



European Employment Observatory

EEO Review: Self-employment, 2010

Latvia

Alf Vanags
NMS Consulting
And
Baltic International Centre for Economic Policy Studies^{*}

July 2010

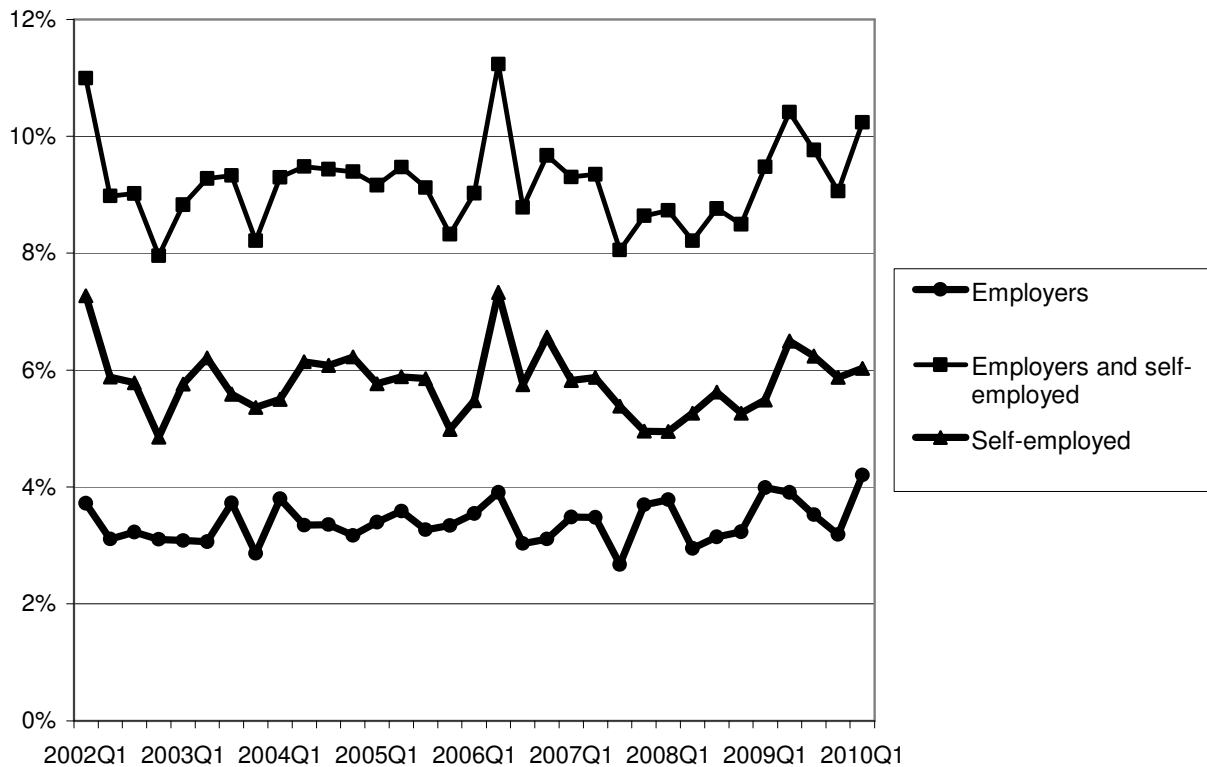
This article is the sole responsibility of the author(s).

^{*} Research assistance from Krisjanis Krustins is gratefully acknowledged.

1. Introduction

Since at least the beginning of 2002, the number of self-employed and employers in Latvia has been fluctuating closely around 93 000 and 58 000, respectively, with a spike in 2006 (see Figure 1). The combined figure represents about 9 % of total employment [1]. This means that the self-employed and employers make up a considerably smaller share of the employment in Latvia than in the EU-27, where in 2009 the average was 14.3 % [2], with many countries such as Spain having much higher figures. Anecdotal evidence suggests that many people have turned to self-employment as they have lost their ordinary jobs during the economic downturn. However, if this is indeed the case, then this must have been accompanied by a similar number of self-employed people not being able or willing to continue their occupation or perhaps leaving the country. At the same time, there is clear evidence from the Latvian Global Entrepreneurship Monitor report that between 2007 and 2009 entrepreneurial activity has increased and that much of it has been driven by necessity¹.

