

**National Reform Programme of Latvia  
for the Implementation of the  
“Europe 2020” strategy**

**Riga  
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## Abbreviations

ALMP	active labour market policy	MLBL	Mortgage and Land Bank of Latvia
CB	“Citadele banka”		
CCFI	Climate Change Financial Instrument	MT	Ministry of Transport
CIS	Commonwealth of Independent States	Mt	Megatons
CM	Cabinet of Ministers	Mtoe	Megatons oil equivalent
CO <sub>2</sub>	carbon dioxide	MW	Ministry of Welfare
CSB	Central Statistical Bureau	NRP	national reform programme
DFDL	Draft Fiscal Discipline Law	PB	“Parex banka”
EC	European Commission	PIT	personal income tax
ESA	European System of Accounts	R&D	research and development
ETS	Emissions Trading System	RE	renewable energy
EU	European Union	RES	renewable energy sources
EUR	EU single currency – euro	SC	State Chancellery
Eurostat	EU statistical office	SEA	State Employment Agency
FCMC	Financial and Capital Market Commission	SJSC	state joint stock company
		TFP	total factor productivity
FDI	foreign direct investments	VAT	value added tax
GDP	gross domestic product		
GHG	greenhouse gas		
ICT	information and communication technologies		
IFLPIS	International Freight Logistics and Port Information System		
IMF	International Monetary Fund		
Ktoe	kilotons oil equivalent		
LVL	national currency of Latvia – lats		
MA	Ministry of Agriculture		
MC	Ministry of Culture		
ME	Ministry of Economics		
MEPRD	Ministry of Environmental Protection and Regional Development		
MES	Ministry of Education and Science		
MF	Ministry of Finance		
MFA	Ministry of Foreign Affairs		
MJ	Ministry of Justice		

## Introduction

According to the Article 121 and 148 of the Treaty on the Functioning of the European Union and taking into account the *Integrated guidelines*<sup>1</sup>, the *Annual Growth Survey*<sup>2</sup> published on January 12, 2011 by the European Commission (hereinafter – EC), the European Council conclusions of March 24–25, 2011<sup>3</sup>, guidance of the EC regarding preparation of national reform programmes of the EU member states<sup>4</sup>, the Ministry of Economics has prepared for submission to the EC the *National reform programme of Latvia for implementation of the “Europe 2020” strategy* (hereinafter – NRP of Latvia).

The NRP of Latvia is submitted to the European Commission simultaneously with the *Convergence Programme of Latvia*, and, according to the Treaty on the Functioning of the European Union, both programmes are a part of economic policy coordination and surveillance tools at the EU level (in the framework of the *European Semester*). Multilateral surveillance of both programmes will be performed at the EU level based on which the European Commission may give a policy warning if the economic policy of any EU member state fails to comply with the EU Integrated guidelines and objectives set at the EU level. The national reform programmes are linked to the EU budget, because part of the measures is co-financed from the EU budget. The EU fund financing plays an important role in the implementation of the NRP of Latvia.

The NRP of Latvia describes the medium-term macroeconomic scenario including potential gross domestic product (hereinafter – GDP), main macro-structural bottlenecks of Latvia and key measures for 2011–2013 to eliminate them, as well as national targets of Latvia for 2020 in the context of the “Europe 2020” strategy and key measures for 2011–2013 to achieve them.

The NRP of Latvia is based on the Integrated guidelines and guidance of the EC regarding the preparation of the NRP of the EU member states, taking into account the national priorities and objectives of Latvia set in other policy planning documents, for example, the Sustainable Development Strategy of Latvia “*Latvia 2030*”<sup>5</sup>, as well as the Strategic Development Plan of Latvia for 2010–2013<sup>6</sup>. The NRP of Latvia is closely related to the *Convergence Programme of Latvia* which has been developed together with the NRP (the responsible institution – the Ministry of Finance).

The NRP of Latvia identifies measures for achieving the objectives of the *Euro Plus Pact* approved by the European Council on March 24–25, 2011 (to foster competitiveness, employment, sustainability of public finances and reinforce financial stability).

The NRP of Latvia has been prepared by the working group established with a decree of the Minister of Economics<sup>7</sup> specially for the development of the NRP and it consists of representatives from the Ministry of Foreign Affairs (MFA), the Ministry of Economics (ME), the Ministry of Finance (MF), the Ministry of Education and Science (MES), the Ministry of Culture (MC), the Ministry of Welfare (MW), the Ministry of Transport (MT), the Ministry of Justice (MJ), the Ministry of Environmental Protection and Regional Development (MEPRD), the Ministry of Agriculture (MA), the Financial and Capital Market Commission (FCMC), Latvia’s Commission of Strategic Analysis under the Auspices of the

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<sup>1</sup> “Europe 2020: Integrated guidelines for the economic and employment policies of the Member States”, 06.05.2010, <http://ec.europa.eu/eu2020/pdf/Brochure%20Integrated%20Guidelines.pdf>

<sup>2</sup> Annual Growth Survey 2011, [http://ec.europa.eu/europe2020/tools/monitoring/annual\\_growth\\_survey\\_2011/index\\_en.htm](http://ec.europa.eu/europe2020/tools/monitoring/annual_growth_survey_2011/index_en.htm)

<sup>3</sup> European Council conclusions, EUCO 10/11, March 25, 2011.

<sup>4</sup> The letter from the Secretariat-General of the European Commission to the EU member states on further progress of the national reform programmes of the EU member states, SG/D1/SW/cf ARES (2010), 22.09.2010.

<sup>5</sup> The Sustainable Development Strategy of Latvia until 2030, [http://www.latvija2030.lv/upload/latvija2030\\_saeima.pdf](http://www.latvija2030.lv/upload/latvija2030_saeima.pdf)

<sup>6</sup> The Strategic Development Plan of Latvia for 2010–2013, <http://polsis.mk.gov.lv/view.do?id=3338>

<sup>7</sup> Decree No. 280 of the Ministry of Economics of December 16, 2010 “On the working group for development of the National reform programme of Latvia”.

President of the Republic of Latvia, the Employers' Confederation of Latvia, the Free Trade Union Confederation of Latvia, the Latvian Chamber of Commerce and Industry, the Latvian Association of Local and Regional Governments.

It should be noted that the issues related to the "Europe 2020" strategy and preparation of the NRP of Latvia were repeatedly viewed:

- in the Cabinet of Ministers (regarding the "Europe 2020" strategy – on March 15, 2010; the national targets of Latvia for 2020 in the context of the "Europe 2020" strategy – on May 5, 2010 and September 30, 2010; Integrated guidelines – on May 17, 2010 and June 7, 2010; Latvia's preparation for a bilateral dialogue with the EC – on August 24, 2010 and September 30, 2010; the Draft NRP of Latvia for implementation of the "Europe 2020" strategy – on November 16, 2010; Annual Growth Survey – on February 8, 2011 and February 14, 2011);
- in the Saeima (Parliament) (regarding the national position of Latvia with respect to the "Europe 2020" strategy – on March 12, 2010; the national targets of Latvia in the context of the "Europe 2020" strategy – on May 5, 2010; Integrated guidelines – on May 14, 2010 and June 4, 2010; further progress of the "Europe 2020" strategy and preparation of the Draft NRP of Latvia – on September 28, 2010; the Draft NRP of Latvia for implementation of the "Europe 2020" strategy – on November 12, 2010 and November 23, 2010; Annual Growth Survey – on February 14, 2011; the NRP of Latvia for implementation of the "Europe 2020" strategy – on April 11, 2011);
- in the inter-institutional meetings where social partner and non-governmental organizations also participated, for example, in the meeting of the National Economy Council – on April 4, 2011, in the Reform Management Working Group – on April 7, 2011, in the meeting on coordination of the NRP of Latvia with social partners and non-governmental organizations – on April 14, 2011, etc.;
- in the meeting with the representatives of the EC (on May 6, 2010; October 5, 2010 and February 24, 2011 in the framework of the bilateral dialogue, and on October 18, 2010 during the visit of the EC mission to Latvia).

The NRP of Latvia consists of 3 chapters. Chapter 1 describes the medium-term macroeconomic scenario. Chapter 2 identifies the main macro-structural bottlenecks of Latvia and key measures for 2011–2013 to eliminate them. Chapter 3 defines the national targets of Latvia for 2020 in the context of the "Europe 2020" strategy and key measures for 2011–2013 to achieve them.

All numerical information and data, except specific cases, have been received from the Central Statistical Bureau (hereinafter – CSB) or the EU statistical office – Eurostat.

## 1. Medium-Term Macroeconomic Scenario

The integration of Latvia to the EU has positively affected the economic development – since 2004 the economic growth of Latvia had been the most rapid in the EU, however, it was unsustainable. Along with the rapid growth, the external imbalance (high current account deficit) and internal imbalance (high inflation) of the economy of Latvia developed and deepened. The imbalance of the current account was based mainly on the rapid increase in domestic demand, which was fostered by credit expansion, i.e. substantial inflows of foreign capital. The main economic problem during this period was the low competitiveness of industrial sector in attraction of these capital inflows.

Under the impact of the global financial crisis and due to the diminishing financial inflow, private consumption and investments decreased rapidly consequently resulting in the decline of economic activities. The economy of Latvia went into deep recession – during the crisis the GDP decreased by ¼. The rapid growth during the previous years led to a short-term improvement in the convergence process of the living standards of Latvian population regarding the living standards of the developed EU member states. As a result of the crisis, Latvia has returned to the level of 2006, but the decrease in employment is even higher. The unemployment rate in 2010 reached its highest level since 1996.

Due to the crisis, Latvia has faced significant macroeconomic adjustments. The economic model based on the rapid increase of domestic demand due to significant capital inflow is over. Currently, a transition to sustainable economic model is taking place with exports being the key driver. It is proven by the significant rise in exports – by 10.3% in 2010, as well as by the increase in manufacturing output.

The potential growth of Latvia has also changed considerably indicating to significant changes in the economic structure.

Capital was the main growth-stimulating factor before the crisis. However, the capital inflow was rather exaggerated as the flow of large amounts of money was directed to unproductive economic segments. It is characterized by the decrease in the total factor productivity (hereinafter – TFP) since 2005. Unproductive development of sectors, including formation of the real estate bubble, cannot create any further value added that could cover the repayment of the borrowed capital without hindering the economic growth. The structure of the economy, which was based on the high money supply, was able to exist only due to continuous capital inflow. The capital inflow into the economy of Latvia shrank rapidly as a result of the financial crisis, thus significantly limiting the ability of unproductive market segments to develop, for example, construction sector, companies related to this sector, as well as companies oriented towards high level of consumer purchasing ability.

The medium-term macroeconomic development scenario foresees that the investments in the economy of Latvia will remain at a low level, thus contribution of accumulated capital to potential growth is also comparatively low. Therefore, along with the economic recovery, further growth base will be directed mainly towards improved efficiency that is proven by an increase in the TFP component. However, the adaptation period for the new economic structure in the labour market is expected to be more moderate. Structural unemployment increased during the crisis period, and additional financing is needed to be invested in labour requalification in order to reduce it.

