summer Holidays for Persons Acquiring Education in General, Special or Professional Education Institutions” has been implemented for several years. The aim of this measure is to promote summer employment of pupils and create opportunity for them to acquire work experience. In the project, the SEA finances pupils’ wages from the state budget resources in the amount of 50% of the minimum monthly wage determined in the country and covers expenses for the manager of the work practice. Expenses of employers were constituted by pupils’ wages in the amount of at least 50% of the minimum monthly wage, tax payments, bonuses, lunches, etc. 7.8 thousand pupils were involved in this measure in 2007.

In order to provide an opportunity for young people of Latvian origin living abroad to acquaint themselves with work and life opportunities in Latvia, therefore encouraging potential return to their ethnic motherland, as from 2007 a summer employment project for young people has been implemented for young people of Latvian origin living abroad.

Although the **employment rate of women** is comparatively high in Latvia, the employment rate of female and male 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.

Ageing tendencies of the society raise particular attention to extension of the working life. Ideas are

considered about retention or attraction of **older people** to employment.

Although the level of employment has increased in all regions, considerable **regional differences** still exist.

Therefore, the preventive measure for reduction of unemployment is envisaged – promoting regional mobility of the persons employed by enterprises. Therefore, the unemployment risk related to movement of the employed persons between home and workplace would be reduced.

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**.

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 interests of both, the employer and the employee. In the 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 a person’s 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 facilitate mobility and faster return to the labour market.

It is important to provide conditions for safe work 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 2008. It is a medium-term policy planning document reflecting the existing situation, identifying the problems, and setting the main directions of development and goals to be achieved, as well as indicators in the field of labour security. The goal of the guidelines envisages improvement of the working conditions in enterprises and reduce the number of fatalities at work by 30% (per 100 000 residents).

Latvia has a relatively high **rate of undeclared employment** in particular sectors having a negative influence on employees and creating conditions of unfair competition. To solve this problem more intensively and to encourage the population to act in the formal economy, the net wages are increased for the low-paid employees by increasing the minimum wage, by increasing the amount of the untaxed minimum, as well as by consolidating state audit institutions and activating co-operation with social partners – trade unions and employers’ associations.

In the framework of implementation of the illegal employment reduction measures, the administrative capacity of the State Labour Inspectorate is strengthened, co-operation between supervisory

institutions is improved, and the measures for informing the society and promoting legal culture are implemented.

An important component from the aspect of the employment policy is development of the **education system** by putting a special emphasis on the **importance of lifelong learning** in development of the labour market. The investments into the education system must provide substantial improvements in capacity of the education system to adapt to the changing requirements of the labour market, to improve availability of education 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 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 students drop out 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 of 25–64 years must participate in the measures of lifelong learning by 2010.

In February 2007, the Cabinet of Ministers adopted the *Lifelong Learning Policy Guidelines for 2007-2013*. The basic principles of the lifelong learning policy, objectives, as well as directions and plan of activity are defined in this document. The attention is paid to acknowledgement of informal education, as well as development of the lifelong learning system in the regions.

In order to ensure implementation of the guidelines, on April 9, 2008, the Cabinet of Ministers approved the *Programme for Implementation of the Lifelong Learning Policy Guidelines for 2007–2013 in 2008-2010*. The main result of implementation of the programme is the number of persons involved in the process of lifelong learning in 2010 amounting to 12.5% of the lifelong learning target group. The number of persons involved in the lifelong learning process in 2006 was 6.9%. In comparison with 2006, the number of people involved in the lifelong learning in the age of 25–64 years increased in 2007 amounting to 7.1%.

Changes in the labour market for a timely balancing of the labour market demand and supply create necessity to develop a **labour market forecasting system**. As from July 1, 2007, the Cabinet of Ministers has assigned the Ministry of Economics as a responsible institution for co-ordination of medium and long-term labour market forecasting in the country.

The Ministry of Economics has started work and has established an institutional framework for making the labour market forecasts. The Labour Market

Forecasting Co-ordination Department has been established at the Ministry of Economics. Its task is to co-ordinate the preparation of medium and long-term forecasts of the labour market and application thereof.

Functions of the state agency “Latvian Statistical Institute” were supplemented with medium-term and long-term forecasting of the direct work, i.e., labour market development scenario accepted by the Cabinet of Ministers (as of July 1, 2007 the name of the agency was “Latvian Institute of Statistics and Labour Market Forecasting”).

In order to ensure more economic expenditure of the state budget and to optimise performance of public administration functions, the Ministry of Economics initiated reorganisation of the state agency “Latvian Institute of Statistics and Labour Market Forecasting”. The Cabinet of Ministers accepted joining the agency to the Central Statistical Bureau as of November 1, 2007, where the Central Statistical Bureau has taken over the functions of the agency.

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

In order to elaborate labour market development scenarios and forecasts, an appropriate set of instruments of modelling is necessary. By support of the European Social Fund the Ministry of Welfare ordered a study “Research of the Labour Market Demand Long-term Forecasting System and Analysis of Improvement Opportunities”. The study results include the modelling set of instruments required for making medium-term and long-term labour market forecasts. The Cabinet of Ministers assigned the Ministry of Economics to start fulfilment of the medium-term and long-term labour market forecasting function by adopting the results of the abovementioned study. After receiving the set of instruments the ministry has assessed its application and has approbated it.

After making the necessary improvements, the initial medium-term labour market forecasts until 2013 were made within the set of instruments. In June 2008, the Cabinet of Ministers accepted the *Informative Report on the Forecasts Regarding Medium-Term Compliance of*

Labour Demand and Supply of the Ministry of Economics including these forecasts.

The key factors influencing the situation in the labour market within a medium-term period until 2013 are as follows:

- dynamics and character of economic growth, which will determine increase and structure of the aggregate labour demand;
- unfavourable demographic development, as a result of which the number of persons of working age decreases;
- increase of the participation rate of population affected by both, the economic growth rates and the state employment policy.

The forecasts (3 development scenarios – slow, moderate and dynamic development) are made in the framework of 15 economic sectors and 37 groups of aggregated professions. The obtained results reflect the

situation, which may develop in the labour market, if no changes are provided to the structure of the education system.

In order to prevent the potential labour market problems revealed by the forecasts, the main directions of activity must be as follows:

- corrections to the education system must be duly made, especially on the level of secondary education and secondary professional education, as well as to training of employees and job-seekers;
- the measures for increasing the level of economic activity of the population must be continued;
- operative and regular assessment of the labour market situation must be carried out in order to establish and duly prevent current labour market problems.

6. ECONOMIC POLICY AND PRIORITIES OF STRUCTURAL POLICY

6.1. National Lisbon Programme of Latvia

On October 19, 2005, the Cabinet of Ministers approved the *National Lisbon Programme of Latvia for 2005–2008* (hereinafter – Programme) aimed at promotion of growth and employment. The Programme is a policy-planning document that shows how Latvia is going to achieve the Lisbon Strategy goals in 2005–2008 on the basis of the *Integrated Guidelines* approved by the European Council in July 2005¹.

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

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

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

According to the meeting of the European Council in March 2008, Latvia prepared the *Report on Progress in Implementation of the National Lisbon Programme of Latvia* (hereinafter – Report), which was approved by the Cabinet of Ministers on October 14, 2008. The Report comprises assessment of the measures carried out in the previous cycle of the Lisbon Strategy (for 2005–2008), as well as sets the new tasks and measures for 2008–2010 on the basis of the updated *Integrated Guidelines* and EU Council country-specific recommendations. The Report also contains 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 and is in line with the three key priorities for development of the country in 2007–2013 identified by the government – an educated and creative person, technological excellence and flexibility of enterprises, development of science and research (*National Development Plan of Latvia for 2007–2013*).

Taking into consideration the current economic development trends both in the world and in Latvia, the government has set the main current task not to allow rapid decrease of growth and provide conditions for sustainable growth. Therefore continuation of the structural reforms set in the *National Lisbon Programme of Latvia* is very important for strengthening the growth potential of Latvia.

The *National Lisbon Programme of Latvia* points out five main economic policy directions to reach the Lisbon strategy 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 main economic policy directions, main tasks (priorities) are defined and specific measures with implementation terms are determined and, if the government has decided so, also funding is set. The Programme takes into account the EU approach of the necessity to distinguish the economic growth from the resource use so that the economic and social progress is not achieved at the expense of excessive use of natural resources and deteriorated environmental quality.

As it has been mentioned, in October 2008, the new tasks and measures for 2008–2010 were set in the *Report on Progress in Implementation of the National Lisbon Programme* approved by the government in order to reach the goals of the Lisbon strategy and implement the country-specific recommendations to Latvia of the Spring European Council of 2008. These recommendations to Latvia are a substantial investment in determination of priorities of our country and formulation of the necessary reforms and economic policy measures (see Box 6.1).

¹ In March 2000, in Lisbon, the European Council approved the EU strategic development document (Lisbon Strategy), which sets the main goal to achieve that the EU becomes the world's most competitive and dynamic knowledge-based economy in 10 years, which would ensure sustainable economic growth with more and better workplaces and greater social cohesion. In March 2005, the European Council approved the re-launched Lisbon Strategy, envisaging the necessity to focus its policy on growth and employment. It was decided that every member state has to develop a national reform programme for 2005–2008. In July 2005, the European Council approved the *Integrated Guidelines for Growth and Jobs*, which combine the Broad Economic Policy Guidelines and the Employment Guidelines, and they constitute a base for development of national reform programmes.

Box 6.1**Assessment of the European Commission on implementation of the Programme and recommendations to Latvia****European Commission considers that the main challenges for Latvian economic policy are as follows:**

- bigger attention should be paid to the development of more concrete measures to secure macroeconomic stability in the face of overheating pressures;
- priorities of the R&D strategy should be set, as well as private sector involvement should be increased;
- labour supply should be increased and the labour skills should be improved.

Recommendations of the European Commission to Latvia are as follows:

- to pursue a more restrictive fiscal policy, with a careful prioritisation of expenditures and wage developments that are in line with productivity, in order to contribute to correcting overheating pressures and reducing the risk of macroeconomic instability;
- make faster progress in the implementation of the research and innovation policy reforms, in order to meet the ambitious targets set. This concerns especially policies to stimulate partnerships between research and education institutions and businesses;
- within an integrated flexicurity approach, intensify efforts to increase labour supply and productivity by improving regional mobility and enhance the responsiveness of education and training systems to labour market needs by putting in place a lifelong learning system and pursuing active labour market policies.

In addition, Latvia should focus on: improving further the regulatory environment, notably by means of an explicit better regulation policy and improving access to childcare.

As regards **macroeconomic policy**, the following main tasks are defined for the period of 2008–2010:

- implementation of restrictive fiscal policy;
- ensuring efficiency of budget spending;
- ensuring compliance of wage payment with macroeconomic stability and growth;
- ensuring accession of Latvia to the Euro zone;
- ensuring sustainability of public finances;
- establishment of the taxation system promoting economic development.

The government considers that a responsible fiscal policy is one of the cornerstones of the state macroeconomic policy and substantial signal to national economy. Therefore, the fiscal policy in the country has been aimed at fiscal consolidation during the last years. Latvia has managed to improve the general government budgetary balance. In 2004, the budget deficit was in the amount of 1% of GDP, but upon gradual improvement of the financial situation the budget surplus amounted to 0.06% of GDP in 2007.

In autumn 2007, the Saeima accepted the budget of 2008 with a surplus in the amount of 1% of GDP (in accordance with the national budget methodology). However, taking into account the macroeconomic situation in the country and assessing the state budget revenue forecasts, amendments were made to the 2008 state budget in summer of 2008. The amendments envisage providing a budget surplus in the amount of 0.05% of GDP or LVL 8 million. Thereby, a strict fiscal policy is provided by ensuring a state budget surplus, which is one of the key instruments for decreasing the demand pressure on inflation.

A deficit amounting to 1.85% of GDP is envisaged in the draft state budget for 2009 submitted by the government to the Saeima which is closely related to the generally approved economic cycle concept. In the cases of deteriorating economic situation, especially, when it is influenced by decrease of the domestic consumption growth rates, it is necessary to use the

instruments of promoting nature, which in this case is budgetary balance.

The government pays special attention to increasing the **budget expenditure efficiency**, as well as prioritising the expenditures. The work takes place in two directions: introducing medium-term budget planning and improving operation of the public administration.

Ministries and other central public institutions performed a functional audit in 2007. As a result of the functional audit, proposals were made for improving the work quality and efficiency. Organisational structures of institutions were assessed by ensuring their optimisation. The implemented functions were also assessed, as well as proposals made to restructuring the functions.

In 2007, a transition to a medium-term budget was started, 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. Medium-term budget objectives and priority development directions for 2008–2010 have been approved by the government, on the basis of which the new policy initiatives submitted by the public administration institutions are assessed. Ministries and their subordinated institutions have implemented strategic planning; thereby budget formation is based on financing the goals and results of the action policy.

The main tasks in the field of the medium-term budget and strategic planning for 2008–2010 are as follows:

- to provide connection of the budget planning system with the performance indicators;
- to ensure gradual implementation of the quality management system in the administrative bodies;
- to improve the system of results and performance indicators in order to improve the result and informative quality of their

performance indicators, as well as their practical application in the process of policy planning, implementation and supervision, as well as in the process of budget planning, implementation and supervision;

- to draft regulations of the Cabinet of Ministers for submission and assessment procedure of the new policy initiatives of ministries and other central public institutions, thereby providing a unified assessment and preparation system for them. The goal of these regulations is to perform prioritisation of the state budget expenditures;
- to make assessment of the institutions' operational strategies of the planning cycle for 2007–2009 and develop new medium-term strategies based on the obtained conclusions.

In order to eliminate additional economic instability, at the same time taking into consideration the consequences of inflation, the government policy is aimed at **wage developments that are in line with productivity**:

- implementing the Concept on minimum wage;
- decreasing the tax burden for persons with low income increasing the amount of the untaxed minimum;
- improving the wage system in the direct public administration institutions;
- promoting social dialogue.

As from January 1, 2008, the minimum wage was increased to LVL 160, but it is planned to increase the minimum wage to LVL 180 as from January 1, 2009. Such increase of the minimum monthly wage will create insignificant pressure on increase of the average wage, because under current conditions when the competition within the labour market has increased considerably, the increase dynamics of the average wage is less determined by amount of the minimum monthly wage, thereby other factors play more significant role.

It is expected that increase of wages in 2009 and 2010 will not be as rapid as in the preceding years and increase of the labour costs complies with the expected increase of productivity, therefore unit labour costs will not increase allowing to maintain competitiveness of enterprises.

Implementation of a new wage system is started within the direct public administration, which will provide unified principles of wage fixing and planning. It is planned to establish the new wage system until 2011 on a gradual basis. As from July 1, 2007, the system has been applied in all direct public administration institutions. As of 2008, the procedure for fixing premiums and awarding bonuses has been improved.

Social dialogue plays an important role in promoting agreed wages and increase of labour productivity. Within the last years, several measures have been

carried out to improve the social dialogue both on the state and regional level. In the framework of the national programme “*Support to Strengthening Capacity Regarding Implementation of the Labour Market and Gender Equality Policy in the Competent Institutions, Distribution of Information and Increasing Understanding*”, co-financed by the ESF, the institutions involved in the co-operation partnership have been strengthened, including the *Employers' Confederation of Latvia* and *Free Trade Union Confederation of Latvia*. Capacity of Latvian local governments and *Latvian Association of Local and Regional Governments* has been also strengthened in the framework of the programme in order to ensure development of employment partnership and social dialogue on the level of local governments.

In order to continue the initiated work, it is planned to implement different measures within the period of 2008–2010 in order to promote social dialogue and strengthen administrative capacity of social partners, as well as attract financing also within the framework of absorption of EU structural funds. The main goal of these measures is to increase participation opportunities of social partners in development and implementation of the action policy, obtain active and qualitative participation of the nongovernmental sector in the decision making process and providing public services, as well as facilitate quality improvement of the public services provided by the NGO.

It is planned to establish regional centres of the social partners: the Employers' Confederation of Latvia and Free Trade Union Confederation of Latvia in each of the five regions (Latgale, Vidzeme, Zemgale, Kurzeme, Riga) with support from the European Social Fund.

In order to promote **knowledge and innovation**, the main tasks for 2008–2010 are as follows:

- to increase public investment and foster private investment in R&D;
- to ensure renewal of the intellectual potential in science, improving the system of doctoral grants and modernising the scientific infrastructure;
- to facilitate innovation and new technologies;
- to promote distribution and efficient application of ICT, as well as establish a completely integrated information society.

The *Programme* sets a target determining that gross expenditures on research and development (R&D) have to reach 1.5% of GDP by 2010. In order to reach this target, according to the *Law on Scientific Activity* the annual increase of financing for scientific activity in the state budget is prescribed to be at least 0.15% of GDP or by LVL 10–15 million on average annually. The total financing for research and development in 2007 amounted to LVL 87.9 million or 0.6% of GDP.

EU structural fund financing for 2007–2013 available to Latvia for such activities as innovation will facilitate increase of the private sector expenditures on

research and development. During this period it is planned to attract a private sector financing in the total amount of LVL 70 million for research and innovation activities, therefore the private sector financing could increase by LVL 10 million on average annually.

The national programme “*Support for the Doctoral Study Programs and Post-Doctoral Studies*” is being implemented for renewal of intellectual potential in scientific activity. In order to facilitate renewal and development of intellectual potential in scientific activity, it is planned to achieve an increase in the number of new doctors of up to 500 doctors of science per year until 2013 (146 doctoral dissertations were presented in 2007).

The following tasks are set as the priority directions in increasing the national innovation capacity:

- *promoting co-operation between research, education institutions and private sector;*

Since 2006, commercial companies have been having an opportunity to submit projects for receiving support in order to implement research projects in the framework of EUREKA programme. Implementation of the *Market-Oriented Research Project Programme* is also continued. Implementation of 28 new research projects has been supported in the framework of the programme in 2007, as well as implementation of 48 already initiated projects is ensured. At the same time, in the first half of 2008, financial support has been provided to 18 projects of the market-oriented research programme. In 2007, implementation of the *Innovation Centre and Business Incubator Development Programme* was started. Its goal envisages promoting improvement of the innovation infrastructure, supporting innovation centres, as well as establishment and operation of business incubators. 11 innovation centre and business incubator projects have been supported in the framework of the programme. Implementation of the programme will be continued also in 2009–2013 by attracting resources of the European Regional Development Fund. In 2008 the work has been continued in order to facilitate formation of the competence centres by organising training and informative seminars. In 2009, implementation of the programme “*Competence Centres*” will be started. It is planned that as a result, 5–6 research projects developed by the competence centres will be co-financed;

- *supporting transfer of knowledge and technologies;*

Since 2005, operations of 6 technology transfer contact points have been supported in higher education institutions. Upon attracting structural fund financing in 2008, a decision was made on co-financing the operation of 9 contact points after a new project competition. Operation of the single Enterprise Europe Network is also provided in Latvia.

- *facilitating development and introduction of new products and technologies into production;*

Upon attracting structural fund financing, implementation of the state support programme “*Attraction of Highly Qualified Employees*” was started in the first half of 2008, in the framework of which entrepreneurs can receive state support in order to employ engineers, scientists or other highly skilled specialists for some period of time. At the end of 2008, implementation of two more support programmes will be started in the framework of which state support will be available to enterprises for development and introduction of new products and technologies into production, as well as for protection of the industrial property.

The following main tasks are set as priority directions for **developing favourable and attractive environment for investment and work** in 2008–2010:

- to promote business culture, reduce administrative barriers and burden, create environment which is friendly for SMEs;
- to strengthen supervision of competence and provide efficient competition within public services;
- to improve and develop the transport infrastructure, increase the number of connections with other European infrastructure networks;
- to accelerate the administratively territorial reform;
- to ensure efficient, safe and sustainable energy supply.

The main measures for arranging **business friendly environment**, as well as normative environment, which are already being initiated and will be continued in 2008–2010, are as follows:

- *Action Plan for Improvement of Business Environment;*

Since 1999, the annual inter-ministerial policy planning document *Action Plan for Improvement of Business Environment* has been drafted. It comprises the directions of action, tasks, measures to be implemented, competent institutions, assessment indicators for fulfilment of the tasks and performance deadlines of the business environment policy.

The *Action Plan* contains amendments to the legal acts, revision and simplification of the procedures, improving co-ordination among various institutions, preparation and publication of information, as well as training of civil servants. A total of 300 measures are included in the *Action Plan*.

- *A survey for assessment of business environment improvement measures;*

Since 2001, a *survey for assessment of business environment improvement measures* has been carried out every second year. The survey is prepared on the basis of methodology of the World Bank. It consists of three main components: survey of entrepreneurs,

influence of the public and local authorities on the business environment in the report of self-assessment and policy recommendations.

- *Ex-ante assessment of the normative acts;*

As from July 1, 2008, assessment of the administrative burden is also included in the annotations of normative acts for performers of economic activity and physical persons.

- *Establishment of a one-stop-shop for performers of economic activity;*

In compliance with the requirements of the Directive on services within the domestic market, it is necessary to establish a one-stop-shop until the end of 2009 by ensuring an opportunity to a service provider to perform administrative procedures remotely by means of electronic resources, as well as facilitating availability of the information on the state requirements and procedures not only for service providers, but also recipients of services;

- *Co-operation with social partners;*

The topical problems (*problems included in the Action Plan for Improvement of Business Environment*) and their solutions are identified, closely co-operating with the organisations representing entrepreneurs – *Foreign Investors Council in Latvia*, as well as with councils established by the Ministry of Economics – the *Small and Medium-Sized Enterprises and Crafts Advisory Council*, *National Economic Council*, and by assessing the problems identified in the business environment studies.

The European Council specifies in its conclusions that Latvia should focus on further improvement of the regulatory environment, notably by means of an explicit **better regulation** policy.

On June 3, 2008, the government approved the *Public Administration Policy Development Guidelines for 2008–2013*, containing the directions of action which envisage implementation of a *better regulation* in public administration. The national target of Latvia is also consolidated in the guidelines for decreasing the administrative burden in the amount of 25%.

On the basis of the Decree of the Cabinet of Ministers on approval of the guidelines, several documents will be prepared ensuring achievement of the set goals, including such goals as the concept on implementation of a better regulation policy, concept on introduction of a one-stop-shop principle regarding administrative procedures for performers of economic activity, etc.

Pilot projects were implemented in 2007 in such areas as taxation, construction, real estate, fuel circulation, labour legislation, receipt of licences and permits, as well as in clarification of administrative burden for self-employed persons.

The studies on the administrative burden and options for decreasing it (including the studies on measuring the administrative burden) will be continued also in the upcoming years by focusing not

only on undertakers of the administrative burden, but also setting and decreasing the administrative burden for the population. At the same time, development of specialised methodical materials (including within the electronic environment) is planned and training of administrative employees (including the local level) in order to strengthen capacity of the public administration to identify and efficiently decrease the administrative burden by using the EU structural funds financing and the measures identified for decreasing the administrative burden by introducing them in the normative acts.

Promotion of financial availability for small and medium-sized enterprises (SME) is one of the priorities of the government policy.

The Mortgage Bank of Latvia (MBL) plays an important role in the support system for SMEs. The MBL implements the support programmes financed by the state and EU for improving availability of loans with preferential conditions by granting high risk loans to viable and perspective SMEs and business start-up projects, which are not financed by commercial banks due to insufficient mortgage security and other project risks. The MBL also implements other support programmes, including training of business starters and the programme of consultations, as well as the guarantee programme for acquisition and renovation of housing.

The MBL continues development and implementation of new support instruments. On May 13, 2008, the Cabinet of Ministers approved the *Support Programme for Improving Competitiveness of Entrepreneurs*, which will facilitate finding financing for small and medium-sized enterprises for investment in technologies or for business assets. The enterprises oriented on the international market, manufacturing products or providing services with high value added, technologically intensive manufacturing enterprises, as well as establishment of new enterprises will be particularly supported. The total investment volumes of the Programme will reach LVL 200 million, including almost LVL 50 million in 2008. That will enable to provide support to at least 300 enterprises. It is planned that implementation of the programme will be performed by the MBL closely co-operating with Latvian commercial banks and risk investment funds.

The LLC “Latvian Guarantee Agency” (LGA) provides also state support to SMEs.

The LGA is a state enterprise aimed at promoting availability of financing to Latvian small and medium-sized enterprises, by issuing:

- loan guarantees as the necessary additional security for receiving a loan in the commercial bank;
- financial leasing guarantees as an additional security for receiving industrial leasing;
- co-financing investment in Latvian small and medium-sized commercial companies through specifically established risk capital funds.

The Holding fund is established on the basis of the LGA with the total amount of financing of LVL 128 million, which will make investment in guarantees, high risk loans, risk capital funds and other financial support instruments in order to provide access to the financing for the small and medium-sized enterprises for starting and developing business activity, as well as guaranteeing export credits. The *European Investment Fund* will initially manage this fund and application for resources of the Holding fund will be started at the end of 2008. By means of financial instruments planned to be implemented in the framework of the Holding fund, the small and medium-sized enterprise will be able to receive financing, which otherwise would not be received, for example, due to lack of security or because of excessively high risk. The enterprises will be provided with access to the European Union structural funds financing through the investment fund for starting and development of the business activity by such financial instruments as high risk loans, risk capital financing, export credit insurance and financing, as well as technology transfer.

The main tasks to **foster employment** for 2008–2010 are as follows:

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

During the last four years the employment rate in Latvia has increased by 6 percentage points and in 2007 it was already 68.3%. The target of the programme for 2010 is to reach the employment rate of 70%, which is also the target set by the EU. However, due to decreasing economic growth, Latvia will have to face new challenges in the employment policy, including more unfavourable indicators characterising the labour market and especially the indicators of long-term unemployment.

In order to implement the set tasks, it is planned to strengthen the **administrative capacity of the institutions** responsible for promotion of employment and decreasing unemployment. Within the period of 2008–2010 it is planned to implement the activity “*Strengthening Capacity of the Labour Market Institutions*”. The goal of this activity is to establish modern and customer-oriented institutions operatively responding to the customer (employer, employee, unemployed, job-seeker, economically inactive population at the age of ability to work) demand, as well as provide respective competent consultations and ensure informative support. In the framework of this activity, it is planned to train the existing and newly engaged employees of 200 labour market institutions

per year, implementing the state policy in the field of support for the unemployed and job-seekers and career development support system.

Implementation of the active employment policy measures plays an important role in the **labour force activation**. The State Employment Agency (SEA) constantly expands the active employment measures in co-operation with local governments and social partners in order to make them more available and suitable to the needs of customers. In 2007, the SEA and Professional Career Counselling Agency were merged in order to ensure more efficient provision of services available to customers according to the principle of one-stop shop.

Since 2007, separate target groups (economically inactive population – the persons addicted to alcohol, drugs, toxic or other intoxicating substances, as well as the persons taking care of some family member, etc.) have been set apart for promotion of inclusive market requiring special methods and measures for their integration in the labour market. It is a substantial step for providing long-term systematic support to these target groups.

Several new measures concerning inclusion of youth, pre-pension aged persons and women after child care leave, as well as the disabled and the residents of other social exclusion risk groups in the labour market have been expanded and started.

Within the period of 2008–2010, it is planned to involve also those groups of population in the active employment policy measures, which previously were not within direct attention of the State Employment Agency, namely, passive population and the employed threatened with dismissal. It is planned to implement the activity “Increasing Competitiveness of the Population of Giving Age in the Labour Market, including retraining of Employees and Active Employment Measures”. It is planned to involve 6 080 employed persons and 13 374 unemployed persons and job-seekers in this measure in 2009, respectively a total of 28 400 employed persons and 36 000 unemployed persons and job-seekers until 2013. It is also planned to implement the activity “Support to Starting Self-Employment and Entrepreneurship” by attracting 1 200 participants to this measure in 2009, and a total of 5 000 until 2013.

An action plan is developed for solving the problems related to **development of the network of pre-school education institutions** in order to develop the pre-school education institutions network meeting the interests of the residents of the state for 2008–2010. The action plan envisages performance of several measures for promoting development of the pre-school education institutions network within the period before 2010, as well as making amendments to normative acts related to hygiene standards of pre-school education institutions and personal income tax allowances, ensuring research development regarding baby-sitting service development forecasts

for children of pre-school education institutions and alternative baby-sitting options in the country.

In order to facilitate equal employment opportunities and increase availability of services for pre-school age children and other dependants, the activities “Development of the Pre-School Education Institutions Infrastructure in the Development Centres of National and Regional Importance” and “Support to Development of Availability of Alternative Care Services” co-financed by the European Union structural funds for 2007–2013 will be implemented by ensuring co-ordination of the labour activities and family life.

The amendments of 2007 to the Support for Unemployed Persons and Persons Seeking Employment Law envisage implementation of promotion of new preventive unemployment decreasing measures – promotion of **regional mobility** of the persons employed by enterprises. The goal of the measure envisages decrease of the risk of unemployment related to movement of the employed persons between home and work. The regulations of the Cabinet of Ministers are currently in process of drafting to set the criteria for involvement of the persons employed by enterprises in the regional mobility promotion measures, regulations for financing these measures, as well as procedure of their implementation. The measures will be carried out in the framework of the Sub-Activity “Complex Support Measures for Integration of Population in the Labour Market” of the Activity “Promotion of Economic Activity of Population” and its implementation will be started at the end of 2008. It is planned to involve a total of 3 542 persons in the complex support measures in 2009, and until 2013 – a total of 13 900 persons.

In order to facilitate implementation of the principle of **labour market flexibility and employment security or flexicurity** in Latvia, amendments to several regulations of the Cabinet of Ministers were drafted and approved in 2007, which supplemented and specified the number of those cases when it is possible to conclude employment contracts for a specified period.

As of January 1, 2008, the amended procedure for paying the unemployment benefit came into force by conforming the period of its payment with the length of insurance and respectively setting the maximum periods for paying the unemployment benefit of 3, 6 or 9 months. The duration of the qualification period was also changed: previously it was necessary to settle social insurance contributions for not less than 9 months during the period of the last 12 months in order to get the unemployment benefit, but at present they must be settled for not less than 12 months during the period of the last 18 months. The abovementioned amendments are aimed at provision of labour market flexibility by facilitating return of the unemployed to the labour market as soon as possible and trying to prevent the situation of the unemployed

becoming long-term unemployed persons. As from January 1, 2008, a new social insurance allowance was implemented instead of the child care allowance – a parental allowance and unlike the previous allowance, the maximum allowance restrictions are not set for this allowance. The parental allowance is granted and paid to a socially insured person, who takes care of a child under one year old (one of the parents of the child, guardian or another person actually taking care and bringing up the child in accordance with the decision of the orphan’s court), if this person is employed on the day of granting the allowance. The parental allowance is granted in the amount of 70% of the average wage of insurance payments of the recipient of allowance, but not less than in the amount of 70% of a double amount of the state social security benefit valid on the day of claiming for the parental allowance. In the first half of 2008 on average per month 16 091 persons (6 176 of them – men) applied for this allowance.

As of 2009, it is planned to reduce the period of employer’s payment of sickness benefit to employees from 14 to 10 days. This measure is aimed at facilitating labour market flexibility.

Improvement of the legislative acts regulating the labour law will be continued in the field of flexicurity in 2009 and 2010 (concerning such spheres as introduction and application of the aggregated working time, notices, general agreement and undeclared employment), taking into consideration proposals and objections of the social partners, as well as the directives regulating the latest labour law will be implemented in Latvian legislative acts.

The main tasks for improving **education and skills** for 2008–2010 are as follows:

- improve availability of education at all levels and reduce the number of students, who do not complete studies or do not achieve a professional qualification;
- strengthen co-operation between public administration institutions, education institutions and employers in order to adjust the supply of the education system with the needs of the labour market;
- increase involvement of population in lifelong learning providing supply and availability of adult education;
- raise the overall level of technological skills and natural science knowledge, improve the career education and career service system and ensure the availability of career counselling services for all inhabitants.

The Programme sets the target to increase the youth (young persons in the age of 20–24 years with at least secondary education) education attainment level to 85%. This indicator corresponds to the target indicator set by the EU for 2010. At present, Latvia already exceeds the respective EU average indicator. In 2007, the share of young persons having at least

secondary education reached 80.2% in comparison with 78.1% in the EU-27.

In order to improve **the capacity of educational and training systems to respond to the needs of the labour market**, co-operation is being strengthened among the public administration institutions, education institutions and employers regarding adjustment of educational system supply meeting the needs of the labour market and the level of technological skills and knowledge of natural sciences increased in general, the system of career education and career services has improved and availability of career counselling services provided to all residents in the context of life-long learning.

In order to strengthen triangular co-operation of public institutions, employers and employees:

- *Regional Vocational Education and Employment Councils* have been established in South-Latgale, Kurzeme, Vidzeme and Zemgale dealing with the development issues of labour resources, vocational education, further education and requalification in the region;
- representatives of the *Vocational Education Co-operation Council* and *Triangle Co-operation Sub-council of Vocational Education and Employment* are included in the accreditation commission of study and training programmes;
- sectoral specialists are invited as experts, in order to assess the study process quality of the respective education institutions, as well as for participation in the *Licensing Commission of Higher Education Programmes*.
- *Employers' Confederation of Latvia* and the *Free Trade Union Confederation of Latvia* are involved in the implementation of the NP project “Development of Unified Methods for Increasing Professional Quality and Involvement and Education of Social Partners”;
- representatives of the *Employers' Confederation of Latvia*, *Free Trade Union Confederation of Latvia*, *Trade Union of Latvian Education and Science Employees*, *Latvian Adult Education Association* are involved in the development of assessment criteria of EU fund project applications of the planning period of 2007–2013;
- by implementing the active employment policy measures, the State Employment Agency co-operates with employers, so that the re-qualification and qualification improvement training programmes would have been chosen, which meet the needs of the labour market.

One of the goals of Latvia is to **increase the number of students in natural sciences and engineering study programmes**. In the academic years 2005/2006 and 2006/2007, the number of study places financed from the state budget was increased by meeting the needs of the labour market in such thematic education groups as engineering and

technology, natural sciences and mathematics, health and social care.

In order to optimise study directions, it is planned to use the obtained results of the labour market demand and supply forecasting system as of 2008.

In the recent years, the number of pupils studying mathematics, natural sciences and technologies in the secondary education programmes (26% of pupils in 2007/2008 academic year) has increased in general secondary education institutions. In comparison with 2005/2006 academic year, the programmes of mathematics, natural sciences and technologies were mastered only by 22% of all secondary school pupils. The number of those pupils and students grows every academic year, who choose to take the state centralized exams in subjects of hard sciences. As of academic year 2008/2009, the centralized exam in mathematics is set as compulsory for all secondary school graduates.

The project “Development of the Content of Teaching and Further Education of Teachers in Natural Sciences, Mathematics and Technologies” of the NP “Improvement of Training Quality in Natural Sciences, Mathematics and Technologies in Secondary Education” is implemented with the support of the ESF. The goal of the NP is to improve the training quality in natural sciences, mathematics and technologies on the level of secondary education, in order to prepare knowledgeable and competitive youth after they receive a secondary education degree, create preconditions for national development in science and technology-intensive sectors, promote development of education in accordance with strategic guidelines of the Lisbon Convention. In the framework of the NP – 50 secondary schools were provided with technologies necessary for implementation of modernised content of teaching and study equipment in Physics, Chemistry, Biology, Natural Sciences and Mathematics, as well as all secondary schools in Latvia are provided with teacher support materials corresponding with the guidelines of contemporary didactics of Natural Sciences and Mathematics and implementing modern technologies. The work initiated with the support of the European funds in 2009–2013 will be continued also on the level of Forms 7–9.

The following activities are planned in the period of 2008–2010:

- to provide the number of teachers necessary for education institutions in Natural Sciences, Mathematics, Information Technologies and Foreign Languages;
- to improve the content of general education by paying particular attention to the necessity of mastering practical application of theoretical knowledge.