Figure 1: Share of employers and the self-employed in total employment



Source: Central Statistical Bureau

There are no well-defined societal views on self-employment in Latvia. For some people and some employers, self-employment is probably seen as a way of legally avoiding some part of the rather large tax wedge on labour as well as some of the inflexibilities associated with a

¹ According to the Global Entrepreneurship Monitor for Latvia, the share of the population involved in nascent entrepreneurial activity rose from 2 % in 2007 to over 5 % in 2009. In the same period, the share of necessity-driven entrepreneurial activity in total entrepreneurship increased from 15 % to 32 % [3].

standard work agreement. There is anecdotal evidence that when the tax rate on the self-employed was reduced to 15 %, some employers encouraged employees to switch to self-employed status.

Support for self-employment and business creation is certainly one of the government's stated priorities. The Ministry of Economics claims that its aim is to "raise entrepreneurship activity and initiative," with particular emphasis on small- and medium-sized enterprises [4]. On 30 October 2009, a plan was adopted for the support of micro-enterprises at the initiative of the government's social partners. This plan includes proposals to lower the costs of registering, to introduce a friendlier tax policy, to simplify accounting requirements and to ensure the availability of financing and information for micro-enterprises [5]. At the same time, in the process of budget consolidation, the government has reversed some of the tax advantages of self-employment [6]. In particular, after several years of facing an income tax rate of 15 % (the same as the rate of corporate tax) the self-employed now face a rate of 26 %, which is the same as for other workers. On the other hand, more favourable terms for social security contributions remain.

Longer-term initiatives for the support of business creation include: the creation of business incubators [7]; consultancy support for self-employment and entrepreneurship, training, and start-up financing [8]; and support for initiatives to raise motivation for innovations and entrepreneurship [9]. Similarly, providing support for starting a business and/or the transition into self-employment is one of the policies of the State Employment Agency (SEA) and the Ministry of Welfare. The SEA provides support in the form of consultancy and financing to a small number of unemployed people who wish to start their businesses or transition into unemployment, with the recipients of support being those with the best business plans [10].

2. Assessment of national labour market policies and recovery measures

2.1. Recent measures - Plan for the support of micro-enterprises

The government's October 30 plan for the support of micro-enterprises has five key goals. Firstly, it aims to decrease the costs of starting micro-enterprises by reducing the minimum capital requirements and simplifying the bureaucratic procedures for registering and operating such businesses. Secondly, the plan aims to implement a tax policy that is friendlier to micro-enterprises by allowing certain categories of micro-enterprises to replace all tax payments with a tax based on a fixed percentage of turnover and radically simplifying the payment of VAT for smaller entities. Thirdly, the plan has the goal of enabling micro-entrepreneurs to do their own accounting by allowing them to file simplified income statements and providing free access to accounting computer software. Fourthly, the purpose of the plan is to provide financing for micro-enterprises by expanding the loan facilities of the State Mortgage and Loan Bank and the scope of services provided by business incubators. Lastly, the plan intends to inform micro-enterprises and to facilitate their cooperation with state institutions by providing more services electronically and establishing information portals and information centres for entrepreneurs [5].

The proposed measures are in line with the principles of the “Small Business Act” (SBA) for Europe², in particular principles III-V. However, most have not yet been implemented. The exception is the changes to the Commerce Law that permit limited liability companies to be founded with a starting capital of less than LVL 2 000 (EUR 2 823) under certain conditions [11]. Other measures are still undergoing lengthy discussions – for example, MPs have been debating the size of the micro-enterprise tax and whether the social security payments it implies are consistent with precedents set in constitutional court rulings [12].

There is a potential concern that while measures such as the micro-enterprise tax might decrease direct administrative costs, they may not necessarily be beneficial to micro-entrepreneurs overall, and the procedures for participating in such measures may be so complicated as to outweigh the benefits of participation. Moreover, many of the measures (e.g., informing micro-enterprises and facilitating cooperation) are vague and it is hard to pin down how much in the way of real benefits they are likely to generate for entrepreneurs.

2.2. Long-term measures

2.2.1. Business incubators

The purpose of business incubators is to promote the formation of new, sustainable and competitive enterprises in all the regions of Latvia. The initiative was agreed upon by the cabinet of ministers on 7 October 2008, and it is set to last from 27 February 2009 until 31 December 2014. Within the framework of the initiative, more than LVL 20 million (EUR 20 million) will be available for the establishment and ongoing activities of nine privately-run business incubators across Latvia; 85 % of this financing will be provided by the European Regional Development Fund. Business incubators will provide discounted consulting and business services, the use of premises and facilities in the early years of business development. Incubators will not be available to enterprises in certain traditional business sectors (such as agriculture, financial intermediation, transport, alcohol and tobacco) and the available services and eligibility criteria vary [7].