Table 1

## Medium-term macroeconomic scenario

	2010	2011	2012	2013	2014	2015
Gross domestic product (GDP), million LVL	12735.9	13415.9	14129.8	14982.8	15895.0	16848.7
growth in current prices, %	-2.7	5.3	5.3	6.0	6.1	6.0
growth in constant prices, %	-0.3	3.3	4.0	4.0	4.0	4.0
GDP deflator (y-o-y), %	-2.3	2.0	1.3	2.0	2.0	2.0
Consumer price index (y-o-y), %	-1.1	3.5	2.0	2.0	2.0	2.0
Employment, thousand	940.9	955.1	967.0	980.4	993.8	1007.3
Unemployment level, % of economically active population (aged 15–74)	18.7	16.4	14.5	12.4	10.3	8.1
Exports of goods and services, million LVL	6797.2	7361.1	7886.8	8446.1	9043.4	9682.9
growth in constant prices, %	10.3	5.1	5.0	5.0	5.0	5.0
Imports of goods and services, million LVL	6903.3	7617.3	8237.8	8915.5	9651.5	10448.2
growth in constant prices, %	8.6	6.1	6.0	6.1	6.1	6.1
Growth of potential GDP	-3.6	-1.6	0.5	1.9	2.6	
contribution:						
- labour	-1.8	-1.2	-0.4	0.0	0.2	
- capital	-0.3	-0.1	0.1	0.3	0.5	
- total factor productivity	-1.4	-0.3	0.8	1.6	1.9	
Output gap	-10.3	-5.1	-1.5	0.5	1.8	

The main assumptions of the medium-term macroeconomic scenario are the following:

- The economy of Latvia reached the lowest point in the 3<sup>rd</sup> quarter of 2009. Since the 4<sup>th</sup> quarter of 2009, GDP growth has been observed (compared to the previous quarter according to seasonally adjusted data). In 2010, the GDP grew every quarter, however, the average level still lagged behind from the level of 2009 by 0.3%. The macroeconomic development scenario foresees positive year-on-year growth in 2011, when the GDP is expected to increase by 3.3%;
- Exports will be still the main economic growth driver in 2011. Private consumption and investments of enterprises are expected to contribute positively to the growth. Rapid growth of private consumption in the medium-term will be hindered by low growth rates of employment and wages, as well as a high level of household debt. A significant crediting that would allow the consumption to grow faster than income is not expected. In 2011, the growth of private consumption will be slower than the growth of GDP, however, its growth rate will be equal to that of GDP in the coming years. Investments will be one of the sources of growth in the medium-term, although the overall investment volumes will remain at a low level. The necessity for investments is determined by the load of production capacity, which currently is approximating the pre-crisis level. Investment attraction in the medium-term will be fostered by the low unit labour costs, as well as by successful reduction of the budget deficit. Due to the further implementation of consolidation measures, decrease in public consumption is expected to continue also in 2012;
- The rapid increase in employment is not expected in the medium-term, as the growth will be mainly based on productivity that will be an important condition of competitiveness;
- The rise in inflation rate in a short term will be to a great extent based on the rise in prices for food and energy resources all over the world. The increase in consumer prices in the

medium-term will be limited by the weak domestic demand and the economic growth will be followed by moderate inflation rate that is typical to balanced growth;

- Until 2014 changes in wages will be mainly determined by productivity growth in tradable sectors (i.e. export-oriented sectors). Due to the remaining high unemployment, the rise in wages in the medium-term will depend on changes in productivity.

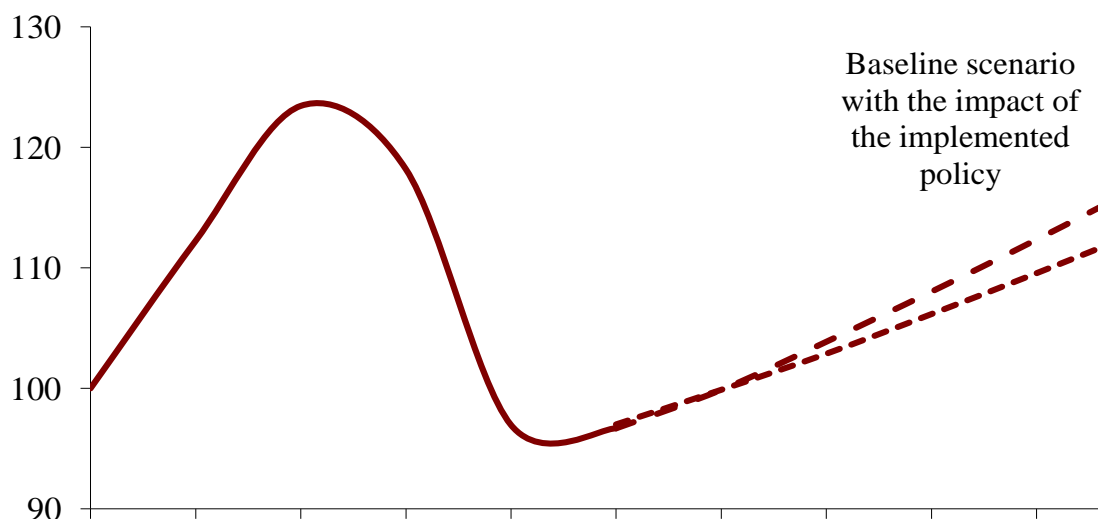
### **Impact assessment of the NRP of Latvia for the medium-term**

The measures included in the NRP of Latvia will have a direct impact on the economy of Latvia in 2011–2013. It is based on public financing that is mainly related to public investments in infrastructure, as well as to direct support to entrepreneurs (mainly by use of the EU funds).

The total financing from the EU funds for the measures included in the NRP for 2011–2013 is LVL 2.02 billion. The implemented policy will foster increase in investments and private consumption that will affect the growth of GDP by 1.5% annually.

Figure 1

**Macroeconomic impact of the NRP's implementation, forecasts of Latvia's GDP**  
(2005 = 100)



In the medium-term (2014–2015), the impact on GDP is related to changes of the corresponding potential GDP.



## **2. Main Macro-Structural Bottlenecks of Latvia and Reform Directions**

Latvia's economic growth has resumed. Improvement of the economic situation is mainly based on an increase of export volumes and growth of tradable sectors that allows a partial compensation of the still weak domestic demand and development of domestic market-oriented services sectors.

Although the economic disproportions that developed during the years of rapid growth have decreased during the crisis, yet still, due to remaining budget imbalances of the public and private sector (households and enterprises), the so-called balance sheet effect continues. The risk of financial stability of the public sector is the deteriorating demographic situation, because the number of Latvian working age population will decrease by 2020 according to the forecasts.

In order to stabilize the financial condition of private and public sectors, it is necessary to raise competitiveness of economy, which is an important pre-condition for ensuring sustainable growth of the economy.

The main **macro-structural bottlenecks of Latvia** to growth and jobs are as follows:

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

**The NRP of Latvia sets the following frontloading measures:**

- Improvement of active labour market policy measures by gradual transition from crisis-related measures to traditional active labour market policy measures;
- Elimination of administrative barriers;
- Modernization of higher education;
- Speeding up the absorption of the EU funds.

### **2.1. Reducing the high general government structural deficit**

The deterioration of the economic situation has significantly affected the fiscal condition of Latvia – budget deficit of the general government sector in 2008 reached 4.2% of GDP, but in 2009 – 9.7% of GDP and in 2010 – 7.7% of GDP.

Considerable budget consolidation measures have been carried out in Latvia, implementing cumulative fiscal adjustment from 2008 to 2011 in the amount of 16.6% of GDP int. al. by both cutting down expenditures and raising revenues. Reforms for optimization of the state institutional structure have been launched – secretariats of special assignment ministers are liquidated, the Ministry of Regional Development and Local Government has been incorporated into the Ministry of Environment, the number of state agencies is reduced by 50%, as well as savings in the area of support functions are made by carrying out their centralization.

The objective of Latvia's fiscal policy for 2012 is to prepare a budget that could ensure the general government deficit below 3% of GDP (according to the ESA '95 methodology), while striving to reach the deficit target in the amount of 2.5% of GDP to prove the commitments to

observe the fiscal discipline and ensure sustainability of public debt. The general government deficit is expected to be below 1.9% of GDP in 2013 and below 1.1% of GDP in 2014 (according to the ESA'95 methodology). By achieving these targets, the excessive budget deficit will be reduced and the Maastricht criterion on budget deficit will be fulfilled in a sustainable way, thus creating precondition for introduction of the euro in Latvia on January 1, 2014, being the exit strategy for the Economic Stabilisation and Growth Revival Programme of Latvia.

On December 21, 2010 the Parliament (Saeima) approved the budget for 2011 envisaging the general government budget deficit in the amount of 5.4% of GDP, which is considerably below the previously set target on budget deficit – 6% of GDP. On April 14, 2011 the Saeima approved the amended budget for 2011, reducing the general government budget to 4.2% of GDP, however, taking into account the possibility to carry out additional appropriations for extraordinary cases laid down in the budget law, **the estimated budget deficit for 2011 is 4.5% of GDP**. Overall, the budget for 2011 introduces consolidation measures in the amount of LVL 350 million, thus ensuring that the target on budget deficit is being met.

In order to ensure fulfilment of the Maastricht criteria and to introduce the euro in 2014, the Saeima has instructed the government upon preparing draft laws on the government budget for 2012, 2013 and 2014 to ensure implementation of the fiscal consolidation measures and to reduce the general government budget deficit below 3% of GDP in 2012 according to the ESA methodology and the deficit must not exceed 1.9% of GDP in 2013 and 1.1% of GDP in 2014. It should be noted that the government has firmly committed to fulfil the Maastricht criteria and has set the deficit target for 2012 in the amount of 2.5% of GDP.

- Revenues in the amount of about 0.5% of GDP will be gained by improving tax collection, by implementing the real estate tax reform, as well as by continuing implementation of a comprehensive strategy for combating the grey economy;
- Expenditures in the amount of about 0.5% of GDP will be reduced by cutting down the wage fund for the public sector employees, by decreasing state subsidies (including for SJSC ““Riga” International Airport”), by implementing measures to ensure sustainability of the state special budget, as well as by reducing state co-financing to municipalities for social protection measures (or by reconsidering the possibility to redistribute the personal income tax (hereinafter – PIT) for the benefit of the central government), and by restricting the borrowing possibilities of municipalities, for example, to complete infrastructure projects, take over professional technical schools, for investment projects of local boarding-schools and social programmes.

In order to reach the final agreement on already developed fiscal consolidation directions and to work out additional consolidation measures to achieve the budget deficit target for 2012, the government by the mid-August 2011 has committed to include such fiscal consolidation measures in the draft state budget for 2012 that are aimed at decreasing expenditures, thus ensuring also fulfilment of the inflation criteria in 2012. Elements of consolidation possibilities discussed in 2011 (recommendations of the IMF, the EC and the World Bank that were not included in the state budget for 2011) are expected to be included in the abovementioned list. The consolidation directions will include measures to rationalize the social benefit system and to improve sustainability of pension system that overall are aimed at ensuring long-term stability of the social security system. Moreover, the provision allowing the Saeima to increase additional appropriations for financing allocated for extraordinary cases up to 0.2% of GDP might not be included in the state budget for 2012, thus eliminating any possible deviations from the budget's target. The draft law on the budget for 2012 will be submitted to the Saeima at the end of September 2011.

### Key policy directions and measures to ensure sustainability of the state budget:

- ***Fiscal consolidation*** (responsible institution – MF)

The Law *On the State Budget for 2011* approved by the Saeima at the end of 2010 is in line with the framework of the fiscal target. Fiscal consolidation measures in the amount of 2.2% of GDP ensured that the expected deficit for 2011 is 5.4% of GDP, at the same time keeping 0.6% of GDP as a room for fiscal manoeuvre.

In order to strengthen the fiscal sustainability of Latvia, improve confidence of financial market and investors regarding Latvia's creditworthiness, as well as to promote attraction of new investments (int.al. to ensure further growth of manufacturing and exports), the government made a decision on additional fiscal consolidation measures to be implemented within the state budget for 2011. Being aware that inflation will be another challenge in the nearest future, and to fulfil the Maastricht criterion on inflation (conformity of Latvia will be evaluated in 2012), the consolidation measures for 2011 were approved mainly on the revenue side, as they cannot be implemented in 2012. Consolidation directions for 2011 are mainly related to the increased taxes (incl. gambling tax, excise tax on natural gas and fuel, elimination of reduced VAT rates for natural gas) and to a lesser extent also related to the reduction in expenditures (subsidies and other current expenditures).

By making the decisions on additional consolidation measures for 2011 the burden on consolidation planned for 2012 was also eliminated due to the expected significant decrease in deficit from 5.4% to 2.5% of GDP.

In order to ensure the abovementioned measures, it is necessary to evaluate functions, prepare and carry out audit of particular functions, as well as submit proposals for ensuring the structural reform process. The reform was launched in 2009 and is expected to be completed in 2014. The aim of the reform is to increase the efficiency of public administration by reducing budget expenditures and by maintaining or improving quality of services. The aim of each function audit measure (general revision of functions financed from the state budget, specific inter-sectoral function audit) is individually specified by a particular decree of the Cabinet of Ministers or the Prime Minister.

- ***Combating the grey economy*** (responsible institution – MF)

The aim is to reduce the grey economy and ensure fair competition by carrying out a set of measures including reduction of administrative burden, ensuring more efficient control, applying sanctions, foreseeing cooperation with social partners, support for the reliable entrepreneurs, promoting transition of entrepreneurship from unregistered to registered economy, etc.

In August 2010 the Cabinet of Ministers (hereinafter – CM) has adopted the *Plan of Measures for Combating the Grey Economy and Ensuring Fair Competition for 2010–2013*, where each measure has a specified term of implementation, which will be carried out gradually in the upcoming years. Several measures have been implemented so far, including cash control, improvement of the Electronic Declaration System. Many measures are currently in the development process (for example, declaring the property status of natural persons).