The **life-long learning system** is being developed, which would ensure an opportunity for the inhabitants to adapt to conditions of changing labour market. On February 13, 2007, the Cabinet of Ministers approved

Life-Long Learning Policy Guidelines for 2007–2013. Introduction of the life-long learning strategy is implemented by offering the education to all inhabitants of Latvia wishing or having compulsory determined education, which ensures integration into labour market, active participation in civil society and personality growth.

In order to ensure implementation of the guidelines, the *Programme for Implementation of the Life-Long Learning Policy Guidelines for 2007–2013 in 2008–2010* has been developed, which was approved by the Cabinet of Ministers on April 9, 2008.

The main goal for implementation of the programme is the number of persons involved in the life-learning process in 2010 in the amount of 12.5% of the life-long learning target group (the number of employed people within the age of 25–64). In 2006, the number of persons involved in the life-long learning process amounted to 6.9%, but in 2007 – 7.1%.

In 2008 and thereafter, it is planned to implement the sub-goals of the life-long learning policy:

- to provide availability of life-long learning to inhabitants irrespective of their age, gender, previous education, place of residence, level of income, ethnic identity, functional disorders;
- to develop qualitative education supply for adults providing sustainable competences for work, civil participation, personality growth and promoting development of competitive knowledge economy based on high skills, as well as democratic society in Latvia;
- to establish a co-ordinated system of normative acts and efficient resource (including financial) management, by observing the principles of distributed responsibility and sectoral policy interaction for development of a single life-long learning system.

Utilisation of structural funds of the European Union facilitates achieving the targets set in the Lisbon Strategy in Latvia. Approximately 60% of financial resources from structural funds in 2004–2006 planning period were channelled for implementation of priorities of the Lisbon Strategy. It is also planned to channel approximately 56% of the total allocated financing for implementation of priorities of the Lisbon Strategy within the planning period of structural funds and the Cohesion Fund of 2007–2013.

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

- *Supervisory Board of the Lisbon Strategy*, in order to ensure the fulfilment and supervision of tasks set up in the Lisbon Strategy in Latvia. The Board is chaired by the Minister of Economics, approved by the Cabinet of Ministers as the co-ordinator of implementation and supervision of the Lisbon Strategy. Ministers and representatives of the Saeima, local governments and social partners, who are linked to the Lisbon process, are included in the Board. Tasks of the Board are to co-ordinate the development of the *National Lisbon Programme of Latvia*, involve public institutions, the Saeima, local governments and social partners in the development process of the Programme, supervise implementation of the Programme and inform the society about the fulfilment of the tasks. It should be noted that Supervisory Board of the Lisbon Strategy was expanded in 2007, by including the Minister for Special Assignments for Administration of EU Funds and a representative of the Saeima European Affairs Committee;
- *Advisory Working Group of the Lisbon Strategy*, in order to ensure development of the *National Lisbon Programme of Latvia* and its implementation at the inter-institutional level. The group is chaired by the State Secretary of the Ministry of Economics. Senior officials of the ministries linked to the Lisbon process are included in the Working Group.

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

The issues connected with the Lisbon Strategy are discussed in the Saeima commissions, National Economy Council, Advisory Council of the Small and Medium Enterprises and Crafts of Latvia, Free Trade Union Confederation of Latvia, seminars, conferences, etc. The EU Information Agency organizes regular discussions regarding the issues of the Lisbon Strategy.

It should be noted that assessment of the European Commission on implementation of the National Lisbon Programme in Latvia, as well as country-specific recommendations and points to watch were reviewed in the meetings of the *Supervisory Board of the Lisbon Strategy*. Proposals for fulfilment of the European Commission recommendations and points to watch were discussed during the meetings.

A consequently implemented economic policy oriented to establishment of a new knowledge-based economy and promotion of employment enables Latvia to achieve the goals set in the Lisbon Strategy.

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 Fund¹

Latvia as an EU member state has access to the financial support from the EU Structural Funds, which is an instrument for implementation of the EU regional cohesion policy.

Planning period of 2004–2006

The total accessible financing for Latvia from 2004–2006 was EUR 625 million in the framework of Structural Funds programmes.

Absorption indicators of financial resources of the planning period of 2004–2006 of the EU Structural Funds enable to forecast that Latvia will absorb the financing allocated in the previous period of structural funds, because until September 30, 2008 the project implementers have submitted financial repayment claims for nearly 104 percent.

The absorption process of EU structural funds process until October 31, 2008 is shown in Table 6.1.

Table 6.1

Absorption of EU structural funds until October 31, 2008

	SF financing		Paid to beneficiaries of SF financing		Community expenditure declared in the European Commission		Payments received from the European Commission	
	million LVL	million LVL	% of financing	million LVL	% of financing	million LVL	% of financing	
ERDF	268.50	248.22	92.4	169.94	63.2	169.9	63.3	
ESF	89.50	82.20	91.8	71.28	79.6	54.83	61.2	
EAGGF	64.55	65.05	100.7	58.12	90.9	50.83	78.7	
FIFG	17.10	17.56	102.7	15.55	90.6	13.51	79.0	
Total	439.65	413.04	93.9	314.90	71.6	289.14	65.7	

In order to ensure that all SF resources allocated to Latvia were repaid to Latvia's budget, EC must declare EUR 140.23 million (LVL 96.56 million) of ERDF financing, EUR 25.92 million (LVL 18.22 million) of ESF financing, EUR 9.14 million (LVL 6.43 million) of EAGGF financing and EUR 2.2 million (LVL 1.55 million) in the framework of FIFG before the end of 2008.

EU Structural Fund resources from the European Commission are divided as follows in time frame from 2004 to 2008:

- in 2004 – LVL 64.1 million;
- in 2005 – LVL 86.2 million;
- in 2006 – LVL 63.8 million;
- in 2007 – LVL 245.4 million;
- in 2008 (until 22.11.2008) – LVL 51.9 million.

In order to reduce the differences existing between the member states, after joining the EU Latvia has had access to the Cohesion Fund resources substituting the ISPA resources accessible before joining the EU. In the framework of the fund those EU member states may receive assistance, the GDP per capita of which is lower than 90% of the EU average indicator. The basic objectives of the Cohesion Fund are to provide support to environmental protection measures and improvement of transport infrastructure.

Like Structural Funds resources, The Cohesion Fund resources are also allocated only as a co-financing to the measures financially supported by the member state. EU co-financing from this fund was set in the amount of 80–85%. Furthermore, if the financing is received also from Structural Funds, EU investment may reach even 90% of the total project costs. The total project costs must be in the amount of at least LVL 7 million (EUR 10 million).

Expenditures of the Cohesion Fund resources are regulated by the Reference Framework Document, coordinated with the European Commission in December 2003. Unlike the Single Programming Document, which sets only priority support areas, particular projects are prescribed in the Reference Framework Document to which financing will be allocated. In comparison with ISPA, the Cohesion Fund has a wider range of investment:

- transport sector – roads, railways, ports, airports, public transport;
- environmental sector – municipal waste management (regional polygons), waste water treatment, drinking water supply.

The total Cohesion Fund financing accessible to Latvia within the period from 2000–2006 amounts to EUR 710 million; EUR 310 million of it is financing for currently implementable projects (former – ISPA projects), EUR 230 million – the Cohesion Fund project applications of 2004, EUR 170 million – the

¹ Source: Ministry of Finance

Cohesion Fund (CF) project application financing submitted in 2005 and 2006.

In order to ensure that all the Cohesion Fund resources allocated to Latvia were repaid to Latvia's

budget, EC must declare EUR 230.3 million (LVL 161.85 million) before the end of 2008.

Absorption of the Cohesion Fund until October 31, 2008 is shown in Table 6.2.

Table 6.2

Absorption of the Cohesion Fund until October 31, 2008

	Access- ible finan- cing	Projects approved by the European Commission (undertaken obligations)		Paid to beneficiaries of CF financing		Payments claimed from the European Commission		Payments received from the European Commission	
	million EUR	million EUR	% of available financing	milli- on EUR	% of undertaken obligations	milli- on EUR	% of undertaken obligations	milli- on EUR	% of undertaken obligations
Ministry of Environment		353.2	49.7	211.1	59.7	242.2	68.5	227.4	64.3
Ministry of Transport		353.9	49.8	217.7	61.5	256.1	72.3	251.1	70.9
Ministry of Finance		3.7	0.5	1.5	43.2	2.0	54.6	2.0	54.6
Total	710.8	710.8	100	430.4	60.5	500.4	70.4	480.5	67.6

The Cohesion Fund resources received from the European Commission from 2004 to 2008 is divided by years as follows:

- in 2004 – EUR 4.8 million;
- in 2005 – EUR 55 million;
- in 2006 – EUR 114.9 million;
- in 2007 – EUR 217.7 million;
- in 2008 – EUR 311.1 million.

Planning period of 2007–2013

In order to ensure qualitative absorption of structural funds and the Cohesion Fund, all the necessary planning documents and normative acts must be prepared, which would ensure starting of absorption of SF and CF. The resources were available for Latvia as of January 1, 2007, however development, harmonisation and approval of the planning documentation delayed, which did not allow to start the absorption of financing in a due time.

In order to start efficient absorption of SF and CF resources, it is offered to implement the programming in 3 levels in accordance with the project of SF and CF general regulation (strategy of EU level or *Community Strategic Guidelines*, strategy of the member states or the National Strategic Framework Document and *operational programmes* of the member states (hereinafter – OP).

The *National Strategic Framework Document* for the period of 2007–2013 (hereinafter – NSFD) is the main SF and CF planning document of Latvia level ensuring connection of the cohesion policy with national priorities and justifying the choice of these priorities, as well as setting an absorption strategy of the funds, as well as management framework and ensures co-ordination between the OP and other financial instruments.

NSFD, on which distribution of the SF and CF financing in the amount of EUR 4.53 billion available to Latvia within the period of 2007–2013 is based,

was approved by the Cabinet of Ministers on June 19, 2007. On September 20 it was also approved by the European Commission so that absorption of the programme, as well as resources could be started.

It is planned to manage SF and CF investment for achievement of the goals with assistance of three operational programmes, which determine beneficiaries of financing, supported activities and sectors in more detail. They are as follows:

- Operational programme of the European Social Fund “Human Resources and Employment”;
- Operational Programme of the European Regional Development Fund “Entrepreneurship and Innovation”;
- Operational Programme of the European Regional Development Fund and Cohesion Fund “Infrastructure and Services”.

These programmes are approved both by the Cabinet of Ministers and by the European Commission, thereby enabling start of absorption of the available resources and promulgation of support programmes.

OP financing sources are the European Regional Development Fund – 53.9% of the total SF and CF allotment, European Social Fund – 12.1% of the total allotment, as well as Cohesion Fund – 34% of the total allotment (see Table 6.3). Furthermore, the state budget, as well as private co-financing must be provided.

In total EUR 4.53 billion are available to Latvia from the financing of structural funds and the Cohesion Fund. The support breakdown by sectors shows that the most part of the financing (59%) is provided for infrastructure projects and entrepreneurship development promotion projects (25%).

Table 6.3

Financing Available to Latvia in 2007–2013
Financial Perspective per Year
(million EUR)

Fund	Allotment	% of the total allotment
ERDF	2440	53.9
ESF	551	12.1
CF	1540	34.0
Total	4531	100.0

Distribution of the allotment of EU Structural Funds and the Cohesion Fund between the project thematic axes and measures of the National Strategic Framework Document for 2007–2013 is as follows:

- 1) development of human resources and efficient utilisation – 10%;
- 2) development of competitiveness and transition to knowledge-based economy – 20%;
- 3) improvements of public services and infrastructure – 46%;

4) technical assistance – 24%.

The absorption status of EU Structural Funds and the Cohesion Fund projects is shown in Table 6.4.

Table 6.4

Status of Starting Project Application
Selection until November 4, 2008
(EU SF/CF financing, EUR)

	Selection started	Selection is not started	Total EU financing
1. Operational Programme	111.8	438.8	550.7
2. Operational Programme	232.9	503.8	736.7
3. Operational Programme	848.3	2394.7	3243.1
Total:	1193.1	3337.3	4530.4

The activities within the competence of the Ministry of Economics are summarised in Box 6.2.

Box 6.2

Activities under supervision of the Ministry of Economics

In total LVL 555.14 million are available for the activities of the Ministry of Economics within the period of 2007–2013, which are distributed in the following way:

- Operational Programme 1 “Human Resources and Employment” – LVL 38.54 million;
- Operational Programme 2 “Entrepreneurship and Innovation” – LVL 373.51 million;
- Operational Programme 3 “Infrastructure and Services” – LVL 143.09 million.

Until November 21, 2008 the Cabinet of Ministers has approved 15 regulations of the Cabinet of Ministers regarding implementation of the activities in the amount of LVL 356.98 million, which is 64% of the total available financing.

On July 16, 2008, the Minister of Economics and the Head of the European Investment Fund signed an Agreement between the government of the Republic of Latvia and European Investment Fund on implementation of EU Structural Funds Holding Fund.

With assistance of financial instruments planned to be introduced in the framework of the Holding Fund a small and medium-sized enterprise will receive a financing, which would not otherwise be received, for example, due to the lack of provision or excessively high risk. With the intermediation of the Holding Fund access to EU Structural Funds financing will be provided to enterprises for starting and developing business activity involving such financial instruments as high risk loans, risk capital financing, export credit guarantee and funding, as well as transfer of technologies.

In the framework of the Holding Fund financing will be allocated to enterprises not as a grant, but rather as a fixed capital investment, a loan, or guarantee, thus the financing will be gradually repaid to the fund and available for repeated support to enterprises. Thereby the Holding Fund will operate as a long-term support instrument.

In accordance with the agreement the European Investment Fund will implement the investment strategy of the Holding Fund, select financial intermediaries with whom agreements will be concluded on introduction of the particular financial instruments, implementation of the concluded agreements supervised, management of the Holding Fund investment portfolio performed, as well as free resources of the Holding Fund placed.

In the framework of the Holding Fund it is planned to absorb EUR 183 million by channelling them to the following financial instruments:

- export guarantees – EUR 30 million;
- portfolio guarantees – EUR 80 million;
- risk capital – EUR 50.5 million;
- transfer of technologies (pre-seed, seed financing to enterprises in the initial stage of development) – in the amount of EUR 22.5 million.

In order to establish a strong national institution in the field of financial instruments, the agreement with EIF also prescribes the procedure for transferring functions of the Holding Fund to LLC “Latvian Guarantee Agency”, which currently issues loan and financial leasing guarantees, as well as operates as a reserve fund in the risk capital sector.

Information on financial instruments

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

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

Box 6.2 continued

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

Along with **export credit guarantees and guaranteeing services**, the commercial, political and accident risks of export transactions will be decreased, as well as funding of the export credit ensured, which would enable Latvian entrepreneurs to increase export volumes by offering an opportunity of applying conditions of the deferred payment to their foreign customers.

Agreements concluded within the activities under the management of the Ministry of Economics as of November 13, 2008

- 2 agreements have been concluded within the Activity 1.3.1.9 “Attraction of Highly Qualified Employees” for the total sum of the agreement LVL 94 950.
- 65 agreements have been concluded within the Activity 1.3.1.1.4 “Support to Individually Organised Training for Enterprises” for the total sum of the agreement LVL 1 978 320.
- 90 agreements have been concluded within the Activity 2.3.2.2 “Co-financing to the Investments in Micro and Small-sized Enterprises Operating in the Specially Assisted Areas” for the total sum of the agreement LVL 4 350 871.

As the Ministry of Economics responds to changes in the economic situation:

- the financing is increased from LVL 70 thousand to LVL 150 thousand within the Activity 2.3.2.2 “Co-financing to the Investments in Micro and Small-sized Enterprises Operating in the Specially Assisted Areas (SAA)”;
- decreases the number of activities, consolidates small activities, the management of which proportionally to the available financing is expensive, and increases financing of the Activity 2.1.2.4 “Co-financing to the Entrepreneurship with High Value Added”.

6.2.2. Foreign Trade Policy

Multilateral relations

Global economic development over the course of last sixty years has been affected by activities co-ordinated by the world countries concerning establishment and operation of different international mechanisms and establishments. Furthermore the conclusion of the General Agreement on Tariffs and Trade in 1947 and establishment of the World Trade Organisation (WTO) in 1995 played a determinant role in creation of a multilateral trade system, which has nowadays become the main forum for solving the issues regarding multilateral trade.

Regardless of the multilateral trade system measures for facilitation of the global economic growth and currently the insufficiently efficient management of global economic processes may be acknowledged as a substantial cause of its recession. Therefore, in order to stimulate sustainable development of the global economy, it is necessary to strengthen the global financial market and macro-economic supervision, where along with the work in the framework of the International Monetary Fund and the World Bank a substantial investment may be provided by improvement of the legal contractual base of the multilateral trade system.

Taking into consideration the geopolitical character of the WTO, strengthening and further development thereof is the priority of the EU common trade policy, because, upon providing globally binding trade regulations, it is possible to promote predictability and transparency of the international trade environment in the long term, which is important for sustainable provision of EU external competitiveness.

Currently, 153 countries of the world, including Latvia are lawful participants of the multilateral trade system, which have undertaken obligations during the accession process to the WTO to decrease trade restrictions and observe the basic principles of

non-discrimination. 28 candidate states are currently on the way towards participation in the WTO, including such trading partners important for Latvia as Russia and Belarus.

Although they manifest formal interest concerning participation in the WTO, several issues still remain open in the entry process of both countries. The further entry process of Russia mainly depends on its willingness to solve the most economically and politically sensitive issues in the framework of multilateral negotiations, also regarding such EU priorities as export duties for non-processed timber products and discriminating railway freight tariffs, as well as foreign investment restrictions, sanitary and phytosanitary measures, etc. The decision of the Russian government to postpone the planned rise of export duty for non-processed timber products by 9 months from January 1, 2009 may also be positively assessed. This decision must currently be used, in order to achieve that during the entry process of Russia to the WTO, an agreement with Russia beneficial for the EU, including Latvia corresponding to the interests of wood-processing industry concerning its further export duty policy would be reached. At the same time, completing multilateral negotiations with Georgia and Ukraine is also a prerequisite for participation of Russia in the WTO.

Within the entry process of Belarus into the WTO, substantial progress has not been observed since 2005, which may be explained by the domestic political situation of the country and the lack of ambitions thereof concerning improvement of bilateral offers of market availability of goods and services and harmonisation of national legislative acts with the WTO standards.

In addition, among all candidate states, Montenegro is currently in the closest position to enter the WTO, having finished the bilateral negotiations regarding access to the market with all the WTO member states and is within the final stage of the

multilateral negotiations. Therefore, already in the beginning of 2009 a decision could be adopted concerning its accession to the organisation.

Along with accession of new member states, the regulations of the multilateral trade system are improved, *inter alia*, in the framework of the stages of negotiations regarding trade. Up to now 8 stages have taken place, but at present, the negotiations started in 2001 in Doha, the capital of Qatar, are continuing. In the framework of these negotiations, the direction of activity of the WTO member states comprises overall reduction of restrictions within the trade of agricultural and manufactured goods and services, improvement of the trade regulations, including promotion of trade, protection of intellectual property rights, as well as environmental issues related to trade, etc.

Taking into account the expected results of the stage of the Doha negotiations, its successful conclusion by restricting the protectionism in the world is particularly significant in order to overcome recession of the global economy as soon as possible. Therefore, irrespective of the different interests and

efforts of the WTO member states to benefit as much as possible from the Doha negotiations, they still maintain political determination to finish them as soon as possible. In order to achieve this goal, support of all the member states of the organisation must be obtained, i.e. single package of negotiations, with the central components being agriculture and access to the market of manufactured goods. The special protection mechanism for developing countries and liberalisation of the international cotton market are the most essential open issues concerning agriculture, whereas it is the issue of sectors concerning access to the market of manufactured goods and on the basis of an agreement of this issue the WTO member states would make extended tariff reductions and suspension pursuant to the principle of voluntary participation for the import of products of particular industrial sectors. Previously, various sectoral agreements have facilitated rapid international trade development of the products of the respective sectors. One of the most successful examples is the WTO's Information Technology Agreement concluded in 1996 (See Box 6.3).

Box 6.3

Report on the WTO's Information Technology Agreement (ITA) – new opportunities for development of exports

In 1996, 29 WTO member states approved a ministerial declaration (agreement) in the 1st WTO Ministerial Conference in Singapore on international trade of the information technology products by discharging the import duty for goods included therein. Participation of the member states in the ITA is voluntary and currently 70 WTO member states have joined it, including Latvia, which became its participant along with accession to the WTO in 1999.

Discharge of the import duty in the framework of the agreement has substantially promoted international trade of the IT products, which has increased by 2.5 times on a world scale since 1996 and currently amounts to about USD 1500 billion a year by reaching approximately 20% of the total global exports of manufactured goods.

Since conclusion of the ITA, it has never been previously reviewed and therefore it does not currently include the latest technology achievements. Taking into consideration the rapid technology development, as well as the increasing non-tariff barriers including within the international trade of IT products, the EU proposed to start a revision of the Agreement in the WTO's IITA Committee of October 30, 2008 in the nearest future by envisaging the action in four lines:

- to revise/expand the choice of products included in the agreement;
- to reduce/eliminate the existing non-tariff barriers, as well as prevent development of new barriers;
- to establish an efficient revision/improvement mechanism of provisions of the Agreement;
- to facilitate joining of new countries to the Agreement.

Implementation of such measures may be assessed as a substantial step in modernisation of the Agreement and further promotion of international trade of IT products, because reduction and discharge of both, tariff and non-tariff barriers (different existence of standards, overlapping or disapproval thereof) would improve the conditions concerning access to the market in third countries for exporters of IT products by observing the consumer interests to obtain them for the lowest price at the same time.

Taking into consideration the initially reserved attitude of the most ITA member states to the EU intention to perform revision of the Agreement, active work must be continued by the EU in explaining the essence of the issue, as well as the potential benefits for all parties.

The expected most substantial benefits for Latvia from the revision of the Agreement planned by the EU are as follows:

- facilitation of the latest IT technology transfer from third countries;
- decrease of the market price for IT products;
- improvement of competitiveness of IT products in the third country markets.

In the framework of the access to the market, the most important task is to obtain reduction of non-tariff barriers for the exports of Latvian IT products, including such ITA member states as USA, India, China and Ukraine, as well as Brazil (which is a WTO member state, but not a participant of the ITA) and WTO candidate states – Russia, Kazakhstan and Belarus.

Taking into consideration the abovementioned, it is evident that along with development of the WTO its role increases not only in reduction of the international trade restrictions, but also in management of global economic processes.

In order to extend the regulations of the multilateral trading system, the WTO member states facilitate improvement of specific trade regulations in

various formats (bilaterally, regionally, multilaterally, etc.). In this context, upon responding to the increasing international trade in counterfeit goods and copyright infringements several developed countries, including the USA, Japan and the EU member states are working on conclusion of the multilateral Anti-Counterfeiting Trade Agreement (ACTA), which is planned to stipulate on detailed

conditions regarding application of the intellectual property rights and establishment of a mutual co-ordination mechanism thereof. ACTA is considered to be as an important and strategic instrument for efficient protection of intellectual property rights by facilitating development of knowledge-based economy of Latvia in the long term, its international competitiveness and diversification of export markets in the markets of rapidly economically developing third countries. At the same time, it should be acknowledged that in the future success of the ACTA depends on the fact, whether it will be possible to succeed in involving such problematic countries in the field of protection of intellectual property rights as Brazil, Russia, China, Ukraine, etc.

Bilateral relations in the framework of the EU common trade policy

Trade relations of Latvia with third countries are regulated by the EU agreements concluded with third countries.

EU has concluded several preferential agreements with third countries, such as:

- European Economic Area agreement with Iceland, Liechtenstein and Norway;
- Free trade agreements with Faeroe Islands, Switzerland and Mexico;
- Association Agreements with Chile, Mediterranean countries¹ and several overseas countries and territories;

- Customs unions with Turkey and Andorra;
- Stabilisation and Association Agreements with Macedonia, Croatia, Serbia, Montenegro, Albania, Bosnia and Herzegovina;
- Trade, Development and Co-operation Agreement with South Africa.

In addition to already previously initiated negotiations on the free trade agreements (FTA) with Mediterranean countries, Gulf Co-operation Council countries² (hereinafter – *GCC*), negotiations of the association level with *Mercosur*³ countries (hereinafter – *Mercosur*) and negotiations on the Economic Partnership Agreement (hereinafter – *EPA*) with the African, Caribbean and Pacific Group of States (hereinafter – *ACP*) and negotiations on association agreements including FTA with the countries of Central America⁴ and the Andean Community⁵. EU member states also continue negotiations on conclusion of extended FTA of new generation with the Republic of Korea, Republic of India, Association of Southeast Asian Nations⁶ (hereinafter – *ASEAN*), as well as the negotiations with Ukraine and Libya have been started.

The European Community member states (hereinafter – Community) have agreed on starting negotiations concerning conclusion of an extended FTA with the Russian Federation after its entry to the WTO.

Box 6.4

EU bilateral relations with third countries

Economic co-operation between EU and Russia is regulated by the Partnership and Cooperation Agreements (*PCA*) on prolongation of the term of validity to which the parties agreed on October 26, 2007 in Mafra, Portugal during the meeting of the leaders of EU and Russia. The priority FTA negotiations for Latvia with Russia completely depend on development of the entry process of Russia to the WTO. EU member states including Latvia support entry of Russia to the WTO as soon as possible, however the results of negotiations are more important than swiftness of the entry. Taking into consideration the Community position envisaging commencement of the process of FTA negotiations with Russia only after entrance of Russia to the WTO, on May 26, 2008 EU Council of Ministers has approved the mandate on starting negotiations with Russia regarding conclusion of the new framework agreement and at present, its drafting is taking place. The new framework agreement will solve the issue of the trade barriers between the EU and Russia by focusing on the normative regulation.

Along with the entry of **Ukraine** into the WTO, the prerequisite for starting negotiations between the EU and Ukraine on conclusion of the Enhanced Agreement was fulfilled, which will replace Partnership and Cooperation Agreements (*PCA*). Formally negotiations on conclusion of the EU-Ukraine Enhanced Agreement, in the framework of which it is also planned to conclude the free trade agreement, were started on February 18, 2008 in Kiev (Ukraine). Previously, the both parties have exchanged with initial tariff proposals, as well as discussed the draft versions of the agreement on the trade in goods and services, trade protection instruments, sustainable development, rules of origin, protection of intellectual property rights, as well as the regulations on trade promotion and public procurement. On October 20–24, 2008 the 4th round of FTA EU-Ukraine negotiations took place in Brussels (Belgium) during which technical issues were discussed. The next round of negotiations is planned in January 2009. A total of 7 rounds of negotiations are planned. Latvia has particular economic interests concerning conclusion of FTA between the Community and Ukraine, taking into consideration that such an agreement with Ukraine existed before Latvia's accession to the EU and promoted development of transit and trade. Latvia is especially interested in considerable reduction of bureaucratic requirements and liquidation of other non-tariff barriers for admission to the Ukrainian market.

¹ Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Autonomy, Syria, Tunisia

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

³ Argentina, Brazil, Paraguay, Uruguay

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

⁵ Bolivia, Ecuador, Columbia, and Peru

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

Box 6.4 continued

The EU economic co-operation with the USA takes place in the framework of the initiative of the Transatlantic Economic Council. The EU and USA are the biggest mutual trading partners and the biggest global economies comprising 57% of the world GDP. In order to extend the transatlantic economic relations, the EU and USA initiative for promotion of economic integration and growth was adopted on June 20, 2005 during the EU-USA summit talks. On April 30, 2007 a new document “Strengthening the Transatlantic Economy between the EU and USA” was adopted in the EU-USA summit in Washington. The document envisages promotion of co-operation within such fields as intellectual property, trade security, financial markets, innovations and technologies, as well as investment. During the Summit, the Transatlantic Economic Council was established supervising and facilitating implementation of economic co-operation between the EU and USA. The task of the Council is to achieve harmonisation of the EU and USA regulations, as well as to promote development of the dialogue concerning trade and entrepreneurs of both parties. On May 13, 2008 the 2nd EU-USA Transatlantic Economic Council Meeting took place in Brussels, during which the joint notification on promotion of the open investment policy of both parties was approved, as well as issues regarding trade and standardisation were discussed.

The 3rd EU-USA Transatlantic Economic Council Meeting took place on December 12, 2008 in Washington. The agenda of the meeting includes the regulation co-operation issues, import security, 100% container scanning rules in the USA, issues of investment dialogue, as well as financial, energy, etc. issues concerning EU-USA economic co-operation. The Report on Progress of the 3rd Transatlantic Economic Council Meeting approving promotion of a close economic dialogue between the EU and USA, including the issues of investment, standardisation, finances, intellectual property, regulation, trade, import security, etc. Latvia will continue to support implementation of initiative by paying attention to promotion of external trade, the sector of investment and co-operation of entrepreneurs.

The EU and China economic dialogue is based on the EU-China Trade and Economic Co-operation Agreement concluded in 1985, in the framework of which the Joint Trade Committee has been established. On September 25, 2008 a meeting of the Joint Trade Committee took place in Beijing (China), during which the issues on EU-China relations, sectoral dialogues, co-operation in development and reports on trade dialogues (trade in goods and services, trade protection instruments, government orders, intellectual properties, geographical indications and investment regimes) were reviewed. At the end of November 2008, the 11th EU-China Summit was planned, however, taking into account the political situation, it was postponed for indefinite period.

In 2007, the EU started negotiations on conclusion of FTA with **South Korea, ASEAN states and India**. At present, FTA negotiations with **South Korea** have advanced the most. Taking into account the poor activity of Asian states and unwillingness to concede in controversial issues, it is planned that conclusion of FTA with South Korea and India could take place in 2009.

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

Negotiations with **GCC countries** on conclusion of FTA were restarted in 2002 comprising also the conditions of trade of services and investment. The goal of this FTA is asymmetric opening of the trade in goods and services complying with the WTO standards and aimed at development, taking into consideration the development level of GCC countries. Upon solving some open issues, including the issues concerning energy and trade of alcohol, the negotiations will possibly be finished in 2009.

Negotiations regarding conclusion of the **EU-Libya FTA** have been started. On November 12-13, 2008 the 1st round of EU-Libya FTA negotiations took place in Brussels. In general, the negotiations may be positively assessed. Out of all sections of the Agreement only the issues concerning energy were not discussed. In relation to the connection of FTA negotiations with the entry process to the WTO Libya supports inclusion of general WTO principles in FTA, however without including a specific reference to it. The next round of FTA negotiations is planned in Tripoli (Libya) in February 2009.

The goal of the Economic Partnership Agreement between the **African, Caribbean and Pacific Group of States (ACP)** and EU member states is to establish new trade agreements compliant with WTO regulations after the expiry of the existing Cotonou Trade Agreement on December 31, 2007, as well as to support the regional integration of ACP states and facilitate easier and gradual integration of ACP states with the global economy, especially promoting sustainable development and decrease in poverty. The primary goal of the European Commission is to ensure conclusion of EPA with all 6 ACP regions – Western Africa, Central Africa, Southern part of Eastern Africa and Africa, Southern African Development Community (SADC), as well as **Caribbean and Pacific Group of States**. If the overall agreement may not be obtained with some ACP regions during the process of negotiations, EPA are concluded also with particular countries. On October 15, 2008 the Economic Partnership Agreement was signed in Barbados between the European Community and its member states on the one hand and the **Caribbean Group of States**¹ on the other hand. Therefore, all Caribbean Group of States have obtained unlimited (without taxes and duties) access to the EU market, except particular agricultural products to which a transition period has been applied. The Caribbean Group of States shall undertake to open gradually a market for the goods and products of the Community origin along with application of the EPA. On November 26, 2008 the Interim Economic Partnership Agreement was signed in Abidjan between Côte d'Ivoire on the one hand and the European Community and its member states on the other hand. Until the end of 2008 it is planned to conclude an interim EPA with the **Central African States and Ghana**. The interim EPA with 5 SADC states (Botswana, Lesotho, Namibia, Swaziland and Mozambique) is planned to sign in the middle of February 2009. The interim EPAs are concluded, in order to ensure application of the favourable trade regulations until complete conclusion of trade and development EPA. The interim EPA agreements include regulations on trading of goods, namely, tariff, non-tariff barriers, trade protection instruments, customs procedure and trade promotion measures, sanitary and phytosanitary measures, as well as trade measures involving forest management and the products related to forestry.

¹ Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, Saint Lucia, Saint Vincent and Grenadines, Saint Christopher and Nevis, Suriname and Trinidad un Tobago

Box 6.4 continued

The negotiations have been started concerning **Conclusion of Partnership and Co-operation Agreement with Mongolia**. Since 1993 the Trade and Co-operation Agreement between the EU and Mongolia is effective, which was initially concluded for five years, but is prolonged every five years.

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

On June 14, 2007 negotiations were started on conclusion of a new Association Agreement between the EU and **Andean Community** countries. In the framework of the talks related to conclusion of the Association Agreement 4 rounds of talks have taken place. At present, the lack of progress has been observed for a long period of time in the negotiations concerning the EU-Andean Community Association Agreement. Therefore, a possibility to change the further potential format of negotiations concerning the EU-Andean Community Association Agreement is considered – bilateral negotiations individually with each country, negotiations with a sub-regional group or another format of negotiations.

On October 6-10, 2008 the fifth round of negotiations of EU-Central American Association Agreement took place in the talks regarding conclusion of the Association Agreement of the EU and **Central American countries** in Guatemala, during which the parties reviewed the issues concerning services and investment, access to the market, competition, intellectual property, etc.

The economic relations of the EU and 4 *Mercosur* states are based on the Interregional Framework Agreement, which was signed in 1996 and envisages co-operation in the issues related to trade, economics, customs, statistics, intellectual property, integration, interinstitutional co-operation and education and science. In November 1999, the talks were started and are still taking place between the EU and *Mercosur* states on conclusion of the **EU–Mercosur Association Agreement**. The goal of the Agreement is to promote co-operation of the EU and *Mercosur* states within the issues related to trade, economics, customs, statistics, intellectual property, integration, interinstitutional co-operation and education and science, as well as envisages establishment of the Free Trading Room of the EU-Mercosur states. Since 2004, only the talks of technical character have taken place and their further development depends on the progress of the talks of WTO Doha development round which have just finished unsuccessfully.

Economic co-operation agreements of Latvia and third countries and regions of third countries

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

On October 8, 2008, an economical, industrial, scientific and technical co-operation agreement was signed between the government of the Republic of Latvia and the government of Turkmenistan.

These agreements are the most important umbrella agreements regulating bilateral economic co-operation including co-operation within industry, tourism, transport, pharmacy, agriculture, financial services, communications, professional training, investment policy, technology and innovation, as well as other areas, thus promoting development of economic co-operation.

The concluded economic co-operation agreements between Latvia and third countries envisage establishment of the Intergovernmental Commission and/or Joint Committee ensuring supervision and opportunities for analysis of validity of these agreements concerning improvement of further co-operation (see Box 6.5).