The idea of business incubators is in line with SBA principles I, VIII, and X. The initiative has shown positive results so far and most of the four-month-old incubators are already fostering more than twenty businesses each. It remains to be seen how many of these businesses turn out to be economically viable and how many jobs they will create. The positive aspects of business incubators are that they exist in all Latvian regions and that the application process is simple and rests almost entirely on the quality of the business idea, with few other bureaucratic restrictions; other countries have also had positive experience with similar initiatives.

Among the negative aspects of business incubators as implemented in Latvia is the lack of a sufficient number of business incubators in Riga; there have also been concerns about a lack of competition among businesses for applying as providers of incubator services, mainly due to very high requirements set out in the procurement procedure [13]. Furthermore, the lack of a centralised or at least uniform system for the evaluation of business ideas may mean that when the number of applications becomes large in some regions, business ideas are rejected even though they are better than the ideas accepted in less active regions. It is also unclear

² See the Annex for a list of the principles,

whether the services that incubators offer are sufficient for the support of very R&D intensive businesses in areas such as biotechnology or nanotechnology.

2.2.2. Activities for the support of self-employment and entrepreneurship

This is a set of measures approved by the Cabinet of Ministers on 31 March 2009, for which LVL 23 million (EUR 32 million) has been allocated, of which 60 % will be financed by the European Structural Fund and the Latvian Government, while the rest will be provided by the Latvian Mortgage and Land Bank. Within the framework of this initiative, start-up financing will be available for up to 600 new business start-ups, while free consultations, training and advice will be available for up to 1 200 start-ups. Businesses that are less than a year old will each be eligible for up to LVL 54 000 (EUR 76 205) in loans and up to LVL 5 000 (EUR 7 056) in grants for the starting of the business and the repayment of the loan. The interest rate on the loans is either 8 or 11 % of 4 %, plus the six-month RIGIBOR rate. The assets of the firm will serve as collateral, and the applicants are expected to give a personal guarantee for 30 % of the total amount of the loan. In addition to this, applicants have to obtain co-financing for 10 % of the start-up capital. Businesses between one and three years old will be eligible for consultations only [8, 14]. Applications for support within the framework of these measures closed in May 2010.

This activity focuses almost exclusively on addressing SBA principle VI. It addresses the problem of obtaining finance, which has historically been a significant obstacle to entrepreneurship in Latvia and has become even more so during the economic downturn [3]. However, the organisers of this activity have been criticised for being very slow to evaluate applications and to give support to the projects that have in fact been approved; for example, only 2 % of the financing had been allocated by January 2010, almost half a year after the start of the activity [15]. Furthermore, while the requirement to provide co-financing on the part of the applicants may be necessary due to information asymmetries between lenders and borrowers, the requirement for applicants to give a personal guarantee (in effect, agreeing to be liable with their personal property up to that amount) may have prevented many would-be entrepreneurs from applying and is in direct contradiction to SBA principle II.

2.2.3. The motivation programme

This activity was approved on 22 December 2008 and its aim is to encourage as many people as possible to start their own businesses, to raise the overall prestige of entrepreneurship and to inform society about the potential of innovation. It was introduced to support activities that improve the capacity of teaching personnel to motivate young people (including practical training in primary and secondary school about starting businesses and support for mentoring programmes for entrepreneurs, business plan competitions), activities that spread the best practices of starting businesses and developing innovations (including business plan competitions) and marketing activities for innovations and businesses (including the preparation and publication of informative materials). More than LVL 2 million (EUR 2.8 million) of financing has been allocated to this activity, of which 85 % is provided by the European Regional Development Fund [9].

This activity is centred on SBA principle I. While eight specific initiatives have already been supported in the framework of this activity (such as mentoring programmes, debate tournaments, idea competitions), many of its stated goals remain vague (for example, “to

inform society about innovations and their potential”), which will both make it more difficult to attain the goals and may lead to an inefficient use of the allocated funds.

2.2.4. Promotion of self-employment and entrepreneurship

This measure is targeted at those unemployed people who already have some sort of business-related education: professional or higher education, or some other formal or informal educational courses in those subjects. Its purpose is to develop entrepreneurship and thereby to actually create new jobs for the unemployed. Within the context of the programme, consultations (a total of 20 over 3 months) and advice are offered to programme participants as they develop their own business plans. These are evaluated afterwards and each business plan that is approved and chosen to be implemented receives start-up financing of up to LVL 4 000 (EUR 5 645), coupled with a stipend to the entrepreneur equal to the minimum wage for the first three months of implementation [10].