By fostering voluntary tax payment and limiting activities of persons who avoid tax payment, the amount of state budget revenues will be positively affected thus promoting reduction of the excessive budget deficit. The government plans to achieve an overall positive fiscal impact for the total amount of LVL 60 million in 2011.

- ***Strengthening fiscal discipline*** (responsible institution – MF)  
The aim is to strengthen the national legal framework by developing the *Draft Fiscal Discipline Law* (hereinafter – DFDL) and by evaluating the need for introducing the key regulations of the DFDL in the *Constitution (Satversme)* to ensure development of sustainable, counter-cyclical fiscal policy, thus strengthening medium-term budget planning, as well as by stipulating clear conditions for defining the fiscal targets.

The legal framework is planned to be applied starting from 2012, providing transitional provisions until 2015.

The DFDL and proposal for amendments to the Constitution (Satversme) have been submitted to the State Chancellery in autumn 2010. Discussions have been started on the necessity for the proposed amendments to the Constitution (Satversme), and a high level working group has been established by a decree of the CM as well. The working group is composed of members of the Saeima, and the working group has been established with an aim to improve the draft amendments to the Constitution (Satversme) where principles and institutions related to the fiscal discipline are going to be accordingly introduced at a constitutional level.

The Ministry of Finance plans, that the DFDL with possible amendments in the Constitution (Satversme) could be submitted to the Saeima by the end of November 2011.

- ***Ensuring sustainability of the pension system*** (responsible institution – MW)  
The aim of the measure is to reduce the expenditures of the state social insurance special budget and promote long-term sustainability of the system. The following two main changes are to be introduced in the existing system:
  - Stop granting supplements to the old-age pension for newly granted pensions (for the insurance period until December 31, 1995) starting from 2012. As a result of this change, the estimated savings in the social insurance special budget are LVL 2.6 million (0.2% of the social budget financing resources) in 2012 and LVL 7.2 million (0.5% of the social budget financing resources) in 2013. The corresponding amendments to the *Law on State Pensions* were adopted by the Saeima on December 20, 2010;
  - Increasing the retirement age and the qualification period. It is planned to increase the retirement age gradually from 62 to 65 years starting from 2016 until 2021 (by 6 months every year). Along with the increase of the retirement age, the qualification period (minimum insurance period necessary to be entitled to the old-age pension) is planned to be increased from 10 to 15 years starting from 2016, and to 20 years – starting from 2021. As a result of this change, the estimated savings in the social insurance special budget are 0.1% of GDP in 2016, reaching 1% of GDP in 2021. Due to the high unemployment rate, the reform cannot be implemented until the beginning of 2016. There is a risk that, when speeding up the reform, the number of persons applying for early-retirement and invalidity pensions would increase. The MW has drafted corresponding amendments to the *Law on State Pensions* that were approved by the CM and will be submitted to the Saeima for consideration.

## **2.2. Ensuring a well functioning and stable financial sector in the light of the ongoing deleveraging of the private sector**

Latvia faced a very rapid increase in the debt level which had a rather negative impact on the quality of the loan portfolio. In order to solve the increasingly growing amount of overdue loans for private persons, several important improvements were made to the insolvency process thus making it simpler, faster and more efficient including making the insolvency proceedings of natural person more accessible. Some amendments to the tax legislation have

been made as well, including a temporary two-year exemption from the personal income tax liabilities arising out of the writing-off of natural person's debts, if specific conditions are fulfilled. Amendments to the *Law on Corporate Income Tax* allow companies that apply to certain criteria to transfer the debt to another person (to assign) for the actual market value without raising the taxable income, as well as enable the corporate income taxpayers, subjected to specific conditions, to accumulate savings for doubtful debts (up to 3 years) without increasing the taxable income of this value in the year of accumulating savings.

On the background of several positive indicators which are a sign of the beginning of the economic recovery, the risks of financial stability have decreased and the overall situation in the financial sector has stabilized in 2010. The banks have been able to absorb losses, raise the level of capital adequacy and improve liquidity indicators. The balance of banks' reserves for doubtful loans has been gradually decreased. At the end of 2010, the balance of overdue loans continued to shrink. The share of lats denominated deposits in the overall deposits has increased, which indicates restoration of population's confidence in the national currency and the banks.

In order to ensure financial stability further, the legal basis of regulations for bank operations will be improved, thus strengthening the base of bank capital and liquidity requirements. Taking into account the already implemented measures regarding promotion of debt restructuring and regularly implemented measures regarding supervision of the financial sector, and as the situation in financial markets is gradually becoming stable, further particular attention should be paid to public information about financial services. The knowledge level of customers regarding the nature of financial services and related risks may prevent the customer from further undertaking of excessive risk.

Key policy directions and measures to stabilize the financial sector:

• ***Strengthening the capital base of banks and setting stricter liquidity requirements*** (responsible institution – FCMC)

The aim is to strengthen stability of the banking system and ensure higher banking resilience to potential market disruptions in the future.

The *Regulations on Liquidity Risk Management, Regulations on Development of Internal Capital Adequacy Evaluation Process* and *Regulations on Development of Internal Control System* of the FCMC shall be amended by June 30, 2011, where:

- The procedure will be specified for applying liquidity security expenses to costs for financial services and products. It will help improve risk management and risk culture in the banks as evaluation of work efficiency of structural units will be improved and justified price for products and services will be ensured;
- When estimating the capital requirements intra-risk, concentration arising out of inter-risk should be taken into account as well. It will help to limit the excessive intra-risk and ensure capital to cover potential losses;
- Segregation of responsibilities between the supervisory board and the executive board, requirements for the strategy of banks, insurance companies and other financial institutions will be further specified, duties and authority of the risk management function will be defined, to strengthen an integrated approach to risk management (not only regarding specific risks, but also regarding their interactivity, overall risk profile and the level at the institution and its conformity to the strategy of institution).

The *Regulations on Calculation of the Minimum Capital Requirements* must be amended by December 31, 2011 to ensure adequacy of capital requirements to the risks typical for such transactions, where:

- New requirements for value at risk models subjected to risk will be specified including also evaluation of credit risk inherent in market risk transactions;

- Capital requirements for resecurisation positions will be increased.

In compliance with the reform in banking regulations and supervision at the global and European level and by implementing the *Basel III* regulations of the Basel Committee on Banking Supervision and the new EU framework (CRD IV), the banks will have to meet:

- Higher requirements for capital quality and quantity by amending the own capital definition and setting stricter requirements for the elements included in the own funds;
- Requirements for two capital buffers – requirements for banks to maintain sufficient capital above the minimum indicators in order to be able to ensure compliance with the minimum capital indicators during stress test periods if necessary;
- Introduction of the leverage ratio to limit directly the rapid increase in assets of banks funded by borrowings and to ensure sufficient amount of high quality capital in the system. The overly large share of borrowings in total funding was one of the main reasons why the last global economic and financial crisis was that deep in the banking sector of many countries;
- Introduction of two new minimum quantitative standards for liquidity management – liquidity coverage ratio for short-term liquidity management and stable funding ratio for long-term liquidity management;
- The right of the supervisory authority to identify systemically important financial institutions and set increased requirements, as well as carry out appropriate supervision.

These requirements are planned to be introduced gradually from 2013 until 2018. Respective amendments to the *Law on Credit Institutions* and the FCMC regulations will be approved by December 31, 2012.

- **Reorganization/selling of state-owned banks** (responsible institutions – MF, ME)  
The aim of the measure is to reduce risks for the state as a shareholder of a bank, thus promoting stability of the financial sector. The work is performed in two directions:
  - The SJSC “Mortgage and Land Bank of Latvia” (hereinafter – MLBL) will be reorganized (by transformation into development financial institution), exiting from commercial activities of the bank. The transformation plan of the MLBL had been submitted to the European Commission on April 15, 2011. According to the existing decisions, the final deadline of the transformation is December 31, 2013;
  - Implementing the restructuring plan of the joint stock company “Parex banka” (hereinafter – PB) and “Citadele banka” (hereinafter – CB). As a result of implementation of the PB restructuring model, on August 1, 2010 a part of the company was transferred from the PB to the CB, thus since August 1, 2010 the PB and the CB are operationally independent credit institutions. The CB is a universal bank that is gradually increasing its focus in the Baltic market. According to the restructuring plan, the total share of the CB shall be sold by the end of 2014. However, the PB focuses on activities that would help repay the syndicated loan in May 2011 and then maximize the repayment of public investments. According to the restructuring plan, the PB will operate until 2017. The aim of the developed sales strategy is to recover the public invested financing as efficient as possible, continue providing high quality banking services to customers and depositors, ensure stability of the state financial system, as well as ensure conformity to the state aid restructuring plan approved by the European Commission. Currently, the state aid restructuring plan is implemented smoothly and all activities are carried out in accordance with the plan.

- **Public information on financial services and improving regulation of consumer protection rights in the field of consumer crediting** (responsible institutions – FCMC, ME)

The aim is to provide a general view on the financial sector and its development tendencies for potential users of financial services, as well as to strengthen supervision of the financial services sector to ensure that financial services are available for consumers and appropriate to their needs and abilities. Fostering understanding and long-term thinking of the financial services users regarding purchasing the financial services. The measure envisages to:

- Maintain and regularly update the website “Customer School” developed in March 2011. The website was developed to inform the customers, who use financial services, about the financial system of Latvia and to provide a better understanding on financial risks and about the importance of the undertaken commitments;
- Improve regulation on consumer protection rights in the field of consumer crediting by developing a Draft Law on the Regulation of Consumer Crediting by December 31, 2013, thus specifying the regulation for all crediting fields in one law;
- Implement a licensing system of non-bank creditors by November 1, 2011, thus providing the consumers with financially stable creditors in the market.

### **2.3. Promoting rebalancing the economy towards the tradable sectors and raising productivity levels**

In order to foster competitiveness of enterprises in open product markets apart from cost competitiveness structural policy measures that support expanding export possibilities and promote productivity to ensure more rapid growth are also important.

The economy of Latvia is characterized by a low share of the tradable sectors (the manufacturing industry in 2009 – 9.9% of GDP, in 2010 – 12.2% of GDP), low productivity of manufacturing (the average level of the EU member state is four times higher than in Latvia) and a small share of innovative enterprises.

The structural policy measures fostering competitiveness are necessary not only in product markets, but also in the financial market (see Chapter 2.2.), labour market (see Chapter 2.4.) and improvement of business environment (see Chapter 2.5.).

In order to foster exports/competitiveness of Latvia, the key policy directions and measures in product markets are as follows:

- **Support for access to external markets** (responsible institution – ME)

The aim of the measure is to support Latvian enterprises to increase export volumes and diversify the market. The measure includes:

- Direct export support services for enterprises;
- Expanding the network of the Latvian Foreign Economic Representative Offices abroad (4 new offices for entrepreneurs in priority countries in 2011);
- support in external marketing;

The public financing for the measures in 2011–2013 is LVL 12.4 million, including the EU funds financing – LVL 10.4 million. In the framework of this measure 530 Latvian enterprises will be advised on issues related to foreign markets and supported in searching for business partners, as well as 170 entrepreneurs will be supported in organizing national stands in international exhibitions.

- **Attraction of foreign direct investments to export-oriented sectors** (responsible institution – ME)

The aim of the measure is to attract foreign direct investments (hereinafter – FDI) to export-oriented sectors, especially those with high value added.

Currently, the *Foreign Direct Investment Attraction Strategy* and the *Action Plan* for its implementation (2011) is being developed. It will be a set of measures to increase investor motivation (offer of investment stimuli, appropriate labour, developed industrial areas, marketing activities, etc.).

Special support measures will improve competitiveness of tradable sectors in attraction of FDI that might ensure return after 2012.

- **Promotion of innovations**, by developing a framework for efficient cooperation between scientists and entrepreneurs, improving research infrastructure and supporting joint research, as well as supporting innovative companies in developing new products and technologies and their introduction in production, etc. (see Chapter 3.2.).

- **Ensuring qualitative and competitive infrastructure of logistics and transit services** (responsible institution – MT)

The aim of the measure is to increase competitiveness of logistics services and to ensure carrying capacity of the EU external border according to the potential flow of cargo and passenger transport. By introducing the International Freight Logistics and Port Information System (hereinafter – IFLPIS), Latvia will become more attractive in freight transport competition, thus attracting extra cargo and creating new jobs and additional budget revenues. It is calculated that every extra cargo ton handled in Latvia would contribute about LVL 10 to the economy of Latvia.