Box 6.5

Operational activities of Intergovernmental commissions of Latvia and third countries

- On November 11, 2008 the 2nd meeting of the **Latvia-Russia Intergovernmental Commission on Economic, Scientific, Technical, Humanitarian, Cultural Co-operation took place in Moscow (Russia)**, in which the issues regarding trade and economic co-operation, development of legal contractual base, co-operation in the field of tourism, energy, information and communication technologies, finance, innovation, cross-border co-operation and medical products supply were reviewed, as well as operation of Latvian-Russian Business Council.
- On November 10, 2008 the 3rd meeting of the **Latvia-Russia Intergovernmental Commission on Economic Co-operation Working Group took place in Moscow (Russia)**, in which the issues concerning trade and economic co-operation, development of legal contractual base, co-operation in the field of tourism, energy, information and communication technologies, finance, innovation, cross-border co-operation and medical products supply were reviewed.
- On July 15, 2008 the 2nd meeting of the **Latvia-Azerbaijan Intergovernmental Commission on Economic, Scientific, Technical and Cultural Co-operation took place in Riga**, which was chaired by the Minister of Economics – Mr. K. Gerhards – from the side of Latvia, but from the side of Azerbaijan – the Minister of Economic Development of the Republic of Azerbaijan – Mr. Haydar Babayev. The main issues, which were discussed during the meeting, were dedicated to the co-operation expansion opportunities of the entrepreneurs of both countries in the spheres of mutual interests – transport and transit, trade, banking, information technology, industry, wood-processing, education, science, tourism, etc. During the meeting, an agreement was obtained to activate co-operation in the framework of EU, especially in the energy sector, as well as the co-operation potential was particularly specified between both countries in the field of tourism, education, sports and youth policy, as well as exchange of experience between both countries in the field of information technology and standardisation.

Box 6.5 continued

- On **October 16, 2008 the 4th meeting of Intergovernmental Commission of the Republic of Latvia and Republic of Belarus on Economic, Scientific and Technical Co-operation took place in Minsk (Belarus)**, which was chaired by the Minister of Economics of the Republic of Latvia – Mr. K. Gerhards – from the side of Latvia and Minister of Economics of the Republic of Belarus – Mr. N.Zaichenko – from the side of Belarus. In the framework of the Intergovernmental Commission, the experts of both countries discussed the most topical economic co-operation issues in the fields of industry, energy, agriculture, transport, tourism, scientific, technical, standardisation, and conformity assessment, as well as other prospective areas for activation of the further trading-economic co-operation. During the meeting, it was decided to draft and conclude an agreement in the sphere of building energy efficiency, as well as establishment of the Business Co-Operation Council of Latvia and Belarus was approved, the goal of which is to promote closer co-operation of entrepreneurs and producers of Latvia and Belarus. The first meeting of the Business Co-Operation Council took place on October 15, 2008 in Minsk.
- On **November 26-28, 2008 the 1st meeting of Intergovernmental Commission of the Republic of Latvia and Republic of Moldova on economic, industrial, scientific and technical co-operation took place in the capital of the Republic of Moldova Chisinau**. Co-chairmen of the Intergovernmental Commission were the Minister of Economics of the Republic of Latvia – Mr. K.Gerhards – and Deputy Minister of Economics and Trade of the Republic of Moldova – Mr. Iurie Muntean. During the meeting, the co-operation opportunities of both countries on economics and trade, agriculture, industry, standardisation, metrology, accreditation and consumer rights protection, health care, tourism, regional development promotion, science and research, information and communication technologies were discussed, as well as it was decided to make and sign agreements in the fields of standardisation, metrology, accreditation and statistics.
- In the first half of 2009, meetings of Intergovernmental Commission on several economic co-operation agreements are planned involving Ukraine, Turkmenistan and Uzbekistan.

Although an agreement has been concluded between Latvia and Russia on economic co-operation, active co-operation is taking place also with regions of the Russian Federation.

On April 9, 2008 the Ministry of Economics of the Republic of Latvia concluded the agreement on economic co-operation with the government of Vologda region (Russian Federation), as well as conducts talks with administrations of Pskov region and Yaroslavl region of the Russian Federation and the government of the Republic of Bashkortostan concerning conclusion of the agreement in the field of economic co-operation.

EU sectoral agreements**Steel**

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

In 2007, the world production of steel reached 1.3 billion tons and in comparison with 2006 increased by 8%. Taking into consideration the current economic recession, decrease in production, as well as consumption was observed in 2008, which would fall even more rapidly in 2009. That is why the EU is also concerned about the market instability and overproduction in the future. A positive aspect is the fact that the rise of USD against euro enables to improve European steel exports and decrease the imports.

The EU is currently applying quantitative restrictions regarding imports of particular steel products from Russia and Kazakhstan. In October 2007, the EU and Russia concluded an agreement on steel trade for 2007 and 2008, as well as agreed on its

prolongation in 2009 by envisaging annual increase in quotas. In relation to Kazakhstan, autonomous measures are currently being applied. On May 16, 2008 Ukraine became a WTO member state. Therefore, the previously set quantitative restrictions in relation to Ukrainian imports of steel products to the EU were cancelled. After accession of Russia and Kazakhstan to the WTO, the EU steel agreements with these countries will automatically lose validity.

In addition to steel flow monitoring purposes, the EU applies the Prior surveillance system to the imports of particular steel products from all third countries.

Textiles

Textile sector is a socially sensitive sector characterised by intensive use of labour force and having great importance in both, regional development and international trade. The protective textile products are mentioned as one of the promising progressive markets in the notice of the European Commission “The Lead Market Initiative for Europe”, which is highly innovative, as well as meets the needs of customers, it has a strong technological and industrial base in Europe and it is affected by favourable basic conditions of operation more than other markets which is provided by public political measures. Within the next years, the exports of such textile products from the EU to some regions of the world within which rapid growth is expected could increase by approximately 50%. More rapid drafting and application of the European standards in the global market along with appropriate measures in the sphere of protection of intellectual property, for example, in the form of support services for SMEs would cause additional demand.

Since January 1, 2005, quantitative restrictions have not been applied among the WTO member states in relation to trade in textiles. EU quantitative restrictions

are currently applied to Belorussian and North Korean imports of textiles, whereas apart from the quantitative restrictions, the double control surveillance system (licensing) relates to the imports of particular textiles of Uzbekistan origin. As of January 1, 2009 licensing for the imports of textiles of Chinese origin was cancelled.

6.2.3. EU Internal Market

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 states (including European Economic Area countries – Norway, Iceland, and Liechtenstein) with approximately 500 mln. consumers and it encompasses a territory without internal borders where free movement of goods, persons, services and capital is provided. After lasting and serious work, a unified set of regulations is obtained within the framework of EU for performers of economic activity, border control cancelled, more competitive business environment is established, wider choice of goods and services is provided for consumers, new work places are created, a possibility to live, work, study and retire in another country is provided for residents, an opportunity to introduce single currency has been found, as well as many other benefits have been provided. However, the potential of internal market has not been fully used yet and its improvement still continues by promoting sustainable, stable EU economic development and welfare of the residents.

In Latvia, implementation of internal market directives is taking place successfully and sufficiently high results have been reached regarding the adoption efficiency of the directives. Latvia lags only behind Germany, Romania, Slovakia and Bulgaria. The latter currently is the only member state, which has achieved transposition deficit in the amount of 0%. As of May 13, 2008, 99.4% of the internal market directives were adopted by Latvian normative acts (the directive implementation measures are not notified about 10 directives), ensuring the Lisbon goal of 2009 already now envisaging adoption of 99% directive requirements, or allowing the directive transposition deficit in the amount of 1%.

In Latvia, the process of implementation of the principles of free movement of goods and services and the right of establishment, which are set out in Articles 28–30 and Articles 43–55 of the Treaty Establishing the European Community, is supervised and co-ordinated by the Ministry of Economics, by constantly identifying the standards, which may potentially or actually hinder implementation of the freedoms behind the EU internal market, inter alia, by assessing normative acts still being in a draft stage.

The procedure for submitting draft technical regulations (Directives 98/34/EC and 98/48/EC), which prescribes 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, which serves as a preventive, single and transparent monitoring instrument, in order to assess and avert inclusion of such requirements into the normative acts, which have the potential to create barriers to the free movement of goods, as well as to the freedom to provide information society services. The responsible institutions of EU member states are not the only participants in the harmonisation process of technical regulations. 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 export of the business's products or exceeding the limits of information society services.

In 2008, Latvia has submitted 8 draft technical regulations to the European Commission concerning the fields of agriculture and public health.

In general, Latvia informed the European Commission of 57 draft technical regulations from May 1, 2004 to May 1, 2008, for which objections from the European Commission have been received in 13 cases. In most cases, objections from the European Commission have been related to the fact that draft normative acts do not include the principle of mutual recognition, which prescribes that products legally manufactured or put into the market in some EU member states or Turkey or legally manufactured in any of the European Free Trade Association country, which is a contractor of the European Economic Area Treaty, should be recognized in Latvia.

The principle of mutual recognition is the sole legal instrument in the non-harmonised sphere of application of national technical regulations and standards for harmonisation of draft technical regulations pursuant to the procedures set by Directives 98/34/EC and 98/48/EC, in order to provide free movement of goods.

In order to improve application of the principle of mutual recognition within the administrative practices of the national competent authorities, 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 according to a suggestion of the European Commission and support of EU member states, which was enforced on September 2, 2008. Thereby, a substantial step was taken towards introduction of a new legal instrument at EU level. Currently, Latvia and other member states must prepare for ensuring implementation of requirements of the abovementioned Regulation, application whereof will have to be started on 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. The Regulation sets an obligation for the state to establish one or several product information points for informative support of performers of economic activity in order to simplify the administrative procedures to be implemented.

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

The European Parliament and Council Directive 2006/123/EC on services in the internal market is essential for Latvia among initiatives of the recent years of EU legal acts, which must be implemented by the state before the end of 2009. The goal of this directive is to create the necessary legal framework, in order to facilitate implementation of free movement of business activity rights and free movement of services within the EU internal market. Correct and timely implementation of this directive may give a positive contribution in relation to promotion of cross-border economic activities in the services sector, as well as improvement of business environment, particularly in decreasing the administrative burden for businesses.

In accordance with requirements of this directive, the national authorities have an obligation to arrange their activities pursuant to the one-stop shop principle before the end of 2009, *inter alia* providing an opportunity to a service provider to carry out the administrative procedures remotely by means of electronic resources, as well as facilitating access to information in relation to national requirements and procedures not only for service providers but also for the beneficiaries. At present, the developed draft concept for implementation of the one-stop shop principle is delivered to all ministries for harmonisation.

In order to facilitate starting and performing business activity, the existing administrative barriers

and procedures are reviewed by accordingly liquidating and simplifying requirements for the issue of permits (licences, certificates, certifications and other documents), as well as creating an opportunity to settle all the required procedures electronically. The permits terminated in certain spheres are planned to be replaced by termless licences permit prolongation procedures are simplified, as well as the list and amount of the documents to be submitted is reviewed.

In addition to adoption of requirements of the Directive 2006/123/EC, amendments will be made to the existing normative acts. Report about the performed work will be submitted to the European Commission for assessment.

In 2008 a national information campaign regarding **SOLVIT co-ordination network** was continued in several cities of Latvia operating as an alternative mechanism in solving the internal market problems of the European Economic Area. The basis of the SOLVIT idea is to find a quick and real solution for the internal market problems emerged as a result of operations of public institutions by incorrect transposition of the EU legal norms. SOLVIT solves both, the problems of inhabitants and entrepreneurs and this service is free of charge.

In 2008 the SOLVIT Co-ordination Centre of Latvia has received 30 cases for review, 6 of which are still being solved in 2009. 22 complaints have been submitted by the inhabitants, but 8 complaints have been received from enterprises. As the solution solved by the SOLVIT network contrary to the judgement of the court is not binding to the public institution violating EU normative acts, the share of successfully solved cases is still a substantial indicator: 80% in 2007 and 83% in 2008.

Till now, inhabitants have mostly complained about the approval of professional qualification and diplomas, the problems emerging from the crossing of borders between countries, as well as the rights of family members of EU citizens to stay and work in the member states.

6.3. Sector-Specific Development Policies

6.3.1. Industrial Policy

Industrial Policy in Latvia is established by taking into consideration development directions of EU policy at the same time identifying and solving the topical issues for the local industrial enterprises in co-operation with the organisations representing industrial enterprises. The industrial policy is closely related to innovation, as well as entrepreneurship, education and other spheres of the policy.

On June 28, 2007, the *Programme on Promotion of Entrepreneurship Competitiveness and Innovation for 2007–2013* developed by the Ministry of Economics was approved. The Programme includes measures for promotion of development of innovation, business, small and medium-sized enterprises and industries (see Chapters 6.4, 6.5, 6.7).

One of the directions of action of the *Programme on Promotion of Entrepreneurship Competitiveness and Innovation for 2007–2013* is development promotion of **industrial design**. As from 2007, the activities have been implemented with intermediation of the Investment

and Development Agency of Latvia aimed at improvement of co-operation between industrial enterprises and professional design service providers. The previous activities include performing design audits within the SMEs of various sectors, as well as organisation of events and seminars aimed at increasing the level of awareness and promoting co-operation of design professionals and industry. Pilot projects are being implemented in ten SME's as a continuation to design audits for development of new design products and for introduction into production.

In 2008, the portal of Latvian Industrial design www.designlatvia.lv has started its operation with the goal to become the co-operation and information exchange platform between representatives of design and production sectors. Establishment of contacts between designers and producers, providing information about design projects in Latvia and all over the world, providing information regarding co-operation opportunities and popularisation of successful design projects are the key tasks of the portal. The manual "Practical Steps for Implementation of Innovation and Product Design into Industrial Production" has been compiled and published in the portal of Latvian Industrial design.

On October 24, 2008, the first meeting of the Design Advisory Council took place. The Council has been established to be managed by the Ministry of Economics and the goal of its activity is promotion of design development in order to increase national economy competitiveness and the value added of products and services as well. The Council consists of the representatives authorised by legal entities representing different sectors – ministries, higher education institutions, institutions, societies, organisations and associations. One of the key tasks of the Council is to develop proposals for promotion of design development and to identify the problems hindering design development in Latvia, offering particular solutions for improvement of the situation, as well as to follow implementation of proposals.

In July 2008, a joint study of the Ministry of Economics and Ministry of Defence was started regarding development of **defence and related sectors** in Latvia. Within its framework the capacity of enterprises is assessed to incorporate into deliveries for the needs of armed forces and military industry supply chains, as well as the policy recommendations provided for increasing competitiveness, including recommendations for arrangement of the *offset* (compensation transactions) policy in Latvia. The military industry in Latvia is practically not represented directly. At the same time, several enterprises have already been involved or may potentially be involved in deliveries to the armed forces and supply chains of the military industry. Such enterprises operate in textile and clothing manufacturing, engineering industry and metal working, electronics and electrical engineering, as well as other sectors. The research will be continued until April 2009.

Implementation of the international co-operation project BSR InnoNet (The Baltic Sea Region Innovation Network) is continued. The project BSR InnoNet is oriented to co-operation in the sphere of developing a **cluster policy**, promotion of contacts, exchange of experience and co-operation among clusters, as well as cluster analysis within the region. The Nordic Innovation Centre is proposed as the institution co-ordinating the project, the Investment and Development Agency of Latvia and Ministry of Economics represent Latvia in the project by involving also representatives of other public institutions and private sector in different project activities.

One of the project tasks is to develop and start one or several international innovation and cluster promotion programmes. In 2008, implementation of two such international pilot programmes is started.

One of the international pilot programmes is oriented towards development of co-operation among the clusters of the countries in the region. This co-operation may be both, horizontal involving establishment of co-operation and contacts among similar clusters, as well as intersectoral co-operation involving the clusters on different value added chain levels or the clusters of different sectors, which potentially may supplement each other and facilitate development of synergy. The pilot programme is oriented to promotion of cluster co-operation of four sectors in the Baltic Sea Region: in the sectors of food, bioenergy, information technologies and wood-processing, as well as furniture. After assessment of the pilot programme results, it is planned to start to complete implementation of the programme in 2009, the goal of which is to establish co-operation among the Baltic Sea Region clusters with an opportunity to apply for the clusters of different sectors pursuant to the tender procedure.

Another significant area, within which an international programme is developed, is related to capacity development issues. It is planned to establish an international programme in the framework of which the mutual exchange of experience and training would be ensured for the persons and institutions involved in cluster development. The target audience for such a programme is cluster co-ordinators and personnel, as well as public agencies and institutions implementing the cluster promotion policy. The project "BSR InnoNet" will continue until August 2009, but it is planned that the activities started within its framework in the field of mutual co-operation of clusters and training will be continued by attracting additional EU financing.

In 2009, the Mobility Programme for Entrepreneurship and Industry of the Nordic Council of Ministers for 2009–2013 aimed at promotion of economic co-operation among the Northern Europe and Baltic States will be started. The Programme is oriented to development of contacts, co-operation, direct visits and practical study where the small and medium-sized enterprises, business and innovation

support institutions, as well as organisations uniting entrepreneurs in the Baltic States and Nordic countries will be enabled to participate. Implementation of the Programme will be administered by the agencies of the Nordic Council of Ministers in Riga.

Cluster development and the issues of sustainable industry are set as the most substantial **priorities of EU level industry policy**. In January 2008, the EU Presidency Cluster Conference took place in Stockholm and adoption of the European Cluster Memorandum was made in its framework. The document is planned as a declaration emphasizing the importance of clusters in development of innovation in Europe and inviting EU member states at the national and regional level, as well as EU institutions to facilitate cluster development at the EU level, as well as providing recommendations in implementation of initiatives regarding cluster support. Upon following the Cluster Memorandum, the European Commission has developed Communication “Towards world-class clusters in the European Union”. The Communication includes the analysis of the previous cluster policy at the EU level and member states, as well as provides justification for the necessity of developing competitive clusters on a global scale, as well as recommendations for development of the cluster policy.

In summer 2008, the European Commission published the *Action Plan for Sustainable Consumption and Production and Sustainable Industry Policy*. The document comprises the objectives and directions of action for development of sustainable production and consumption within the EU. The most sustainable

priority directions are set within the area of competitiveness:

- Sustainable public procurement development;
- Development of appropriate and available standards;
- Market development of environmental technologies and products;
- Promotion of eco-innovations;
- Promotion of the global trade involving environmental technologies and products, development of global standards.

6.3.2. Energy Policy

The main directions of the energy policy are aimed at increasing security of the state energy supply by promoting diversification of deliveries of primary energy resources and creating conditions for the growth of self-provision of electricity generation, as well as preventing the electricity market isolation of the region with the help of new interconnections. Upon creating competition conditions, promotion of utilisation of the renewable and local energy resources and environmental protection are also substantially important.

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.

Box 6.6

Harmonisation of normative acts with EU directives

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

- **Security of supply and creation of oil product reserves.** The Concept of the State Oil Product Reserve was approved on June 27, 2006. On June 27, 2006 the Cabinet of Ministers adopted its Regulations No. 541 “Procedure for the Establishment and Storage of Petroleum Product Reserve”, which regulates the procedure for oil product reserves to be established by entrepreneurs;
- **Electricity sector.** The legal regulation for efficiently functioning electricity market, within which all the electricity users are supplied with electricity in a safe and qualitative way and for reasonable prices, 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. The law “Amendments to the Electricity Market Law” came into force on May 15, 2008. 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 competition on establishment of new production capacities or reconstruction of the existing equipment. The winner of the competition will obtain the rights to receive payments for the new electricity capacities. At the same time the respective producer of electricity will be entitled to participate in the electricity market and sell the produced electricity for the agreed price to any participant of the electricity market.
- **Gas sector.** On May 26, 2005, the Saeima passed the “Amendments to the Energy Law” determining principles for operation of the natural gas market. The aim of the law is to create conditions for competition in the natural gas market in Latvia as well as harmonise regulatory normative acts with requirements of EU legislation. Transitional provisions of the law prescribe that the time and procedure for coming into force of the legal norms, which regulate principles for operation of the natural gas market, are determined by a special law. Concerning the procedure for coming into effect of particular sections of the Energy Law, the law prescribes that these provisions of the Energy Law will become effective as of January 1, 2010. Delivery and utilisation of natural gas are regulated by the Regulations No. 99 of February 12, 2008 “Regulations regarding Delivery and Utilisation of Natural Gas”.

In **electricity supply**, 86% of all electricity generated in Latvia is generated by the JSC “Latvenergo” in 2007, which also ensures import of electricity and its supply to consumers. As from September 1, 2005 all functions of electricity transmission system operator are performed by the JSC “Augstsprieguma tīkls”. As from July 1, 2007 all functions of electricity distribution system operator are taken over by the JSC “Latvenergo Sadales tīkls”. The sole owner of both joint-stock companies is the JSC “Latvenergo”. In addition, approximately 150 small power plants operate in Latvia, the total installed capacity of which amounts to 25 MW, 14 wind power plants with the total installed capacity of 25.2 MW and 43 cogeneration plants with the total installed capacity of 569 MW, as well as 15 licensed electricity distribution and trade companies.

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

At present, JSC “Latvijas Gāze” is the only enterprise in the **natural gas market** in Latvia, which carries out transmission, distribution, storage and sale of natural gas in compliance with the licences issued by the Public Utilities Commission. Approximately 70 companies compete in supply of liquefied petroleum gas.

Amendments to the Energy Law made on May 26, 2005 prescribe main conditions for opening the natural gas market and were developed, taking into account Directive 2003/55/EC of the European Parliament and of the Council concerning common rules for the internal market in natural gas. The law includes issues concerning operation of systems, duties and rights of market participants, as well as competition opportunities in the natural gas market. The Saeima has passed a special law prescribing that these amendments will become effective on January 1, 2010.

By choosing a regulated procedure of access, the member states implement the necessary measures to confer rights or accessing the system to natural gas companies and qualified users inside or outside the area, which contains an interconnected system, on the basis of published tariffs and other conditions and obligations that are to be complied with, when the system is used.

In order to update the regulation in **heat supply**, on October 21, 2008 the Cabinet of Ministers adopted Regulations No. 876 “Regulations for Supply and Use of Thermal Energy”, which sets 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 cease supply of thermal energy to a user, who has not paid for received thermal energy or has not fulfilled other obligations to the supplier.

In compliance with provisions of Directive 2003/30/EC of the European Parliament and of the Council of May 8, 2003 regarding promotion of the use of bio-fuels and other renewable fuels for transport (hereinafter – Directive) and the requirements prescribed in the Biofuel Law (15.04.2005), the share of biofuel in Latvia has to amount to at least 5.75% of the total amount of fuel used for transport until December 31, 2010. In order to reach the objectives set in the Directive and Biofuel Law (15.04.2005) in relation to the use of biofuel for transport, the Ministry of Economics is working out a draft concept on provision of the compulsory market share of biofuel of 5% of the total amount of fuel turned out for free turnover and provided for transport (hereinafter – Draft Concept).

The Draft Concept contains a review of all the possible solutions in relation to the time on the basis of which the admixture of biofuel to the fossil fuel is determined, as well as the way according to which the traders of fuel should start the trade of fuel containing admixtures of biofuel. The Draft Concept includes the variants concerning the excise tax rate for the fossil fuel, to which biofuel is admixed in the amount of 5% of the capacity by assessing their advantages and drawbacks, required resources, as well as influence on the fuel prices and budget.

Investments in energy sector

State support in the energy sector is only given to projects that are linked to adjustment of heat supply systems. The earmarked grants to the local government budgets amounted to LVL 5 million in the framework of the energy policy appropriation planned by the Ministry of Economics in the budget of 2007, which were provided for raising efficiency of production, transmission and distribution of thermal energy, as well as promotion of energy efficiency for public buildings. The abovementioned financing was allocated to 42 local government projects in accordance with the procedure of the project competition of the Local Government Energy Efficiency Programme. However, the state budget of 2008 did not envisage financing for investment into the energy sector.

In order to raise the efficiency of thermal energy production, reduce the losses of thermal energy in the transmission and distribution systems and facilitate replacement of the types of imported fossil fuel with renewable fuels or local fuels of another type, the Ministry of Economics has worked out draft Regulations of the Cabinet of Ministers “Regulations on Activity 3.5.2.1 “Measures regarding the Increase of Efficiency of Centralised Heat Supply Systems” of Supplement to the Operational Programme “Infrastructure and Services”” in the framework of the

utilisation of the Cohesion Fund prescribing the procedure according to which financing is allocated in the framework of Activity 3.5.2.1 “Measures regarding the Increase of Efficiency of Centralised Heat Supply Systems” 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”.

In order to considerably increase production volumes of electricity and thermal energy from the renewable energy resources, diversify deliveries of primary energy resources and increase self-provision of electricity, therefore reducing dependence of Latvia on the import of primary energy resources, the Ministry of Economics has worked out draft Regulations 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”, 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”.

A co-financing is planned from the resources of EU Cohesion Fund in the amount of EUR 127400000 in the framework 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” (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 projects were submitted and assessed. The co-financing of European Regional Development Fund (ERDF) was allocated to 29 projects, while 6 projects are approved and being implemented in the framework of SPD Sub-Activity 1.1.4.1 of the national programme “Improvement of Heat Supply Systems by Reducing the Content of Sulphur in Fuel”.

Supporting reconstruction of district heating systems, construction of heat sub-distribution units and other heat regulation equipment and reduction of heat losses in buildings, the Minister of Economics Regulations No.192 “On Energy Efficiency Programme of Local Governments” of April 23, 2007 was issued, through which utilisation of appropriation in the amount of LVL 5 million, granted in the form of earmarked subsidy to local governments by the Law “On the State Budget for 2007” in the Ministry of Economics Programme 29.00.00 “Energy Policy”, was

ensured in the framework of an open tender of local government projects.

6.3.3. Construction Policy

The goal of the state policy in construction is creation of conditions to meet the demand of national economy for environmentally friendly, healthy, energy-saving, resource-saving and modern buildings. The main goal of the construction policy is development of a competitive construction sector by facilitating qualitative and energy efficient construction, establishing efficient information circulation system and providing efficient drafting of normative acts concerning construction by meeting the EU requirements and market interests.

The following tasks are set to promote development of the construction sector:

- improving business environment by reducing administrative barriers in construction;
- optimising the institutional structure of construction;
- increasing transparency of the construction process and awareness of society;
- promoting competitiveness of the construction sector.

In the recent years construction has been one of the most solidly developing economic sectors. The annual construction volumes nearly tripled from 2000 to 2007. It was facilitated by the rapid integration of Latvia to the EU and intensified capital inflow (particularly financing of EU structural funds and mortgage loans). During the period when the open EU construction market and comparatively low wages in Latvia facilitated outflow of labour from Latvia, but the domestic demand was increasing and in the result the labour shortage caused increase of wages. The growth of construction costs was facilitated also by levelling of prices among the EU member states, as well as growth of prices for energy resources and production costs. In 2008, the rapid growth rate has decreased.

A new policy document of the sector *Development Guidelines of Construction Sector for 2009-2013* has been prepared aimed at reaching the goals set in the Government’s declaration relating the construction sector. Constructive and productive co-operation of public institutions and non-governmental organisations will be of great importance in achievement of the set goals, therefore on October 23, 2008 the Memorandum of Co-Operation was signed between the Ministry of Economics and non-governmental organisations of the construction sector, the main task of which is considered to be development of a sustainable system of normative acts of construction facilitating development of the construction sector which is based on observance of fair competition and of the normative acts of the Republic of Latvia and its

binding international agreements and European Union documents, as well as fighting against the use of illegal labour force and tax evasion, improvement of construction public procurements, improvement of the register of construction enterprises, as well as assessment of particular opportunities of delegation of fulfilment of the state functions to non-governmental organisations.

In order to strengthen the government control, prevent overlapping of the functions of supervisory institutions in construction and energy sector, and to facilitate operation efficiency of public institutions, the Cabinet of Ministers adopted a decision on December 4, 2007 to merge the *National Energy Inspection* and *State Construction Inspection* as from January 1, 2008.

In compliance with Regulations No. 831 of the Cabinet of Ministers of December 4, 2007 “By-Laws of the State Construction Inspection”, as from January 1, 2008, the *State Construction Inspection* performs the functions set in the *Construction Law*, the *Law on Safety of Hydrotechnical Structures of Hydroelectric Power Stations*, *Energy Law* and the *Law on Technical Supervision of Dangerous Equipment*.

Upon performing inspections jointly with the *State Labour Inspectorate* and *State Revenue Service*, the *State Construction Inspection* pays attention to disclosure of illegal employment in construction companies, as well as facilitates decrease of violations of “envelope salaries” and tax payments.

524 local governments perform direct supervision of construction in their administrative territories (municipalities of 7 big cities, 52 towns, 37 districts and 428 parishes), which have established their building authorities for this purpose or delegated supervision authority to the others. In 2008, 147 building authorities operated with 99 building inspectors.

The *Construction Law* does not precisely separate the supervision and control functions of local governments and public institutions. As a result, a situation has developed where the competence assigned to the state and municipal building inspectors is identical, the same area is supervised by two independent institutions and different decisions may be adopted by a local government or public institution on the same situation.

In order to further improve the construction control system, amendments to the *Construction Law* have been prepared by specifying unified functional subjection of building inspectors to the *State Construction Inspection*, thereby ensuring independence

of building inspectors on the decisions made by the local government.

Upon optimising the institutional structure of construction, the *Building, Energy and Housing State Agency* was established and started its operation on January 1, 2008, performing the following main tasks:

- collection of information in the field of building, energy and housing in order to ensure preparation and analysis of energy resource balances, maintain and update the construction information system, register of construction businesses and register of builder’s practice and architects practice, energy, as well as housing monitoring systems;
- development of draft construction and energy technical regulations and draft standards in the regulated sphere;
- preparing methodical materials for public procurements in construction in co-operation with the Procurement Monitoring Bureau;
- preparing reports on the research and analyses made in the sphere of housing, building and energy, etc.

In compliance with the Article 10 of the *Construction Law* and Regulations No. 453 of the Cabinet of Ministers of June 28, 2005 “Regulations for Registration of Construction Companies” a total of 6969 construction companies have been entered in the *Construction Company Register* until December 1, 2008, 697 of which were registered in 2008.

Information on 7514 certified persons and 9270 certificates of builder’s practices and architects practices is included in the common register of certified specialists, 757 of them were issued in 2008.

Proposals have been made on the necessary priority requirements for public procurements in construction and the process of their implementation.

A particular attention is paid to public information and education in regards to environmental quality issues, economic utilisation of energy resources in buildings, provision of sustainability and accessibility of buildings and new approaches regarding implementation of construction intentions, such as “green procurement”, construction of passive houses and alternative heating solutions of buildings.

Upon improving the existing normative base of construction and standardisation system, Latvia also participates in development, harmonisation and introduction of a unified base of EU normative acts at the same time (see Box 6.7).

Box 6.7

Harmonisation of the normative base of construction with the EU normative base

The normative base of construction is reviewed and harmonised with the requirements set in the EU horizontal normative acts (Directive 2006/123/EC of the European Parliament and of the Council of December 12, 2006 on services in the internal market, Directive 2005/36/EC regulating requirements on the recognition of professional qualifications and temporary provision of services in the field of market surveillance, labour protection and public procurements) by preventing contradictions in the previously adopted normative acts.

Box 6.7 continued

The current normative regulation of construction products, drafted in compliance with the EU Council *Directive 89/106/EEC of December 21, 1988 on the approximation of laws, regulations and administrative provisions of the Member States relating to construction products* ensures implementation of the basic principle of the free movement of goods. This Directive will soon be replaced by the *Regulation of Construction Products on Unified Requirements Regarding Circulation of Construction Products*, the draft of which is currently under the process of approval.

Several requirements included in the draft *Regulation of Construction Products* have already been included in the Construction Law and Regulations on Construction Products, for example, efficient utilisation of natural resources for structures, compulsory attachment of the copy of Conformity Declaration to each delivery lot of construction products, responsibilities of a construction work manager as a final consumer, compulsory CE marking of a construction product if its conformity is confirmed by harmonised technical regulations.

In 2008, the amount of the declared (notified) institutions assessing conformity of construction products in Latvia has been extended. On April 7, 2008, the European Commission acknowledged the Testing laboratory of Forest and Wood Products Research and Development Institute of the Latvian University of Agriculture as the institution declared (notified) by the EU in the framework of Directive 89/106/EEC on construction products, thereby confirming competence of this laboratory and the right to perform assessment of conformity of construction products and issue of the internationally recognised (also beyond EU) testing reports within the regulated sphere on mechanical properties of wooden products and constructions and their reaction to fire.

On July 28, 2008, the Cabinet of Ministers approved the National Implementation Plan of Eurocode Standards for 2008–2011 (Decree No. 455 of July 29, 2008), adopting *European Commission Recommendation 2003/887/EC on the implementation and use of Eurocodes for construction works and structural construction* and envisages replacement of the previously effective designing regulations of building designs until 2010, maintaining the required safety level of constructions. The plan envisages translation of Eurocode standards (the system comprises 58 standardisation documents) and drafting of national supplements.

In order to promote economical utilisation of energy resources and implement requirements of *Directive 2002/91/EC of the European Parliament and of the Council of March 31, 2004 on energy efficiency of buildings*, on March 13, 2008 the Saeima adopted the *Energy Efficiency Law for Buildings*. In compliance with delegation of the law the regulations regarding energy auditors, energy efficiency calculation method of buildings and energy certification of buildings have been drafted, minimum requirements of energy efficiency set for newly constructed buildings concerning also the buildings to be reconstructed the total area of which is more than 1000 square metres and the total reconstruction costs of which exceed 25% of cadastre value of the respective buildings or reconstruction work of which concerns 25% of construction volume of such buildings.

6.3.4. Tourism Policy

The main goals of the Latvian state tourism policy are to improve competitiveness of the tourism sector and, through promotion of sustainable growth of tourism, create new workplaces, encourage balanced

development of regions, preserve cultural and natural heritage and foster social integration of the society.

In order to determine and implement state tourism development policy, a system of tourism policy planning documents and normative acts (see Box 6.8) is created and is being improved on a regular basis in Latvia.

Box 6.8**Latvian tourism development policy planning documents**

Basic guidelines of Latvian tourism development policy is a medium-term policy planning document specifying the basic principles of the tourism development policy and the goal of Latvian tourism development policy for 2004–2008 – growth in the share of tourism in GDP of Latvia.

In order to achieve the goal, the following directions of action are set:

- positioning of Latvia as a different, safe and recognizable tourist destination;
- development of incoming and local tourism;
- promotion of co-operation.

The basic guidelines were approved by Decree No. 559 of the Cabinet of Ministers of August 11, 2004 regulating the basic principles of the tourism development policy, the established tourism development goals and the main directions of action for reaching these goals.

In order to ensure achievement of objectives set in the Guidelines, the Tourism Development Programme of Latvia for 2006–2008 was elaborated and it was approved by Decree No. 505 of the Cabinet of Ministers of July 5, 2006.

Specific activities promoting tourism development in the framework of the allocated state budget are determined in the annual action plan. **Action Plan of Latvian Tourism Development for 2008** (approved by Decree No. 403 of the Cabinet of Ministers of July 9, 2008) is developed in accordance with the directions of activity set in the Guidelines and Programme and includes particular measures for promotion of tourism development, as well as prescribes responsible institutions, expected financing, performance deadlines and performance assessment indicators. The action plan also includes a comparative report regarding achievement of the particular goals within the period from 2004–2007.

Horizontal tourism development measures are included in the **Programme** and in the **Plan**, implemented by the Ministry of Economics, Latvian Tourism Development Agency, other ministries and public institutions in co-operation with local governments, the private sector and non-governmental organisations.

Elaboration of *Latvian Tourism Development Basic Guidelines for 2009–2015* is currently in progress. This draft document sets strategic directions for sustainable

and competitive development of the tourism sector by promoting the growth of the state export capacity and positioning of Latvia as the leading travel destination

in the Baltic Sea Region, thereby increasing the tourist flow and income from tourism, as well as promoting development of Latvian national economy, economic and social welfare of population and international integration in general.

LVL 1.28 million were allocated for implementation of the state budget programme “Implementation of Tourism Policy” in 2008, which are applied in accordance with the priorities set in the Guidelines in order to strengthen positions of Latvia as a tourist destination, improve tourism infrastructure, promotion of development of new tourism products and expansion of co-operation.

In 2008, several meetings of the heads of Ministry of Economics and other ministries with social partners of the tourism sector took place in order to discuss

different topical issues regarding tourism development, including resort development, drawbacks in the foreign tourist declaration system, external economic (inter alia tourism) representation of Latvia.