This measure mainly covers SBA principles I and VI. While it might lead to individual success stories, its scope may well be too small to have a major economic impact, especially if the business plans involve the creation of sole proprietorships (e.g. hairdressing services). Requiring participants to have a business-related educational background severely limits the range of persons who can benefit from this measure, while not necessarily improving the quality of the businesses created. Lastly, the unemployed are not necessarily those with the best business ideas; in fact, one could argue that those with truly unique sets of skills, ideas and entrepreneurial talent are unlikely to become unemployed.

3. Quality of self-employment jobs

Quality of work is in general not an area of high political and social priority in Latvia and this applies even more so to the self-employed. Accordingly, effectively no indicators are available which provide evidence on the quality at work of the self-employed, e.g. indicators of in-work stress and well-being. Thus the official attitude is that while being self-employed is better than being unemployed, the needs of the self-employed are not a government priority. In particular, by definition, the self-employed have no job security, career pathway, or entitlement to training. Indirect evidence on the quality of work for the self-employed can be seen in the statistics on the occupations and economic activities that the self-employed undertake, and the qualitative indicators of such jobs.

Tables 1 and 2 show that the highest proportion of self-employed work in agriculture for which, unfortunately, accurate salary data is unavailable. The second largest proportion of the self-employed is in wholesale and retail trade, followed by construction. Both appear (at least officially) to be poorly paid sectors, and together with agriculture they absorbed more than half of the total number of self-employed people. The data do not yet show distinct trends in the distribution of workers across sectors.

Table 2 shows that while agriculture remains the most widespread occupation of the self-employed, more than a quarter of the self-employed are senior officials and managers with a very high average salary in 2006. Overall, only a total of about 16 % of the self-employed (service, shop and market workers, as well as those in elementary occupations) could be considered poorly paid relative to average wage levels.

The share of the self-employed that are professionals, technicians, or senior managers has been rising (for example, only 3.5 % of the self-employed were professionals in 2002,

compared with 12 % in 2009). At the same time, the share of the self-employed that have occupations that demand skills in agriculture, hunting, and fishery has been falling (49.1 % in 2002, as compared with 27.6% in 2009). This indicates that either the self-employed have shifted to jobs that can be considered to be of higher quality or, more likely, that more workers in high-quality jobs have found it beneficial to change their status to that of self-employed workers.

There are no statistics for the average annual holidays taken by the self-employed, while the sector and occupation-level data do not show substantial differences between labour market participants in these categories (except for the category of professionals, where people enjoy on average seven more holidays per year than people in other occupations). However, data on working hours indicate that self-employed people who work full-time as service, shop, or market workers or as skilled agricultural or fisheries workers work 46 hours a week, which is more than the standard 40-hour work week.

There have been cases where the status of a person as self-employed has been abused: employees have sometimes had to transfer to a status of self-employed to allow the employer to avoid payment of social security contributions, to reduce overall tax payments, and to evade work safety and quality regulations – especially in the construction sector. It is also suspected that many self-employed people who engage in small-scale commercial activity simply do not pay taxes [16].

Table 1: Self-employed and employers by sector³

Sector (NACE 1.1)	Self-employed and employers	Average annual salary (EUR)
Agriculture, hunting and forestry	35.8%	N/A
Wholesale and retail trade	20.2%	4600
Construction	13.6%	5300
Real estate, renting and business activities	10.6%	6200
Manufacturing	9.7%	5000
Other community, social, personal care services	6.1%	5000
Health and social work	4.0%	5600
Transport, storage and communication	2.8%	6000

Source: Eurostat

³ The percentages of self-employed and employers relate to year 2009. The average annual salary relates to year 2009. For reasons of data availability at the level of occupational categories, salary data relates to 2006.

Table 2: Self-employed and employers by occupation

Occupation (ISCO88)	Self-employed and employers	Average annual salary (EUR)
Skilled agricultural and fishery workers	34%	N/A
Legislators, senior officials and managers	25%	8800
Craft and related trades workers	9%	4500
Elementary occupations	9%	3200
Technicians and associate professionals	7%	6400
Professionals	7%	7600
Service workers and shop and market sales workers	7%	3400
Plant and machine operators and assemblers	2%	4500

Source: Eurostat

4. Conclusions

Traditionally in Latvia the share of workers on non-standard work contracts, including self-employment, has been lower than in the EU. This has not changed significantly, even in the recession. Thus, traditionally self-employment has not been an important part of the labour market, perhaps because the flexibility it brings can in Latvia be achieved by other means e.g. due to the lack of effective trade unions in the private sector and the widespread "envelope wage" system. Moreover, while entrepreneurial activity has accelerated considerably during the crisis, the share of the population who are employers or business owners is still below the EU average.