The main directions for 2011–2013 are reconstruction and improvement of railway, road, port and air transport infrastructure, as well as development of the IFLPIS.

The total public financing is LVL 403.7 million, including the EU funds financing – LVL 370 million (2011–2013).

- **Developing information and communication technologies (ICT) and introducing a digital single market** (responsible institutions – MT, MC, MEPRD, MJ)

The aim is to ensure equal availability of electronic communications all over Latvia, to increase contribution of information and communication technologies (hereinafter – ICT) in growth and innovation of all economic sectors. The main activity directions in the coming years are:

- Implementing a development project on broadband network availability (the project and its implementer to be selected in the project selection in 2011);
- Defining guidelines on high quality next generation electronic communication networks and work out guidelines on Scandinavian–Eurasian data transfer main transit network development to be prepared by the end of 2012 and by the end of 2013 respectively;
- Improvement of ICT infrastructures and services by setting standards for better interoperability between digital services and devices, secure usage and building digital confidence, for public procurement, use of electronic payments and eInvoicing, broad availability of public sector information, commercial and cultural digital content and services, facilitating better administrative cooperation (2011–2013). The direction of the activity envisages implementation of the measures listed in the “Europe 2020” strategy’s flagship initiative “Digital Agenda for Europe” in Latvia (see also Chapter 2.5.).

*The Electronic Government Development Plan for 2011–2013* has been prepared in 2011 covering measures to reduce the administrative burden and increase efficiency of the organizational process in the public administration; develop electronic services tailored to



the needs of population and enterprises; develop state information systems and the ICT infrastructure, fostering internet access; facilitate public involvement in the policy-making process.

Public financing for the measure is LVL 71.3 million, including the EU funds financing – LVL 69.1 million (2011–2013).

By implementing this measure it is expected that 73% of all population will use internet on a regular basis in 2013 and 75% of households will have the opportunity to connect broadband services, moreover 50% of the population will use e-government in 2015.

#### **2.4. Avoiding high unemployment from becoming structural and ensuring better matching in the labour market**

The share of job seekers in Latvia is currently among the highest in the EU. The average rate in 2010 was 18.7%. Although the labour market situation started to stabilize in the mid-2010, the increase in labour demand will be moderate in the coming years, as growth will be based mainly on productivity gains.

The structure of unemployment has changed. The share of long-term unemployed in the total number of registered unemployed has increased significantly– from 11% at the end of 2008 to 38% at the end of 2010. The share of unemployed not receiving an unemployment benefit has grown as well. The average duration of unemployment indicates high structural unemployment risk that might have further negative impact on labour skills and on the willingness to integrate into the labour market.

In order to diminish the social consequences of the crisis and its impact on the labour market, a special large-scale measure “Workplaces with Stipend Emergency Public Works Programme” was launched in September 2009 with the aim to activate the unemployed, providing simultaneously the means of subsistence to those who need it most.

Traditional active labour market policy (hereinafter – ALMP) measures aimed at improving labour skills and qualification were further implemented and developed as well. The training voucher system has been introduced. With the considerable increase in the number of registered unemployed, the workload of the State Employment Agency’s employees (hereinafter – SEA) increased as well, thus creating the need for immediate improvements in capacity and work efficiency of the SEA within the limited resources available.

Since the spring 2010, certain improvements are observed in the labour market. It provides the reason for adjusting the labour market policy measures to the new situation by gradual transition from short-term crisis-related measures aimed at mitigating the social consequences of the crisis to traditional labour market measures aimed at improving quality of labour supply and economic activity. The measure “Workplaces with Stipend Emergency Public Works Programme” will be continued until the end of 2011, however, starting from the 3<sup>rd</sup> quarter of 2011 the amount of stipend payable will be reduced from LVL 100 to LVL 80. Starting from 2012 the measure “Paid Temporary Public Works” is planned to be resumed, thus strengthening cooperation with the social municipal services (also regarding requirements for obligatory participation in activation measures for social assistance clients).

For further improvement of the situation, additional investments in training of unemployed for improving their qualifications will be needed, as well as additional investments in other activation measures, including development and maintenance of the working capacity/skills in public work programmes, particularly for the disadvantaged unemployed, at the same time developing a closer link between the ALMP measures and social assistance services in order to decrease the risks of economic potential being deteriorated. The regional mobility issue becomes more important – economic activity is limited due to the insufficient concentration of the working-age population in particular regions of the country. The SEA working methods

also need to be adjusted to the new labour market conditions, by harmonizing accordingly the labour market and social assistance policies.

Reforms in tertiary and vocational education are necessary to ensure that education supply goes in line with the economy needs. In terms of lifelong learning it should be noted, that the education system is not always based on learning outcomes, recognition of knowledge and skills acquired outside the formal education is not fully ensured, as well as there are limited possibilities for adults to acquire formal basic and secondary education.

Key policy directions and measures for decreasing the risk of structural unemployment:

- ***Improving active labour market policy measures by gradual transition from crisis-related measures to traditional active labour market policy measures*** (responsible institutions – MW, ME)

The aim is to carry out ALMP measures' reforms to increase their efficiency and quality of the unemployed training process (2011–2013):

- By introducing the “training voucher” (i.e. “money follows the unemployed”) system in the unemployed training;
- By making more efficient the measures of subsidized employment (wage subsidies) and on-the-job training for the disadvantaged unemployed;
- By introducing new measures targeted at young unemployed for a practical work trial and for voluntary work;
- By supporting small scale financial investments in self-employment and business start-up, by expanding the range of persons able to submit a business plan for the business grants' competition (see also Chapter 3.1.);
- By introducing training of unemployed on request by the employer based on the needs of the sectors.

On average, 160 thousand services will be provided annually to unemployed, job seekers and other persons in need of assistance while entering into the labour market. One person can benefit from several services within a year (2011–2013). Public financing is LVL 49.4 million, including the EU funds financing – LVL 30.5 million (2011–2013).

- ***Activation of economically inactive population and efficient inclusion of the social assistance clients into the labour market and support to regional mobility*** (responsible institution – MW)

The aim is to activate the economically inactive groups of population, especially social assistance clients by providing more targeted support to long-term unemployed and to promote the geographical mobility of labour:

- By developing a new conceptual solution for implementation of paid temporary public works (2011) that might be implemented in 2012–2013, involving mainly the social assistance clients in that measure;
- By linking more efficiently the ALMP measures, job search assistance and social assistance through strengthening the obligations of the unemployed in the *Law on Support for Unemployed Persons and Job Seekers*, as well as in other related laws and regulations, reducing simultaneously the poverty trap (2012);
- By developing new measures to promote regional mobility, int.al. by supporting employment commencement in other administrative territories (2011).

- ***Making the work of the SEA more efficient*** (responsible institution – MW)

The aim is to improve existing and introduce new working methods in the SEA, thus ensuring faster inclusion of unemployed into the labour market, by offering the customers timely and qualitative services and ensuring efficient cooperation with employers:

- By developing new labour market supervision and service provider monitoring system (2011–2013);
- By ensuring periodic impact evaluation of the ALMP measures (2011–2013);
- By developing new and improving existing methodologies (instructions) for work with each of the customer groups to enhance the possibilities of unemployed to enter the labour market (2011–2012);
- By enhancing the quality of job search assistance and career guidance services, by further developing of methodologies and requirements for service providers and diversifying the range of these services (2011–2013);
- By exploring synergies in everyday work of the SEA and the State Social Insurance Agency and optimizing everyday work of the social and labour inspectorates.

About 370 thousand services for competitiveness enhancing and career guidance are expected to be provided in 2011–2013. One person can be involved in several services. Public financing is LVL 2 million, including the EU funds financing – LVL 1.6 million (2011–2013).

- ***Implementation of the lifelong learning principle*** (responsible institutions – MES, ME)  
The aim is to foster continuous improvement and development of population skills and competences by ensuring availability of lifelong learning programmes to population irrespective of age, gender, previous education, place of residence, income level, ethnic identity, functional impairments; by developing qualitative adult education supply and developing a harmonized system of laws and regulations and efficient resource (including financial) management so that 15% of the population (aged 25–64) would be continuously involved in the learning process by 2020. In 2009, the share of the mentioned persons was 5.3%, however it is planned to reach 12.5% by 2013.

Key directions to improve the implementation of lifelong learning principle are as follows:

- Development of national qualifications framework and adjustment of its levels to the European qualifications framework, thus fostering transition to education based on learning outcomes (by 2013);
- Ensuring assessment of knowledge, skills and professional competence acquired outside the formal education (by 2013);
- Offering the second chance education as a compensating mechanism to reduce the number of early school leavers;
- Support to qualification improvement of the employed according to the employers requirements that are necessary for the employed training in the framework of sectors. This training improves the knowledge of employers and employees and motivate them to use more information technologies in production and business management and employ other methods of modern production and business management (16 thousand employees to be trained by 2013).

In the framework of the EU funds activity “Development of Sectoral Qualification System and Restructuring of the Vocational Education” (2011–2013) the recognition of knowledge, skills and professional competences acquired outside the formal education will be approbated and 80 persons will obtain professional qualification that is equal to the professional qualification of the first, second or third professional qualification level. Starting from 2013, a reference to the corresponding level of the European Qualifications Framework will be indicated in the documents certifying education.

Public financing in 2011–2013 is LVL 25.9 million, including the EU funds financing – LVL 17.2 million. Several measures will be implemented in the framework of the allocated state budget.

- **Structural changes in vocational education**, by optimizing and differentiating the number and location of vocational education institutions in the regions, thus developing material-technical supply of vocational education that conforms to the current requirements and improving quality of vocational education (see Chapter 3.1.).
- **Modernization of higher education**, by increasing the efficiency, quality and international competitiveness of studies and research; by ensuring better conformity of the acquired qualification and skills to the labour market requirements (see Chapter 3.1.).

## **2.5. Addressing the weaknesses in the business environment, ensuring efficient use of EU structural funds and adequate access to finance for companies with a view of favouring productive investment**

The global financial crisis has negatively affected the investment process in Latvia. During 2009 and 2010 the investments in the economy of Latvia decreased almost twice.

The main reasons for weakening of the investment process are worsening of enterprise's financial situation during the crisis and narrowing of financing possibilities, low demand, low level of production capacity load, as well as future uncertainty. The balance of granted loans has decreased significantly and rapid crediting is not expected to resume in the nearest future. The EU funds are one of the key business support instruments under the current circumstances. Therefore it is necessary to speed up their absorption.

The world faces increasing competition for investments, where the business environment plays a significant role. In the World Bank's *Doing Business 2011* index Latvia ranks 24<sup>th</sup> among 183 analyzed countries, moving up by three places in the overall evaluation compared to the previous year. Still, however, property registration, dealing with construction permits, closing a business, paying taxes, starting a business are still the areas where it is necessary to continue reforms, so that the business environment in Latvia would become more attractive for both the local entrepreneurs and foreign investors.

The strengthening of services market is also an important business promoting factor. Latvia, like other EU member states, is implementing the *Services Directive*, by carrying out a range of measures (broad assessment of laws regulating the services sectors and their respective amendments, adoption of a horizontal law, establishment of a single contact point, etc.).

Key policy directions and measures for improvement of the business environment:

- **Reduction of administrative barriers** (responsible institutions – ME, MJ, MEPRD, SC)  
The aim is in cooperation with entrepreneurs to improve constantly the regulation basis for the business environment and develop electronic services according to the needs of entrepreneurs.