Regardless of the activities of public and private sector for promotion of the sector development, supply of tourism services lags behind the increasingly growing demand, therefore decrease in the quality of the rendered services may be observed. Meanwhile, the high inflation in the country has affected the prices of tourism services, therefore compliance of the value of the rendered services with the price has worsened, which has been one of the most essential attraction factors of Latvia up to now from the point of view of foreign tourists.

Box 6.9

Latvian tourism development indicators

The share of the tourism sector was 1.5% in 2007 (1.7% in 2006) of Latvian GDP. However, taking into consideration that tourism is closely connected with other sectors its total (direct and indirect) contribution in the national economy in 2007 is much bigger – 7.5%.

In general, rapid growth of the tourism sector continued – export of services related to tourism reached LVL 343 million or 18.1% of Latvia's total exports of services.

In 2007, the number of border crossings made by foreign tourists reached 5.2 million, which is by 12.7% more than in 2006. Expenditures of foreign tourists also increased by reaching LVL 338 million, which is by 27% (LVL 266.2 million) more in comparison with 2006. The number of employees in the tourism sector grew by 11% by reaching 35.6 thousand in 2007.

Growth of the tourism sector in 2007 was mainly facilitated by the following factors:

- Strengthening of Latvia as a new tourist destination after joining the European Union (EU);
- Accessibility to the EU financial resources;
- Latvian tourism marketing measures in high-priority, priority and perspective countries;
- Growth of the number of direct flights;
- Increase in the number and volume of low cost airline services;
- Growth of the number of tourist class hotels.

Despite these positive tendencies, indexes of the tourism balance of payment are still negative – expenditures of the residents of Latvia abroad exceeded the expenditures of foreign tourists in Latvia by LVL 146.8 million in 2007. The average duration of visits of foreign tourists in our country has decreased from 1.5 days in 2006 to 1.4 days in 2007 without reaching the planned annual growth to 2.5 days. During the first half of 2008, longer average duration of visits of foreign tourists in Latvia was observable – 1.4 days. Within six months of 2007 foreign tourists stayed in our country for only the average of 1.2 days, which may be explained by global tendencies – development of air traffic, changes of tourist travel habits and shortening of the travel duration thereof.

The number of border crossings of foreign tourists within six months of 2008 reached 2487.7 thousand, which is by about 8.7 % more than in the respective period of 2007.

In accordance with the data provided by the Central Statistical Bureau, there were about 400 tourist campsites in 2007 in Latvia, which is by 2% more than in 2006. The number of the served guests in 2007 increased more rapidly (by 12% in comparison with 2006) amounting to 1487.4 thousand. In the first half of 2008 the number of persons served in hotels and other tourist campsites amounted to 683.9 thousand or by 49 thousand of the served persons more than within the respective period in 2007.

A considerable contribution to development of Latvian economy is made by the European Union Structural Funds. Both, the previous and current division of the available resources in sectors provides an opportunity for tourism to attract considerable amounts of financial resources to its development. In the planning period of 2007–2013 the financial resources of the European Regional Development Fund managed by the Ministry of Economics are accessible for development of the tourism sector in the amount of LVL 30 million for Measure 3.4.2 “Tourism”

of Priority 3.4 “Quality Environment for Life and Economic Activity” of Supplement to the Programme “Infrastructure and Services”. The goal of the measure is to promote consolidation of Latvia as a tourist destination and increase of competitiveness by creating favourable conditions for complex development of the tourism products of national importance. Two activities are planned in the framework of the measure: 3.4.2.1 “Development of Tourism Product of National Importance” and 3.4.2.2 “Development of Tourism Information System” (see Box 6.10).

Box 6.10**Utilisation of the European Regional Development Fund Resources****Measure 3.4.2 “Tourism”****Activity 3.4.2.1 “Development of Tourism Product of National Importance”****Sub-activity 3.4.2.1.1 “Maintenance and Renewal of Town Planning Monuments of National Importance and Infrastructure Adjustment to Develop a Tourism Product”**

- the goal – promoting development of cultural tourism products of national importance by ensuring internationally recognised improvement of tourism infrastructure regarding Latvian cultural and historical values;
- amount of ERDF financing – LVL 10 542 060;
- type of introduction – open selection of project applications;
- potential investment locations – town planning monuments of national importance in compliance with the list of the State Inspection for Heritage Protection as of January 1, 2007;
- beneficiaries of financing – local governments;

Sub-activity 3.4.2.1.2 “Development of Cycling Tourism Product of National Importance”:

- the goal – facilitating development of a cycling tourism product by establishing a bikeway infrastructure and observing requirements for ensuring tourist safety and tourism resource sustainability;
- amount of ERDF financing – LVL 4 919 628;
- type of introduction – open selection of project applications;
- beneficiaries of financing – local governments;

Sub-activity 3.4.2.1.3 “Development of Cultural, Active, Health and Recreational Tourism Product of National Importance”:

- the goal – promoting development of internationally competitive and recognisable tourism products in Latvia by investing in creation of new tourism products or substantial quality improvement of the existing ones;
- amount of ERDF financing – LVL 13 528 098;
- type of introduction – open selection of project applications;
- beneficiaries of financing – businesses and local governments;

Activity 3.4.2.2 “Development of Tourism Information System”:

- the goal – establishing a complex tourism information media system ensuring convenient finding of tourism objects and obtaining information for tourists;
- amount of ERDF financing – LVL 790 499.88;
- type of introduction – limited selection of project applications;
- beneficiary of financing – Latvian Tourism Development Agency.

The tourism development state policy is implemented by the **Latvian Tourism Development Agency** (see Box 6.11).

Box 6.11**Activities of the Agency in 2008**

In order to promote implementation of the directions of activity set in the strategy, which involves promotion of identification of Latvia's tourism image and popularisation of Latvia as a tourist destination in the international tourism market, the Agency:

- has carried out direct marketing activities in 13 tourism target markets: tourism companies and mass media were studied, updated contact databases are established and maintained, as well as meetings organised with the potential co-operation partners;
- popularised Latvia as an attractive tourist destination and participated in 17 international tourism fairs, arranged 32 visits of journalists and 5 work seminars for tourism professionals, as well as published informative materials of 22 types. Meanwhile, mass media and tourism industry representatives were informed on the new travel opportunities provided by Latvia joining the Schengen zone for residents of these states in the press conferences organised by the Agency in eight CIS states in co-operation with the Ministry of Foreign Affairs and the airline company “airBaltic”;
- improved the technical system and content of the state tourism portal www.latviatourism.lv. A new design of the portal, as well as content concept are developed by including new sections in it, for example, “Latvian experts recommend”, “Event calendar”, “Photo and video bank”. Information in 14 languages is provided in the portal;
- organised an international work seminar for tourism professionals “Buy Latvia, Buy the Baltics 2008”. The goal of the event was to acquaint the existing and potential sellers of Latvian and Baltic tourism products with tourism opportunities in Latvia and the Baltic states, show the tourism products, diversity thereof, provide an opportunity for tourism professionals to meet the providers of tourism products and services, as well as acquaint themselves with the supply of tourism products not only in presentations, but also in presence by going on 35 different excursions throughout Latvia for several days. Taking into consideration the great interest (of more than 200 foreign and 100 Latvian tourism sector representatives from more than 100 foreign tourism companies and 78 tourism companies of the Baltic States) such an event will be organised also in 2009;
- a travel campaign of the Baltic States “Grand Travelling round the Baltic States” was organised jointly with the Lithuanian and Estonian national tourism organisations already for the second year with a purpose to popularise new tourism products, as well as get acquainted with the tourism supply, and facilitate local tourism development of the Baltic region. 36 tourism objects were included in the marathon (12 from each country) visited by about 10 000 tourists. In the framework of the project the homepage www.greatbaltic.eu was established, 4 visits of Baltic journalists conducted by comprising all campaign objects, as well as the most active tourists awarded in the final event of the campaign;

Box 6.11 continued

- popularised Latvia in the remote tourism markets by concluding a co-operation agreement with Japanese tourism operator “JTB Business World Tokyo Corp.” envisaging various activities in the Japanese market;
- completed organisation of a foreign tourist inquiry, as a result whereof 1000 respondents were polled from June to September 2008 throughout Latvia. The inquiry data testify that most part of the tourists in Latvia were on holidays (62 %) or spent their weekend (20%). 32% obtained information from friends, 20% – from the Internet, 19% – from tourism guides. Most tourists visited Latvia for the first time (83%) and mostly used air transport when travelling to Latvia (61%). Tourists still show the most interest about the old Riga (78%), Jūrmala (35%), enjoying the national cuisine and cultural history. Tourists are dissatisfied with the price level (25%), weather (11%) and service culture in different tourism service fields;
- completed a study about 10 target markets (Great Britain, Germany, Lithuania, Estonia, Poland, Russia, Sweden, Finland, France, Spain). The data obtained in the studies characterize the structure, tendencies, the most prospective marketing channels of these markets and potential actions for more successful involvement of these markets. The study data may be used for planning and implementation of the Agency marketing activities within the set target markets, as well as they may be applied by tourism sector representatives;
- developed a tourism service quality system Q-Latvia. The Swiss tourism service quality system was used and adapted as a basis for establishment of the quality system. The enterprises directly and indirectly involved in the provision of tourism services may voluntarily participate in Q-Latvia. Upon introduction of Q-Latvia, particular attention within the activity of tourism service providers will be focused on hospitality and clients, their wishes and assessment, as well as on increased understanding of enterprises on importance of the service quality and means of its provision. It is expected that Q-Latvia will help to reduce the amount of complaints, facilitate growth of positive tourist comments, repeated visits, improve co-operation among companies within the sector and create a positive image of Latvia as a tourist destination. The Agency will provide marketing activities for the companies having obtained Q-Latvia certificate;
- established a free hotline “Tourist Hotline – 22033000” in order to provide safe tourism in Latvia, enabling to inform foreign tourists of different conflict situations related to tourism service providers in Latvia, as well as provide round-the-clock informative assistance. In addition, popularisation measures of the phone line are carried out;
- continue participating in the European Commission project “Most prominent European tourist destinations” in the framework whereof wide publicity is ensured for the best travel destination of Latvia. The goal of the project is to draw attention to diversity of European travel destinations, different and common values, as well as support the destinations, where economic growth is ensured by sustainable tourism development. In 2008, the topic of EDEN project was “Tourism and Intangible Heritage”. A project application was prepared and approved by the European Commission, and therefore a competition was also organised in 2008 on the best Latvian tourist destination, as well as 13 applications assessed. The application “Latgale Potters – Stoneware Masters” submitted by Rēzekne District Council was acknowledged as the most outstanding in Latvia. Awarding took place at the European level in autumn 2008 in the framework of the European tourism forum.

In 2008, the following directions of activity should be considered as priorities in the field of tourism also reflecting in the Action plan of the Agency and activities to be performed:

- strengthening of the positions of Latvia as a tourism centre of the Baltic States;
- improvement of the information system and increasing the role of Internet;
- adjustment of the market activities to the target markets;
- quality promotion of tourism services;
- facilitating development of new tourism products.

Taking into consideration the existing tourism tendencies of Latvia and the world, the Agency has set further application of modern technologies in Latvian tourism marketing, as well as establishment of the tourism service quality system as the main priorities of 2009, which will facilitate creation of a positive image of Latvia as a tourism destination.

In order to ensure further international integration of the tourism sector of Latvia, representation of the state interests and adoption of the best practice, international co-operation is being developed, for example participation in UN WTO European Travel Commission and operation of European Commission Tourism Advisory Committee and Sustainable Tourism Group.

6.4. Business Environment

Business environment in Latvia is being consistently improved through development of the legal framework, harmonising it with EU requirements and monitoring the effects of administrative procedures on business activity. Considerable reforms and improvements have been achieved in registration of enterprises, taxation policy, customs legislation and cross-border procedures, construction, real estate development and other areas.

Reforms for improvement of business environment are evaluated positively in various surveys.

Latvia takes the 29th position among 181 countries in the report *Doing Business 2009: How to reform* by the World Bank published in 2008 (Latvia took the 26th position among 178 countries in the report *Doing Business 2008: How to reform*).

Business environment is assessed according to 10 aspects and assessment of the Baltic States (see table 6.5).

Table 6.5

Business environment in the Baltic States				
No.	Sphere	Latvia	Lithuania	Estonia
1.	Starting business activity	35	74	23
2.	Receipt of licences	78	63	19
3.	Recruitment and dismissal of employees	103	131	163
4.	Registering property	77	4	24
5.	Receiving loans	12	43	43
6.	Protecting investors' rights	53	88	53
7.	Taxes	36	57	34
8.	Foreign trade	25	26	5
9.	Ensuring fulfilment of contracts	4	16	30
10.	Termination of business activity	86	34	58
Total ranking		29	28	22

One of efficient mechanisms for improvement of business environment in Latvia is the annual *Action Plan for Improvement of Business Environment* worked out annually since 1999. The *Action Plan* is an inter-ministry policy planning document setting out directions of activity for implementation of business environment policy, as well as tasks, measures to be implemented, responsible institutions, indicators for assessment of how the tasks have been accomplished and their accomplishment terms.

Directions of activity and the tasks of the *Action Plan* to be implemented include such spheres as taxation policy and administration, improvement of business legal environment, reduction of the number of procedures and required period of time, improving access to information.

Problems included in the *Action Plan* and their solutions are identified through close co-operation with organisations representing entrepreneurs (Council of the Small and Medium-Sized Enterprises and Crafts, National Economy Council, Foreign Investors Council in Latvia), as well as through assessment of the problems identified in business environment surveys. The *Action Plan* covers amendments to legal acts, revision and simplification of procedures, improvement of co-ordination between various bodies, preparation, and publication of information, as well as training employees of public institutions.

The *Action Plan* for 2008 approved by the Cabinet of Ministers on April 29, 2008 includes 32 measures for

improvement of the taxation system, promotion of employment, simplification and improvement of construction process, simplification of the registration process of real estate, provision of efficient public administration, etc. The most essential measures reflected by the *Action Plan* are as follows:

- not imposing taxes on reinvested profit and promotion of investments in development of enterprises and innovations (see Box 6.12);
- increasing the limit of RIT justified expenses for education and health:

On October 7, 2008 amendments were made by the CM to the *Regulations on Justified Expenses for Education and Medical Services*. The amendments envisage increasing justified expenses for education and medicine from LVL 150 to LVL 300 by approximating them to the actual costs. The justified expenses will also include payments for education in other EU member states. It is expected that the amendments will be enforced on January 1, 2009.

- Establishment of the one-stop shop principle for receiving work permits and residence permits:

Amendments to the *Regulations regarding Work Permits for Third-country Nationals* came into force on July 1, 2008, by which the amount of work permits was reduced, namely, the state fee for revision of the documentation required for applying for the work permit in order to employ one foreigner in the Republic of Latvia amounting up to 35 LVL per year.

- Incentives of businesses for employing a person with functional disorders:

Amendments to the Law on Corporate Income Tax and the Law on Personal Income Tax were adopted by the Saeima on November 14, 2008. Amendments to the Law on Corporate Income Tax specify that the taxable income is adjusted for the costs arising in the taxation year in order to create special new work place for an employee having a disability group.

At the same time, the standards of the Law on Personal Income Tax are adjusted so that the employed senior citizens could fully use the untaxed minimum prescribed by the law, the standards envisaging application of the untaxed minimum also to the senior citizens' income, the income taxable by the personal income tax, as well as other income are adjusted in the Law on Personal Income Tax.

- Implementation of the reforms regarding payment procedures for sick-leave certificates:

The Ministry of Welfare has prepared amendments to the Law on Maternity and Sickness Insurance envisaging shortening the temporary disability period of an employee payable by an employer and stipulated in the law from 14 calendar days to 10 calendar days.

The draft law was reviewed by the Saeima in Second Reading on October 23, 2008. Analogical amendments envisaging shortening of the temporary disability period of an employee payable by the employer from 14 calendar days to 10 calendar days are also prepared in the Law on Compulsory Social Insurance in Respect of Accidents at Work and Occupational Diseases. The abovementioned draft law was adopted by the Saeima on November 14, 2008.

- Simplification of construction harmonisation procedures and revision of construction requirements for small-sized public buildings:

The Ministry of Economics has prepared amendments to the Regulations No. 112 of the Cabinet of Ministers of April 1, 1997 “General Construction Regulations” envisaging decrease in the amount of procedures in development of the building design, as well as the time and costs required for harmonisation. The abovementioned regulations specify that the building board issues the planning and architectural regulations along with the technical and specific provisions of the respective local government institutions, i.e., the one-stop shop principle is introduced in relation to the procedure for the issue of technical and specific regulations in the local government. In addition, amendments to the Regulations No. 299 of the Cabinet of Ministers “Regulations regarding Accepting Structures for Service” of April 13, 2004 are prepared in order to regulate the requirements for accepting structures only in relation to functionality of the building, elaborate the criteria and facilitate construction requirements to small public buildings, etc.).

- Expansion of e-signature services:

In the framework of the National Programme “Development and Improvement of E-Government Infrastructure Base” the Secretariat of Special Assignments Minister for Electronic Government Affairs continues to develop services. The services are available in the Latvian State portal www.latvija.lv. Testing of the services made is performed and preparation for operation of the services takes place in the authorities holding the services.

Currently available e-services:

- requesting a copy of the decision of local government council (Municipality of Riga),
- requesting a copy of the decision of the orphan’s court (Municipality of Riga),
- verification if a person is included in the Population Register and if there is any information about death of a person,
- verification if registration of a person is valid in the place of residence in the specified address,

- my data in the local government (Municipality of Riga and Ventspils City Municipality),
- verification of a document in the *Invalid Document Register*,
- information about the persons having valid registration in the place of residence in my property,
- requesting a tree cutting permit (Municipality of Riga),
- repeated request for a birth certificate (Municipality of Riga),
- repeated request for a marriage certificate (Municipality of Riga),
- repeated request for a death certificate (Municipality of Riga).

A *Public Services Electronic Catalogue* has been established including the information about 1419 public services of public and local government authorities provided by 80 public authorities and 35 local government authorities. Publication of the information about public services provided by the authorities is continued in the Latvian State portal www.latvija.lv;

- ensuring participation of enterprises in reducing administrative burden:

The webpage of the Investment and Development Agency of Latvia (hereinafter – IDAL) contains a section where businesses may inform about administrative burden and bureaucratic requirements online, as well as make proposals for preventing administrative burden and improving administrative procedures. The information about the problems sent in by entrepreneurs is aggregated and analyzed weekly. Descriptions of the problems submitted by entrepreneurs are also posted on the website.

A link with the section mentioned in the previous Article of the IDAL website is provided on the website of the Ministry of Economics.

On October 21, 2008 the Cabinet of Ministers supplemented the **“Informative Report on Measures for Stabilisation of Macroeconomic Situation for 2008-2009”** adopted by the government on April 15, 2008 with new measures in the fields of taxation policy, distribution of EU structural funds and reduction of the administrative burden. The goal of the abovementioned measures is to extend access to financing for enterprises, facilitate investment in the private sector, and continue reducing barriers for business activity.

New proposals in the field of taxation will enable to divide the outstanding tax payments in terms for a period to one year, excluding payments calculated as a result of audit, as well as increase the amount of the

sum up to LVL 10 000 (currently in the law LVL 5 000) for the deferrable or divisible sum, for exceeding of which the State Revenue Service (SRS) claims for a security. Likewise, the proposals envisage identifying rights of the SRS to cancel a half of the overdue amount set as a result of audit if a taxpayer concludes an agreement contract and agrees with the amount of tax payment calculated in the audit, as well

as exclude Paragraph 102 of transitional provisions of the Law on Taxes and Fees, thereby enabling taxpayers to apply for the receipt of tax overpayments as a result of the activity of whom a criminal procedure is started, unless the particular taxpayer or his/her official has obtained the status of a person having the rights of defence within 18 months since the beginning thereof.

Box 6.12

Amendments to the Law on Corporate Income Tax

In order to facilitate competitiveness of businesses and promote investments of enterprises in modernisation of equipment, the Ministry of Economics prepared proposals for amendments in the Corporate Income Tax Law in co-operation with social partners, which were introduced in the Law on Corporate Income Tax and which were approved by the Saeima on November 14, 2008. The amendments envisage:

- increasing equity – to create incentive for the owners of enterprise not to divide the gained profit in dividends, but invest in development of the enterprise by increasing equity;
- replacement of fixed assets – to create incentive for taxpayers to replace inefficient and outdated technological equipment with new and efficient equipment by postponing the payment of tax for the alienated fixed asset at the moment of replacement, promote the transfer of production complexes from the territories with high cadastral value and the real estate tax burden to more profitable territories in terms of taxes to rural areas of Latvia. The draft law envisages exemption from the corporate income tax for the profit derived from the sale of fixed assets (incl. technological equipment), if a new similar fixed asset is acquired instead within 12 months;
- increasing the value of fixed assets for the needs of writing off depreciation – to facilitate manufacturing industry, which is the main export-oriented sector, continue application of substantial tax incentives for taxpayers performing manufacturing and acquiring new production technological equipment within the period until 2013. The amendments to the law envisage extension of writing off procedures for specific fixed assets of new production technologies for five years (from 2009 to 2013) by increasing the rate scaling up the depreciation value of fixed assets to 1.5 within this period;
- writing off procedures for intangible investment – to facilitate registration of patents and trademarks in Latvia, thereby increasing the private sector investment in research and development. Orientation to the average index of European Union member states within the proportion of GDP in research and development costs. The draft law envisages introduction of the rate scaling up the depreciation value of fixed assets for such intangible investments, as a result of which a patent or trademarks are registered;
- loss transfer procedures – to promote competitiveness of tax treatment in relation to taxpayers making considerable investment in production, therefore it is not possible to earn the investment made within five years. The amendments to the law envisage extension of the loss transfer period from 5 to 8 years;
- allowances for attracting employees to the tasks not related to economic activity without adding expenses for taking the employees from home to work and vice versa if due to specific character of the work (for example, working at night, early in the morning) getting to work or getting home after work is not possible for employees by public transport.

In accordance with the updated measures of stabilisation of macroeconomic situation for 2008–2009, it is planned to develop a simplified enterprise liquidation procedure, pursuant to which the Register of Enterprises would be entitled to exclude the enterprises after receipt of their application and having no creditors from the Register of Enterprises without claiming for insolvency process in order to return the resources at the enterprise's disposition to economic circulation.

To promote exports of goods and services, cost efficiency, as well as to attract foreign investment, it is planned to introduce the choice standards of VAT:

- introduction of the deferred payment of the extended value added tax in cases of the import of goods or introduction of value added tax deposits,
- adjustment of the value added tax payable to the budget taking into consideration the bad debts,
- grouping the value added tax payers.

The updated plan motivates to resign from several small EU structural funds activities and transfer their

financing to the Activity “High Value Added Investments”, prescribing provision of support for acquisition of technologies and equipment, as well as construction and also increasing amount of support and extend the range of the recipients of financing in the framework of Activity “Support for Investment in Micro, Small and Medium-Sized Enterprises in the Territories Requiring Special Assistance” by increasing the maximum amount of support from LVL 70 000 to LVL 150 000. It is planned to reduce bureaucracy within the distribution process of EU structural funds by simplifying supervision of the activities of EU structural funds.

Meetings of the Foreign Investors Council in Latvia (FICIL) with senior government officials are held annually. The Prime Minister conducts a high level meeting by representing the government and the government ministers also participate, as well as officials of high level ministries and subordinate institutions, who are responsible for the administrative and regulating fields concerning entrepreneurs. At the same time, foreign investors and their representatives in Latvia participate in the meeting by representing FICIL.

Since the second high level meeting the recommendations of the FICIL have been included in the Action Plan.

On June 5–6, 2008, the twelfth high level meeting of Latvian government and Foreign Investors Council in Latvia took place, where the following was discussed:

- labour force planning;
- energy policy;
- future perspective of the Latvian macro-economic situation and taxation policy;
- sustainable planning in local governments.

6.5. Innovation and New Technologies

The goal of Latvian innovation policy is promotion of increasing the national innovation system capacity and efficiency. The main directions of activity for innovation development envisage facilitation of knowledge and technology transfer, establishing favourable institutional environment for innovative activity, promoting co-operation of science, education and private sector, as well as supporting development of new products and technologies.

In order to facilitate research, development and innovation and to achieve a more rapid growth of the entire EU, the Lisbon Strategy sets the goals to increase investment in research and development to 3% of GDP. The average financing of EU member states for research and development in 2006 was 1.84 % and only in Sweden and Finland the financing is above the set 3% of GDP. The total financing for research and development in Latvia in 2007 was 0.63% of GDP or LVL 87.9 million, which is only by LVL 9.7 million more than in 2006. However, the private sector investment in research and development decreases, which fell by LVL 6.2 million in 2007 compared to 2006. At the same time, if substantial growth of the public sector investment was still observable in 2007, the investment growth rates in 2008 have decreased, and already in the draft state budget of 2009 it is planned to decrease the public expenditures on research and development substantially, which will disable successful implementation of several industrial studies and innovation support measures.

In 2008, both the started activities are continued in order to facilitate carrying out industrial research, development of new products and their introduction into market and several new activities were initiated.

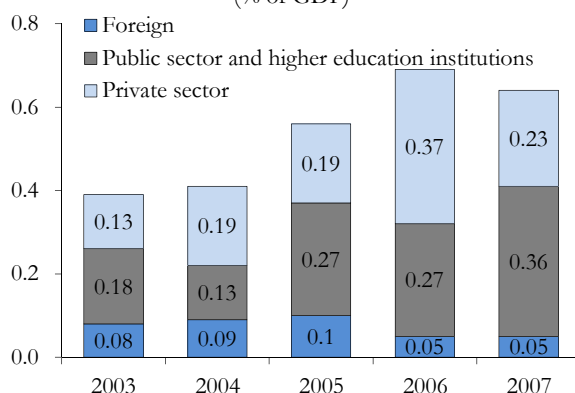
Commercial companies had an opportunity to submit projects to the Ministry of Education and Science also in 2008 in order to receive support for project implementation in the framework of EUREKA Programme¹. Commercial companies may receive up to LVL 91 000 for implementation of collaborative research project and the aid intensity may constitute 75% of the costs of conduction of industrial research and 50% of the costs for planning work. 7 new projects were supported in 2008 for the total amount of LVL 536 259.86.

The Ministry of Education and Science also continued implementation of the the *Market-Oriented Research Programme*, in the framework of which the research projects aimed at integration of science and production are supported. Scientific institutions including commercial companies registered in the *Register of Scientific Institutions* can receive financing in the amount of 70% of the referable costs. In the framework of the programme 21 projects were supported in 2008.

In 2007, the *Programme for Development of Innovation Centres and Business Incubators* was started with a goal to support innovation centres and establishment and operation of business incubators, as well as provision of services to start-ups, thereby facilitating establishment and development of new innovative companies. 11 projects of innovation centres and business incubators have been supported in the framework of the programme. In 2007, LVL 1 628 212 have been granted for operation of the centres and incubators and LVL 1 641 594 in 2008. In the framework of the programme a total of 158 new businesses have received support for developing their business ideas in the incubators until October 1, 2008, as well as 348 workplaces established and LVL 768 000 paid as state taxes. It is planned to continue the Programme also within the period of 2009–2013 by attracting EU Structural Funds financings. Regulations of the Cabinet of Ministers “Regulations on the Activity 2.3.2.1 “Business Incubators” of Supplement to the Operational Programme

Figure 6.1

Financing for Research and Development in Latvia for the Period of 2003–2007 by Sectors
(% of GDP)



Source: CSB

¹ EUREKA Programme is the EU programme for promotion of commercial activities and international co-operation of scientific institutions, in order to foster development of high technologies, new, competitive products and services.

“Entrepreneurship and innovation” were drafted on October 7, 2008 for continuing the Programme. The Regulations envisage supporting at least 10 incubators and total support to business incubators for 2009–2013 is planned in the amount of LVL 20.2 million.

In order to promote technology transfer, Investment and Development Agency of Latvia organised a project competition for higher education institutions and scientific institutes in compliance with Regulations of the Cabinet of Ministers of February 26, 2008 “Regulations on the Sub-activity 2.1.2.1.2 “Technology Transfer Contact Points” of Supplement to the Operational Programme “Entrepreneurship and Innovation” from May 6 to May 20, 2008. The goal of this Activity is to facilitate commercialisation of the research results, as well as to study systematically the existing research competence and to develop purposefully the necessary research competence in higher education institutions and institutes. The main directions of the activity of technology transfer contact points are providing information concerning competence of a scientific institution and knowledge and technology transfer, preparation of commercialisation offers of research results, organisation of co-operation seminars, conferences and contact exchanges of entrepreneurs and scientists. The Programme will be financed from resources of the European Regional Development Fund. The total public financing available in the framework of the activity amounts to LVL 2.5 million, and 9 technology transfer contact point projects will receive support from 2008–2013.

On February 29, 2008, the Enterprise Europe Network started its operations in Latvia. It merges the previously independently existing European Information Centre in Riga as one of the structural units of the Investment and Development Agency of Latvia and Innovation Relay Centre which operated under supervision of the Latvian Technological Centre. The Enterprise Europe Network is the entrepreneurship and innovation support network of EU scale consisting of nearly 600 different partner organisations within more than 40 countries and its goal is to provide informative and advisory support to entrepreneurs in order to facilitate their competitiveness and development in the framework of the European Union, as well as beyond it. The main services provided by the network for innovation improvement are as follows:

- searching co-operation partners in the field of innovative technologies;
- finding solutions for technological problems of enterprises within Europe;
- marketing of technologies, processes, products, etc. developed in Latvia;
- information regarding international co-operation opportunities and measures in the field of innovation and technology transfer;

- information concerning application opportunities of the new foreign technologies in Latvian enterprises;
- support to commercialisation of research and technological development results;
- assistance to research projects in searching partners;
- information regarding the research projects being drafted, for which co-operation partners are necessary;
- consultations on the issues related to innovative activity.

The network also provides information and practical advice concerning development policy of trade, EU legislation and entrepreneurship, as well as provides consultations to entrepreneurs regarding participation in the Seventh EU Framework Programme for development of knowledge and technologies.

In 2008, several activities have been started aimed at providing support to entrepreneurs in order to develop new products and implement them into production. On August 12, 2008, the Cabinet of Ministers approved “Regulations on the Sub-activity 2.1.2.2.2 “Aid for Implementation of New Products and Technologies into Production” of the Activity 2.1.2.2 “Development of New Products and Technologies” of Supplement to the Operational Programme “Entrepreneurship and Innovation””. In the framework of this activity, businesses will have an opportunity to receive support for such initial investment in the fixed assets (acquisition and mounting of equipment, acquisition of patents and licences), which directly ensures implementation of new products or technologies into production. The maximum admissible amount of financing is LVL 350 000 and the aid intensity may be up to 35% of the referable costs of the project. The projects were to be submitted to the Investment and Development Agency of Latvia from September 29 to November 7, 2008.

On October 7, 2008, the Cabinet of Ministers approved the Regulations “Regulations on the Sub-activity 2.1.2.2.1 “Development of New Products and Technologies” and Sub-activity 2.1.2.2.3 “Development of New Products and Technologies – Aid for Industrial Property Rights” of the Activity 2.1.2.2 “Development of New Products and Technologies” of Supplement to the Operational Programme “Entrepreneurship and Innovation”. In the framework of this activity businesses will have an opportunity to receive support for industrial research and experimental development, *inter alia* development of prototypes, as well as strengthening the industrial property rights. In the framework of the Sub-activity “Development of New Products and Technologies”, the projects can be submitted to the Investment and Development Agency of Latvia from December 15, 2008 to January 23, 2009, while in the framework of

the Sub-activity “Support to Strengthening Industrial Property Rights”, the projects can be submitted from December 15, 2008 to December 30, 2009.

In 2008, the Investment and Development Agency of Latvia implemented the pilot project “Project Competition for the Authors of Innovative Business Ideas”. Within the framework of the project the authors of business ideas had an opportunity to establish co-operation with mentors and potential investors, partners willing to co-operate within the idea implementation process, as well as there was an opportunity for the most successful authors to receive financing in the amount of up to LVL 5000 for development of the business idea. In the framework of the competition, 55 business idea applications were received, of which 16 will receive financial support.

Particular attention is paid to the measures with the goal to facilitate as wide as possible society awareness regarding innovation and its role in promoting competitiveness. Regional innovation days are one of the instruments for establishing society awareness. Like in the previous years, also in 2008 informative seminars were organised in order to popularise innovation in the regions of Latvia. The purpose of the seminars organised by the Investment and Development Agency of Latvia is to interpret the concept and meaning of innovation in developing

entrepreneurship, provide information on financial support available to innovative entrepreneurship, *inter alia*, the state support programmes and opportunities to apply for the financing of the Seventh EU Framework Programme envisaging development of science and technologies.

Another significant measure for establishment of new innovative enterprises is the business idea competition “Cup of Ideas” organised by the Investment and Development Agency of Latvia in co-operation with other partners. In the framework of the business idea competition its participants have an opportunity to obtain expert advice and contacts for starting their business, as well as attract fixed capital for starting their business activity. In 2008, the competition takes part for the second time, and the number of submitted business ideas testify its popularity, namely, in 2007 there were 269 ideas, while in 2008 – already 376 ideas.

As in the previous years, the Investment and Development Agency of Latvia supported a free entrepreneurship and innovation training course for students “Entrepreneur in 5 days”. This year the courses were organised at the University of Latvia, Ventspils University College, Stockholm School of Economics in Riga, Baltic International Academy and Rēzekne Higher Education Institution.

6.6. Information Society

Information society is a social development phase based on free mutual exchange of information and developing a knowledge-based economy. Information society consists of the technological base (infrastructure, software), range of information services available to the society, and the level of individual skills and knowledge. As a result of development of

information and telecommunications technologies, information and knowledge are more and more widely used in work and labour relations, education and everyday life.

Development of the information society is one of the priorities of the National Lisbon Programme of Latvia (see Chapter 6.1).

Box 6.13

Computer and Internet usage in Latvia

According to the data of the CSB survey “Computer and Internet Usage in Households”, 57% of all households (households where at least one person in the age of 16–74 years lives) had computers and 53% of households had Internet connection in 2008. 63% of inhabitants used a computer on a regular basis (within the last 3 months) (persons in the age of 16–74 years) and 61% of inhabitants used Internet. 40% of all households had broadband Internet connection. In order to get access to Internet, desktop computers amounting to 42% were most used by households, as well as mobile phones with Internet capabilities amounting to 20%.

In January 2008, 93% of all companies having 10 and more employees had computers, 86% of such companies had Internet connection and 41% of companies had their own Internet website. 54% of companies having 10 and more employees used Internet for communications with the public and local government institutions. 31% of all employees of companies used computer on a regular basis, while Internet was used regularly by 27% of employees.

At the beginning of 2007/2008 academic year, the number of computers per 100 full-time students at higher education institutions and colleges was 13.5, (9.7 per 100 students at professional education institutions, but 8.2 computers at comprehensive schools). 100% of higher education institutions and colleges, 89% of professional education institutions and 99.6% of comprehensive schools had Internet connection.

The main measures planned for promotion of ICT and development of the information society are as follows:

- to promote wide application of ICT in the state and local government agencies, SME’s and households (see Box 6.13);
- to provide network and information security, as well as coordination and mutual availability in order to establish information space without borders;
- to facilitate distribution of the broadband network, including the regions with bad access

to services in order to develop knowledge-based economy.

According to the CSB data, the share of ICT¹ sector within GDP reached 5.5% in 2007. In 2007, 3077 companies operated in the ICT sector in Latvia, which employed 25 562 persons, company turnover reached LVL 2.7 billion, staff costs – LVL 167 million. The value added of ICT production reached LVL 29 million, provision of ICT services – LVL 644 million. The external trade balance of ICT was negative:

LVL -360.9 million, because the imports exceeded exports considerably, which were LVL 508.1 million and LVL 147.2 million respectively.