At the same time, the recession has meant that both officially and in practice, self-employment and entrepreneurial activity have come to be regarded as a potential alternative to unemployment and indeed as potentially a means of creating new jobs. This, together with the view that the development of micro-businesses is seen as a driver of growth has resulted in a collection of measures aimed at promoting and supporting self-employment and small business activity.

However, a number of issues remain. Many of the measures that are being implemented or are just in the planning stage still suffer from excessive red tape, unclear goals, as well as slow and opaque bureaucratic and political procedures, even though the measures were aimed at removing these in the first place. Moreover, progress has been slow or nonexistent with regard to several SBA principles, in particular principles II, VII, and IX.

The quality of work for the self-employed has received little attention, possibly because the concept is ill-defined and it is not obvious that this is an area where the government could, or should, intervene, beyond making sure that it is as easy as possible to become and to remain self-employed in terms of the legislative and tax environment. On the other hand changes in the occupational mix of the self-employed suggest that higher quality work is now done by the self-employed than used to be the case.

5. Bibliography

- Central Statistical Bureau: <http://data.csb.gov.lv/dialog/statfile16.asp>
- Eurostat: http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database
- Global Entrepreneurship Monitor: 2009 Latvia Report
- Ministry of Economics: Uzņēmējdarbības politika: <http://www.em.gov.lv/em/2nd/?cat=23394>
- Ministry of Economics: Mikrouzņēmumu atbalsta pasākumi: <http://www.em.gov.lv/em/2nd/?cat=30108>
- Delfi: Tatjana Verjē – Latvija neveicina pašnodarbinātību: <http://www.delfi.lv/news/comment/comment/tatjana-verje-latvija-neveicina-pasnodarbinatibu.d?id=29244593>
- LIAA: Biznesa inkubatori: http://www.liaa.gov.lv/?object_id=2843
- LIAA: Atbalsts pašnodarbinātības un uzņēmējdarbības uzsākšanai: http://www.liaa.gov.lv/?object_id=49793
- LIAA: Motivācijas programma: http://www.liaa.gov.lv/lv/es_fondi/projektu_istenosana/motivacijas_programma/
- NVA: Atbalsts pašnodarbinātības un komercdarbības uzsākšanai: <http://www.nva.gov.lv/index.php?cid=3&mid=311#komerc>
- Lursoft: Grozījumi Komerclikumā: <http://www.lursoft.lv/press/2010/05/07/Grozijumi-Komerclikuma-no-2010-gada-1-maija>
- Delfi: Darbs ar mikrouzņēmumu nodokļa likumu Saeimā virzās lēni: http://www.delfi.lv/news/business/budget_and_taxes/darbs-ar-mikrouzņemumu-nodokla-likumu-saeima-virzas-leni.d?id=32265977
- Delfi: Ierobežota konkurence biznesa inkubācijai: <http://www.delfi.lv/news/national/politics/uznemeji-ierobezota-konkurence-biznesa-inkubacijai.d?id=26429713>
- ALTUM: Starta programma: <http://www.altum.lv/public/29220.html>
- Delfi: Mazajiem uzņēmējiem grūtības rast valsts finansējumu: <http://www.delfi.lv/archive/article.php?id=29173715>
- Latvijas Avīze: Pašnodarbinātos mēģinās “pārveidot”: http://www2.la.lv/lat/latvijas_avize/jaunakaja_numura/saimnieciba/?doc=61632

Annex: Principles of the Small Business Act

- 1) Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded
- 2) Ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance
- 3) Design rules according to the “Think Small First” principle
- 4) Make public administrations responsive to SMEs’ needs
- 5) Adapt public policy tools to SME needs: facilitate SMEs’ participation in public procurement and better use State Aid possibilities for SMEs
- 6) Facilitate SMEs’ access to finance and develop a legal and business environment supportive to timely payments in commercial transactions
- 7) Help SMEs to benefit more from the opportunities offered by the Single Market
- 8) Promote the upgrading of skills in SMEs and all forms of innovation
- 9) Enable SMEs to turn environmental challenges into opportunities
- 10) Encourage and support SMEs to benefit from the growth of markets