The *Annual Action Plan for Improvement of Business Environment* and accompanying measures will be developed and implemented in 2011–2013 including simplification of administrative procedures, reduction of administrative costs and burden, and implementation of e-services for entrepreneurs in such areas as business start-up, tax administration, foreign trade, registration of real estate, insolvency process, improvement of construction regulation, etc. The main indicators to be achieved are as follows:

- Latvia is ranked at least 19<sup>th</sup> in the *Doing Business* rating in 2013;
- Reduced number of days for construction process from 186 to 69 days in 2011;
- A one stop agency principle introduced for property data registration and ownership corroboration in 2011 envisaging mutual updating of the data in the Real Estate State Cadastre Information System and State Unified Computerised Land Register;
- Improved regulation for the protection of investor rights in 2011 and 2012, thus ensuring better transparency of enterprise transactions, etc.;

- New e-services ensured in 2012 envisaging electronic request and receipt of services (permits, licenses, reports, accounts, etc.);
  - Adjusted issues related to contractual obligations in 2013 ensuring the use of e-services and possibilities of information technologies aimed to promote availability of courts.
- ***Strengthening services market in Latvia*** (responsible institution – ME)  
The aim is to promote competitiveness of the services sector, to minimize administrative burden in the field of services and to foster broad application of the one stop agency principle:
    - To make the 20 basic government services available fully online in Latvia, if the nature of the service allows it;
    - To introduce the physical infrastructure single contact point (user “support centre”) in the services sector by 2014;
    - In 2011 and further, in cooperation with non-governmental organizations, to carry out an analysis of the requirements of laws and regulations and to prepare proposals for the necessary amendments on a regular basis in order to simplify rendering of services in Latvia outside the fields mentioned in the Services Directive;
    - By adoption of the new *Construction Law* and *General Construction Regulations* (the draft law is currently submitted to the Saeima), to develop appropriate legal framework for rendering of services in Latvia, thus simplifying the administrative process of construction by refusing many intermediate decisions made by the involved public and municipal institutions, as well as reduce the terms for decision-making.
  - ***Speeding up absorption of EU funds*** (responsible institution – MF)  
In order to speed up absorption of EU funds, the following is planned:
    - To improve the monitoring system of EU funds’ procurement, in order to reduce and prevent potential ineligible costs in the EU fund projects by increasing capacity of the Procurement Monitoring Bureau. A decision dispute mechanism regarding project procurements financed by customer will be introduced, as well as the pre-inspection process of procurements in state budget projects will be improved. Corresponding amendments to the regulations of the CM shall be made during the 1<sup>st</sup> half of 2011;
    - To reduce the number of institutions involved in the EU funds administration to optimize the implementation system of the EU funds. The reform must be carried out until the end of 2013. Beneficiaries of the EU funds financing have to cooperate with a maximum of 3 agencies. Besides, the beneficiary of the EU funds financing has to observe unified requirements set for administration of the EU funds financing, thus facilitating the implementation of the project;
    - To evaluate the possibilities to redistribute unutilized EU funds financing to active labour market policy measures, thus ensuring new and innovative labour market policy measures, justifying their necessity, scope and efficiency. In cooperation with the ministries, a proposal for financial redistribution must be prepared and submitted to the EC by August 2011;
    - To facilitate the access of enterprises to loans or grants for project implementation. Amendments to the regulations of the CM on the sub-activity of the EU funds *Development of new projects and technologies – support for introduction of new products and technologies in production* regarding the second and next stages of the selection of project application envisaging that the Investment and Development Agency of Latvia concludes contracts on implementation of the EU funds projects when the project applicant has concluded a contact with a credit institution on loan granting for project implementation, thus making the process more efficient. Availability of loans and guarantees for enterprises will prevent situations when the

EU funds financing is “frozen” and the EU funds financing allocated for the activity is not fully utilized.

- ***Access to finances*** (responsible institutions – ME, MF, MA)

The aim of this measure is to provide financial support for business development, ensure access to loans and support risk investments. The main financial support instruments for 2011–2013 are as follows:

- Loans on improvement of competitiveness and growth of the enterprises;
- Individual guarantees to improve enterprise competitiveness;
- Short-term export guarantees;
- Risk capital instrument;
- Preparation and start-up capital instrument;
- *Mezzanine* and co-investment instruments;
- Loan fund for agricultural and rural development investment projects.

In 2011–2013, the Financial Development Institution of Latvia must be established by gradual consolidation of work of several exiting institutions (Latvian Guarantee Agency, MLBL, Latvian Environmental Investment Fund, Rural Development Fund, *JEREMIE Holding Fund – LATVIA*) to create such development instruments that conform the best to the demand and to complement each other instead of competing. The new financial institution will administer the entire range of products thus not only simplifying the availability process of state support financial instrument, but also ensuring a better understanding about the offered products and faster response to market failures.

More than 750 enterprises will be supported in the framework of this measure.

300 enterprises are planned to be supported within the state support programmes administered by the ME in a form of loans, guarantees and risk capital financing, as well as short-term export guarantees are planned to be provided for enterprises until 2013. Public financing for 2011–2013 is LVL 120.1 million, including the EU funds financing – LVL 111.2 million.

478 entrepreneurs and households are expected to receive support from the loan fund of the agricultural and rural development investment projects in 2011–2013. Public financing for 2011–2013 is LVL 31.4 million, including the European Agricultural Fund for Rural Development and the European Fisheries Fund – LVL 23.5 million.

- ***Strengthening capacity of municipalities in attraction of companies and investments*** (responsible institutions – MEPRD, MC, MT)

The aim is to strengthen the role of municipalities in attracting investments and promoting entrepreneurship:

- By redistributing EU structural funds, attracting additional financing to 18 region municipalities in the amount of LVL 30 million to improve the business infrastructure (development of industrial territories, construction/reconstruction of access infrastructure, construction of transport infrastructure, etc.), as well as to ensure availability and accessibility of public services (2011);
- By expanding possibilities of municipalities to foster entrepreneurship by amending laws and regulations that govern the rights of municipalities to lease and alienate its own property, as well as by amending the *Public Procurement Law*, thus stipulating application of the candidate selection criteria regarding the average income of the employed in the respective sectors to the average income in the region (2011);
- By improving availability and quality of services offered by the municipalities by implementing the one stop agency principle (corresponding draft laws are planned to

- be prepared by October 1, 2012 envisaging a unified procedure for rendering of public and municipal services according to the one stop agency principle);
- By improving and developing the water and waste management infrastructure, including ensuring qualitative water management services to 68% of the Latvian population, ensuring waste pre-processing before disposal, improving infiltrate cleaning and developing new waste disposal cells in the existing sites, as well as developing separate waste collection and sorting, and continuing the dump re-cultivation (2011–2013);
  - By improving the cultural environment, developing multifunctional centres of national and regional importance, as well as by ensuring restoration of cultural heritage objects of socio-economic importance in municipalities and promoting maintenance of cultural monuments owned by private persons and efficient use of the socio-economic potential (2011–2013);
  - By improving the country's regional roads, thus increasing traffic safety in populated areas (2008–2014).

The public financing is LVL 459.9 million, including the EU funds financing – LVL 367.4 million (2011–2013).

### 3. National targets of Latvia for 2020 in the context of the “Europe 2020” strategy

Latvia’s aim is to promote growth and jobs by ensuring the growth of GDP in the medium term by 4–5% and a high employment rate of 73% by 2020.

Table 2  
National targets of Latvia for 2020 in the context of the “Europe 2020” strategy

	EU-27		Latvia		
	Fact	Targets 2020	Fact	2020	Targets 2030 <sup>1</sup>
<b>Employment rate</b> (aged 20–64), %	69.1 (2009)	>75.0	67.1 (2009)	<b>73.0</b>	Increase labour participation and to use maximally all human capital resources available in Latvia, including older people
<b>Expenditures on research and development (R&amp;D)</b> (% of GDP)	1.9 (2008)	3.0	0.46 (2009)	<b>1.5</b>	>3
<b>Tertiary education</b> (share of population aged 30–34 having completed tertiary education)	32.3 (2009)	40.0	30.1 (2009)	<b>34.0 ... 36.0</b>	>90 per 1000 inhabitants aged 20–29 years
<b>Share of early school leavers</b> (aged 18–24, %)	14.4 (2009)	<10.0	13.9 (2009)	<b>13.4</b>	Share of population aged 20–24 having completed at least upper secondary education >90
<b>Persons at-risk-of-poverty (%)</b> <sup>2</sup>	17.0 (2008)	20 million people lifted out of the risk of poverty or exclusion <sup>3</sup>	26 <sup>4</sup> (2008)	<b>21.0</b> <b>(121 000 people lifted out of the risk of poverty or exclusion)<sup>5</sup></b>	Persons at-risk-of-poverty after social transfers <16
<b>Energy efficiency</b> (gross inland energy consumption, Mtoe)	1799.29 (2008)	To increase energy efficiency by 20%	4.6 (2008)	<b>To gain energy savings of 0.668 Mtoe in consumption of primary energy resources or 0.48% that is total contribution of Latvia in achievement of the EU common energy efficiency target</b>	< 150 <sup>6</sup>
<b>Share of renewable energy sources in gross final energy consumption (%)</b>	10.3 (2008)	To increase the share of renewable energy sources in gross final energy consumption to 20%	29.9 (2008)	<b>To increase the share of renewable energy sources in gross final energy consumption to 40%</b>	>50
<b>Greenhouse gas (GHG) emissions</b> (% compared to 1990 level)	88.7 (2008)	To reduce GHG emissions by 20% compared to 1990	44.4 (2008)  11.9 Mt (2008)	<b>To limit GHG emissions in sectors outside the ETS<sup>7</sup> so that the increase does not exceed 17% compared to 2005</b>  <b>To limit the overall GHG emissions so that in 2020 they do not exceed 12.19 Mt CO<sub>2</sub> equivalent</b>	–

<sup>1</sup> Targets set in the Sustainable Development Strategy of Latvia – “Latvia 2030”.

<sup>2</sup> Persons with an equivalised disposable income below the risk-of-poverty threshold, which is set at 60% of the national median equivalised disposable income (after social transfers).

<sup>3</sup> Expressed using three indicators – number of people who are either at-risk-of-poverty and/or materially deprived and/or living in jobless households.

<sup>4</sup> Indicator includes at-risk-of-poverty rate and/or jobless households.

<sup>5</sup> Expressed using two indicators – at-risk-of-poverty rate and/or jobless households.

<sup>6</sup> Energy intensity of the economy is reflected here (gross inland energy consumption against GDP (kg oil equivalent per 1000 EUR of GDP)) according to the Eurostat methodology.

<sup>7</sup> Sectors not covered by the EU Emission Trading System (EU ETS), for example, transport, small-sized industry and energy sector, agriculture.

The national targets of Latvia for 2020 in the context of the “Europe 2020” strategy (hereinafter – the national targets of Latvia) have been set taking into account medium term



development scenario of the economy of Latvia, as well as targets of the Sustainable Development Strategy of Latvia – “Latvia 2030”.

**A successful achievement of national targets of Latvia depends on several conditions:**

- Overall economic growth, which is currently negatively affected by the crisis;
- Demographic development in the framework of which, according to the projections, the number of the working age population of Latvia will continue to decrease until 2020;
- Possibilities of Latvia’s budget, which until 2014 will be very limited that is determined by the necessary budget consolidation measures;
- Possible EU support, including support from EU funds in the framework of the new EU financial perspective after 2013. The support of the Cohesion policy for convergence of less developed EU member states and regions, as well as tackling the issues at the EU level regarding the equal competition conditions to all EU farmers should be particularly mentioned here.

**3.1. Employment target**

Along with a decline in the economic activity and due to economic restructuring, unemployment has increased sharply, particularly the long-term unemployment among the less qualified people, and overall employment rate has decreased (see Chapter 2.4.). The employment rate has decreased significantly due to a decline in labour demand.

The employment level will be mostly affected by the overall economic growth and demographic trends in the coming years. At the same time, there are the following labour supply side challenges hindering the achievement of the employment target:

- Mismatches between skills and qualifications of the workforce and labour market needs;
- Low internal regional mobility;
- Economic inactivity.

Table 3

Employment target’s achievement trajectory (population aged 20–64 years)

	2008	2009	2010	2015	2020
Number of population (aged 20–64)	1400.3	1403.9	1405.3	1390.4	1322.1
Number of employed (aged 20–64)	1061.1	941.9	907.5	958.4	965.1
Employment rate, %	75.8	67.1	64.6	68.9	73.0

Key policy directions and measures to foster labour demand:

- **Structural reforms in goods and services markets**, by improving FDI attraction mechanism to the export-oriented sectors, especially sectors with high value added, by supporting Latvian entrepreneurs in increasing the export volumes and market diversification, fostering innovations, raising competitiveness of Latvian logistics and transit services, speeding up the contribution of ICT to growth and innovation in all sectors of the economy, etc. (see Chapter 2.3.).
- **Improvement of business environment**, by regularly improving the legal basis concerning business environment in cooperation with entrepreneurs, by reducing administrative burden imposed by municipalities and establishing appropriate infrastructure, by speeding up absorption of the EU funds, providing financial support for development of businesses, ensuring access to loans and supporting risk investments, etc. (see Chapter 2.5.).

Key policy directions and measures to improve labour supply:

- **Reducing structural unemployment, incl. fostering economic activation of the workforce**, by improving the ALMP measures, by moving gradually from short-term crisis-oriented measures to the traditional training and raising competitiveness measures, thus encouraging the economically inactive population and social assistance clients to return to the labour market efficiently, and by supporting the regional mobility, by improving work of the SEA and lifelong learning system, etc..