Along with accession to the EU, EU initiatives have become binding to Latvia (see Box 6.14), which refer to development of the information society.

On July 18, 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.

Box 6.14

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 for Growth and Employment*”. 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. eGovernment 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 low investment of both public and private sectors in the ICT sector.

Short-term priority tasks are:

- 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 lines of long-term action for development of information society are:

- 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.

A financing from the EU structural funds and resources from the state and local government budgets will be used for implementation of the development programme.

¹ ICT sector is set in accordance with the OECD definition, envisaging inclusion of the following types of economic activity (NACE): production of ICT (production of office equipment; production of computers and other information processing equipment; production of isolated wires and cables; production of electrons and electron-beam tubes, as well as other electronic components; production of television and radio transmitters and equipment for telephone and telegraph communications; production of television and radio receivers, sound or video cassette or playback equipment and similar goods; production of instruments and equipment for measuring, check, testing, navigation and other purposes; designing and mounting of industrial process control and supervision equipment) and provision of ICT services, including wholesale trade (wholesale trade of household electrical appliances, equipment and electric appliances; wholesale trade of computers, peripheral equipment and software, as well as wholesale trade of other office equipment and devices; wholesale trade of other electrical and electronic equipment and hardware, wholesale trade of other equipment and devices to be used in industry, trade and navigation), telecommunications (telecommunications) and services (computer and office equipment lease; consulting on the issues related to computer equipment; development and distribution of the standard software, programming upon order, consulting on the issues related to software; data processing; maintenance and operation of data bases and Internet portals; repair and maintenance of computers and office equipment; other actions related to computers).

On December 11, 2007, the Cabinet of Ministers approved “*Concept on Establishment of the Electronic Election System*”. The goal of the Concept is establishment of the electronic election system by ensuring introduction of electronic registration of voter participation and electronic voting in the local government elections and European Parliament elections. The solution envisaging previous and secret e-voting with an opportunity of repeated voting was supported in the Concept which ensures complete secrecy of voting at the highest level.

On July 21, 2008, the Cabinet of Ministers approved the Regulations “*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.

Electronic services

Decree No. 689 of the Cabinet of Ministers of November 10, 2008 stipulated that the Electronic Procurement State Agency shall be merged with the Secretariat of Special Assignments Minister for Electronic Government Affairs as of January 1, 2009. According to the data of the Electronic Procurement State Agency, the total sum of general agreement procurements was LVL 498 thousand in 2006, LVL 3.5 million in 2007, LVL 6 million in 2008. The most part consisted of procurements of computer equipment, printing equipment and photocopiers. The procurement of antimicrobial medicine was performed in 2008 by involving 70 medical treatment institutions the sum of which amounted to LVL 1.052 million.

In September 2006, the SJSC “Latvijas Pasts” introduced the e-signature service and started the issue of e-signature smart cards. To facilitate introduction of e-signature, a competition was organised for procurement of 50 000 e-signature smart cards for the employees of public institutions. 28 657 e-signature smart cards were issued until the end of 2008.

Taking into account the small amount of available electronic services and financial loss caused by introduction and maintenance of e-signature, on May 28, 2008, the Ministry of Transport informed the Cabinet of Ministers about the proposal of the SJSC “Latvijas Pasts” not to continue provision of certification services. The Cabinet of Ministers assigned the Ministry of Transport to work on transfer of the functions of providing certification services to another institution in co-operation with Secretariat of Special Assignments Minister for Electronic Government Affairs. The SJSC “Latvia State Radio and Television Centre” was appointed to be such an

institution which has to adopt the abovementioned function as from May 31, 2009.

Since several public administration institutions establish individual authentication resources for the needs of their information systems, the Secretariat of Special Assignments Minister for Electronic Government Affairs is assigned to submit proposals on introduction of a single authentication mechanism into the state information systems to be newly established to the Cabinet of Ministers until April 1, 2009.

According to the *Eurostat* data, Latvia had introduced 6 basic services or 30% (EU-27 average – 58%) of 20 electronic basic services in 2007. Introduction of new e-services took place in 2008 some of which are basic services. The Internet portal www.latvija.lv contains the list of currently accessible e-services.

Broadband Internet

According to the *Eurostat* data, the share of broadband Internet connections reached 15% in the beginning of 2008 in Latvia (EU-27 average – 20%) of all Internet connections. Owing to the project “Development of broadband communication infrastructure in rural areas” implemented by 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 provide broadband networks of appropriate quality in remote areas for the subscription price which is maximally approximated to the subscription price in the densely populated areas is set in the EU for 2010 in compliance with the initiative “*2010 – 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% (EU – 35%) in 2007, while the losses to Latvian economy caused by piracy have reached USD 29 million. Although the level of computer piracy has not decreased in Latvia as compared to 2006, the International Intellectual Property Rights Protection Organisation has crossed out Latvia from the so-called black list containing the countries to be controlled in the sphere of piracy in 2007.

E-Commerce¹

17.5% of all companies in 2007 having 10 and more employees had made purchases over the Internet, but 6.9% of companies had sold services and goods over the Internet. The turnover of the goods and services purchased over the Internet in Latvia

¹ Data source on Latvia: CSB; data source on EU: *Eurostat*

constituted 5% of the total purchases in 2007, but the turnover of the goods sold over the Internet amounted to 5.2% of the total net turnover. According to the *Eurostat*, the total turnover of e-commerce of EU companies amounted to 12% in 2007.

In the 1st quarter of 2008, 22% of all the population or 33% of Internet users had made purchases or ordered goods or services over the Internet for own needs at least once in a life. Purchases over the Internet are mainly made by the users in the age group from 25 to 34 years (43% of Internet users).

On June 28, 2007, the Cabinet of Ministers approved the *Programme on Promotion of Enterprise Competitiveness and Innovations for 2007-2013* developed by the Ministry of Economics. The key sub-objectives of the Programme are as follows:

- to provide favourable conditions for development of business activity;
- to facilitate increase of capacity and efficiency of the national innovation system;

- to achieve substantial increase of competitiveness and productivity in industry by facilitating the growth of production volumes of high value added products.

It is also planned to implement e-commerce development promotion measures in the framework of the Programme: to organise e-commerce information days, seminars, competition “*The Best E-Commerce Enterprise*” and other activities promoting annual improvement of healthy competition and trade quality among e-commerce enterprises. A cooperation agreement “*On Performance of Separate Administration Tasks in the Framework of the Programme on Promotion of Enterprise Competitiveness and Innovations for 2007-2013: E-Commerce Information Days, Organisation of Seminars and E-Commerce Competition “The Best E-Commerce Enterprise in 2008”*” was concluded with the Latvian Information Technology and Telecommunications Association on July 21, 2008 to implement these activities in practice.

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 6.15).

Box 6.15

The number of small and medium-sized enterprises in Latvia

According to provisional data, there were 66 810 economically active enterprises and commercial companies in Latvia in 2007 (excluding agricultural and fishing farms and self-employed persons, which perform economic activity), of which more than 99.4% fell in the category of SMEs. The distribution of economically active SMEs in Latvia according to their size is similar to the one in the EU member states: micro enterprises – 76.9%, small enterprises – 18.7%, medium-sized enterprises – 3.8%, large enterprises – 0.6%. 69.9% of private sector employees in the country are employed in SMEs, which create 63.2% of GDP.

Important indicator characterising economic activity is the number of economically active enterprises and commercial companies per 1000 inhabitants. This indicator in Latvia has grown constantly over the last 7 years from 17 in 2001 to 29 in 2007.

It is of the same importance to emphasize the number of performers of individual piecework (self-employed persons), which amounted to 47 990 in 2007 (21 per 1000 inhabitants), and the number of agricultural and fishing farms, which equalled to 14 184 in 2007 (6 per 1000 inhabitants). Taking into account the fact that there is no single methodological practice among the EU member states for calculating such indicator characterising economic activity as the number of enterprises per 1000 inhabitants, it is difficult to conduct objective comparative analysis of this indicator. The current practice of the responsible EU institutions shows that calculation of the number of enterprises per 1000 inhabitants includes not only businessmen and commercial companies but also performers of individual piecework, agricultural and fishing farms, etc. Accordingly, applying an analogous practice, Latvia had 56 performers of economic activity per 1000 inhabitants in 2005, which is close to the EU average.

Statistical data of the recent years indicates positive trends in growth of the number of newly established enterprises. According to the statistical data calculated by the “Lursoft” in co-operation with the Register of Enterprises of the Republic of Latvia, 14 185 enterprises and commercial companies were registered in 2007, which is the biggest number of newly registered entities conducting commercial activity in the last 13 years. It is by 21.24% more than in 2006 (11 700).

Nevertheless, promoting establishment of newly founded enterprises is not sufficient to ensure sustainable development. In order to ensure the rise of competitiveness, these newly established enterprises have to be viable. Statistical data shows that the total number of enterprises increases by approximately half of the growth of the number of newly established enterprises, hence indirectly indicating problems in regard to their viability.

Since January 1, 2003 support to SMEs has been regulated by the *Business Support Control Law* in Latvia effective since January 1, 2003.

On January 27, 2004, the Cabinet of Ministers approved the “**Policy Guidelines on the Development of Small and Medium-Sized Enterprises**” (hereinafter – Policy Guidelines). This

document lays down 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 *Policy Guidelines* is to ensure promotion of favourable environment for business activity, spur initiative of entrepreneurs and lessen the total risk, prevent obstacles

to business activity, and foster stability and efficiency of the financial system and capital market in order to improve competitiveness of enterprises in the market.

The *Policy Guidelines* foresee implementation of a policy based on the best practices of the developed countries in accordance with the directions of activity outlined in the European Charter for Small Enterprises and other EU documents, at the same time taking also into account the specifics of SME development problems in Latvia.

Development of SMEs is promoted by the ***Programme on Promotion of Enterprise Competitiveness and Innovations for 2007-2013*** approved on June 28, 2007 by the Cabinet of Ministers. The Programme comprises settings and action policy for promotion of business activity competitiveness, innovative activities and industry development by describing the development vision of competition promotion, as well as innovation and

industry development for the next 7 years. The main objectives of the Programme envisage providing favourable conditions for development of business activity, facilitation of growth of capacity and efficiency of the National Innovation System, obtaining substantial growth of competitiveness and productivity in industry by facilitating growth of production volumes of high value added products.

The Programme defines particular measures to be carried out in order to improve business environment, promote access to finances, development of new business initiatives and their competitiveness, facilitating society's understanding in relation to the role of innovation in promotion of competitiveness, encouraging co-operation of industry, education and science sectors, knowledge transfer and commercialisation, as well as promoting development of industry sectors and increasing productivity.

Box 6.16

Definition of SMEs

The **Law on Control of Aid to Commercial Activity** provides the definition of small and medium-sized enterprises (according to the European Commission Regulation No. 70/2001 and amendments to the European Commission Regulation No. 364/2004, and according to the European Commission Recommendation No. 361 of May 6, 2003):

Medium-sized enterprises:

- number of employees: 50–249;
- annual turnover does not exceed EUR 50 million;
- annual balance sheet value is under EUR 43 million;

Small enterprises:

- number of employees: 10–49;
- annual turnover does not exceed EUR 10 million;
- annual balance sheet value is under EUR 10 million;

Micro enterprises:

- number of employees: 1–9;
- annual turnover does not exceed EUR 2 million;
- annual balance sheet value is under EUR 2 million.

A structural unit of the ***Mortgage Bank of Latvia*** (hereinafter – Mortgage Bank)¹ – Support Programme Department ALTUM – has a substantial role in the sale of support instruments. This Department implements the support programmes financed by the state and EU by granting high risk loans to viable and perspective SMEs and business start-up projects, which are not financed by commercial banks due to insufficient mortgage collateral and other project risks.

ALTUM implements the following programmes:

- crediting programme for starting business activity;
- crediting programme for the rapidly growing SME;
- financial support programme for training, consultations and financial support for business starters.

In the framework of *Crediting Programme for Business Starters*, loans are granted to business starters for implementation of investment projects, i.e., enterprises established less than 5 years before receipt of the loan. The total budget of the programme is LVL 24.57 million and it is financed by the ERDF, as well as the state and Mortgage Bank. Pursuant to conditions of the programme, SMEs may apply for a loan of up to LVL 700 thousand with the loan term from 3 to 10 years. The requirements are facilitated in relation to the loan security – the loan may exceed the security. LVL 26.07 million were granted in the framework of the programme and LVL 332 were granted for financing investment projects of business starters. Amount of the granted loans is LVL 22.76 million (see Box 6.17). The programme completed its activity on October 31, 2008, though SME crediting will continue in accordance with the conditions of the programme from resources repaid by borrowers.

¹ In October 2006, the Cabinet of Ministers accepted the Concept “On Development of the State Joint-Stock Company “Mortgage and Land Bank of Latvia” for 2007-2013”, by envisaging gradual reorganisation of the Mortgage Bank as a bank of full spectrum development. The Concept prescribes that one of the activity priorities of the Mortgage Bank also in the future is establishment and development of SMEs.

Box 6.17**Implementation of the crediting programme of business starters**

It is planned that about 1400 new job places will be created as a result of investment projects to be implemented by business starters. In the framework of the Programme, the average amount of the granted loan is LVL 78 000. More than one third of the granted loans are microcredits amounting to LVL 17 500.

On sectoral background the most loans (86 loans for LVL 9.3 million) have been granted for implementation of manufacturing projects (wood-processing, production of non-metallic mineral products, production of chemical substances and products, etc.). 61 loan has been granted in the sphere of wholesale trade and retail trade for LVL 3.6 million, 29 loans for LVL 3.9 million in the sphere of accommodation and catering services.

In the regional breakdown, Riga region dominates in terms of the granted loans – 127 loans for LVL 11 million. The amount of the loans granted in other regions is relatively levelled, but the loans in Vidzeme region are comparatively small (the average loan being in the amount of LVL 52 000), while comparatively high loans have been granted in Kurzeme region where relatively high expenses are made for smaller amount of loans (the average loan being in the amount of LVL 97 000). As regards districts, except Riga and Riga district, the most active districts are Cēsis district (25 loans), Daugavpils district (15), Jēkabpils and Ogre (13).

The *Crediting programme of the rapidly developing SME* grants loans to rapidly developing enterprises for implementation of investment projects. Unlike the loans for business starters, it is possible to receive a loan in the framework of this Programme in the amount of up to LVL 2 million. The programme is financed by the loan guaranteed by the state and pursuant to the Programme 323 loans have been

granted up to now for LVL 32.62 million. Amount of the granted loans is LVL 28.17 million.

Training, Consultations and Financial Support Programme of Business Starters is provided for the people willing to start business activity, but lacking the required knowledge and initial financing. The total budget of the programme is LVL 9.2 million and it is formed of the financing of the ESF, as well as the state and Mortgage Bank (see Box 6.18).

Box 6.18**Training, Consultations and Financial Support Programme of Business Starters**

Implementation of the Programme was started at the end of 2006, where one provider of training was selected by the Mortgage Bank per each of five planning regions of Latvia according to the competition procedure. The training took place within a year – from January 2007 to January 2008 by comprising nearly 1000 persons in total. The training was organised in groups of up to 20 people per each planning region. Upon acquiring the training course within about 2 months, participants of the Programme prepared a business plan for starting business activity after completion of the training course. The business plan is reviewed by experts of the Mortgage Bank and, in case of a positive decision, a participant of the Programme receives a financing for implementation of the project (micro-loan, grants for starting operation of the enterprise and providing subsistence within the initial stage of operation of the enterprise, payment for consulting services).

Although training opportunities were very actively used in the framework of the programme, until the end of 2007 relatively low activity was observed in the use of financial support of the programme. In order to ensure absorption of the Programme resources in the planned amount, from January 2008 up to the final term of submission of financial support applications – March 31, 2008 – the range of recipients applying for the financial support of the Programme was extended. Along with the existing Programme trainees, other developing entrepreneurs with adequate higher or professional education or with suitable work experience in the selected business area could also apply for financial support or relevant qualification (other similar training courses completed). In addition to the existing and new clients of the Programme, the amount of financial support was increased: the amount of loans to LVL 50 000, as well as the amount of subsistence grant to LVL 3 700.

Upon the end of the term for submission of the financial support applications, ALTUM received a total of nearly 600 applications from the potential business starters. In the framework of the programme, financial support has been allocated to 327 projects of business starters for the total loan sum in the amount of LVL 5.8 million. Besides, LVL 619 200 have been paid to the clients of the Programme for the company establishment grants, LVL 1 221 000 for subsistence grants and LVL 650 thousand for adviser grants.

The previous Programme was completed on October 31, 2008. The Mortgage Bank has expressed readiness to participate also in implementation of the next Programme co-financed by the ESF in 2009.

Along with the programmes implemented by ALTUM, while maintaining the functions of the development bank, the Mortgage Bank additionally continues development and implementation of new support instruments in the framework of its resources. On May 13, 2008, the Cabinet of Ministers accepted the *Support Programme on Improvement of Competitiveness of Entrepreneurs*. In the framework of this Programme, at least 300 SMEs will receive loans for investment and receipt of business assets, where the total investment volumes would reach LVL 200 million.

The necessity for implementation of such programme is determined by the situation of Latvian economy, when it is necessary to support sectors, where it is possible to compete successfully with manufacturers and service providers of other countries. The Programme will facilitate finding a financing for SMEs for investment in technologies or business assets. In the framework of the new Programme, the enterprises will be particularly supported, orienting to international market, manufacturing products or providing services with

high value added, technologically intensive production plants, as well as establishment of new enterprises.

The Mortgage Bank started implementation of the Programme in July 2008. In accordance with conditions of the Programme, the loans for investment and business assets allocated to one client may not exceed LVL 3 million by covering not more than 80% of total costs of the business project. In case of investment loans the maximum term of the loans is up to 10 years, but for the business asset loans – up to 3 years. Upon assessing applicants for support, the following support criteria for SMEs are taken into account: a company does not have tax liabilities; the project is economically viable and implementable, project implementers have good reputation and credit history.

Until November 2008, 28 loans have been allocated in the framework of the Programme for LVL 9.8 million, including 12 loans for business assets allocated in the amount of LVL 2.6 million in order to finance mounting and production projects envisaging manufacturing of catamarans, wood-processing, timber cutting, production of biodiesel, polygraphy, ventilation equipment. 16 loans have been granted for investment in the amount of LVL 7.2 million (establishment of the production plant of log buildings and furniture, acquisition of wood-processing equipment, acquisition of glass fibre composite profile production equipment, acquisition of dry cargo vessel, etc.).

The LLC “**Latvian Guarantee Agency**” (hereinafter – LGA) is a state company, the goal of which is to facilitate financing accessibility to small and medium-sized enterprises of Latvia by issuing:

- loan guarantees as the necessary additional security for receiving a loan in the commercial bank;
- financial leasing guarantees as additional security for receiving industrial leasing;
- via specially established risk capital funds by co-financing investment into Latvian small and medium-sized enterprises.

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’s implementation, the LGA has made and introduced guarantee products of investment loans, business asset loans, and financial leasing. LGA has also performed wide informative measures in order to inform entrepreneurs and credit institutions of guarantee products and receipt procedure of these products. The Programme results are summarised in the Table 6.6.

In 2005, the State Support Programme for Development of the Risk Capital System was approved by the European Commission in order to develop a risk capital system. In the framework of the Programme, LGA announced a tender in 2005 for selection of managing companies of the risk capital

funds. 8 applications were received and the companies LLC “Zaļas gaismas investīcijas”, JSC “Eko Investors” and LLC “TechVentures Fondu Vadības Kompanija” were selected as winners of the tender by which agreements 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, risk capital funds attracted private investors, including several Latvian institutional investors, for example, JSC “Atklātais pensiju fonds SEB Unipensija” and JSC “Pirmais Slēgtais Pensiju Fonds”. The total amount of subscribed capital of the risk capital fund for investment in Latvian companies reached LVL 21.8 million. The risk capital funds started their investment activity in the beginning of 2007, by ending the year with investment in 15 companies with the total amount of LVL 3.5 million. After the 3rd quarter of 2008 and at the end of the programme, the number of companies having received support has increased to 28 and the total amount of investment – to LVL 11.7 million.

Table 6.6

LGA Guarantee Programme Results

	2005	2006	2007	3 quarters of 2008
Number of the issued guarantees	20	31	130	146
Amount of the issued guarantees (million LVL)	0.89	2.31	11.50	15.88
Amount of the guaranteed loans (million LVL)	1.81	6.05	23.10	28.25

On July 16, 2008, the *Agreement between the Government of the Republic of Latvia and European Investment Fund on Establishment of Holding Fund* was signed. The Holding Fund will make investments in guarantees, high risk loans, risk capital funds and other financial support instruments in order to provide access to financing to small and medium-sized enterprises for starting and developing business activity, as well as guaranteeing export credits (see Chapter 6.2.1).

In order to promote competitiveness and sustainable development of SMEs, as well as successful involvement and participation of society in public administration, in 2007 the Ministry of Economics has concluded 3 participation agreements on separate performing of the public administration tasks the goal of which is to provide entrepreneurs with detailed information regarding:

- further education and development of human resources;
- business process management innovations, their implementation solutions and practice;
- application of new and modern management methods and instruments in Latvian

enterprises, as well as the best local experience and the experience of organisations of other

states in the field of management systems (see Box 6.19).

Box 6.19

Participation agreements

In 2007, the Ministry of Economics has concluded 3 participation agreements on performing of particular public administration tasks:

- the participation agreement “On Performing Particular Public Administration Tasks in the Field of Quality Development – Organisation of the International Quality Management Conference in 2007, 2008 and 2009” in co-operation with the association “Latvian Association for Quality” on organisation of the international quality management conference in 2007, 2008 and 2009, in order to promote competitiveness of business activity in order to establish understanding of responsible business activity and ensuring its sustainable development, facilitate competitiveness and sustainable development of Latvian enterprises, particularly small and medium-sized enterprise sector by applying new and modern management methods and instruments;
- the participation agreement “On Performing Particular Public Administration Tasks in the Field of Business Activity Development – Organisation of the Business Forum “Entrepreneurs’ Knowledge Days” in 2007, 2008 and 2009” in co-operation with the LLC “Komerccizglības centrs”, in order to popularise support and growth of social and knowledge capital of business environment for business activity entrepreneurs and business starters promoting development of competitive business environment based on knowledge and business management innovation in Latvia;
- the participation agreement “On Performing Particular Public Administration Tasks in the Field of Mentoring Development” in co-operation with the association “Lidere” on implementation of the Mentoring programme in Latvia in 2007 and 2008. In 2007, implementation of the Mentoring programme was started in Latvia. In the framework of the Programme the Mentoring programme was organised for entrepreneurs and business starters dividing the programme in stages. Stage I of the Mentoring programme was started in March 2007 (duration of the programme – 1 year, until February 2008) with 10 pairs being involved in the programme. Stage II of the Mentoring programme was started in August 2007 (duration of the programme – 1 year, until July 2008) with 10 pairs being involved in the programme. In total, 20 pairs have been involved in the programme.

6.8. Competition Policy

The Competition Council (hereinafter – CC) is responsible for the development and implementation of competition policy in the country, the goal of activity of which is to promote the opportunity of market participants to perform economic activity under free and fair competition conditions, as well as facilitate development of competition in all economic sectors within public interests.

The CC acts in accordance with the *Competition Law* and three directions of activity defined in the Operational Strategy of the CC for 2007–2009. They are as follows:

- Protection of competition;

- Promotion of competition;
- Strengthening the role of the CC in development and implementation of EU legal acts and in international organisations and networks.

Protection of competition

Protection of competition comprises activities directed against the following violations of the Competition Law: prohibited agreements, abuse of dominant position and unfair competition. CC also carries out control over merger of enterprises.

Box 6.20

CC fines the book publishing house LLC “Lielvārds” for a prohibited agreement

Upon carrying out surveillance of the textbook market, the CC obtained information confirming potential violation of the Competition Law in the activities of the LLC “Lielvārds”. The CC established that the contract provision between LLC “Lielvārds” and its cooperation partners obliging them to sell books and other editions to the third parties for the retail selling price established by the publisher, i.e., the LCC “Lielvārds” thus is restricting the resale retail selling prices of books. Provision, obliging distributor to sell the goods for a fixed retail selling price must be deemed as a competition restriction, hindering, restricting or distorting competition. In this case several commercial companies had followed this contract provision.

Upon examination the mentioned case, the CC took into consideration also the practice of European Commission, where in similar cases the provisions by which an obligation is imposed on a distributor to sell the goods at a fixed price are considered as obvious competition restriction, prohibited in compliance with the Article 81 of the Treaty establishing the EC. The CC concluded in its decision that the LCC “Lielvārds” has been the author of the abovementioned contract and contract of such a content have been concluded with 40 co-operation partners throughout Latvia, thereby the CC deemed LCC “Lielvārds” the initiator of the mentioned violation and imposed a fine in the amount of LVL 10 368.63. CC fined the LCC “Apgāds Zvaigzne ABC” for a similar violation in January 2008, which had included provisions on restricting the minimum retail selling price in the contracts with book retail companies.

Within ten months of 2008, in total the CC has adopted 90 decisions, including 14 decisions regarding

prohibited agreements, 13 decisions – abuse of dominant position, 47 decisions – merger of

enterprises, 6 decisions – unfair competition and 10 decisions regarding possible violation of Advertising Law.

The priority of the CC is disclosure and prevention of the most grievous violations of the *Competition Law* – prohibited agreements and abuse of dominant position. From January until October 2008, the CC has disclosed violations of the prohibited agreement in six investigated cases. For example, the CC established a violation and adopted a decision to impose a fine on the LLC “Lielvārds” due to the fact, that the publishing house “Lielvārds” has included provisions in contracts with book retail companies forcing

retailers to keep the catalogue prices set by the LLC “Lielvārds” (see Box 6.20).

Upon assessing the impact of market participants’ mergers on competition in the particular market, the CC is entitled to allow the merger, prohibit the merger, as well as clear merger by setting binding provisions. In 2008, the CC has allowed mergers of market participants in most cases, however, decisions have been adopted allowing or prohibiting the merger and prescribing binding provisions for merging parties. For example, the merger of the JSC “A.C.B.” and JSC “8CBR” was allowed by setting binding provisions, which prevent the negative impact of the merger on competition (see Box 6.21).

Box 6.21

CC allows the merger of the JSC “A.C.B.” and JSC “8CBR” by setting binding provisions

The main types of activity of the JSC “A.C.B.” are construction, reconstruction and repair of roads and bridges, as well as production and sales of construction materials, real estate development. The main types of activity of the JSC “8CBR” are construction, reconstruction and repair of roads and bridges, as well as production of bituminous concrete.

Upon assessing the obtained information about the particular markets which may be influenced as a result of the merger, CC concluded that barriers exist for the entry of new market participants in the market of road construction, reconstruction, renovation and periodical maintenance. Thereby, the CC considered that the merger of the abovementioned market participants may be allowed only by binding provisions, to avoid substantial reduction of competition.

The CC concluded in its decision that a dominant position will not appear and consolidate as a result of the merger in the market of bridge construction, reconstruction, renovation and periodical maintenance and in the career production market, nor will competition be substantially reduced. At the same time, the CC did not consider that such problems could appear also in the market of production and sales of bituminous concrete. Taking into consideration the fact that competitiveness of market participants in the aforementioned market directly depends on accessibility of bituminous concrete, it was necessary to establish binding provision that the JSC “A.C.B.” and the commercial companies in which it has decisive influence sell bituminous concrete to all customers for market prices under clear and uniform conditions.

The CC considered that setting an obligation for participants of the merger as a binding provision from the moment of the merger until July 1, 2013 that if the JSC “A.C.B.” or the companies related to it attract subcontractors for performance of the work, they must announce a tender at least 15 days before starting the work where the basic selection criterion of the applicants is the price offered by a subcontractor, so that the competition situation was not substantially influenced in the particular markets as a result of the merger.

Competition promotion and advocacy

This direction of activity of the CC includes surveillance and research of market sectors, as well as formation of the competition culture in society. The CC has the task to ensure appropriate gathering and analysis of comprehensive information about competition situation in various markets, to promote competition in those markets without competition or where competition is insufficient, and improve public awareness about the positive impact of competition on the welfare of society.

Amendments to the *Competition Law* were adopted on March 13, 2008 and became effective on October 1, envisaging wider ability for the CC to turn against abuse of the dominant position, including abuse of market power in the retail sector. The CC worked out guidelines with aim to explain interpretation of the concepts and terms used in the *Competition Law*, as well as set the basic principles, applied upon assessing violations of the dominant position in retail trade in order to promote understanding of market participants, how the new provisions of the law will be applied and interpreted. The CC followed the decisions adopted by the European Commission and

research made by the competent institutions of other member states of the European Union when preparing the guidelines. The CC also made the analysis of mutual co-operation agreements of more than 150 retailers and suppliers, as well as inquiry of suppliers of different sectors regarding the previous co-operation practice with retailers in order to obtain detailed, justified information and viewpoint of the involved parties. The CC also organised several discussions with retailers and suppliers, as well as with representatives of law offices. Within the process of harmonization of the guidelines upon listening to the parties concerned, the CC established that not only suppliers but also retail companies are interested to regularize their co-operation aspects.

In September 2008, the government adopted six regulations of the Cabinet of Ministers elaborated on the basis of the law adopted on March 13, 2008 by the Saeima (the Parliament) “Amendments to the Competition Law”. Adoption of these regulations improves opportunities of the CC to turn against violations of competition in Latvia, as well as reduces administrative barriers for entrepreneurs by submitting merger reports of a definite type (see Box 6.22).

Box 6.22**Regulations of the Cabinet of Ministers related to the law “Amendments to the Competition Law”**

Regulations of the Cabinet of Ministers following the law “Amendments to the Competition Law” adopted on March 13, 2008 by the Saeima:

- **The fine imposing criteria, aggravating and mitigating circumstances, as well as other cases when a fine is dismissed or reduced are included in the Regulations No. 796 of the Cabinet of Ministers of September 29, 2008 “Procedures of Imposing a Fine for Violations Prescribed in the Paragraph One, Section 11 and Section 13 of the Competition Law”** taking into consideration the basic principles set in the Model Leniency Programme of the European Competition Network and the Commission Notice of December 7, 2006 on immunity from fines and reduction of fines in cartel cases (2006/C 298/11). Section 11 and 13 of the *Competition Law* regulates the activities restricting competition – prohibited agreements and abuse of dominant position;
- **Regulations No. 800 of the Cabinet of Ministers of September 29, 2008** “Procedures by which the Complete and Abbreviated Report on the Merger of Market Participants is Submitted and Reviewed”. The *Competition Law* envisages right for the market participants to submit the abbreviated report by including considerably less information necessary for assessment of competition conditions on the merger of market participants if at least one of the two factors exists:
 - 1) none of the merger participants acts in one particular market or in the vertically connected market;
 - 2) the joint part of the market of market participants involved in the merger within the particular market does not exceed 15%;
- **Regulations No. 798 of the Cabinet of Ministers of September 29, 2008** “Regulations Regarding Non-Subjectation of Exclusive Horizontal Co-Operation Agreements to the Agreement Prohibition Set in the Paragraph One, Section 11 of the Competition Law” prescribe the criteria pursuant to which particular horizontal co-operation agreements concluded by two or several competitive market participants are released from prohibition of agreement, respectively, are allowed, if they meet the requirements specified in these regulations;
- **Regulations No. 799 of the Cabinet of Ministers of September 29, 2008** “Procedures by which the Report on Agreement of Market Participants is Submitted and Reviewed” specify the terminology, include the information on requirements of setting restricted access information, as well as other issues related to the report on receipt of individual immunity and submission of the prohibition prescribed in the Paragraph One of Section 11 of the *Competition Law*;
- **Regulations No. 797 of the Cabinet of Ministers of September 29, 2008** “Regulations on Non-Subjectation of Exclusive Vertical Agreements to the Agreement Prohibition Stipulated in the Paragraph One, Section 11 of the Competition Law” specify more precise criteria to be observed, so that vertical agreements of market participants were considered as released from the agreement prohibition specified in the Paragraph One of Section 11 of the *Competition Law*;
- **Regulations No. 795 of the Cabinet of Ministers of September 29, 2008** “By-Laws of the Competition Council” specifies the structure of the CC, appeal procedures of the CC decisions, as well as appeal procedures of the actual action in compliance with the Administrative Procedure Law.

The CC carries out market surveillance in the framework of which the situation of the existing competition situation is analysed in the respective market – inquiries of the respective market participants are made, as well as the information obtained from different authorities and institutions regulating or related to the respective market and its participants. After completion of the market surveillance the CC draws conclusions concerning the competition situation in the respective market

and pursuant to it may make proposals for improvement of the competition situation. If indications of the violations prescribed in the *Competition Law* are established within the framework of surveillance, the CC adopts a decision on bringing an action and performs investigation of the potential violation of the *Competition Law*. In the second half of 2008, the CC has completed the dairy market surveillance process (see Box 6.23).

Box 6.23**Competition Situation in the Dairy Market**

The CC started market surveillance in the dairy market in May 2008 according to the application which specifies complaints of dairy producers regarding reduction of the milk purchase price, as well as taking into consideration the existing situation in the dairy sector.

Since the milk purchase prices reduced in the first half of 2008 in Latvia, the goal of surveillance was to clarify, whether the milk processing companies have not reduced the milk purchase prices simultaneously as a result of concerted practices and whether the milk purchase prices are not assessed as equal.

The information provided by cooperative societies of Latvian dairy producers testified that the price of milk is set by milk processing companies, thereby cooperative societies do not have influence in fixing the price of milk – upon fixing its milk purchase price, cooperative societies of Latvian dairy producers take into consideration the expected milk purchase price paid by a milk processing company.

Upon assessing the milk purchase prices of the biggest Latvian milk processing companies, the CC concluded that the milk purchase prices for milk processing companies in 2008 are not equal – they may differ by a couple of santims. For example, on April 1, the milk purchase prices for Latvian milk processing companies ranged within LVL 0.17-0.23 per 1 kg (without VAT). In addition, the milk purchase prices of the societies of Latvian dairy producers differ depending on different cooperative societies.

Box 6.23 continued

In accordance with the information at the disposal of the CC, the milk purchase prices of the biggest milk processing company JSC “Rīgas piena kombināts” differ depending on different cooperative societies, however, more substantial decrease of the purchase price was stated as of April 1, 2008. The decrease of the milk purchase price of the JSC “Tukuma piens” has been different for each supplier in 2008, however the most substantial decrease of the purchase price was stated on March 1, 2008. In comparison with other milk processing plants, decrease of the milk purchase price of the JSC “Valmieras piens” in 2008 has been gradual already from the second part of February. The decrease of the purchase price by one santim has taken place also in the second half of March like in the second half of February. However, a rapid price decrease has continued also on April 1, 2008. The milk purchase price of the LLC “Jēkabpils piena kombināts” has more substantially decreased already in the first half of March 2008.

According to the information of the CC, the milk purchase prices of such milk processing companies as JSC “Lazdonas piens”, JSC “Preiļu siers”, JSC “Cesvaines piens”, LLC “Saldus piena kombināts” have not decreased in 2008 or they have decreased very minimally and stayed relatively high (LVL 0.22-0.21).

The information obtained during market surveillance did not confirm the suspicion regarding the possible agreement between Latvian and Lithuanian milk processing companies, which has manifested itself as simultaneous decrease of the milk purchase price for dairy producers.

The CC determines annually in its performance plan the priority market sectors where the market research is necessary to perform in accordance with the allocated financing. Upon selecting the market sector to be investigated, the CC takes into consideration the actual situation in the market, existing restrictions concerning importance of the particular market sector and impact on society and national economy. The goal of such studies is to thoroughly inquire the respective market sector. Qualified, independent experts are involved for providing research.