- **Improving normative regulation of labour legal relations and labour protection and its application** (responsible institution – MW)

The aim is to ensure pre-conditions for high quality jobs:

- To evaluate and develop proposals for strengthening flexicurity principles in labour legal relations (for example, regarding working hours), lifelong learning and employment in cooperation with social partners (2011);
- By introducing e-services in the State Labour Inspectorate thus improving its functioning, as well as strengthening its control functions concerning reduction of undeclared work with regard to inspections (2011–2013);
- In cooperation with social partners carry out information campaigns, consultations and training measures targeted especially at employers, employees, youth on issues related to contractual working arrangements and safety and health at work (2011–2013).

Public financing is LVL 3.7 million, including the EU funds financing – LVL 3.2 million (2011–2013).

- **Promoting self-employment and entrepreneurship** (responsible institutions – ME, MA, MW)

The aim is to provide support to business start-ups and micro-enterprises, thus fostering establishment and development of new competitive micro-, small- and medium-sized enterprises; to support business incubator operation; to organize training for new entrepreneurs and provide loans and grants, as well as to promote non-agricultural business or employment in rural territories.

The measure includes training of 1200 new entrepreneurs, at the same time creating 400 new jobs. Within the measure loans to 900 projects are planned to be granted. By ensuring business incubator operation, approximately 270 jobs will be created (maintained) yearly. It is planned to support about 300 projects within the framework of the *Rural Development Programme* - to create enterprises and ensure development in rural territories in order to diversify non-agricultural activities.

Public financing is LVL 29.6 million, including the EU funds financing – LVL 20.4 million (2011–2013).

- **Structural reforms in vocational education** (responsible institutions – MES, MC)

The aim is to improve the quality of vocational education, thus ensuring its conformity with the labour market needs, as well as to foster efficient use of available resources. The measure includes:

- optimization of the network of vocational education institutions (development of a more balanced institution network in particular regions) and its differentiation (vocational education institutions with a specific field of specialization). By optimizing the number of vocational education institutions (from 56 institutions in 2010 to 29 in 2015) it is planned to establish 13 vocational education competence

- centres, 14 vocational education institutions with specialization and 2 vocational education institutions to acquire basic skills;
- strengthening the cooperation with social partners to improve and develop vocational education;
- modernizing infrastructure of vocational education institutions;
- establishing cultural education competence centres.

It is planned to change the proportion of the number of students in vocational education and general education in favour of vocational education by 2015 from 37/63 (in 2010) to 50/50 (in 2015), thus ensuring the increase of the share of qualified labour.

In general, the measure is planned to be implemented by the end of 2015. Public financing is LVL 45.2 million, including the EU funds financing – LVL 38.6 million (2011–2013).

- ***Modernization of higher education*** (responsible institution – MES)

The aim is to increase efficiency, quality and international competitiveness of studies and research; to ensure better conformity of the obtained qualification and skills with the labour market requirements.

The reform envisages a transition from programme accreditation to accreditation of study fields, int. al. by performing international evaluation of study programme quality, resource adequacy and sustainability. The measure is being developed and will be implemented in 2013.

The measure envisages:

Stage 1:

- to develop methodology and criteria for evaluation of the study fields (2<sup>nd</sup> quarter of 2011);
- to evaluate study programmes by study fields (evaluation will be finished in the 3<sup>rd</sup> quarter of 2012);
- to prepare recommendations for further improvement, development, consolidation, closing of study programmes, fostering international competitiveness, efficient use of resources and financing from the state budget (2011–2012), as well as ensuring fulfilment of recommendations by closing the most uncompetitive and lowest quality study programmes;

Stage 2:

- to improve the content of study programmes in cooperation with employers;
- to develop new study programmes and courses, especially in the interdisciplinary fields at the higher education level and college level;
- to support inter-university cooperation projects for programme improvement, including supporting integration of branches of Riga higher education institutions into regional universities or colleges or establishment of new colleges in the regions;
- to improve the study quality, by developing and introducing innovative experience, including involving foreign lecturers, developing e-study solutions, updating and increasing intellectual resources of studies, as well as strengthening the link between studies work (within practice) and enterprises;
- to improve qualification of academic staff, including college lecturers;
- to allocate state budget financing only to qualitative programmes, by implementing the principle “money follows the quality”.

The implemented measures will help improving indicators characterizing quality and international competitiveness of study programmes. The share of foreign students in 2013 is expected to reach 3% of the total number of students (in 2009 – 2.9%). Several study programmes are going to be developed in the languages of the EU member states, by

making respective amendments to the *Law on Higher Education Institutions* (or adopting a new *Law on Higher Education*).

Public financing is LVL 5.1 million and is 100% EU funds financing.

### 3.2. Research and development (R&D) target

The share of investments in research and development (hereinafter – R&D) in Latvia in 2000 was 0.47% of GDP, but in 2009 it reached 0.45% of GDP, which is the lowest amount of public and private sector investments in R&D in the EU (for comparison, the EU-27 – 2.0% of GDP). Public and private sector investments in R&D continued to decrease in 2010.

The low share of R&D in GDP is explained by the small amount of the state budget financing, as well as the insufficient contribution of the private sector to the research (0.37% of the total financing for the R&D in 2009). There are the following challenges for increasing the financing for R&D in Latvia:

- A small number of employed in science and research (ageing of scientists, insufficient number of doctoral candidates);
- Underdeveloped scientific and research infrastructure, insufficient number of up-to-date equipped laboratories for implementing technology-oriented projects;
- Weak commercialization potential of research results, poor cooperation between scientific and industrial sectors;
- The business structure of Latvia is composed mainly of small- and medium-sized enterprises with no capacity to invest in R&D, and relatively low high technology sector.

Table 4

R&D target's achievement trajectory

	2008	2009	2010	2015	2020
Total financing for R&D (million lats)	99.5	59.9	76.3	169.2	331.1
% of GDP	0.61	0.45	0.5	1.0	1.5

#### Key policy directions and measures to increase investments in R&D:

- ***Developing potential of scientific activity*** (responsible institution – MES)

The aim is to increase the number of employed in science and research, establish competitive scientific institutions with up-to-date material-technical supply by consolidating the state scientific institutions and strengthening their infrastructure, thus promoting attraction of human resources to science and fostering competitiveness of scientists.

The measure envisages supporting 9 National level research centres in the priority research fields for research programmes that cover the following:

- Use of Energy and Environmental resources, Extraction Technologies;
- Pharmacy and Biomedicine;
- ICT and Signal Processing Technologies;
- Latvian Cultural Heritage and Creative Technologies;
- Use of Agricultural Resources and Food Technologies;
- Use of Forest and Water Resources;
- Nanotechnologies and Nanomaterials;
- Health and Clinical Medicine;
- Social Economy and Public Administration.

The measure includes purchase of up-to-date equipment and improvement of scientific infrastructure (2011–2015), establishment of new scientific groups and attraction of

additional human resources (2009–2013), implementation of state research programs (2010–2013).

The total public financing is LVL 84.7 million, including the EU funds financing – LVL 75 million (2011–2013), which might attract also financing from the private sector in the amount of LVL 15.7 million during this period.

- ***Development of a long-term cooperation platform for enterprises and scientists*** (responsible institutions – ME, MES)

The aim is to develop a framework for efficient cooperation between scientists and entrepreneurs, thus improving the research infrastructure and supporting joint research as well as fostering technology transfer.

The measure includes support to competence centres (2010–2015), technology transfer contact points (2009–2013) and development of such research infrastructure that promotes commercialization of research results (2011–2015) and practice-oriented research. The majority of these activities have been already launched and the support conditions for development of commercial research infrastructure are currently being developed.

Public financing provided for the support in 2011–2013 is LVL 69.6 million, including the EU funds financing – LVL 68.1 million that might allow attracting also private financing in the amount of at least LVL 23.5 million.

- ***Support to development of innovative enterprises*** (responsible institutions – ME, MJ)

The aim is to support innovative enterprises in developing new products and technologies and introducing in production, as well as to increase the number of innovative enterprises. In the framework of the measure, entrepreneurs will be able to receive grants for introduction of new products and technologies in production (2011–2013), support to high value added investment projects (2010–2013), support to development of innovative environmentally friendly products and technologies and their introduction in production in the framework of the technology incubator (2011–2015).

Raising capacity of patent technical library and introduction of new support services will contribute to the achievement of the R&D target as well.

The majority of activities have been already launched. Conditions and normative acts on establishment of a technology incubator will be developed in 2011.

The public financing for grants in 2011–2013 is LVL 98.9 million, including the EU funds financing – LVL 94.3 million and Norwegian Financial Instrument – LVL 4 million that allows attracting private sector investments in innovations in the amount of LVL 190 million.

### **3.3. Tertiary education target**

The share of the Latvian population aged 30–34 with tertiary education attainment in 2008 was 27%, but in 2009 – 30% (for comparison: in 2000 – 18.6%).

Due to the deterioration of the purchasing power of the population, the number of students studying for a tuition fee decreased in 2009 and 2010. Currently, the number of students studying for state budget financing did not change practically and in 2010 even a slight increase had been observed because of the opportunity to use the EU structural funds for financing studies also in the private higher education institutions. Taking into account the purchasing power of the population and the curve of the birth-rate reaching the lowest point, the total number of students will continue decreasing in the upcoming 4–5 years. The number

of students might gradually increase again after 2020 reaching 85–90 thousand, when the demographic situation and purchasing power of the population will improve.

Taking into account the rapid increase in the number of students in the previous years, the share of population aged 30–34 having acquired tertiary education might increase until 2016, after 2016 – decrease, and in 2020 the share will be lower than in 2015.

There are the following challenges (bottlenecks) to increasing the share of population in tertiary education in Latvia:

- As a result of the crisis, the purchasing power of the population has decreased, thus reducing the number of students studying for a tuition fee;
- Insufficiently developed material-technical base of the higher education institutions;
- Insufficient number of lecturers and scientific staff;
- Study programmes are fragmented, and as the number of students and available resources decreased (state budget financing reduced, wages of the academic personnel reduced, personal income decreased), the quality of studies and ensuring critical mass is likely to be endangered (see Chapter 3.1.);
- Educational programmes offered by higher education institutions situated in the regions have very little to do with the specific character of the region and needs of the particular territory in the labour market (see Chapter 3.1.).

Table 5

Tertiary education target's achievement trajectory

	2008	2009	2010	2015	2020
Number of population having acquired tertiary education aged 30–34 years, thousand	42.7	47.3	54.4	64.5	61.1
Number of population aged 30–34 years	158.3	157.2	156.9	168.4	177.9
Share, %	27	30.1	35	38	34–36

Key policy directions and measures to increase the number of people having acquired tertiary education:

- **Modernization of higher education**, by improving the study and research efficiency, quality and international competitiveness; by ensuring conformity of the obtained qualification and skills to the labour market requirements (see Chapter 3.1.).

- **Modernization of the material-technical base of higher education institutions and raising the efficiency of resources' use** (responsible institution – MES)

The aim is to improve the supply with advanced devices, equipment and technologies in such priority fields of studies as natural sciences, mathematics and information technologies, engineering, manufacturing and construction, as well as to rationally use the public and attracted private financing.

It is planned to modernize 29 higher education institutions in the framework of the measure (in 2011 – 12, in 2012 – 11, in 2013 – 3 and in 2014 – 3). To achieve this objective, the higher education institutions are granted financial support from the EU funds financing to implement modernization projects.

In 2011, a performance based higher education and science financing model is expected to be approved in the CM and introduced as of 2012/2013 academic year, but in 2013 additional financing from the state budget in the amount of LVL 5 million is planned to be allocated to the performance- and quality-based financial share.

The total public financing of the measure is LVL 65.3 million, including the EU funds financing – LVL 51.3 million (2011–2013).

- ***Ensuring equity of higher education*** (responsible institution – MES)  
The aim is to improve the mechanism for granting scholarships and study and student loans, thus giving a larger number of people an opportunity to study and promoting more targeted choice of study field. It is planned to introduce the new mechanism in 2013. No additional budget financing is needed.

At the same time, the loan repayment procedure is planned to be restored. Until 2008, specialists employed in state-defined professions and institutions had the possibility to repay the loan from the state budget financing. This possibility was temporary suspended due to the limited budget resources. However, it is expected to be restored in 2013. By restoring loan repayment from the state budget financing, it will be possible to promote attraction of highly qualified and talented professionals to work in public and municipal institutions in the fields where such professionals are needed (teachers, social workers, health care specialists and others), thus fostering also attraction of students to particular studies.

- ***Improvement of the quality of studies and scientific activities*** (responsible institution – MES)

The aim is to increase the share of highly qualified professionals in the priority fields of the labour market (natural sciences, mathematics and information technologies, engineering, health care, environmental sciences and creative industries), by regularly evaluating the efficiency of master and doctoral studies and by developing new innovative study programmes, as well as by ensuring scholarships to students. It is planned that 700 master students and 200 doctoral students on average annually will be prepared and receive scholarship.

Currently, the higher education of Latvia lacks lecturers and scientific staff to qualitatively implement the existing programmes apart from developing new programmes. Sometimes the existing university teaching staff is employed in several universities or study programmes. The more new master and doctoral students there are, the higher are the possibilities to increase the total number of academic and scientific staff, and thus also the possibilities to develop new qualitative study programmes available for more potential students.

The total public financing is LVL 22.9 million, including the EU funds financing – LVL 21.2 million (2011–2013).

### **3.4. Early school leavers target**

Although the educational system of Latvia offers sufficiently diversified possibilities and programmes to acquire education, a part of the youth having started to acquire secondary education face different challenges during the study process and leave the school without having completed secondary education. The share of early school leavers aged 18–24 having left or not acquired secondary education was 15.5% in 2008, which was higher than the EU average (14.9%). This indicator improved slightly in 2009 reaching 13.9%, but in 2010 the share of early school leavers in the same age group was 13.3%. According to the data of the MES, 63.3% of the population having acquired primary education entered a secondary school at the beginning of 2010/2011 academic year, but 35.4% of population having acquired primary education entered vocational education institutions (1.3% chose not to continue education at all). The statistical data for 2009/2010 academic year show that about 9.8% of the youth, who entered general secondary education institutions and 12.6% of those, who entered vocational education institutions, left the education process.

The most common reasons for early school leaving are social-economic conditions of the family, lack of motivation and learning difficulties, influence of peers and unsatisfactory school resources. There is insufficient cooperation between parents, education institution and municipal specialists to prevent absence. The decision-making to improve the educational system and ensure dynamic development is hindered by the slow information exchange between the education institution and the ministry regarding annual education achievements.

There are the following challenges in reducing the share of early school leavers:

- Lack of support (including pedagogical) to the youth starting a new stage of education;
- No uniform procedure has been practically introduced stipulating how an education institution should inform parents, municipal or public institutions if a pupil is absent from the education institution without a justified reason;
- Out-of-date material-technical base of the education institutions (teaching aids, teaching material and methodological base) that fails to encourage pupils motivation and interest in learning.

Table 6

Trajectory for decreasing the share of early school leavers

	2008	2009	2010	2015	2020
Share of early school leavers	15.5	13.9	15.2*	14.3	13.4

\* Estimation of the European Commission

Key policy directions and measures to reduce the share of early school leavers:

- ***Ensuring availability of primary and secondary education*** (responsible institution – MES)

The aim is to ensure accurate accounting of pupils, by introducing a single procedure within the framework of normative regulations stipulating how an education institution should inform parents, municipal or public institutions if a pupil is absent from the education institution without a justified reason, and to ensure support to the youth at the risk of social exclusion and teaching support to the youth having learning difficulties.

The measure is currently at the implementation stage and is expected to be completed by 2013. The normative regulation has entered into force in February 2011. The information about the number of systematic non-attendance cases in the country and experience in avoiding such cases is planned to be summarized at the end of the academic year 2010/2011; an inspection regarding procedure introduced by the education institution to register unjustified absence and efficiency of its avoiding, experience in cooperation with parents and respective municipal services, as well as adequacy of resources to ensure the procedure is planned to be carried out in the academic year 2011/2012. Data on dynamics of absences are planned to be summarized and efficiency of the measure, as well as the necessity to improve it will be evaluated in the academic year 2012/2013.

By the end of 2013, it is planned to develop the supporting system for the youth, ensure teachers and supporting personnel and improve competence, as well as strengthen the capacity of institutions involved in the supporting system.

Total public financing is LVL 7.4 million, including the EU funds financing LVL 7 million (2011–2013).

- ***Introduction of advanced teaching methods*** (responsible institution – MES)

The aim is to modernize the teaching process and foster availability, including vocational education institutions and evening schools, develop distance learning opportunities for adults by implementing individual approach and introducing compensating mechanisms



(the opportunity for second education), modernizing education institutions and improving methodological teaching supply and environment.

The measure envisages implementation of reforms in general education programmes by optimizing the field of natural and social sciences and emphasizing the use of knowledge. By using advanced teaching methods (electronic teaching materials, opportunities of the e-learning environment), students are given an opportunity to learn the subjects they are interested in, a comprehensive cooperation with universities, scientific institutions and entrepreneurs is organized; support of teachers and consultations in the field of natural and social sciences is ensured. The measure is being implemented until the end of 2012.

A model of general secondary education in a form of distance learning is going to be developed and approved in 2011. Implementation of such distance learning programme is planned to be launched as from the academic year 2011/2012. The programme is expected to be accredited in 2012.

The total public financing is LVL 1.9 million, including the EU funds financing – LVL 1.6 million (2011–2013).

### 3.5. Poverty reduction target

The at-risk-of-poverty rate in Latvia has increased from 19% in 2004 to 26% in 2008 and was one of the highest among the EU member states. The at-risk-of-poverty rate or the share of the population below the poverty line increased during the period when the total income of the population was increasing substantially and the unemployment rate was comparatively low. It means that the increase in income of the population was unequal and not all people were able to adapt to the changes and benefit from the growth opportunities.

The at-risk-of-poverty rate in Latvia decreased to 21% in 2009. As the total income of the population decreased due to the impact of the crisis, the risk of poverty threshold decreased from LVL 192 in 2008 to LVL 160 in 2009. As a result, the share of people under the risk of poverty threshold decreased while their income was the same or even lower than before.

Families with 3 or more children (39%) had the highest risk of poverty in 2009 if classified by the household type; if classified by age, children aged 0-17 years had the highest risk of poverty – 27%. High (increasing) dependence on social transfers can be observed as well. At risk of poverty index before social transfers is 44%.

There are the following challenges to reduce the high poverty rate in Latvia:

- Income inequality, including low income of the employed and rather high tax burden on low income employees ('working poor' problem);
- High unemployment rate and insufficient or inadequate skills;
- Existing prejudices and discrimination, especially in the labour market<sup>8</sup>;
- Limited budget resources in the upcoming years;
- Insufficient availability of different services and lagging-behind territories in terms of service provision.

Table 7

Poverty reduction target's achievement trajectory

	2008	2009	2010	2015	2020
Share of persons at-risk-of-poverty (%)	26	21	21	25	21 (or by lifting 121 000 people out of the risk of poverty)

<sup>8</sup> According to public survey results the most important reasons for discrimination in Latvia are age and disability, which are mentioned more frequently than on average in the EU (*Discrimination in the EU in 2009. Summary. Special Eurobarometer 317, European Commission, [http://ec.europa.eu/public\\_opinion/archives/ebs/ebs\\_317\\_sum\\_en.pdf](http://ec.europa.eu/public_opinion/archives/ebs/ebs_317_sum_en.pdf)*).

Key policy directions and measures to reduce the poverty level:

- ***Reduction of income inequality*** (responsible institutions – MF, MW)

The aim is to reduce the tax burden on economically active population and population groups at high risk of poverty (especially families with children and people with low income) and to facilitate their ability to provide themselves and escape from poverty. The *State Family Policy Guidelines for 2011–2017* approved in the CM on February 15, 2011 envisage two alternative measures to be agreed by the government:

- Raising the rate of personal income tax allowance for dependent persons to 50% of the minimum monthly wage;
- Or introducing differentiated personal income tax policy.

Currently, the *Action Plan for Implementation of the State Family Policy Guidelines for 2011-2013* is being developed offering annual evaluation of possibilities to change the rate of the tax allowance.

- ***Social protection measures directed towards families with children*** (responsible institutions – MW, MEPRD, MJ)

The aim is to ensure and improve the state and municipal support to families with children, as well as to encourage parent participation in the labour market to prevent further increase of the risk of poverty for families with children:

- By supporting families with children through social protection and social assistance measures at the state and municipal level (financial support according to budget resources (benefits, state granted child maintenance provisions) and services (for example, social rehabilitation services for abused children));
- By diversifying work and family life reconciliation possibilities by improving the infrastructure of pre-school institutions and developing alternative day care forms, etc. Improvements in the legal framework regulating the provision of child care services are planned to promote development of safe and qualitative care services (2011). It is also planned to develop support programmes for municipalities to improve the infrastructure of pre-school institutions (2013), etc.

Public financing for the improvement of the infrastructure of pre-school institutions is LVL 3.2 million, including the EU funds financing – LVL 2.8 million (2011–2012).

- ***Encouraging population at risk of poverty and social exclusion to participate in the labour market*** (responsible institution – MW)

The aim is to activate and involve in the labour market the population at social exclusion risk (including persons with disabilities, persons of pre-retirement age, long-term unemployed, parents after childcare leave, the youth, etc.) by offering an opportunity to participate in the active labour market policy measures (including, public works programme, subsidised employment and training tailored to the needs of specific target groups) and improving the methods for work with each of the target groups (see Chapters 2.4. and 3.1.).

- ***Eliminating discrimination threats and stereotypes, as well as fostering participation of civil society*** (responsible institution – MC)

The aim is to promote social inclusion of the most disadvantaged population groups and give third country nationals of different culture, religion, language and ethnical origin an opportunity to take active part in all aspects of the European society:

- By expanding opportunities of civil society's participation and supporting development of the system to develop participation of civil society in political

- processes and consulting mechanisms, by supporting activities of non-governmental organizations and strengthening their capacity (by 2014);
- By implementing information, education and other measures to prevent discrimination threats and prejudices against specific population groups (2011–2013);
  - By practical introduction of the common basic principles of the EU immigrant integration policy (2011–2013);
  - By developing methodology of indicators and evaluation in order to assess progress and adjust the policy and measures, as well as to develop policy potential, promote coordination of comparative training and intercultural competences at various national levels and public administration institutions (2011–2013).

Total public financing for 2011-2014 is LVL 15 million.

### 3.6. Energy efficiency target

The total final consumption of energy in Latvia is ensured by the local energy resources and the flow of primary resources from Russia, other CIS countries, as well as the Baltic States, EU and other countries in the world.

The transformation sector in Latvia constitutes only 9% of the total gross domestic energy consumption, but in the EU it constitutes 30%. The energy policy of Latvia envisages replacement of imported electric energy with energy produced from the local renewable sources (where the efficiency of only wind power stations and of hydroelectric power stations is 100%) and imported fossil fuel. It means that the overall efficiency of the transformation sector will decrease, because the 100% efficient electricity import will be replaced with less efficient local electricity production. Energy production from fossil energy resources to replace import will cause extra greenhouse gas (hereinafter – GHG) emissions. Therefore, efficient energy production and consumption is a challenge not only in terms of energy efficiency, but also in terms of achieving the climate targets.

According to the forecast document of the action plan for the use of renewable energy sources, as well as taking into account the commitments of Latvia regarding implementation of the Kyoto Protocol requirements, the target of energy savings in 2020 is expected to be 0.668 Mtoe (total energy savings in both final consumption and transformation sector). All expert evaluations were carried out taking 2007 as the base year in accordance with the EC requirements.

Table 8

Energy efficiency target's achievement trajectory

2008	2009	2016	2020
Gross domestic energy consumption 4.6 Mtoe	Gross domestic energy consumption 4.3 Mtoe	Energy savings 0.39 Mtoe compared to 2008	Energy savings 0.433 Mtoe (excl. transformation sector) or 0.668 Mtoe (incl. transformation sector) compared to 2008

The target laid down in the *Energy Development Guidelines for 2007–2016* is to reduce the average specific heat energy consumption in buildings from the current 220-250 kWh/m<sup>2</sup>/per year to 195 kWh/m<sup>2</sup>/per year by 2016, and to reach the average specific heat energy consumption of 150 kWh/m<sup>2</sup>/per year by 2020. The target can be achieved if the renovation programme of multi-apartment buildings and public sector buildings is continued.