In the second half of 2008, by involving independent researchers, the research “Determination of Latvian Economy Sectors with High Market Concentration Level” has been completed, the basic goal whereof was to carry out assessment of the competition market concentration in Latvian economy sectors and identify the market entrance barriers, as well as to offer proposals for their reduction. It is concluded within the framework of the research, that economic risks related to the growth of prices for energy resources, continuous increase of wages and macroeconomic recession have become a serious barrier for entering the market within all the economy sectors, which manifests itself as growing inflation, slowdown of the economic growth rates and growing unemployment. It is specified in the research that potentially there is an opportunity for new market

participants to enter the market within several economy sectors by only using support of a foreign investor. Credit allocation conditions are also mentioned as a barrier for new companies without credit history for entering a market. Within the framework of the study the specific character of determining market concentration is also analysed in different economic sectors, as well as proposals made for market concentration and reduction of barriers for entering a market.

In order to strengthen the understanding on the issues of competition policy and law and to promote the interest of different society groups in promotion of fair and efficient competition, the CC organises educational seminars on Competition Law and its practical enforcement to entrepreneurs and their associations, lawyers and other groups of concerned persons.

Strengthening the role of the Competition Council in development and implementation of EU legal acts and in international organisations and networks

The CC, through participation in various working groups, co-operates with the European Commission and competition authorities of other EU member states in development of various legal acts and mutual exchange of information (see Box 6.24).

Box 6.24**Co-operation of the CC with EU institutions**

The CC actively participates in the operation of European Competition Network (ECN), the goal of which is to ensure an opportunity for competition authorities of EU member states to discuss the application of Article 81 (prohibited agreements) and Article 82 (abuse of dominant position) of the Treaty establishing the European Community, **as well as promote co-operation among them**. Representatives of the CC have participated in the plenary session of the ECN and its several subgroup meetings in which such issues were discussed as competition in the field of bank services, application of Article 82 of the Treaty establishing the European Community regarding abuse of dominant position of companies, issues of co-operation, etc. In addition, representative of the CC was appointed and acted as a *rapporteur* in one of the EC Advisory committees in the field of competition.

In the second half of 2008, representatives of the CC participated in several significant international events. In September, the management of the CC participated in the annual meeting of the Chief Executive Officers of competition authorities organised by the Directorate-General for Competition of the European Commission during which the current competition policy issues were discussed. Employees of the CC have also participated in the 6th meeting on electronic evidence of Forensic IT, the methods of its obtaining and usage in court, as well as work groups of the European competition authorities (ECA) concerning legal obligations in relation to dismissal of a case without formal stating of a violation in the meeting.

Box 6.24 continued

The management of the CC also participated in the event of thematic meeting organised within the framework of ePSI^{plus}, dedicated to competition supervision authorities of the European Union and developers of the competition policy. The project ePSI^{plus} has been developed to provide implementation of the European Parliament and Council directives on repeated use of the public sector information.

In November 2008, the management of the CC represented Latvia also in the framework of the European Competition Day in the international conference, which took place in Paris, the purpose whereof is promotion of exchange of experience and viewpoints among European competition experts and representatives of public administration, business and academic environment. The purpose of the European Competition Day is to inform European citizens of the benefits provided by the implemented competition policy. The Competition Day has been organised twice a year since 2000 and it is organized by the EU Presidency.

In 2008, the CC has started implementation of the Transition Facility Twinning Light project “Further Strengthening of Economic Research and Analysis Capacity of the Competition Council” in co-operation with German competition authority (BundesKartellamt), oriented to assimilation of the latest experience accumulated within the European Union competition supervision field concerning market and economic sector analysis. The project is mainly focused on development of a competition authority’s preventive measures (economic analysis as an analysis tool of competition risks) and assessment of the effects of national competition policy. That will promote the development of analytical capacity of Latvian CC, thus stimulating both, the preventive role

of the authority, as well as improvement of competence for assessment of the competition policy consequences within its performance. The activities in the framework of the project are planned to take place within 6 months and during this period the experts of German competition authority will provide assistance and consultations to the CC employees to improve the practical and theoretical methods applied by the authority, as well as guidelines and recommendations will be developed concerning several performance fields of the CC, promotion of co-operation improvement with public, private and non-governmental organisations, strengthening co-operation with scientific research and academic education institutions and other activities performed.

6.9. Regulation of Public Utilities

In accordance with the Law on Regulators of Public Utilities, a two-level regulation system of public utilities is established in Latvia on the state and local government level.

The Public Utilities Commission (hereinafter – Commission) regulates public utilities on the state level, while the local government regulators regulate providers of services in the respective municipal territories and supervise sectors of municipal waste management (with the exception of municipal waste recovery), water supply, sewage and heat supply (except combined heat and power). It must be noted that the Commission does not supervise the local government regulators and is not authorised to influence their operations.

The Public Utilities Commission is a multi-sector regulator performing regulatory functions in the sectors of energy, electronic communications, postal services and railway transport. The task of the Commission is to ensure to all users the opportunity to receive uninterrupted and safe services for economically reasonable prices and to ensure to businesses providing public utilities the possibility to develop with profitability according to the economic situation. An important part of the Commission’s work is promotion of competition in the regulated sectors. The Commission adopts its decisions independently and is not subject to decisions of the government or other public institutions. Members of the Commission’s Board are appointed by the Saeima,

and only a court may declare decisions taken by the Commission substantively unlawful and repeal them. Activities of the Commission are financed from the state duty paid by businesses for regulation of public utilities on the basis of the annual net turnover of the regulated public utilities.

Functions of the Commission include regulation of the regulated sectors and businesses that operate therein, protecting 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.

In accordance with the delegating agreement concluded on November 20, 2007 on regulation of public utilities within the administrative territory of Riga City, as of January 1, 2008 the Commission has been regulating provision of public utilities as business activity within the sectors regulated by local governments (heat supply, water supply and sewage, waste management) within the administrative territory of Riga.

On December 16, 2008 the Cabinet of Ministers adopted amendments to regulations No. 1068 of December 28, 2004 “Regulations of the Rate of the

State Fee for the Regulation of Public Utilities and Payment Procedures Thereof” reducing the annual rate of the state fee for each type of public services within the state-regulated sectors to 0.17% (previously 0.2%) of the net turnover of respective service provided in the previous calendar year. Upon reducing the rate of the state fee for regulation of public utilities within the sectors to be regulated by the state, the amount of the fee payable by the businesses to be regulated will respectively decrease, which directly influences the costs of provided regulated services.

Characteristics and policies of the regulated sectors

Energy sector

In the energy sector (see Sections 3.3.3 and 6.3.2) electricity supply and gas supply are regulated by the state. The dominant position in the electricity supply is taken by the JSC “Latvenergo” that generates more than 90% of the electricity generated in Latvia and ensures the necessary import of electricity, as well as its delivery to those users, who have not chosen another supplier. As from September 1, 2005 all functions of electricity transmission system operator are carried out by the JSC “Augstsprieguma tīkls” fully owned by the JSC “Latvenergo”, but as of July 1, 2007 the functions of distribution system operator are carried out by the JSC “Sadales tīkls” fully owned by the JSC “Latvenergo”.

Electricity is also generated by about 150 small hydropower stations with the total capacity of 25 MW, 14 wind power stations with the total capacity of 25.2 MW, and 39 cogeneration plants with the total capacity of 137 MW. Twelve other licensed businesses carry out distribution or sale of electricity.

Latvian electricity market is fully open for competition as of July 1, 2007 and several electricity users have already taken the opportunity to change a supplier of electricity.

As of May 15, 2008 the amendments adopted by the Saeima are effective in the *Electricity Market Law* envisaging involvement of the big electricity users in the free electricity market, i.e., the businesses, employing 50 and more employees or the annual turnover of which amounts to 7 million lats or more. These users must further buy electricity at the agreed price or market price.

In compliance with the Commission decision of December 12, 2007 starting from January 1, 2009 it will be allowed for the JSC “Latvenergo” to set the differentiated electricity tariffs for the captive users. The permit for the public trader to set the differentiated electricity tariffs for the captive users will allow swifter response to market changes, however the Commission will still check the calculation accuracy. The Commission will continue approving the tariffs of electricity transmission system service and electricity distribution system service, as well as the components of feed-in tariffs of electricity in compliance with the *Electricity Market Law*.

Supply of natural gas in Latvia is ensured by vertically integrated enterprise – JSC “Latvijas Gāze”. As of October 1, 2008 new tariffs of natural gas are effective. The tariffs of natural gas increased on average by 38%. Along with the approval of the new tariff project substantial changes have been made within the structure of the tariffs – the subscriber’s fee is cancelled for all groups of users, therefore all users of gas will further pay only for the actually consumed natural gas.

The main reason for the increase in price of the natural gas tariffs (nearly 90% of the total increase) is the rise in the import price of natural gas determined by higher prices of oil products in the world market. The remaining 10% of the total amount of the rise are formed by increase of the JSC “Latvijas Gāze” costs.

As before, the natural gas tariffs will change automatically depending on the changes of the purchased gas price. The Commission has made amendments to the calculation methods of combined heat and power tariffs which envisage that heat generation tariffs automatically change depending on the purchased gas price changes. As from August 2008, in accordance with amendments made by the Cabinet of Ministers the heat tariffs are approved in the form of a table according to the tariff calculation methods in the sectors regulated by local governments and they automatically change each month depending on the gas price changes.

Along with introduction of these amendments the changes of prices of oil products will automatically influence both, gas and heat prices. It should be taken into consideration that the price for gas delivered to Latvia does not depend on the current prices of oil products, but on the average prices of oil products of the previous 9 months (previously – 6 months). This has allowed reducing influence of the rapid rise in price of oil products on the final tariffs – it works as stabilizing effect of prices, however decrease of the tariffs is also slower.

In accordance with amendments made to the Regulations No. 297 of the Cabinet of Ministers of July 3, 2001 “Regulations on the Types of Regulated Public Utilities” the Commission developed a new methodology for calculation of the tariff of liquefied gas distribution service. In September 2008, the Commission approved the tariff of the liquefied gas distribution service of the LLC “Latvijas propāna gāze”, which is valid since November 1, 2008.

Electronic communications and postal services

The biggest market participants in the sector of electronic communications are the fixed network operator LLC “Lattelecom” and mobile communication operators LLC “LMT” and LLC “Tele2”. A total of 418 companies were registered and actively operated in the sector of electronic communications as of October 29, 2008.

As a result of competition, the service tariffs have not increased for the users of electronic

communications services within 2008 regardless of the high inflation. Offers of mobile operators have led to mobile voice telephony tariff decrease, especially for business users.

Upon introduction of the EU *Roaming Regulation*, tariffs for the users of mobile voice telephony services visiting EU member states have decreased as of August 30, 2008.

In the postal sector, the state JSC “Latvijas Pasts” provides general postal services, while approximately 40 service providers operate actively in the sector of express mail.

New tariffs of general postal services of the JSC “Latvijas Pasts” are effective as of December 1, 2008 and their average increase is 29.8%. The changes of tariffs resulted from the increase of costs of the JSC “Latvijas Pasts” due to a necessity to increase wages of employees, as well as a rise in the costs for transport services and infrastructure maintenance. In addition, the amount of domestic and international postal items is forecasted to decrease in 2009.

More than 50% of service costs of the JSC “Latvijas Pasts” are constituted by remuneration. According to the data of the Central Statistical Bureau and the JSC “Latvijas Pasts”, the average wage in the JSC “Latvijas Pasts” in 2007 was by 30%, but in 2008 by nearly 40% lower than the average wage in the economy, therefore increase of costs related to

increase of wages is considered to be justified. The wage increase for employees planned by the JSC “Latvijas Pasts” is also supported by the Ministry of Transport which is responsible for development of the sector policy.

Railway

In the railway sector, the state JSC “Latvijas Dzelzceļš” ensures maintenance of public railway infrastructure as well as carries out international passenger transportation. Domestic passenger transportation is carried out by the JSC “Pasāžieru vilciens” and the LLC “Gulbenes-Alūksnes bānītis”. LLC “LDz Cargo”, JSC “Baltijas Ekspresis” and JSC “Baltijas tranzīta serviss” work in the sector of cargo transportation.

In February 2008, the Commission made amendments to the *Methods of Calculation of the Fee for Usage of Public Railway Infrastructure for Transportation* envisaging that further on the fee for using public railway infrastructure for transportation will be set for the calendar year. On the basis of the data submitted by the state JSC “Latvijas Dzelzceļš” and audit opinion, the fee of the railway infrastructure is set by the Commission. The fee of the railway infrastructure remained invariable in 2008. The fee for 2009 is calculated by 15-18% higher than the previous one applied within the period of the schedule of trains of 2007/2008.

6.10. Export Promotion Policy

The Ministry of Economics develops and implements foreign economic policy of Latvia aimed towards favourable promotion of exports and imports, as well as towards facilitation of competitiveness of Latvian enterprises in the foreign markets. The goal is achieved by implementing three policy directions – promoting attraction of exports and investment and provision of the state support instruments, as well as contractual security.

These directions are included and implemented in the framework of the *Latvian Export Promotion Programme for 2005–2009* (LEPP) prescribing the export promotion policy goals, main tasks and the results to be achieved. The LEPP is implemented in the framework of annual action plans comprising the work coordinated by several public institutions. Supervision of implementing the LEPP is ensured by the Export Promotion Programme Council made up of public institutions, industry associations, as well as social partners.

Promotion of exports and investment is implemented by introducing the **direct export promotion measures** in the framework of the LEPP Action Plan until 2009. A wide range of support services is available to Latvian exporters in order to increase export capacities and promote exports of Latvian goods and services. Within 9 months of 2008,

different export support services have been provided, including 1421 consultations to enterprises on issues related to exports, including about foreign markets, 16 informative and educational seminars organised concerning the issues of external trade within the regions of Latvia, 14 trade missions of Latvian enterprises arranged to Austria, Germany, Sweden, Finland, United Kingdom and Ireland in which a total of about 90 entrepreneurs participated, as well as 45 individual business visits to the potential co-operation partners in foreign countries.

In June and December 2008, two forums were organised in Riga, in the framework of which Latvian entrepreneurs were informed about the support provided by the Investment and Development Agency of Latvia, foreign economic representative offices of Latvia both in the local and foreign markets. In the framework of the forums, bilateral meetings of entrepreneurs with heads of the representative offices and employees of the Customer Service Department of the Investment and Development Agency of Latvia took place in order to discuss export opportunities and interests of entrepreneurs in the respective domestic market. In the framework of the forum of December 17, 2008 entrepreneurs were provided with a presentation concerning trade missions, participation in the international exhibitions, services provided by

the Investment and Development Agency of Latvia in research of export markets and search for co-operation partners, as well as general information on the support programmes administered by the Investment and Development Agency of Latvia, as well as the opportunities provided by the state support programme “Access to International Trade Markets – External Marketing” were presented to the entrepreneurs in detail.

12 foreign economic representative offices of Latvia – in Germany, United Kingdom, Sweden, France, Russia, Kazakhstan, Netherlands, Denmark,

Norway, USA, Japan and Poland – are currently operating by promoting exports and the flow of investment projects to Latvia, providing support to Latvian enterprises in making and maintaining business contacts, providing information about the requirements of the respective foreign market, implementing the marketing measures of export promotion and attracting investment in foreign countries, as well as the measures of finding co-operation partners by identifying the potential investors and business partners.

Box 6.25

Export and Innovation Award 2008

The Ministry of Economics has established the annual competition “Export and Innovation Annual Award” for Latvian enterprises for achievements in exports and creation of innovative products. The purpose of the award is to approve the most successful export products and services of the last year by assessing the growth of export volume and quality of the products and services offered by Latvian enterprises, as well as their performance results. The winner of the category “The Most Innovative Product” is awarded for creation of a new knowledge-based product.

The Award is presented in three categories:

1. The most export-capable enterprise – the award is received by the enterprise which’s export volume has considerably increased during the last year and which produces a product(-s) with high value added;
2. The most innovative product – the award is received by the enterprise which has created a new, knowledge-based product which is considerably more superior than the previously produced products and/or other products of the market;
3. Export champion – the award is received by the enterprise which has presented the highest export indicators and investment in ensuring sustainable growth.

The winners of “Export and Innovation Award 2008”:

Category 1 – “The most export-capable enterprise” in the group of large/medium enterprises:

- 1) JSC “Grindeks”;
- 2) JSC “Rīgas Piena kombināts”;
- 3) JSC “Valmieras stikla šķiedra”.

Category 1 – “The most export-capable enterprise” in the group of small enterprises:

- 1) LLC “Nexum Insurance Technologies”;
- 2) LLC “Varis Toys”;
- 3) LLC “SWH Sets”.

Category 2 – “The most innovative product”:

- 1) LLC “Real Sound Lab”;
- 2) JSC “Jauda”;
- 3) LLC “JZ Microphones”.

Category 3 – “Export champion”:

LLC “Liepājas Metalurģis”.

Implementation of the activity “Access to International Trade Markets” and operation of the export credit insurance system are envisaged regarding the state aid instrument in the framework of the EU Structural funds operational programme of 2008–2013 “Entrepreneurship and Innovation”.

In the framework of Activity 2.3.1.1 “Access to International Trade Markets” of the Measure “Business Support Activities” of the EU Structural funds operational programme “Entrepreneurship and Innovation”, wide support is envisaged for the enterprises in **implementation of external marketing measures** (support for participation in exhibitions, contact exchanges, trade missions, organisation of seminars and conferences) and **strengthening sectoral international competitiveness** (support to development of market research and acquisition, development of the product export strategy, finding the strategic partners and their visits to Latvia).

On December 15, 2008, the Investment and Development Agency of Latvia started to accept project applications for the sub-activity “External Marketing” in order to support external marketing in foreign countries, as well as the measures promoting integration of enterprises in the international supply chains, facilitate participation of Latvian entrepreneurs in the international exhibitions and trade missions, including single national stands. Acceptance of the project applications will continue until the notification on suspension of accepting project applications, but not longer than until December 29, 2009.

The financing available in the framework of the Sub-activity “Access to International Trade Markets – External Marketing” is LVL 5.27 million.

The export credit guarantee system will be established in the framework of guarantees, high-risk loans, risk capital funds and other financial instruments

of Activity 2.2.1.1 “Holding Fund for the Investment in Guarantee, High-risk Loans, and Venture Capital Funds and Other Financial Instruments” of the Measure “Access to Finances” of the EU Structural funds operational programme “Entrepreneurship and Innovation”.

Initially, the following export credit insurance services will be available to Latvian enterprises provided by a state supported private insurance joint-stock company selected pursuant to the tender procedure:

- short-term (up to two years) insurance of export credit commercial, political and accident risks for business with all countries, except EU member states, United States of America, Australia, Iceland, Japan, New Zealand, Canada, Norway and Switzerland;
- if an agreement is obtained with the European Commission, also short-term (up to two years) insurance of export credit commercial, political and accident risks for business with EU member states, United States of America, Australia, Iceland, Japan, New Zealand, Canada, Norway, and Switzerland, if the exporter is a small or medium-sized enterprise and its total annual export turnover does not exceed EUR 2 million.

On July 16, 2008 the Minister of Economics, Mr. Kaspars Gerhards, and Director of the European Investment Fund, Mr. Richard Pelly, signed the Agreement between the government of the Republic of Latvia and the European Investment Fund on implementation of the holding fund of EU Structural funds.

In compliance with provisions of the Agreement, the European Investment Fund (hereinafter – EIF) soon plans to announce the first competitions for selection of financial intermediaries (for example, banks, risk capital funds, etc.) in order to implement financial instruments.

By means of financial instruments planned to be implemented within the holding fund, a small and medium-sized enterprise will receive financing, which would otherwise not be received, for example, due to lack of security or excessively high risk. By means of the holding fund, the enterprises will be provided an access to the EU Structural funds financing for starting and developing business activity by offering high-risk loans,

risk capital financing and *inter alia* export credit insurance.

In the framework of the holding fund, financing will be allocated to the enterprises as a loan or guarantee in the fixed capital investment instead of the fixed capital grant, thereby the financing will be repaid to the fund on a gradual basis and will be available to the enterprises for repeated support. Thereby, the holding fund will function as a long-term support instrument.

In compliance with the concluded agreement, the EIF will implement the holding fund strategy, select financial intermediaries in order to conclude agreements with them on implementation of the particular financial instruments, supervise fulfilment of the concluded agreements, perform management of the investment portfolio of the holding fund, as well as place the free assets of the holding fund.

It is planned to channel EUR 30 million to export credit insurance from the funds allocated by the holding fund.

The goal of **the contractual security in the foreign economic policy** is ensuring maximum and prospective market access for the goods and services exported to Latvia. The goal of the direction is achieved by the Multilateral Agreement of the World Trade Organization (WTO), EU extended bilateral and regional integration agreement, and Latvian bilateral economic co-operation agreements with third countries. The EU implements a common trade policy. The EC conducts negotiations with third countries on behalf of the EU member states (see Chapter 6.2.2).

Taking into consideration the fact that contractual conditions are gaining increasingly more importance within external trade in today’s rapidly changing environment, the Ministry of Economics pays particular attention to their improvement, thereby a new sub-direction *Contractual Security* is included in the LEPP Action Plan for 2008, including the measures aimed at ensuring maximum and prospective access to the market for the goods and services exported by Latvia.

A substantial investment in efficiently ensuring access to the market is provided by implementation of the updated EU Market Access Strategy, envisaging a set of particular measures for identifying and decreasing trade barriers of third countries.

6.11. Protection of Consumer Rights and Market Surveillance

The consumer rights protection system in Latvia is in a constant process of strengthening and development in order to ensure efficient market surveillance and supervision of consumer rights.

On January 15, 2008, **Consumer Rights Protection and Market Surveillance Programme for 2008–2010** was approved by the Cabinet of Ministers, which develops the existing consumer rights

protection system, as well as prescribes priorities in this field. The following main directions of activity are set in the Consumer Rights Protection and Market Surveillance Programme for 2008–2010:

- improvement of consumer rights protection normative base;
- creating favourable business environment by implementing adequate and efficient market

- surveillance and supervision of consumer rights protection normative acts;
- information of consumers and entrepreneurs on consumer rights protection issues, as well as consumer education promotion;
- improvement of domestic and cross-border extrajudicial dispute settlement procedures;
- facilitating the activity of consumer rights protection associations.

Box 6.26**Amendments to the normative acts regulating consumer rights**

Upon improving the consumer rights protection normative base, on August 25, 2008 regulations of the Cabinet of Ministers “Regulations on Consumer Crediting Agreement” were adopted. The Regulations were developed in order to improve the previously effective regulations and adjust them to the present consumer credit market situation, while providing a high consumer protection level appropriate to the service nature. The annual interest rates and overdraft definitions are specified in the Regulations by making them clearer and more unequivocal, as well as the Regulations are supplemented with new definitions, for example, definitions of loan interest rates and interest-free credit. The Regulations also prescribe additional requirements for the information to be provided to a consumer in the advertisements of consumer crediting agreements by setting a prohibition regarding promotion of irresponsible borrowing within the advertisement and the obligation to include a warning to a consumer in the advertisement concerning the necessity of responsible borrowing and assessment of the credit repayment capacity (the requirements are effective from November 1, 2008). Unlike the previous Regulations, the new wording introduces a compensation mechanism for compensation of the creditor’s administrative expenses closely related to premature fulfilment of the credit obligations in the case of refinancing. The amount of the compensation is not regulated although it should be proportional and reasonable, as well as the creditor must be able to justify these costs in case of a dispute. The Regulations also prescribe other issues connected to information to be specified in the crediting agreement, as well as related to calculation and setting the annual interest rate. The Regulations came into force on September 1, 2008 and are relevant for all creditors – respectively both, the banking and non-banking sector.

Regulations of the Cabinet of Ministers of September 2, 2008 “Amendments to the Regulations of the Cabinet of Ministers of April 4, 2000 “Regulations on the Safety of Toys”” were adopted in the field of the safety of toys. The normative act is oriented to protection of the most unprotected part of society – the children, by setting additional requirements for marking the toys with magnets or magnetic parts, thereby drawing more attention from parents with regard to increased danger of such toys and providing indications on the necessary action if a child has swallowed or inhaled the magnets or magnetic parts. Amendments to the Regulations are made in compliance with European Commission Decision 2008/329/EC, by which the member states are required to ensure that all the marketed or available toys with magnets had warnings concerning the health and safety risk caused by these toys. In compliance with Regulations of the Cabinet of Ministers all the toys within Latvian market containing or consisting of magnets or magnetic parts, as well as such toys introduced for putting into circulation in Latvia must have a respective warning attached in accordance with Paragraph 7 of Annex 3 of the Regulations.

On October 30, 2008 the European Commission presented a proposal for the European Parliament and Council Directive regarding consumer rights. The proposal was made after revision of the consumer *acquis* started in 2004 in order to simplify and improve the effective regulations by establishing a properly functioning EU internal market for commercial transactions between entrepreneurs and consumers and finding the right proportion between high level consumer protection and competitiveness of entrepreneurs. Four directives were revised by the proposal in the field of consumer contractual law:

- Council Directive 85/577/EEC of December 20, 1985 to protect the consumer in respect of contracts negotiated away from business premises;
- Council Directive 93/13/EEC of April 5, 1993 on unfair terms in consumer contracts;
- Directive 97/7/EC of the European Parliament and of the Council of May 20, 1997 on the protection of consumers in respect of distance contracts;
- Directive 99/44/EC of the European Parliament and of the Council of May 25, 1999 on certain aspects of the sale of consumer goods and associated guarantees.

Unlike the four effective directives, which are minimum harmonisation directives (the member states

may introduce different, more severe regulations for consumer protection), a complete harmonisation principle is set in the draft directive, i.e., the member states may not retain or adopt the regulations, which differ those set in the draft directive.

The draft directive prescribes uniform definitions, as well as uniform requirements for the information provided to consumers before conclusion of the agreement and the information to be included in the agreement, right of withdrawal (duration of its validity, application procedures and consequences), regulates the seller’s responsibility for goods noncompliant with provisions of the agreement, 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.

Supervision of consumer rights

The Consumer Rights Protection Centre (hereinafter – CRPC) under supervision of the Ministry of Economics is the main co-ordinating institution that supervises observance of the normative acts of consumer rights protection. The CRPC reviews applications and complaints of consumers about non-compliance of the purchased goods or services with agreement terms, provides practical assistance to consumers for solving conflict situations, protects consumer rights in legal

proceedings, represents interests of consumers in the process of drafting normative acts, gives consultations on consumer rights protection legislation and compliance of goods, and co-operates with international consumer rights protection bodies and national institutions of consumer rights protection of other countries. The information on consumer rights may be obtained from the website of the CRPC *www.ptac.gov.lv*, as well as the website of non-governmental organisations for consumer interest protection *www.pateretaja-celvedis.lv*. These websites contain the information on the effective consumer rights protection legislation, different goods and services, as well as the opportunities to protect the consumer's legal rights. The CRPC has established a database of expertise performers and placed in the website, where 15 expertise performers are registered, but greater diversity would be advisable for performing expertises for different goods and services.

Results of activity of the Consumer Rights Protection Centre within ten months of 2008:

- consultations provided to 24 830 consumers;
- 3028 consultations provided to entrepreneurs;
- within 10 months of 2008, 2187 complaints have been reviewed, which is nearly by 40% more than in the previous year. Particular growth is observable regarding the complaints related to the agreements concluded by consumers and within which unfair contractual obligations are stated.

Out of the reviewed 2187 complaints in 473 cases a positive solution was found, an explanation is provided in more than 600 cases so that a consumer could solve the problem further on his/her own.

Out of the received 705 complaints on the goods noncompliant with provisions of the agreement, most complaints were received about mobile phones, electric appliances and footwear.

Like in the previous year, the majority of all complaints (733) are related to the services that are noncompliant with the agreement provisions. Consumers have complained the most about services related to construction, air traffic, tourism, individual orders for furniture, and electronic communications. Considerable amount of complaints (185) have been received also concerning rental and public utility services. It should be noted that these complaints are specific and in most cases very difficult to solve, therefore rather often it is impossible to help consumers. Particularly observable tendency in 2008 is the growth of complaints regarding air traffic services (89 within 10 months of 2008). In most of them passengers have asked the assistance of the CRPC for receiving a compensation and support from airlines, specified by Regulation No. 261/2004 of the European Parliament and of the Council of February 11, 2004, *establishing common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights, and repealing Regulation*

No. 295/91 (hereinafter – Regulation No. 261/2004). The CRPC, which is responsible for supervision of air transport passenger rights observation in Latvia, has provided assistance to air passengers by explaining their rights and taken decisions in cases of necessity by delegating responsibility to airlines to fulfil the legal claims of passengers.

While reviewing consumer complaints, the CRPC employees actively co-operate with the employees of different institutions in Latvia and other EU member states. The complaints are reviewed in compliance with the legal regulations set in the normative acts.

In 2008, the amount of complaints concerning unfair provisions of the agreement has substantially increased (within ten months of 2008 – 459 complaints, wherefrom in 46 cases, the proceedings were started at the initiative of the institution), particularly regarding unfair provisions of the agreement in real estate purchase contracts and preliminary contracts, as well as management contracts. Within 10 months of 2008, 115 complaints have been received concerning real estate purchase contracts and preliminary contracts (of them 24 proceedings were started at the initiative of the institution) and 87 complaints regarding management contracts. A lot of complaints have been received in relation to the fact that advance payments settled for the real estate purchase are not repaid to consumers, although the term of commissioning of the house is delayed. In the cases where the violation was discovered, the CRPC has taken decisions on unfair provisions of the agreement, as well as decisions prescribing repayment of the advance payment settled by a consumer.

Supervision of advertisement

Within ten months of 2008, the CRPC has assessed 4369 advertisements, inter alia 53 – upon applications of persons. In 156 cases proceedings were started. During ten months of 2008, administrative fines were imposed in 26 cases, and in 4 cases responsibility of cancelling an advertisement was delegated. Like in the previous year, the majority of violations are discovered in special supply advertisements. The proceedings were started in 83 cases.

Supervision of the Unfair Commercial Practice Prohibition Law

During ten months of 2008, the proceedings of 61 cases have been started on unfair commercial practice, administrative fine imposed in 8 cases, the responsibility of cancelling the unfair commercial practice delegated in 3 cases, claimed to exclude particular components in 1 case.

It should be also noted that due to enforcement of amendments to *Advertising Law* and *Unfair Commercial Practice Prohibition Law*, the CRPC has implemented a new practice within its operation – invited performers of commercial practice and advertisers to prevent the violation within a particular term or ensure compliance of an advertisement or commercial practice within a

particular term. During ten months of 2008, violations have been thus prevented in 75 cases.

During ten months of 2008, the CRPC has paid special attention to advertisement supervision of mobile phone services (calling tunes, background images) and supplements:

- CRPC has assessed 14 homepages, where violations were discovered in all of them: incomplete and false information of the price of the service (message), false information regarding refusal possibilities, incomplete information about the service provider. As a result of CRPC activities violations in 3 homepages were prevented voluntarily, 4 binding decisions issued concerning prevention of violations, administrative fine imposed in

1 case, violations were discovered also in the advertisements placed in several press editions. Proceedings are continued in these cases. In the framework of supervision measures, mobile phone operators will be invited to a meeting, as well as advice will be provided to consumers;

- CRPC has begun proceedings in 8 cases on supplement advertisements, an obligation was bound in 3 cases to an entrepreneur to cancel the misleading commercial practice, administrative fine imposed in 2 cases, a notification sent in 1 case to the relevant authority of Lithuania. The violations were established for attributing remedial properties to supplements or attributing the properties, which may be not proved by the advertiser.

Box 6.27

Examples of the CRPC decisions

CRPC adopted two decisions on the misleading commercial practice performed by the LLC “Direct Office” by distributing SlimBall and SlimComplexe supplement advertisements attributing such properties to both supplements, which help consumers to lose weight surprisingly quickly. It was requested by these decisions to the LLC “Direct Office” to cancel the misleading commercial practice in mass media, where these advertisements are distributed and publish the notification specifying the corrected information and cancelling the unfair commercial practice.

CRPC imposed the administrative fine in the amount of LVL 5000 to the JSC “Air Baltic Corporation” due to distribution of a misleading advertisement with a slogan “Easy to fly away!”. The advertisement contained the information that “*All the flights for one price by buying an e-voucher at the “RIMI” cash-desks only from November 1 to 5!*”. During the proceedings of administrative violation, the CRPC discovered that the e-voucher is valid for reservation of direct flights, but except the routes Rīga-Tel Aviv, Rīga-Tashkent, Rīga-Hurghada, Rīga-Liepāja and Kaliningrad-Copenhagen, on which Air Baltic did not inform consumers.

Supervision of agreements

During ten months of 2008, the CRPC has issued 59 administrative acts on unfair and unequal provisions of agreement by requesting to stop fulfilment of the unfair provisions of the agreement

concluded with the particular consumer, as well as the agreements concluded with other consumers and claiming to amend the draft agreements offered to the consumer.

Box 6.28

Supervision of KASKO agreements

From January 2008, the CRPC has been implementing a supervision project of KASKO insurance agreements by assessing 10 insurance agreements of insurance companies in Latvia. All the insurers were sent letters with an invitation to prevent the established non-compliances, as well as the CRPC organised a meeting with insurers on March 5, 2008 where the problem issues established in insurance agreements were emphasized. Individual meetings with insurers also took place during which insurers undertook to prevent voluntarily the majority of non-compliances established by the CRPC. Harmonisation of the revised agreements currently takes place with the CRPC. Advice for consumers is prepared in co-operation with insurers for concluding a KASKO insurance agreement.

Supervision of real estate purchase agreements and preliminary agreements

In 2008, the CRPC has started extensive assessment of real estate purchase agreements and preliminary agreements. Up to now, already 22 decisions on unfair provisions in the real estate purchase agreements and preliminary agreements have been made. Information is also requested from 28 real estate sellers on the concluded agreements and the draft agreements offered to consumers being currently assessed. The most frequent violations established by the CRPC are as follows: the agreement contains provisions prescribing a seller’s right to retain unilaterally the advance payment made by a consumer, although the commissioning term of the house is delayed, a seller’s responsibility limited if defects are established in the purchased flat, unreasonably high contractual penalties included in case of violation of contractual obligations, as well as clauses of arbitration court included in the contracts. The CRPC will also prepare advice to consumers for concluding a real estate preliminary agreement and purchase agreement.

The most frequently found unfair provisions of the agreements concluded with consumers are as follows:

- envisage settlement of disputes only in the arbitration court or the arbitration court by choice of a claimant;
- envisage unreasonably high contractual penalty to a consumer in case of non-fulfilment or

incomplete fulfilment of contractual regulations;

- restrict legal rights of a consumer;
- envisage the rights to unilaterally amend provisions of the agreement;
- envisage rights of a service provider or seller to unilaterally retain the advance payment settled

by a consumer without envisaging such an opportunity for a consumer.

A particularly large amount – 22 decisions were adopted on preliminary real estate purchase agreements and on real estate purchase agreements considering the number of the received applications.

During ten months of 2008, like in 2006 and 2007, the CRPC devoted a lot of time to informing entrepreneurs about different issues of consumer rights' protection by providing an expanded assessment to entrepreneurs of the provisions of the agreement proposed by them or other provided information before making decisions, in order to provide an opportunity to entrepreneurs to voluntarily prevent the violations of consumer rights. Due to the activities implemented by the CRPC, nine entrepreneurs have voluntarily and completely amended the draft agreements, while partial amendments are voluntarily made in several cases.

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.

During ten months of 2008, consumers contacted with the ECC Latvia 473 times, of which 379 were consultations and 94 – complaints.

51% of the received complaints were related to air services, 7% – e-commerce, 4% – low quality household appliances, 3% – problems in relation to tourism, 1% – clothes and footwear, 33% – other issues.

The most consultations – 26% – have been provided to consumers regarding air passenger rights and 14% – about the problems in connection with e-commerce.