The main challenges to achieve the energy efficiency target are as follows:

- Low energy efficiency in the final consumption sectors of energy use;
- Exploitation of energy efficiency potential in the centralized heat supply system and reduction of the large heat energy losses in networks;

- Increasing final energy consumption in the transport sector, especially motor transport.

Key policy directions and measures to increase energy efficiency:

- ***Building insulation*** (responsible institution – ME)  
The aim is to provide financial support to insulation projects of dwelling houses, thus encouraging households and municipalities to insulate buildings. An activity is launched with the support of the EU funds within the framework of which insulation of dwelling houses will be carried out until 2013, thus allowing reducing the energy consumption by at least 0.233 Mtoe.  
  
The total public financing is LVL 51.3 million, including the EU funds financing – LVL 51.3 million (2011–2013).
- ***Increasing energy efficiency in public and industrial buildings*** (responsible institution – MEPRD)  
The aim is to provide financial support to projects for increasing energy efficiency in public and industrial buildings in order to reduce GHG emissions. In the framework of the measure such complex solutions as reduction of heat energy and electric energy consumption, as well as efficient energy supply to buildings are supported as well. The measures are planned to be implemented in 2010–2013, the total Climate Change Financial Instrument's (hereinafter – CCFI) financing is LVL 75.5 million.
- ***Introducing efficient lighting infrastructure in public territories of municipalities*** (responsible institution – MEPRD)  
The aim is to provide financial support to municipalities to introduce such lighting infrastructure that allows reducing the current electric energy consumption and thus also the GHG emissions. The measure is planned to be implemented in 2011–2012, the CCFI financing is LVL 2.8 million.
- ***Improving energy efficiency in heat energy production*** (responsible institution – ME)  
The aim is to reduce heat energy losses in transmission and distribution systems and to promote replacement of fossil fuel with renewable or other type of fuel, by carrying out reconstruction and construction of heating sources, transmission and distribution systems, developing high efficiency cogeneration plants, as well as defining energy efficiency requirements for centralized heat supply systems.  
  
The launched measure is planned to be implemented by 2013 and will allow reducing the average heat energy loss level in heat energy transmission and distribution networks to 14%.  
  
Total public financing is LVL 76.7 million, including the EU funds financing – LVL 76.7 million (2011–2013).
- ***Increasing energy efficiency in transport sector*** (responsible institutions – MT, MF)  
The aim is to improve transport system planning and ensure efficient use of the infrastructure, as well as to distribute information on efficient use of energy among traffic participants. The measure includes:
  - Applying differentiated tax rate to vehicles depending on the weight and age of the vehicle, volume and power of engine (introduced since 2011);
  - Systematic control of the technical condition of a vehicle, thus ensuring its conformity to environmental requirements and participation of energy-efficient vehicles in traffic;

- Improving single public transportation route network by revising parallel subsidizing of regional and intercity railroad and bus routes, and reorienting such bus routes for passenger transportation to railway stations by adjusting schedules accordingly, organizing harmonized transport schedules within the new administrative territories of municipalities, thus improving the public transportation route planning system.

In general, taking into account the survey carried out by the Institute of Physical Energetics, the measure allows saving energy by 0.017 Mtoe by 2016.

### 3.7. Renewable energy sources target

The share of energy produced from renewable energy sources (hereinafter – RES) in the total net final energy consumption in Latvia is one of the highest in the EU and it was 29.9% (EU – 10.3%) in 2008. The share of renewable energy (hereinafter – RE) in the total net final energy consumption in Latvia excluding large hydroelectric power stations was 24% in 2008.

Since 2007, a legislation base is developed in Latvia establishing preconditions for the use of the RES in both electric energy production and heat supply.

Table 9

	2008	2012	2014	2016	2020
Share of renewable energy (%)	29.9	34.1	34.8	35.9	40.0

The national target of Latvia is to raise the share of energy produced from the RES in the total net final energy consumption to 40% by 2020, but the share of renewable energy in transport sector should reach at least 10% of the net final energy consumption in transport.

According to measures covered by the current policy planning documents, in 2020 the hydro-energy will constitute 57%, electric energy produced from biomass – 24%, but wind power – 18% of the total electric energy produced from the RES.

The use of the RES for heating and cooling will ensure an increase from 1020 ktoe in 2010 to 1396 ktoe in 2020, i.e. by 37%. Increase of sun collector and heat pump's contribution to the use of the RES is expected.

The use of the RES in the transport sector is estimated to increase from 42 ktoe in 2010 to 83 ktoe in 2020. The majority of the RES consumption in the transport sector will be formed of biofuel use in motor transport, but electricity consumption in motor transport and railway will form the smallest part. Both the first generation biofuel and the second generation biofuel and biogas are expected to be used in the motor transport.

Table 10

Forecasted development trajectory regarding energy from the RES in heating and cooling, electricity and transport, % of the final consumption of energy in each sector

	2005	2010	2015	2020
Heating and cooling	42.7	45.3	48.6	53.4
Electricity	44.9	44.7	51.4	59.8
Transport	0.9	4.0	4.6	10.0

There are the following challenges for raising the share of energy produced from the RES in the overall final energy consumption:

- The existing legal framework does not fully ensure complete conformity of the RE to the EU requirements;

- The comparatively low competitiveness of the RE compared to the exported fossil energy.

Key policy directions and measures to increase the share of renewable energy:

- ***Adjusting the legal basis*** (responsible institution – ME)

The aim is to promote a broader use of the RES in energy production and consumption, including the transport sector, as well as the use of sustainable biofuel and bioliquid fuel:

- By liberalizing the electricity market;
- By developing sustainable supporting mechanism for renewable energy;
- By setting the criteria of sustainability for biofuel and bioliquid fuel.

The corresponding amendments to the legal acts should be made in 2011.

In order to promote the use of the RE, a draft law “*Renewable Energy Law*” has been developed envisaging replacement of the currently existing support mechanism. It is expected that the total price for energy producers will be determined by the market, thus allowing the use of those RE that are the most important from the national viewpoint.

In order to fulfil requirements of the Directive 2009/28/EC, the *Informative Report “Action of the Republic of Latvia within the field of renewable energy for implementation of the Directive 2009/28/EC of the European Parliament and of the Council of April 23, 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC by 2020”*, which includes planning of new legal regulation development in the field of renewable energy, has been developed and submitted to the EC.

- ***Ensuring availability of financial resources for the production of renewable energy*** (responsible institutions – ME, MEPRD, MA)

The aim is to promote broader use of local RE in energy production and consumption in Latvia, promote energy production in cogeneration thus diminishing dependence of Latvia on the import of primary energy resources:

- By increasing the efficiency of centralized heating systems (2009–2015);
- By developing cogeneration power plants using the RE (2009–2015);
- By supporting the RE projects using the CCFI. The projects are related to technology transfer from fossils to the RES, promoting the use of RES in plants outside the EU Emissions Trading System (hereinafter – ETS) and households sector (2010–2012);
- By supporting energy production from agricultural and forest biomass if the produced energy is planned to be used mainly outside the farm (2007–2013).

The total public financing is LVL 141.9 million, including the EU funds financing – LVL 93.5 million and CCFI financing – LVL 42.8 million (2011–2013).

- ***Promoting the use of biofuels in the transport sector*** (responsible institutions – ME, MEPRD, MA)

The aim is to promote sustainable production and consumption of biofuel in Latvia:

- By developing and implementing a single state policy regarding biofuel (draft law *Amendments to the Biofuel Law* and other laws and regulations, setting and implementing the criteria of sustainability for biofuels). Corresponding changes in the biofuel sector by amending laws and regulations shall be made in 2011;
- By setting the criteria of sustainability for biofuels, the competition of biofuel producers with other biofuel producers from the EU member states and achievement of the RE target by 2020 will be promoted;

- By changing the existing direct state supporting mechanism for biofuel producers by introducing financially eligible quotas;
- By supporting the use of RES and electricity in the transport sector by using the CCFI.

The total CCFI financing is LVL 3.5 million (2010–2012).

### 3.8. Greenhouse gas (GHG) emission reduction target

The GHG emission reduction target has been set taking into account the international commitments of Latvia:

- Fulfilment of requirements under the Kyoto Protocol of the United Nations Framework Convention on Climate Change: for 2008–2012 to reduce GHG emissions by 8% compared to 1990;
- Commitments under the climate and energy package: in sectors outside the ETS for 2013–2020 the increase in GHG emissions within non-ETS sectors in 2020 must not exceed +17% compared to 2005; sectors covered by the ETS do not have individual target at the state level, but have a common EU target -21% compared to 2005.

Latvia's target is to limit the total national GHG emissions so that in 2020 they would not exceed 12.19 Mt CO<sub>2</sub> equivalent. This target includes fulfilment of all the abovementioned international commitments. The target of GHG emissions excludes emissions and removals caused by the land use, land use changes and forestry.

Achievement trajectory of forecasted target envisages an upward tendency of the GHG emissions by 2015, but thereafter the overall country emissions will decrease as a result of the impact of measures implemented within the programming period 2013–2020. According to the trajectory, the intermediate target of emission limitation for 2015 is 12.4 Mt CO<sub>2</sub> equivalent.

Table 11

Greenhouse gas emissions target's achievement trajectory

	2008	2009	2010	2015	2020
GHG emissions, Mt CO <sub>2</sub> equivalent	11.9	11.9	12.0	12.4	12.2
GHG emissions in non-ETS sectors (% compared to 2005)	8.0	8.0	8.0	13.0	17.0

The structure of Latvia's emissions has several peculiarities that should be taken into consideration when planning further measures of emission limitation. The ETS as an emission reducing mechanism covers only 23% of the GHG emissions of Latvia, which is the second lowest share in the EU. It means that such non-ETS sectors as the small-size energy production, small industry, transport, agriculture, households, waste sector are of key importance in reduction of the overall emissions of Latvia. Moreover, the largest part (62%) of the emission structure of the abovementioned non-ETS sectors is comprised by sources in transport and agriculture that are hard to be influenced. Other non-ETS sectors, where emissions are usually decreased by measures for fuel changes, in Latvia already widely use environmentally friendly fuels – wood and natural gas.

To limit emissions in the sectors covered by the ETS, it is important to ensure that the operation of the system complies with the new conditions that will enter into force in 2013. It includes amendments to the laws and regulations regarding auctions of GHG emission allowances, as well as preparation of a list of installations and the number of allowances to be allocated for the period of 2013–2020. The functions to ensure the ETS operation are planned within the framework of the existing state budget. Emissions are mainly reduced at the ETS operator's own expenses. In addition, the ETS operators are granted support from the Cohesion fund for development of biomass cogeneration plants (see Chapter 3.7.).

The development of low-carbon capacity production and services is an important precondition for long-term competitiveness of Latvia. Firstly, complex solutions regarding reduction of GHG emissions (for example, reduction of energy consumption) allow reducing production costs. Secondly, the fossil energy component in the long-term costs is related to the risk of price uncertainty. Thirdly, the product export brand regarding the use of the green energy, as well as environmentally and climate friendly production creates further opportunities.

There are the following challenges for achievement of Latvia's target to limit the GHG emissions:

- The costs of emission reduction in Latvia are among the highest in the EU, therefore a considerable amount of financing will be needed to support the measures for emission reduction. At the same time, the financing available to the private sector has decreased substantially in comparison with the pre-crisis period;
- The society lacks information about the risks of climate change and possibilities to reduce GHG emissions;
- Insufficient development and demonstration of new low-carbon technologies.

#### Key policy directions and measures for achievement of the target to limit GHG emissions:

- ***Limitation of non-ETS sector emissions*** (responsible institutions – MEPRD, ME, MA, MT)

The aim is to reduce GHG emissions in the non-ETS sectors – small-size energy production, small industry, transport, agriculture, households and waste management. The planned measures:

- To foster the use of RES in production of heat and electricity (2010–2013) – see Chapter 3.7;
- To introduce a sustainable transport system – to foster development of the public transportation, use of RES and electricity in the transport sector (2010–2013) – see Chapters 3.6 and 3.7.;
- To increase the energy efficiency in the production and use of heat and electricity (2010–2013) – see Chapters 3.6 and 3.7.

- ***Research, innovations, public information*** (responsible institution – MEPRD)

The aim is to promote transfer of products and technologies reducing GHG emissions in Latvia, as well as to support measures in order to change public behaviour. The planned measures are as follows:

- Raising of public awareness regarding the importance and possibilities of GHG emission reduction (2010–2012);
- Development of technologies reducing GHG emissions, including implementation of pilot projects (2010–2012).

Total CCFI financing is LVL 5.1 million (2010–2012).