Market surveillance

In 2008, the CRPC set such priority directions in the market surveillance as toys and children's goods (cots, baby walkers, nappy changing tables), baby-proof lighters, individual protection equipment, electric appliances and means of cycle transport.

In 2008, the CRPC carried out 2732 inspections in trading and service provision companies.

Box 6.29

Inspections of the CRPC

In 10 months of 2008, the CRPC has performed inspections in the following projects:

Energy efficient luminescence lights

In order to make sure that the information about the goods provided by the manufacturer is always right and meets requirements of the normative acts, the CRPC implemented the compact project of luminescence lights, in the framework of which the expertise of removal of goods was carried out.

37 inspections were performed in the framework of the project and in total 159 models of luminescence lights were inspected. Out of the inspected models, non-compliances of 24 models were discovered.

In the framework of the project, 20 energy efficient luminescence lights were removed for expertise. The results showed that the measured power value (W) of one model of energy efficient luminescence lights does not correspond to that indicated on the package.

Electric appliances

In 2008, a sub-project in the field of electric appliances was started. 151 inspections were performed in the framework of the project, 757 models of electric appliances were inspected, of which 24 models were removed and sent to laboratory for an expertise. Expertise opinions have been received about 10 models of electric appliances.

Construction products

Upon assessing the project results of 2007 and taking into account the established non-compliances, in 2008 the CRPC paid bigger attention to the given group of goods.

34 inspections were made in the framework of the project in the locations of sale and production and a total of 182 models of construction products were inspected. Out of the inspected models, non-compliances were established for 42 models or 23%.

Construction products of 5 types were removed for an expertise in the framework of the project and the expertise results showed that the removed samples meet the requirements of the normative acts.

Individual means of protection

Sunglasses

34 inspections were made in the framework of the project and a total of 134 models of sunglasses inspected. 66 models or about 49% of the inspected models had the established non-compliances.

Helmets for downhill skiing and snowboarding

25 inspections were made in the framework of the sub-project, of which violations were discovered in 22 inspections. 52 models of helmets were inspected in the framework of the sub-project, non-compliances were established for 44 models or 85% of the inspected models.

10 skiing helmets were removed for an expertise. Out of 10 models of helmets removed for the expertise, non-compliances with the safety requirements were established for 6 models.

Box 6.29 continued*Reflectors and reflective vests*

A sub-project was started in 2008, which still continues, in the framework of which inspections of reflectors and reflective vests were performed. In the framework of the sub-project, 12 models of reflectors and 5 models of reflective vests were removed for an expertise.

Toys and children's goods

In the framework of the project, the CRPC inspected 133 locations of sale of toys and/or children's goods in 2008. A total of 197 models of toys and children's goods were inspected.

In the framework of the project, expertises of toys were performed on compliance of technical properties and labelling with requirements of the normative acts and standards, as well as testing of children's goods and toys on such chemical substances as Di-(2-ethylhexyl) phthalate, dibutylphthalate, benzyl-butylphthalate diisononylphthalate, diisodecylphthalate, di-n-octylphthalate, as well as on migration of such toxic elements – antimony, arsenic, barium, cadmium, chromium, lead, hydrargyrum, selenium.

56 models of toys and children's goods were removed for an expertise in the framework of the project. Expertise conclusions have been received on more than 50% of the removed models of toys and children's goods handed over for an expertise, 16 models of toys and children's goods were acknowledged as unsafe. Excess of the particular level of phthalates was established for 4 unsafe children's goods and excess of the remaining limits of chemical substances and products was not established.

The CRPC continues carrying out inspections of toys and children's goods in the framework of the project.

2732 locations of sale and provision of services have been inspected and the supervised spheres beyond the framework of the projects are as follows:

In the field of radio equipment and terminals of electronic communications network

48 sale locations were inspected. In total, 186 models of radio equipment and terminals of electronic communications network were inspected. Out of the inspected models, non-compliances with requirements of the normative acts were established for 39 models.

Expertises of radio equipment and terminals of electronic communications network were not made in the framework of the activity, therefore there is no data on the actual compliance of equipment with the set requirements.

In the field of lighters

At the beginning of 2008, the CRPC continued the activities started in 2007 in order to verify conformity of lighters with both, general safety and child safety. Upon implementation of the first phase of the activities, 19 inspections were performed in 15 trading companies. 81 models of lighters have been inspected. 16 samples of lighters were removed in the framework of the project in order to make an expertise. As a result of the expertise, it was established that 5 models of lighters were unsafe, 11 models did not have information about safe action attached when refilling lighters. Incomplete warnings were established for all the tested samples.

Upon continuing activities in the field of lighters, 52 inspections were performed in 2008, 202 models of lighters inspected, of which 5 models were removed for an expertise. Expertise results on 4 models of lighters have been received up to now. It is established in the expertise conclusions that 4 lighters have noncompliant labelling.

Price specification procedure supervision project

The goal of the project is to check the price specification procedure in order to establish whether correct and detailed information is provided to consumers on the offered goods. The initial stage of the project has been summarised, inspections were performed in 98 locations of sale, 16 of them were performed in Ventspils Regional Board, 6 in Liepāja Regional Board and 7 in Daugavpils Regional Board. In total, 38 companies have been inspected. Upon implementing a project, 90 control purchases were made in order to verify the issue of ECA document (receipt) confirming the transaction and correspondence of the specified prices in the document confirming the transaction.

Upon assessing the project results, it was established that ECA document (receipt) confirming the transaction was issued in all control purchases, violations were established in 53% of inspections, inter alia the limited period of the campaign was not indicated for 222 goods or 39%, the price of the unit of measurement was not specified for 144 goods or 25%.

Price specification procedure inspections are continued on a regular basis. 112 inspections were made and 52 of them have violations established, i.e., 46% of the performed inspections.

Wheeled vehicles and their parts

The goal of the project is to check conformity of scooters, motorcycles and quadracycles with the set requirements by assessing conformity assessment and/or technical documentation, markings and instructions. 49 inspections of wheeled vehicles and their parts were performed in the framework of the project in the locations of sale. In total, 132 models of wheeled vehicles were inspected. Violations were established for 30 models or 23% of the inspected models in 12 inspections.

The CRPC has made 27 decisions regarding such groups of goods as electric appliances, individual means of protection, wheeled vehicles, toys, children's goods, lighters. Out of the adopted decisions, 9 decisions are related to the non-conformity of the goods with requirements of the normative acts, but 18 decisions are related to the safety of goods.

The CRPC prepared 10 RAPEX reports, as well as 2 response reports on unsafe goods.

State metrological supervision

In 10 months of 2008, 19.9 thousand means of measurement (hereinafter – MM) in 499 companies were subjected to metrological monitoring in order to establish conformity of the means of measurement with the normative requirements, including:

- 5 218 means of measurement in 357 trading companies;

- 13 364 means of measurement in 115 production and service provision companies;
- 1 121 means of measurement in 18 health care institutions and companies;
- 60 means of measurement in 3 public administration institutions.

Box 6.30**Metrological supervision control measures in 2008**

Upon implementing monitoring of the means of measurement 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 2008 in the locations of use of non-automatic weighing instruments and fuel filling equipment in order to establish, whether the actual error of the means of measurement corresponds to the maximum admissible operation error specified in the normative acts.

In co-operation with the Excised Goods Department of the State Revenue Service, inspections were performed in fuel retail companies in order to discover, how precisely fuel is measured in petrol stations pursuant to the requirements of the normative acts when selling it to consumers. Observance of the normative metrological requirements was inspected in 65 petrol stations (hereinafter – PS) belonging to 37 fuel sale companies. In order to establish the potential non-conformities with the operation of fuel filling equipment (hereinafter – FFE), officials of CRPC Metrological Supervision Department made control measurements – metrological tests by means of an accurate fuel measuring vessel of an appropriate accuracy class. The metrological test in each inspected PS was made for two fuel capacity measuring instruments used for filling the most common types of fuel – 95E petrol and diesel.

Upon assessing the results of the performed tests, non-conformities (when the actual error of the measurements exceeded the maximum admissible error 0.5% set in the normative acts) were established in 12 fuel sale companies (in 14 inspected PS) or 32% of the amount of companies inspected in the framework of the project. Repeated inspections were made in six companies and non-conformities were repeatedly established in two companies. In all cases the actually filled amount of fuel was less than the expected amount (control dose 10 l), thereby damage was caused for the buyers of fuel.

As a result of the performed monitoring, proceedings were started in 16 cases of administrative violation regarding the violations mentioned in part 6 of Article 155 and Article 99 of Administrative Violations Code. The sale of fuel was suspended in all cases when non-conformities of FFE were established with the normative metrological requirements before readjustment and repeated verification of the useless means of measurement.

The CRPC carried out market research of the means of measurement provided within the sphere regulated for the use by implementing market surveillance projects of manometers and fuel filling equipment. The goal of the projects was to clear up the existing situation regarding conformity of the manometers and fuel filling equipment distributed in the locations of sale and retail companies with the normative acts on metrological requirements. When performing the metrological surveillance in retail companies, the officials of CRPC identified non-conformities, as a result of which binding instructions were provided in order to prevent the violations. In the first half of 2008, the CRPC has assessed a total of 17 manometer sale companies, including 4 companies, which are official representatives of manometer manufacturing companies and 3 companies acquiring manometers in order to deliver them to customers – gas equipment installation project implementers. Advisory inspections have been made in 10 locations of sale of manometers by providing consultations to officials and employees of the inspected objects on requirements of the normative acts. The sellers of FFE were identified in the framework of the project, as well as confidence obtained that FFE non-complying with the current normative metrological requirements are not distributed in the country. In order to establish how the procedures set in the normative acts are observed in relation to putting new means of measurement into operation, inspections were made in recently commissioned objects – 5 petrol stations. 16 FFE with CE mark and additional metrological marking were identified in the inspections, as well as stated that irrespective of the fact that conformity assessment procedures have been performed for the abovementioned fuel filling equipment in accordance with requirements of normative metrological acts and to put the equipment into operation without problems in 7 cases repeated verification was made for FFE and in one case – the first national verification, which is violation of the normative acts.

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 cereal products and beer as a priority.

Control of the pre-packed goods has been performed in 65 production companies, 321 lots of goods have been inspected in them (a static control test has been performed). Non-conformities were established – 34 lots of goods or 10.6% of the total amount of inspected lots of goods did not conform with the normative requirements in relation to the actual amount of goods. Administrative protocols have been issued to a total of 7 legal and natural persons within the reporting period 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 Latvian Administrative Violations Code.

Violations of requirements of the normative acts were established in 208 companies and 924 means of measurement or 4.6% of the total amount of inspected means of measurement were acknowledged as noncompliant with the metrological requirements as a result of inspections, inter alia the means of measurement without the necessary conformity assessment confirmations were inappropriately marked and used by violating the repeated verification terms set in the legislation requirements. As a result of metrological supervision binding instructions were provided for prevention of the violations and administrative protocols drawn up for inobservance of

metrological requirements to 13 natural and legal persons, as well as decisions adopted in accordance with Article 99 and 166.¹⁵ of Latvian Administrative Violations Code.

The CRPC constantly co-operates with the responsible authorities of other states in the sphere of metrological supervision and participates in the Working Groups WG2 of the European Cooperation in Legal Metrology WELMEC “Implementation of Directive 90/384/EEC on Non-Automatic Weighing Instruments”, WG5 “Metrological Supervision” and WG6 “Pre-Packed Goods”.

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 normative acts in the regulated and non-regulated sphere, as well as to improve the base of normative acts in accordance with the EU requirements, taking into account the needs of the national market and national economy, hence ensuring compliance of the products placed on the market and of the provided services and encouraging increased competitiveness of enterprises and reduction of obstacles to international trade.

National quality assurance system in Latvia is regulated by the *Law on Conformity Assessment*, the *Standardisation Law* and the *Law on Uniformity of Measurements*, as well as by the Cabinet of Ministers regulations deriving from the abovementioned laws.

The main directions of the policy are as follows:

- improvement of the conformity assessment infrastructure (including testing and calibration laboratories, inspection and certification institutions, environmental verifiers) in accordance with the needs of the Latvian economy in order to protect consumers and environment from low-quality products and services, promote growth of competitiveness of enterprises and reliability of products and services provided by the Latvian entrepreneurs;
- improvement of the informative and consultative base;
- participation of national institutions of accreditation, standardisation, and metrology in international organisations, ensuring their international recognition and compliance of the Latvian quality assurance system with international requirements;
- maintenance and international comparison of the national base of metrology standards in order to ensure the necessary traceability of measurements and protect society from inaccurately conducted measurements;
- encouraging introduction of 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 the potential unfair competition of companies.

Upon improving the legislative base and therefore the infrastructure of the conformity assessment

system, relevant measures have been implemented in 2008, including:

- the annual National Accreditation Conference organised in co-operation with the state agency “Latvian National Accreditation Bureau”, thereby promoting confidence of society in accredited institutions of conformity assessment;
- the quality assurance system popularised as one of the methods of increasing competitiveness of commercial companies;
- upon improving the Latvian National Conformity Assessment System, the necessary amendments to the normative acts have been made in the sphere of conformity assessment;
- in order to encourage understanding of society regarding quality assurance issues, the society is regularly informed about current events in the field of quality assurance.

In order to improve the conformity assessment infrastructure also in the future, in the first half of 2009 arrangement of the base of normative acts is planned by drafting several regulations of the Cabinet of Ministers in compliance with the *Law on Conformity Assessment*. It is also planned to introduce requirements in the normative acts in accordance with amendments to the *Law on Conformity Assessment* made at the end of 2008, envisaging also optimisation of the accreditation and metrology systems.

6.12.2. Accreditation, Standardisation, Metrology

Accreditation. The state agency “Latvian National Accreditation Bureau” (hereinafter – LATAK) is a public administration institution under supervision of the Ministry of Economics, which ensures operation of the national accreditation system.

According to the *Law on Conformity Assessment*, the main functions of the LATAK are:

- to evaluate, accredit and supervise the testing and calibration laboratories and certification and inspection institutions for conformity with the prescribed requirements of normative acts, Latvian national standards, EU or international standards;
- to organise examination of skills and co-ordinate 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. Currently, 190 accredited institutions are maintained in the system. The conformity assessment institutions are annually accredited in new spheres. New conformity assessment institutions in the field of personnel certification – certification of wind tunnel flyers and surveyors. A new sphere has been extended for a forensic laboratory regarding testing fingerprints and signatures, contactless testing of the temperature of object surfaces accredited and analyzer calibration of explosiveness concentrations. Conformity of one institution with the principles of good laboratory practice has been assessed. The LATAK continues provision of accreditation services in Ukraine, where 1 institution has been accredited.

The LATAK has confirmed conformity of the accreditation system in 6 spheres of accreditation in the framework of the Multilateral Recognition Agreement (MLA) of European Co-Operation for Accreditation (EA). In order to constantly conform to these requirements, the LATAK participated in several committees – EA Inspection and Certification Committee, EA Laboratory Committee, meetings of the Multilateral Recognition Agreement Committee and General Assemblies.

In the framework of international co-operation the LATAK conducted an informative seminar for the employees and assessors of Moldavian accreditation institution concerning the issues of laboratory accreditation and measurement uncertainty. Co-operation is also developed with accreditation institutions of Belarus, Ukraine and Uzbekistan. Co-operation with Georgian accreditation institution has been successfully initiated by providing assistance to implementation of the European and international requirements.

The LATAK has also encouraged national laboratories to participate in the international inter-laboratory comparative testing programmes and organised examinations of skills.

Standardisation. The limited liability company “*Latvijas standart*” (hereinafter – LVS) is the national standardisation organisation with a goal to manage and co-ordinate activities of businesses, institutions and organisations of the Republic of Latvia in standardisation and operates according to provisions of the Standardisation Law.

Since 2004, the LVS is a full-fledged member of the European Committee for Standardisation (CEN) and of the European Committee for Electrotechnical Standardisation (CENELEC), as well as a corresponding member of the International Organisation for Standardisation (ISO) and an associate member of the International Electrotechnical Commission (IEC).

The main functions of the LVS are to set up Latvian fund of standards, co-operate with international and European organisations of standardisation, and issue Latvian standards.

Pursuant to the approved plans the priority directions of activity of the LVS in 2008 are to supplement and update the Latvian standards fund, to improve the LVS information technologies, to develop further the electronic sale system of standards (e-shop), to translate the standards of the regulated sphere into Latvian, to strengthen co-operation with the international, European and national standardisation institutions of the states.

Until October 1, 2008, 28 733 standardisation documents have been registered in the LVS, including 27 336 European standards adopted in the status of a Latvian standard. 50 standardisation technical committees co-ordinated by the LVS (LVS/STC) and 3 working groups have adopted 1093 European standards, 69 mandatory applicable standards have been translated into Latvian.

In 2008, the LVS actively performed implementation of the electronic sale system of standards (e-shop), in January, only 8 standards or 1% were sold in the e-shop, in the 3rd quarter – 15% of all standards.

The LVS Information fund has provided standardisation information services to 5019 legal and natural persons. The automatic electronic information notification system introduced by the LVS has provided a free service to clients “*Monthly Report on the Standards Registered in Latvian Status and Cancelled Latvian Standards*” in the fields concerning the clients. In 2008, this service was already used by 534 regular clients to whom 4574 current reports have been sent.

Standardisation activity is popularised on the LVS website on a regular basis. 5 articles about current standardisation problems in Latvia are placed in the regular column “Standardisation” of the magazine “Quality”.

The LVS has signed an agreement on co-operation in the field of standardisation with Ukrainian and Uzbek national standardisation organisations, helping to create conditions for preventing trade barriers and provision of safety of mutually deliverable products. At present, specification of co-operation types is taking place with Ukrainian national standardisation institution regarding adoption of the positive experience of the LVS in the field of drafting and adaptation of European standards. In accordance with the mutual agreement the Uzbek national standardisation institution will inform LVS of the desirable directions of co-operation until the end of the year.

In the framework of the economic promotion programme based on business activity and knowledge, the LVS has started establishment of a technical infrastructure in order to provide an access to the data bases of European standards for the small and medium-sized enterprises, as well as to the information concerning relation of these standards to EU legislation.

Metrology. The state agency “Latvian National Metrology Centre” (hereinafter – Metrology Agency) is an agency under supervision of the Ministry of Economics and operates in accordance with the *Law on Uniformity of Measurements* and in accordance with regulations. It is the national metrology institution of Latvia.

The goal of the metrology agency is to ensure and develop provision of credibility and traceability of measurements in the country. The main tasks of the Metrology Agency are:

- to ensure the base of measurement standards of physical quantities and reproduction of measurement units;
- to approve the types of measuring instruments and register them in the State Register of Measuring Instruments;
- to provide calibration services;
- to co-operate with metrology organisations of other countries and engage in work of international metrology organisations;
- to organise inter-laboratory comparison and take part therein.

In the field of mass measurements mutual comparison of mass standards was performed after calibration in Danish Institute of Fundamental Metrology (DFM). Stability of the National mass standards and the reference standards for weight have been analysed, as well as the drift calculated and assessed: E1 pr. cl. (2 kg; 5 kg; 10 kg; 20 kg) and F2 pr. cl. (500 kg). Mutual comparison of the National mass standards was made LNE 08 (1 mg ÷ 500 mg; 1 g ÷ 500 g; 1 kg; in total: 26 pieces) before calibration of DFM. The acquired standards for weight were calibrated (F2 pr. class 500 kg × 3 pieces).

In accordance with the plan-schedule of the department, examinations of the work skills were carried out and putting of *Susceptometer* into operation.

Preparation of the inter-laboratory comparison project SP2-2009 “*Calibration of Mass Standards (Weight)*” was continued among laboratories accredited in Latvia.

Information on measuring capacities with approved equipment and standards was prepared in the *Section of Time Measurement*, in order to enter for registration. In the framework of EURAMET project No. 1017 “WS for EURAMET T&F laboratories” in March 2008 a presentation of Latvian National time standard was prepared in the meeting of EURAMET Time and Frequency Technical Committee in Prague. EURAMET project No. 1018 “Survey of GNSS receivers” has been successfully completed. The work is continued in the framework of BALTIME project and EURAMET project No. 917.

Calibration services were provided in the *Geometrical measurement section*. As a result of internal audits, the Quality system was improved.

Implementation of the international comparison project EURAMET 870 – polygon has been started.

Co-operation with laboratories of the Republic of Latvia is continued in the field of geometrical measurements on participation in the inter-laboratory comparison.

Calibration of four measurement units of the section is performed in the *Electric measurement section* in accordance with the calibration schedule. The Direct voltage standard system No. LNE 16 has been prepared for sending for the planned calibration. Services have been provided to six institutions. An agreement was concluded with Metrology Institute of the Netherlands on inter-laboratory comparison of alternating voltage measurements.

Regular measurements of zero drifts of the multimeter “Fluke1529” were performed in the *Temperature Measurement Section*. Measurements of temperature deviations of the calibrator H9009 are periodically taken. Measurements of the range of temperature fluctuations of IR calibrators H9132 and H9133 have been performed. High temperature fluctuations in the calibrator H9009 arch “HOT” are established.

A work seminar in the Vilnius Metrology Centre was attended, where the problems of IR pyrometer calibration methods were discussed.

The quality system EURAMET TC-Q 3 was presented in the meeting of the Radiation Metrology and Testing Centre (RMTC) in Sofia (Bulgaria). RMTC and its quality system EURAMET TC-Q have received complete support as the Designated Institute of Latvia in the field of radiation measurements.

The annual report on the actions with JSA was submitted to Radiation Safety Centre of the Republic of Latvia in 2007 and the licence No. 1537 was received.

Comparative measurements organised by the European Commission IRMM on the quality of drinking water “REM-06 Radium and Uranium in water” have been completed.

Comparative measurements of space dosimetry have been organised with the laboratory of the LLC “NMS GRUPA”.

Employees of the Metrology Agency have taken part in the current meetings of EUROMET Technical Committees, as well as participated in the projects related to measurements. Work on the comparative measurements organised by the European Commission IRMM on the quality of drinking water “REM-06 Radium and Uranium in water” has been started in the RMTC: measurements are taken on the concentration of Ra-226, Ra-228, U-234, U-238 in drinking water. The annual report of IAEA (International Atomic Energy Institute) has been prepared and submitted.

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 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 the State and Local Government Property Privatisation and Use of Privatisation Certificates (hereinafter – *Privatisation Completion Law*), which came into force on September 1, 2005 prescribing the procedure of completing the privatisation process and land reforms and ensuring completion of the use of privatisation certificates (see Box 6.31).

Box 6.31

Law on Completion of the State and Local Government Property Privatisation and Use of Privatisation Certificates

The *Privatisation Completion Law* prescribes:

- the term of August 31, 2006, by which every legal or physical 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 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 carry out public administration functions or commercial activity of the state or local government;
- that the Cabinet of Ministers or a local government could take decisions on bringing the state or local government property to privatisation by December 30, 2007;
- that the state joint stock companies “Latvenergo”, “Latvijas pasts”, “International airport „Rīga””, “Latvijas dzelzceļš”, “Latvijas gaisa satiksme” and “Latvijas valsts meži” will not be privatised or alienated;
- the terms by which the persons willing to redeem land allocated for permanent use have to submit land redemption application (November 30, 2007) or by which the land boundary plan or confirmation of the land redemption payment done in privatisation certificates before conclusion of the land redemption contract has to be submitted to the State Land Service (September 1, 2008), as well as the land purchase agreement has to be concluded by December 30, 2009;
- 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 term of April 28, 2007 is set for persons, by which they can submit an application for privatisation certificates.

In order to ensure successful and open progress of privatisation completion processes, the Cabinet of Ministers has set the procedure on how the institutions conducting privatisation and land reform have to establish publicly available registers of privatisation proposals and land redemption.

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 “Privatizācijas aģentūra” (hereinafter – Privatisation Agency) under the Law “On Privatisation of Property Units Owned by the State and Local Governments”.

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.

623 proposals for privatisation of real estate, 57 proposals for privatisation of state capital shares and 4255 proposals for privatisation of land lots have been registered by the *Register of Privatisation Proposals* of the Privatisation Agency from September 1, 2005 (when the *Privatisation Completion Law* came into force) till October 1, 2008. After August 31, 2006 the Register of Privatisation Proposals registered those privatisation proposals, which were submitted by mistake to other state and local government

institutions by this date and transferred by cognizance to the Privatisation Agency later.

A natural or legal person eligible to acquire movable 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.

In accordance with the *Privatisation Completion Law*, the Cabinet of Ministers has taken decisions on bringing 232 properties to privatisation and denials of bringing to privatisation for 124 properties by October 1, 2008.

From April 17, 1994 till October 1, 2008, privatisation rules had been approved in the statutory procedure for 2370 state property units (excluding land). 94 companies were transformed to public joint stock companies, thus releasing 439.14 million shares into public circulation. The incomes 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 1.657 billion, of which LVL 392.369 million in cash and the nominal value of LVL 1.265 billion in privatisation certificates. New owners took over obligations of privatised state companies (enterprises) for more than LVL 185.8 million. The

amount of the specified investments was LVL 143.8 million, while the amount of investments actually invested reached LVL 265.2 million.

Privatisation Agency carries out privatisation of state-owned lands since 1997. 4647 state-owned land lots were privatised (purchase agreements signed) by October 1, 2008. Total sales price for the privatised state lands reached LVL 192.02 million, of which LVL 90.39 million in cash and LVL 101.63 million in property compensation certificates. As of October 1, 2008 incomes from privatisation of these land lots amounted to LVL 166.30 million, of which LVL 74.80 million in cash and LVL 91.50 million in property compensation certificates.

Privatisation of property units and land lots owned by local governments

Decision concerning real estate owned by a local government is taken by the council of the local government (city, province, rural municipality). The decision is taken on the basis of a privatisation proposal submitted by any natural or legal person.

A natural or legal person eligible to acquire movable or 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 property privatisation commission of the respective local government (rural municipality, city, district, region).

Compliance of privatisation projects, rules and announcements approved by a local government with provisions of the Law “On Privatisation of Property Units Owned by the State and Local Governments” and the *Privatisation Completion Law* is ensured by the Ministry of Economics.

From February 17, 1994 till October 1, 2008 the Ministry of Economics has reviewed and accepted for information 3200 privatisation projects for the total relative price of LVL 127.6 million (including payments in certificates for the nominal value of LVL 56.9 million).

From January 1, 1997 till October 1, 2008 the Ministry of Economics has reviewed and accepted privatisation rules in respect of 1661 built-up and vacant local government lands (announcements of privatisation of built-up land lots separately as from September 1, 2005) with the total value of land lots in the amount of LVL 22.9 million (of which LVL 13.27 million to be paid in property compensation certificates).

According to Item 7 of Article 5 of the *Privatisation Completion Law*, after August 31, 2006 local governments shall submit quarterly data to the Ministry of Economics, regarding the received privatisation proposals for municipal property units and built-up and vacant land lots, decisions on bringing these property units and land lots to

privatisation, the sale price and the amount of privatisation certificates to be used for payment.

Privatisation of apartment houses

Privatisation of apartment houses in Latvia was initiated in 1995. The Central Apartment Houses Privatisation Commission (renamed as the state agency “Mājokļu aģentūra” (Housing Agency) as from January 1, 2004 and “Būvniecības, enerģētikas un mājokļu valsts aģentūra” (Construction, Energy and Housing Agency) as from January 1, 2008) and apartment privatisation commissions of the respective local governments implemented privatization taking into account the procedure laid down in the law “On Privatisation of State and Local Government Apartment Houses”. In accordance with the information provided by local governments and Decrees of the Cabinet of Ministers “On Bringing State and Local Government Apartment Houses to Privatisation”, as of July 1, 2008 there are 30 346 apartment houses with 502 181 apartments to be privatised in Latvia, including 25 152 local government apartment houses with 451 811 apartments and 5194 state apartment houses with 50 370 apartments.

The privatisation process of the state apartment houses – decisions on bringing 5050 apartment houses to privatisation have been adopted until July 1, 2008, which amounts to 96.97% of the total amount of state apartment houses. 5026 apartment houses have been offered for privatisation. Privatisation announcements have been sent to 50 269 tenants of state apartments, but 22 725 announcements on conclusion of purchase contracts have been sent to the persons, who have obtained apartments in possession until privatisation of an apartment house. The possession of 22 955 apartments has been transferred by the decision until privatisation of an apartment house. 44 165 state apartments have been privatised until July 1, 2008, which constitutes 87.71% of the total amount of state apartments. In the 1st half of 2008, 204 state apartments have been privatised. 1350 property units have been privatised in auctions.

The privatisation process of local government apartment houses – 24 219 local government apartment houses have been prepared and offered for privatisation. Privatisation announcements have been sent to 439 420 tenants of local government apartments, but 163 844 announcements on conclusion of a purchase contract have been sent to the persons, who have obtained the apartments in possession until privatisation of the apartment house. In the 1st half of 2008, 65 apartment houses with 991 apartments have been offered for privatisation, of which 467 apartments have already been privatised in the accelerated procedure. 171 506 apartments have been transferred to possession by local government decisions until privatisation of the apartment house. Ownership relations have been arranged for 42 888 owners of the apartments privatised for the shares of agricultural enterprises who live in 1697 apartment houses privatised for shares. Until July 1, 2008, 399 605 local government apartments have been

privatised, which constitute 85.76% of the total number of local government apartments.

At present, 9162 apartment houses are transferred to the management of apartment owners, including 5621 local government apartment houses and 3541 state apartment houses, within which more than 50% apartment properties have been privatised.

Owners of the privatised apartments may decide the most acceptable form for management and maintenance of their apartment house: to establish a co-operative society of apartment owners (CSAO) or conclude an authorisation agreement for management of the house. As a result of this process, 397 CSAOs have been established in Latvia, of which 290 are located in seven biggest cities and 107 districts of Latvia. The most CSAOs have been established in Riga (192), Liepāja (69), Ventspils (21) and Valmiera district (34). Authorisation agreements for property management have been signed for 2778 apartment houses.

Land reform

The principal goal of the land reform is to change over the legal, social and economic relations of land use and ownership from the planned economy to the market economy.

The state land reform includes allocation of free land cognizable to the state for permanent use, restoration of ownership rights, redemption of the land allocated for permanent use, and privatisation (alienation) of land owned by the state or local government. Redemption of land allocated for permanent use is being 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 apartment house owners or orchard users, who have received the land for establishing an orchard with building rights is over, and urban land commissions have reviewed conclusions concerning rights to acquire ownership of land for payment but, in accordance with the conclusions made, conclusion of purchase agreements is continuing in compliance with the Cabinet of Ministers Regulation No. 171 of May 6, 1997 “On Calculation of Compensation for Former Landowners or Their Heirs and on Setting Fee for Urban Land Given into Ownership”. Until October 1, 2008, SJSC “Latvijas Hipotēku banka” (Mortgage Bank of Latvia) has signed a total of 72 263 agreements, of which 829 agreements were signed during the three quarters of 2008.

Allocation of free (unclaimed) rural land cognizable to the state for permanent use, i.e., until June 1, 2006 and submission of redemption claims to the State Land Service for redemption of rural land allocated for permanent use, i.e., until November 30, 2007 have been finished. After submission of a redemption claim, the State Land Service verified the claimant’s rights to acquire ownership of land. If the claimant was entitled to redeem the land, the State Land Service included this land redemption claim into the Rural Land Redemption

Register. The person whose land of permanent use is included in this Register, but for which a cadastral survey has not been performed had to submit a land border plan registered in the information system of the Real Estate State Cadastre, settle a pre-payment for the land to be redeemed (purchased) in privatisation certificates or, in the procedure set by the Cabinet of Ministers, a confirmation of land redemption payment in privatisation certificates before conclusion of land redemption agreement to the respective regional bureau of the State Land Service by September 1, 2008.

State Land Service has received 67 970 claims for redemption (purchase) of land in total for 106 017 land units with the total area of more than 417 170 hectares.

According to the information system of the Real Estate State Cadastre, cadastral survey has been made for 63 500 or 60% of the land units included in the Redemption Register and land border plans have been registered in the information system of the Real Estate State Cadastre.

Confirmations have been received regarding settlement of pre-payment for 8500 or 8% of the land units included in the Redemption Register in privatisation certificates.

The process of rural land redemption is finished and 28% of the land units included in the Redemption Register have been entered in the Land Register.

The land border plan is not registered in the information system of the Real Estate State Cadastre or the confirmation on settlement of the pre-payment for 34 000 land units in the area of approximately 122 000 ha or 32% of the land units included in the Redemption Register is not received. The permanent land users, who have not performed the cadastral survey of the land, allocated for use, nor settled a pre-payment of the land redemption until September 1, 2008, forfeit the rights for permanent use of the land, but shall be entitled to sign a land lease agreement with the respective local government by September 2, 2009. The vacant land units on which the former land user will not have concluded a land lease agreement with the respective local government by September 2, 2009, are to be included within the lands planned for completing the land reform.

Transfer of the rural land to possession for payment continues along with a conclusion of a redemption (purchase) agreement with the Mortgage Bank. The Mortgage Bank has concluded a total of 228 526 agreements, including 6 582 agreements in the three quarters of 2008 on the sale of land of a total area of 1.668 million hectares, including 82 500 hectares in three quarters of 2008.

In accordance with Section 16 of the law “On the Completion of the 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 “Višpārējās Lauksaimniecības banka” (General Agricultural Bank)

or the “Valsts zemes banka” (State Land Bank), as well as the heirs of such persons (hereinafter redeemers of German lands) shall submit a request regarding the restoration of land ownership rights to the Central Land Commission. If the documentation confirming the land ownership and inheritance rights was not at the disposal of a person at the moment of submitting a claim, it was possible to submit it to the Central Land Commission until September 1, 2008. As from January 2, 2009, after summarization of all the applications the Central Land Commission 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 making decisions will be taking place by December 30, 2009. In accordance with the information provided by the Central Land Commission, almost 2200 claims were received from the former land owners and their heirs for restoration of land ownership rights until December 28, 2007. According to the information summarised by the Central Land Commission and Service until September 1, 2008 the documentation confirming the land ownership and inheritance rights has been submitted with 1155 claims of an area of more than 14 700 ha, 87 of which are claims of redeemers of German lands for the land in the area of more than 2090 ha and 25 claims for the area of more than 360 ha for the land of Abrene district. In accordance with the data of the information system of the Real Estate State Cadastre, 7225 land units have been registered as the land planned for finishing the land reform in the area of almost 22 020 ha.

Privatisation certificates

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”*. As of October 1, 2008 a total amount of 103.9 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, 4895 thousand for land in rural areas, 967.7 thousand for property ownership, 813.8 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.

5.95 thousand property compensation certificates have been granted to 55 former owners or their heirs in the three quarters of 2008.

By December 1, 2007 in accordance with the provision set in Article 27 of the Law on Completion of the State and Local Government Property Privatisation and Use of Privatisation Certificates, 55 thousand persons lost their rights to transfer 1.17 million privatisation certificates to their accounts.

Table 6.7

Use of Privatisation Certificates

(as of October 1, 2008)

Type of property	Number	Number of privatisation certificates (million)	including property compensation certificates (thousand)
Apartment houses	432 thousand privatised housing units	37.79	589.8
Enterprises and other properties	accurate data not available	7.20	109.6
Capital shares (stocks)	accurate data not available	44.44	954.0
including:			
in public offering	128.7 million shares	37.14	820.0
Land	300.8 thousand land lots	16.32	5412.8
Total:		105.75	7066.2
% of total certificates issued		94.5%	88.3%

In compliance with the second item of Article 34 of the Law on Completion of the State and Local Government Property Privatisation and Use of Privatisation Certificates, if the number of the non-used property compensation certificates on the first date of each month is less than 3% of the total number of allocated property compensation

certificates for more than three months in turn, the Cabinet of Ministers shall adopt a decision within a month which prescribes that a person acquires the right to use privatisation certificates as the means of payment instead property compensation certificates as of the first date of the following month. In accordance with the third item of Article 34 of this Law, the

Cabinet of Ministers has to set the proportion once in a quarter, within which privatisation certificates may be used as a means of payment instead of property compensation certificates and it is set pursuant to the proportion of the property compensation certificates of the previous 12 months and average prices of privatisation certificates, which is also determined according to the information provided by licensed intermediary companies of the sale of certificates, except the sale to another intermediary company by finishing this period of 12 months one month before the date, from which the privatisation certificates may be used as the means of payment instead of property compensation certificates. Within the period from April 1 to June 30, 2008, 1.37 privatisation certificates may be used as the means of payment instead of the compensation certificates for one property and within the period from July 1 to September 30, 2008, 1.34 privatisation certificates may be used as the means of payment instead of compensation certificates for one property. In total, 73.3 privatisation certificates have been used instead of 54.5 thousand property compensation certificates from April 1 to September 30, 2008.

According to the Law “On Privatisation of Land in Rural Areas”, 11 076 decisions have been made by October 1, 2008 about payment of cash compensations for former land ownership in rural areas. Compensations in the total amount of LVL 17.46 million have been paid to 8413 persons, cancelling 0.62 million property compensation certificates.

Cash compensations in the total amount of LVL 4.64 million were paid to 26.2 thousand politically repressed persons as a payment for privatisation certificates by October 1, 2008. In compliance with the provision prescribed in Article 27 of the Law on Completion of the State and Local Government Property Privatisation and Use of Privatisation Certificates, 3.1 thousand persons have lost their rights to cancel 15 thousand certificates.

105.75 million privatisation certificates or 94.5% of the total number of issued certificates have been used for privatisation of state and local government property units by October 1, 2008 (see Table 6.7).

2.34 million privatisation certificates or 2.1% of the total number of issued certificates, including 0.146 million compensation certificates, were on accounts of 391 thousand natural persons as of October 1, 2008.

Accounts of legal persons held 1.81 million privatisation certificates or 1.6% of the total number of issued certificates, including 0.022 million property compensation certificates, as of October 1, 2008.

In October 2008, holders of privatisation certificates could use services of 14 licensed intermediary capital companies for transactions in the market of privatisation certificates. Total monthly transactions with privatisation certificates (buying from natural persons and selling), carried out by intermediary capital companies in three quarters of 2008, fluctuated from 33.51 thousand privatisation certificates in June to 135.48 thousand privatisation certificates in August.

6.14. Public Private Partnership

Although public private partnership (hereinafter – PPP) all over the world has become a solution for successful provision of public services, development of infrastructure and maintenance, which would promote economic growth and provide welfare of society, the concept of PPP and the opportunities it may provide to development of national economy are increasingly more discussed in Latvia only within recent years.

Promotion of PPP in Latvia was started at the beginning of 2000, when the *Concessions Law* was adopted and enforced by the Saeima. In addition to that, the Ministry of Economics and the Investment and Development Agency of Latvia have facilitated

the potential commencement of implementation of PPP projects since 2004, as well as have organised various meetings and provided consultations for the representatives of public, private and nongovernmental sector regarding the issues related to implementation of PPP projects, thereby promoting development of PPP in Latvia.

Besides the Ministry of Economics and the Investment and Development Agency of Latvia, there are also other institutions, for example, the Ministry of Finance, the State Treasury, sectoral ministries, and local governments involved in the process of PPP and having substantial impact on the opportunities of utilisation of PPP.

Box 6.32

Definition of PPP and pre-requisites of successful PPP

A special definition of PPP is still not included in the European Community law, but only a general explanation of PPP is provided. The European Commission (EC Green Paper on PPPs and Community Law on Public Contracts and Concessions, April 30, 2004) classifies PPP as:

- **purely contractual PPP** if co-operation between the public sector institution and private partner is implemented on the basis of a long-term agreement;
- **institutional PPP**, if co-operation between the public sector institution and private partner is implemented with the help of a joint company.

Box 6.32 continued

In accordance with the abovementioned, PPP is most often understood as long-term contractual relations between a public and private entity or entities in order to ensure implementation of the function of a public entity by constructing, reconstructing and maintaining an infrastructure object of public importance or providing a public service, where a private partner undertakes fulfilment of the obligations set in the PPP agreement by using the resources and knowledge of the private sector, as well as undertakes the risks related to fulfilment of the obligations set in the PPP agreement or a part of these risks.

Similarly, also at the moment different PPP models are identified in Latvia depending on the specification of the project implementation, for example, agreement conditions, schemes of the financing flow, specific character of the object or service:

- **purely contractual partnership** – in the form of concession and partnership procurement agreements;
- **institutional partnership** – by establishing a joint company along with the public partner.

The decision on implementation of some projects with the help of PPP must be well-considered and reasonable in order for the PPP to operate successfully. Therefore, PPP is mostly applied only in relation to large or several joint projects of public importance, where social and economic benefits compensate the project costs. Taking into consideration the international practice, PPP accordingly operates the most successfully in such projects.

Taking into consideration the implementation period of PPP projects (up to 20-30 years), before starting the implementation of a certain PPP project, not only the annual costs for a public partner should be comprehended, but also the influence it will have on the state budget within a long term and how it will fit in the state financial obligations should be realised. Therefore, it is necessary to perform an analysis of the financial and economic calculations of the project before each decision about commencement of implementation of a PPP project, because PPP is only one of several possible project financing and implementation types. After making such calculations, a project is implemented as PPP only if it is proved by the calculations that project implementation with participation of the private sector is profitable for the society within a long term (the corresponding value of the investment is obtained by taking into account the technical, legal, economical (financial), and social aspects of the project within its entire life cycle) instead of project implementation only under conditions of limited budget funds.

Certainly, the private sector must show interest about the respective PPP project, because not only the public partner should benefit from a PPP project implementation, but also the private one, who should be ready to undertake the project implementation. Participation of an entrepreneur in the projects of such type is mainly promoted by financial considerations – it is an opportunity to gain predictable regular revenues within a long term, provide wider business opportunities and identification, thereby providing a stable place in the market.

PPP legal regulation and policy planning

The currently effective legal regulation in Latvia enables implementation of purely contractual PPP projects on the basis of provisions of the *Concessions Law* (effective from February 16, 2000), as well as the third part of Section 67 of *Public Procurement Law* (effective from May 1, 2006), while the purely institutional PPP model is regulated by the *Public Administration Structure Law*, *Commercial Law*, *Law on State and Local Government Shares and Enterprises*, as well as other related normative acts.

A work group has been established by the Prime Minister decree of February 22, 2008, which is appointed for development of a draft law specifying and regulating the main issues regarding the models within which the partnership between the public and private sector is based on contractual relations and the models within which partnership takes place in the framework of a particular society. In order to connect the abovementioned draft law with the rest of the legal system of Latvia, in addition to development of the draft law, the work group must elaborate draft amendments to the rest of the laws thereof and submit to the Prime Minister.

The new law envisages not only improvement of PPP legal regulation, but also arranging the institutional environment for development of PPP. One of the purposes for developing this law is also defining the concept of PPP on the level of a normative act and solving the issues of statistic registration, sustainable financial planning, and quality (joint assumptions, assessment criteria, knowledge transfer) of PPP projects, as well as define the potential risk distribution within PPP projects.

The main PPP policy planning documents, as well as implementation documents thereof are as follows:

- *Concessions Promotion Concept (attracting private capital for performing the state functions)*, adopted by the Cabinet of Ministers on April 16, 2002. It envisaged to establish Concessions Department in the Ministry of Economics, as well as to expand the competence of the Investment and Development Agency of Latvia by including PPP issues;
- *Promotion Guidelines of Latvian Public Private Partnership* adopted by the Cabinet of Ministers on March 22, 2005 specifying the basic principles, goal and its achievement indicators of PPP policy;
- *Action Plan for Implementation of Promotion Guidelines of Latvian Public Private Partnership for 2006–2009*, adopted by the Cabinet of Ministers on November 15, 2005, which prescribes the directions of activity for promotion of PPP for 2009.

Several PPP promotion measures are included in the declaration on the planned activity of the Cabinet of Ministers led by Mr. Ivars Godmanis and the Government Action Plan accordingly adopted at the beginning of 2008. Several measures related to development of PPP are included in the Latvian National Development Plan for 2007–2013, which is a medium-term strategic planning document prescribing the main development directions of Latvia, as well as showing the most important tasks of the state and society on the way to achieving the set long-term goals.

Application opportunities of PPP are emphasized in several sectoral planning documents, for example:

- Activity Strategy of the Ministry of Transport for 2007–2009;
- Transport Development Guidelines for 2007–2013;
- Activity Strategy of the Secretariat of Special Assignments Minister for Electronic Government Affairs for 2007–2009 (updated for 2008–2010);
- National Sports Development Programme for 2006–2012, etc.

In 2007, development of the concept envisaging establishment of a unified and coordinated state investment planning process and implementation in public administration was started prescribing PPP as a national development instrument.

Support to PPP project implementation

Only 16 comparatively small concession agreements have been registered in the *Register of Concessions* before 2008 in Latvia, as well as particular cases identified, when PPP structure is indirectly applied in the public projects, which is a very low indicator, taking into account the high necessity of investment projects in Latvia. In order to promote wider implementation of PPP projects in the national economy, in 2008, the Ministry of Economics and the Investment and Development Agency of Latvia has continued implementation of the activities started for preparation of qualitative PPP projects by means of the financial support instrument.

The main goal of the programme “Promotion of Public Private Partnership in Latvia” co-financed by the Norwegian bilateral financial instrument (manager – the Investment and Development Agency of Latvia) is to support public and local government institutions by implementing consequent and justified PPP approach for development of infrastructure and public services within their efforts and the following activities will be implemented in its framework by envisaging:

- development of the financial and economic substantiation for PPP project by obligatory including training of employees involved in the sub-project of a sub-project application submitter and co-operation partner within the sub-project;
- elaboration of PPP project tender documentation including mandatory training of the employees involved in the sub-project of a sub-project application submitter and co-operation partner within the sub-project.

Ministries, Secretariats of Special Assignments Minister, local or regional governments have an opportunity to apply for the co-financing of the programme consisting of co-financing of the Norwegian bilateral financial instrument and Latvian

state financing. The total planned Norwegian bilateral financial instrument and state budget co-financing of the programme amounts to EUR 1 940 135.

On May 27, 2008, open tender regulations of the programme sub-projects were approved by the Cabinet of Ministers and the applicants for support could submit sub-projects based on the above-mentioned activities supported by the programme within the period from August 14 to November 14, 2008.

In compliance with the meeting of the Cabinet of Ministers of May 15, 2007 on “Construction of New Nursery Schools”, a co-operation agreement was concluded with the Riga City Council and the LLC “Rīgas Pilsēt būvnieks” on December 11, 2007 on repeated use of the documentation of the nursery school technical project “Kindergarten for 136 Places” implemented in Riga housing estate “Dreilīni-2” in order to facilitate development of the nursery school network corresponding to the interests of the residents of the country. Thereby, all the concerned Latvian local governments have an opportunity to use the building design free of charge for construction of a nursery school in their administrative territories by financing only coordination of the project with a particular territory from the local government budget resources. 11 local governments have taken this opportunity until November 2008.

In relation to development of the nursery school network, the decree on “Permit Issued to Tukums Town Council, Ogre Region Council, Mārupe Parish Council and Ķekava Parish Council to Conclude the Joint Procurement Agreement on Construction and Management of Four Nursery Schools within the Local Government Territories” was approved by the Cabinet of Ministers on October 7, 2008. The Decree envisages conclusion of a PPP agreement with the selected applicant on construction and management of nursery schools within the territories of the abovementioned local governments as a result of the public procurement procedure. It is planned that the land lots in possession of the local governments and at their long-term disposal are rented to the applicant for 20 years with building rights, inter alia, for management of nursery schools for 19 years. The next step of the local governments on the way to conclusion of the agreement will be starting the public procurement procedure for the choice of the private partner.

Precurse for establishment of a prison system and infrastructure development has been started within this year by applying the PPP project. The Ministry of Justice has worked out a draft concept for development of prison infrastructure, envisaging attraction of the private partner, in order to implement designing, construction, management, and maintenance of prisons. Thereby, the private sector would gradually adopt the prison management functions from public administration.

On April 29, 2008, the Ministry of Transport started procurement of the first PPP project – road project “Road Section E77/A2 Riga bypass – Sēnīte”, performed in compliance with the *Public Procurement Law* in the form of a restricted competition in two rounds the first of which is selection of applicants, but the second – submission and assessment of tenders of the selected applicants, decision making, announcing results of a restricted competition and conclusion of a procurement agreement. Conclusion of the agreement with the winner of the procurement competition is planned in the first half of 2009.

In addition to the already commenced initiatives concerning implementation of PPP projects, development of standard documentation (regulations, agreement, methods) was implemented in 2008 for selection of the private partner, construction and management of the local government rent flats and implementation of institutional public private partnership of the Guidelines in order to facilitate PPP. The abovementioned documentation is available on Internet homepages of the Ministry of Economics and the Investment and Development Agency of Latvia.

Box 6.33

Establishment of European PPP Expertise Centre

On September 16, 2008, an establishment agreement of European PPP Expertise Centre (hereinafter – EPEC) was officially signed in Paris. The initiator of EPEC establishment is the European Investment Bank in co-operation with the European Commission and its members are the state institutions dealing with development of the documentation of PPP policy and normative acts, as well as promotion of PPP projects (one institution per state).

The main tasks of the EPEC include experience exchange with the member states in development of policy planning, normative acts, project implementation and conclusion of agreements, organisation of seminars by discussing the PPP problem issues.

Improvement of PPP understanding and knowledge

In 2008, the Ministry of Economics and the Investment and Development Agency of Latvia have continued rendering advisory support to potential implementers of PPP projects by informing them on the applicable type of PPP transaction, carrying out the appropriate procurement procedure, financial and economic calculations and procedures for making them, possible legal solutions of the project agreement and other issues regarding PPP. Until the end of November 2008, more than 50 consultations have been provided to both the public and private sector concerning the topical issues of PPP project implementation, as well as four regional informative seminars and one conference organised where both foreign and Latvian PPP experts and advisers

participated (the conference was attended by the total of more than 300 representatives of the public and private sector).

The Ministry of Economics has also established PPP Internet homepage (www.ppp.gov.lv) containing the actual information and summarised available resources about PPP at the disposal of the Ministry of Economics and the Investment and Development Agency of Latvia up to now (methodological materials, standardized PPP draft agreements, etc.) in order to provide maximally extensive information to the society about the most topical events taking place, developed draft normative acts, as well as achieved progress in relation to PPP. Since June 2, 2008, the abovementioned Internet homepage is publicly accessible to all concerned persons.

6.15. Advisory Councils of the Ministry of Economics

6.15.1. 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, “Agreement on Co-operation in the National Economy Council” concluded on February 17, 1999 and Bylaws of the NEC of May 14, 2007.

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 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.

Box 6.34

NEC personnel

In accordance with the decision of the Management Committee, the NEC personnel is approved by the Minister of Economics.

The NEC Steering Committee is a consulting and co-ordinating institution that takes part in settlement of issues referring to business 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 Steering Committee is approved by the Minister of Economics. Steering Committee consists of five representatives of the NEC founders, who are NEC members at the same time – the Ministry of Economics, Latvian Chamber of Commerce and Industry, Employers' Confederation of Latvia, Free Trade Union Confederation of Latvia and Latvian Association of Local and Regional Governments.

The NEC consists of 21 experts designated by the NEC Steering Committee, 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 Steering Committee.

The NEC is chaired by the Chairman elected by the members of the NEC Steering Committee from among the members in the 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, operation of which is ensured by the Ministry of Economics.

In between the NEC meetings, recommending decisions of the NEC are taken by the NEC Steering Committee.

The NEC 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.

In order to ensure professional representation of the interests of economic sectors in an effective dialogue with the Ministry of Economics, the NEC and other business organisations and public institutions, the Ministry of Economics has set up a model of co-operation with economic sectors.

The Ministry of Economics and the NEC have concluded a protocol of agreement on co-operation with the following councils of experts (CE) of industries: CE of Machine Building and Metal Processing Industry, CE of Chemical and Pharmaceutical Industry, CE of Light Industry, CE of Construction Materials Producers, CE of Timber Industry, CE of

Food Industry, CE of Construction Industry, CE of Passenger Carrier Industry, CE of Business Education and Management Advisers, CE of Tourism Industry, and CE of Printing and Publishing Industry.

By signing the protocol of agreement, the parties agreed to unite their resources for development of programming documents, take measures towards implementation of the programmes on improvement of economic development and business environment adopted as part of the governmental declaration, and that the councils of experts will assess and give opinion on draft legislative acts elaborated by the ministries.

Box 6.35

Representation of the NEC in organisations established by the public institutions

The NEC members and experts work in the following councils, committees and working groups:

- Consultative Board for Development Co-operation Policy Issues at the Ministry of Foreign Affairs;
- Supervisory Board of the Lisbon Strategy at the Ministry of Economics;
- Construction Council at the Ministry of Economics;
- Latvian Tourism Advisory Council at the Ministry of Economics;
- Export Promotion Council at the Ministry of Economics;
- National Standardisation Council at the Ministry of Economics;
- European Union Structural Funds Supervision Committee at the Ministry of Finance;
- Working Group for Setting Corporate Income Tax and Real Property Tax of Proposals Promoting Economic Development of the Ministry of Economics;
- Information Society National Council of Special Assignments Minister for Electronic Government Affairs;
- Advisory Council of the Investment and Development Agency of Latvia.

In the second half of 2008, 5 NEC meetings have taken place in which the following most important issues have been reviewed regarding:

- Report on implementation of the Action Plan for Stabilisation of the Macroeconomic Situation for 2008–2009 in the first half-year;

- proposals concerning amendments to the Law on State Social Insurance;
- electric energy markets and price formation;
- regulation principles of electricity and gas tariffs;

- provision of electricity and gas, expected price changes and factors affecting price within a short-term and long-term;
- European Commission plan on implementation of decrease of administrative burden in Latvia;
- draft Business Environment Improvement Action Plan for 2009;
- information updated by the State Revenue Service relating to co-operation with taxpayers and tax payments;
- influence of competition on business activity, etc.

Box 6.36**NEC on priorities of economic policy**

Entrepreneurs are one of the most important “users” of legislative acts and directly face the controlling influence of legislation in daily work, therefore it is necessary to popularise work of the entrepreneur associations as partner in drafting the legislation and to help increasing capacity of entrepreneur associations.

The NEC considers that the work must be continued in order to provide stable macroeconomic environment and encourage competition in Latvia, as well as balanced budget must be established, competition supervision strengthened and competition development promoted within all economic sectors by timely identifying the risk sectors where competition law violations are possible restricting administrative and other barriers for competition.

The NEC still considers taxation policy and administration, labour education, macroeconomic stability and non-predictability of amendments to the legislative acts as one of the most problematic spheres.

At the same time, normative acts must be assessed already during their drafting process, in order to identify and prevent the possible competition law violations, technical barriers to trade and discriminating conditions within the sector of free movement of goods and services, as well as the sphere of 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, as well as research, development and innovation promoted, especially within the private sector and measures elaborated and implemented which would facilitate co-operation of education, research and national economic sectors by ensuring transfer of knowledge and technologies.

Absorption of 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.

Undeclared employment must be decreased in the country, which could be obtained by the following measures:

- increasing the minimum wage and raising the untaxed minimum proportionally in order to decrease tax burden on persons with low income;
- increasing administrative capacities of the State Labour Inspectorate by attracting additional personnel, improving control over observance of the labour legal norms, increasing awareness level of society regarding the labour law issues;
- strengthening the role of trade union and employers’ associations in business activity by promoting merger of entrepreneurs into entrepreneur organisations;
- creating favourable environment for increasing the reputation of socially responsible business activity.

The NEC considers that it is necessary to improve administrative procedures in Latvia, because after Latvia’s joining to the EU entrepreneurs need extremely long time for solving the issues related to the requirements and administrative procedures regulating the public and local governments and absorbing new administrative procedures regarding application of EU legislative acts, as well as for acquainting with often voluminous and directly applicable EU legislative acts.

The NEC plans to discuss the issues concerning the draft law “Amendments to the Law on Personal Income Tax”, Guidelines for Development of Tax and Fee System, the process for implementation the Action Plan for Stabilisation of the Macroeconomic Situation for 2008–2009, as well as other issues important for national economy development in next meetings.

6.15.2. Council of Small and Medium-Sized Enterprises and Crafts

The Council of Small and Medium-Sized Enterprises and Crafts (hereinafter – CSMEC) is an advisory institution of the Ministry of Economics.

The composition of the CSMEC has been updated with a Decree of the Minister of Economics of December 11, 2007 by expanding the institutions represented within the CSMEC and by supplementing it with representatives of producer associations and

regional development agencies. 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 goal of activity of the CSMEC is promotion of development of small and medium-sized enterprises and crafts and establishment of favourable business environment for SMEs in Latvia.

The key functions of CSMEC are: 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

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. Work of the CSMEC is 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 second half of 2008, 4 meetings of the CSMEC took place, where the following most important issues were considered:

- The national position of Latvia concerning report on support to small enterprises drafted by the European Commission, based on ““Think Small First” principle “The Small Business Act for Europe”;
- Adopting measures of Directive 2006/123/EC on services in the internal market, *inter alia* the concept of one-stop shop;
- Support programmes of EU funds;
- Support programmes for starting business activity in the framework of Rural Support Programme for 2007–2013;
- Implementation of the European Commission Plan on decrease of the administrative burden in Latvia;

- Discussion of the draft action plan on improvement of business environment for 2009;
- The implementation process of the Support Programme for Improvement of Competitiveness of Enterprises;
- Influence of competition on business activity.

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 government. Proposals for various legal acts, for the Action Plan for Improvement of Business Environment for 2009, as well as amendments to the Action Plan for Stabilisation of the Macroeconomic Situation for 2008–2009 have been developed at the meetings.

Box 6.37

Representation of the CSMEC in the Council and committees

In order to strengthen the role of the CSMEC in improvement of business environment, as well as non-governmental sector was competently represented in absorption of EU Structural Funds and support programmes, members of the Council are delegated for participation in such councils, committees and working groups:

- EU Structural Fund Steering Committee of the Ministry of Finance;
- Sub-committee of the European Regional Development Fund and the Cohesion Fund of the Ministry of Finance;
- Sub-committee of European Social Fund of the Ministry of Finance;
- Drafting development guidelines for the state tax and fee system of the Ministry of Finance in the work group;
- Supervisory Council of the co-operation memorandum of non-governmental organisations and the Cabinet of Ministers;
- Export Promotion Council of the Ministry of Economics;
- Advisory Committee of the Ministry of Economics and Investment and Development Agency of Latvia;
- Business Development Board of Riga City Council;
- SEPA working group of the Bank of Latvia.

Participating in entrepreneur delegations beyond the borders of Latvia, the CSMEC co-operation agreements have been concluded with similar organisations of the Republic of Azerbaijan and Republic of Israel.

In the next meetings of the CSMEC it is planned to review the most important issues for national economy development – to discuss the draft law “Amendments to the Law on Personal Income Tax”, review the issue on development guidelines of the Tax and Fee System, implementation process of the Action Plan for Stabilisation of the Macroeconomic Situation for 2008–2009, as well as review other topical issues.

6.15.3. Advisory Council of Public Private Partnership

Advisory Council of Public Private Partnership (hereinafter – Advisory Council of PPP) is a consulting

and co-ordinating institution established by the Ministry of Economics.

The goal of its activity is to participate in addressing issues related to PPP policy and thereby foster creation of favourable environment for implementation of PPP projects and encourage use of the PPP instrument, attracting private capital to build-up of public infrastructure and to public services. Its decisions are of a recommending character for public institutions and local governments.

In January 2007, the Ministry of Economics approved the composition of the Advisory Council of PPP, which was updated in December 2008 (see Box 6.38).

Box 6.38**Composition of the Advisory Council of PPP**

Chairman of the Advisory Council of PPP is the Minister of Economics.

It consists of representatives of the National Economy Commission of the Saeima, the Ministry of Economics, Ministry of Finance, Ministry of Education and Science, Ministry of Culture, Ministry of Welfare, Ministry of Regional Development and Local Government, Ministry of Transport, Ministry of Justice, Ministry of Health, Ministry of the Environment, Latvian Association of Local and Regional Governments, Riga City Council, Investment and Development Agency of Latvia, State Regional Development Agency, Association of Latvian Commercial Banks, Public Private Partnership Association, Latvian Builders Association, Association of Latvian Cities, National Economy Council and Latvian Chamber of Commerce and Industry.

In February 2007, the Ministry of Economics approved the Bylaws of the Advisory Council of PPP, which prescribe functions, tasks and rights of the Advisory Council of PPP, as well as organisation of its work, establishing that the Economic Policy Department of the Ministry of Economics performs functions of the Secretariat of the Advisory Council of PPP and organises its work.

In 2008, one meeting of the Advisory Council of PPP took place during which the draft Law of Public Private Partnership developed by the working group established by Decree No. 90 of the Prime Minister of February 22, 2008 was reviewed, thereby taking into consideration recommendations of all the parties concerned for improvement of the draft law already within the developing process.

7. RECOMMENDATIONS

Taking into account the current economic development tendencies in the world and in Latvia, the main task of the government at the moment is to prevent too rapid economic decline and to restructure national economy aiming at increasing its competitiveness. It may be achieved by:

- ensuring stability of the financial system, inter alia providing the state support to the banking system until the crediting situation returns to the normal conditions;
- improving public administration efficiency by decreasing its expenditures and reforming the education, health and internal affairs systems;
- promoting domestic demand, implementing infrastructure improvement projects and expanding the availability to finances for the entrepreneurs;
- implementing purposeful measures to raise competitiveness of enterprises, gain and expand the export markets;
- continuing to decrease barriers for entrepreneurship;
- ensuring flexible labour market.

Despite the financial difficulties, the EU structural fund projects aimed at promotion of knowledge-based economy must be supported – introduction of new products, promotion of innovation, research and development, improvement of training and education, etc. Implementation of these projects will facilitate competitiveness and growth of Latvia in the medium term period. Furthermore, efficient, safe and sustainable energy supply should be ensured.

Taking into account the abovementioned, in our opinion, the most important and urgent tasks of the economic policy are as follows:

- **fiscal policy:**
 - to ensure strict fiscal discipline, in order to achieve that the budget expenditures correspond to the actual revenues;
 - to draft a fiscal responsibility law, which would determine medium-term fiscal policy objectives therefore facilitating implementation of a responsible fiscal policy on a regular basis;
 - to ensure fulfilment of the Maastricht Convergence criteria by 2011, in order to join the Euro area;
- **raising efficiency of budget revenues and expenditures:**
 - to improve efficiency of the public administration by introducing the performance indicator system of state strategic planning and

establishing a single state financial and human resource information and management system;

- to improve efficiency of financial distribution and project implementation of EU funds (EU structural funds and the Cohesion Fund) by decreasing bureaucracy and simplifying supervision;
- to facilitate introduction of the public private partnership mechanism by linking it with public investment plans and programmes (local government, state and European Union);
- **reduction of administrative barriers:**
 - to improve the process of entrepreneurship registration, granting permits and tax administration in order to simplify and hasten the process of starting and performing business activity. It must be ensured that the procedures and requirements for receiving permits are simplified where it is justifiable in cases of issuing permits for an indefinite period or providing an opportunity to settle the necessary procedures electronically. The opportunity to perform registration of the value added taxpayer simultaneously with the registration in the Commercial Register must be provided;
 - to simplify the insolvency and liquidation processes of enterprises by making amendments to the Insolvency Law. To make amendments to the Insolvency Law in order to prevent the possibility of abusing the provisions regulating insolvency of natural persons;
 - 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, all the co-ordinations identified, as well as the necessity of registration, which requires statements from other public institutions and it must be ensured that it may take place automatically and within the e-environment, the e-signature must be introduced in all public institutions and functionality of the e-signature must be expanded;
 - to improve the flow of the state level official statistical information, as well as mutual harmonization of the indicators and terms to be included in the state registers and other information systems in order to prevent repeated enquiry of respondents. The share of the reports to be submitted electronically and the enterprises having submitted them has to be increased;

- to perform optimisation of the regulatory and supervisory institutions of the construction sector, as well as introduction of e-government in order to provide transparency of the construction process and improve supervision of the construction process. The number and time of the procedures required for harmonisation of the building design documentation has to be decreased;
 - to reduce the employment-related costs regulated by various legal acts and create incentives for entrepreneurs in order to integrate various social groups in the labour market more actively by reviewing the regulation of the labour market. The number of sick-leave days paid by employers has to be continued to decrease, more active involvement of various social groups (the disabled, persons after child care leave, prisoners) in the labour market promoted by various incentives for employers; to ensure that the expenses of entrepreneurs related to attraction of labour force are considered as the economic activity related expenses and are not imposed by personal income tax;
 - to improve the real estate registration process by unifying the procedures – introducing a one-stop shop principle in the registration of real estate by reducing the number of days and procedures required for the registration;
- introduction of the business-friendly tax policy and administration:**
- to review the VAT repayment system by simplifying and hastening repayment of VAT;
 - to increase operation efficiency of the State Revenue Service by continuing reorganization of the SRS to an institution, which helps the entrepreneurs;
 - to continue improvement of the normative acts regulating tax administration so that the degree of fault is taken into account, when applying punitive sanctions;
 - to assess thoroughly the overall influence of the planned amendments on entrepreneurship and national economy, when making changes in the tax system, as well as create preconditions to improve competitiveness of Latvian entrepreneurs in the domestic market;
 - to improve the tax relief system in order to facilitate investment of entrepreneurs in development;
 - to establish a taxation system, which would provide preconditions for financial involvement of employees in the development of enterprises;
 - to continue reduction of the tax burden for labour force and transfer the main tax burden to consumption, as well as speculations with the real estate; differentiate the real estate tax taking into account the value of residential buildings;
- ensuring competition, determining administratively regulated prices and protecting consumer rights:**
- to turn against the most serious violations of competition as effectively as possible by ensuring efficient introduction of the amendments to the Competition Law by paying particular attention to the abuse of dominant position in retail trade;
 - to perform preventive and inspective measures for identifying prohibited agreements in the sectors important for national economy by paying particular attention to public procurements, as well as tenders and auctions of structural funds in priority fields;
 - to establish a single public utilities institution in order to introduce a model of public utilities regulation most appropriate to the situation of Latvia;
 - to improve consumer right supervision methods by particularly establishing an efficient market surveillance system, ensuring successful review of consumer rights and protection of collective interests of consumers. Particular attention has to be paid on safety of goods and services in order to protect consumers from the use of goods and services inadequate to the requirements, as well as supervision of observance of economic consumer interests;
- promotion of investment, business start-ups and access to finances:**
- to support the enterprises having difficulties to receive a loan for implementing EU structural fund projects with the help of a specially established financial instruments;
 - to promote establishment and development of new enterprises in the regions of Latvia by providing the necessary infrastructure and advisory services in order to facilitate business start-ups. Business incubators must be established in different regions of Latvia, as well as support provided to the new enterprises established therein;
 - to pay more attention to 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. Informative and advisory support has to be provided to the SMEs and business starters in order to promote understanding of entrepreneurs concerning access to the financing during various development stages of an enterprise;
 - to ensure work of the Holding fund as soon as possible in order to implement introduction of the financial support instruments in a co-ordinated way;

- to support investment in the development of micro, small and medium-sized enterprises in the territories requiring special assistance in order to encourage business start-ups and investment in these regions;
- to review territorial plans of the regional centres by planning new industrial areas;
- to envisage the accelerated procedure for the change of land zoning and transformation for industrial projects;
- **promoting exports:**
 - to establish an export credit guarantee system in order to increase access to the markets with higher risk degree and promote exports of goods and services of Latvian origin beyond the European Union;
 - to develop and introduce individual export support instruments corresponding to the needs of a particular enterprise (“temporary Export Manager”, etc.);
 - to assess the operations of the current external economic representation system of Latvia in order to provide efficient representation of Latvian external economic interests in foreign countries. To consolidate the external economic functions on the basis of the assessment results including the direct representation in foreign countries and support institution in Latvia;
 - to expand export support services for small and medium-sized enterprises in order to promote export diversification and consolidation in the existing markets;
 - to ensure observance of the interests of Latvian entrepreneurs in multilateral and bilateral/regional negotiations in order to promote improvement of contractual provisions in third countries;
- **establishment of flexible labour market:**
 - to encourage economic activity of population by increasing the labour supply and using local resources more efficiently. It is necessary to facilitate participation of youth in the labour market in order to provide an opportunity to employ young persons more flexibly, promote employment of the young persons with special needs by retaining the benefit in case if a young person works, as well as more flexible return of young mothers to work. It is advisable to establish labour courts, which would enable settling labour disputes more efficiently and faster. It is advisable for an employer not to impose an obligation to compensate expenses related to payment of the leaves for studies by compensating them from the state budget;
 - to solve the structural problems of employment by supporting the efforts to obtain suitable higher qualification in accordance with the requirements of the labour market and facilitating the labour mobility, especially, improving the transport infrastructure;
- to reduce undeclared employment by relieving the tax burden on employment and raising administrative capacity of the State Labour Inspectorate by attracting additional personnel, improving supervision of observance of the labour law provisions, increasing awareness of society regarding the labour law issues, strengthening the role of trade unions and employers’ associations, promoting consolidation of entrepreneurs in entrepreneur organisations in order to create favourable environment for raising the reputation of socially responsible entrepreneurship;
- to improve the regulation system of labour market demand and supply by ensuring preparation of medium and long term forecasts of labour market and consider the population census of 2011 as an important data source for improvement of this system;
- **ensuring efficient, safe and sustainable energy supply:**
 - by utilising the co-financing of European structural funds and support mechanism of mandatory procurement of electricity by promoting use of renewable energy resources in production of electricity and heat supply, taking into account the resources and potential available in the country, therefore reducing the dependence from the imported energy resources;
 - to develop the base electric power station projects by choosing the types of electric power stations, which will ensure resource supply guarantees and sustainability, as well as increase the state self-provision in energy;
- **improvement of energy efficiency:**
 - to implement the state support programme for promoting renovation of multi-apartment houses by performing energy audits of residential buildings and renovation projects, as well as raising interest and responsibility of joint owners in renovation of the residential buildings at the same time;
 - to implement the Measure “Energy Efficiency of Housing” of the Priority “Quality Environment for Life and Economic Activity” of the Operational Programme “Infrastructure and Services” of the EU Structural Funds for 2007–2013 by performing heat resistance improvement measures for multi-apartment houses and social residential buildings;
 - to integrate the energy efficiency policy into other sectoral policies (tax, transport, regional);

– **establishment of the knowledge-based economy:**

- to facilitate co-operation of scientists and entrepreneurs by establishing competence centres in order to promote co-operation of the research and industrial sectors in implementation of industrial research, new products and technologies, as well as support the technology transfer contact points 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 entrepreneurs to expand industrial research, introduce new products, services and technologies in production, as well as secure the rights of industrial property;

- to improve the normative acts regulating scientific activity by prescribing that scientific institutions may have owners of the intellectual property developed as a result of the research financed by the state;

- to plan broader activities for raising the education level and self-confidence for youth – potential entrepreneurs and facilitate interaction of the students of exact sciences and entrepreneurship via joint measures. To raise the interest of students to acquire exact sciences, therefore facilitating increase of the number of students in exact sciences.

In order to ensure efficient implementation of the structural policy it is necessary to provide institutional provision in each measure of the policy guaranteeing and supervising that all the subjects of economic activities honestly observe the provisions included in the respective laws, as well as support conditions are clear and the access to them is based on the principles of equality.

A consequently implemented structural policy will promote the transition from the labour-intensive economy to the knowledge-based one, 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 from 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.