

Country Report

Latvia

The Unfinished Business of the Fifth Enlargement Countries

The views expressed in this report are those of the authors and do not necessarily reflect the views of the Open Society Institute – Sofia.

This publication is a product of the Open Society Institute – Sofia within the European Policies Initiative (EuPI) and the project “The Unfinished Business of the Fifth Enlargement Countries”.

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ISBN 978-954-9828-74-0

About this publication

This publication is a product of the Open Society Institute – Sofia within the European Policies Initiative (EuPI) and the project “The Unfinished Business of the Fifth Enlargement Countries”.

“The Unfinished Business of the Fifth Enlargement Countries” is a policy project of the Open Society Institute – Sofia within the European Policy Initiative (EuPI).

The EuPI aims at stimulating and assisting new Member States from CEE to develop capacity for constructive co-authorship of common European policies at both government and civil society levels (www.eupi.eu).

The project was implemented from May 2008 to April 2009. The main outcome of the project is a publication comprised of ten national reports and a comparative analysis. The national reports describe and analyse the post-accession state of affairs in the ten new member states (NMS) from CEE. They do not include data gathered after December 2008, and therefore do not reflect the latest impact of the global economic crisis. The comparative analysis may have references beyond this period.

The project’s research methodology was based on the initial hypothesis that although the new EU member states from CEE have formally complied with all EU membership criteria and thus completed the accession agenda, specific problems persist. These problems are, to a certain extent, common among them due to shared historical experiences and legacies. In view of their comparable level of integration in the EU, the new member states could look for common answers to their post-accession challenges and, in doing so, contribute to the competitive advantage of the EU as a whole.

The research hypothesis has been tested through inquiry and analysis conducted by national experts from each of the ten new member states from CEE: Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. These national experts adhered to the same methodology and were asked to describe and analyse the post-accession state of affairs in eleven policy areas. Through this process, the experts were able to identify existing and/or potential post-accession “problem areas” in their countries’ political development and governance, economic development, welfare system and social inclusion, health system, educational system, justice and home affairs, migration, research and innovation, agriculture and rural

development, regional development, level of EU funds absorption and their correlating impact.

The national experts were also asked to identify the existing membership leverage for post-accession problem-solving in each policy area and to provide a typology according to the following criteria: active and passive EU leverage,¹ hard and soft mechanisms for influence, and level of significance and effectiveness of their impact.²

On the basis of the national experts' ten country reports and the typology of the membership leverage represented by a table (Part C) in each report, a comparative analysis of the post-accession state of affairs was developed.

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¹ The *active* and *passive* leverage typology is defined and used by other authors mainly with regard to the EU's role for stimulating reforms in the candidate countries (Vachudova, M. A. (2002) *The Leverage of the European Union on Reform in Postcommunist Europe*, Paper presented at the Conference of Europeanists, The Council of European Studies, Chicago, 14-16 March, 2002) where the active EU leverage concerns the linking of the progress of accession with the adoption of EU norms while the passive one is the attraction of the EU as a gravity centre of prosperity and successful development. For the purpose of the present study the typology is used to assess the effectiveness of the membership leverage over the new member states from CEE.

² After the accession to the European Union the membership leverage over the member states is *active* with the exception of some policy areas, where the EU still exerts *passive* leverage because further integration depends on meeting certain post-membership conditionality (i.e. accession to the Schengen area; accession to the Euro area). Moreover in the policy areas where decisions are taken primarily on the EU level, the membership leverage is *hard* as breaching the rules is accompanied by sanctions and therefore it is *significant* in terms of influence on a national level and *effective* as it manages to ensure the necessary enforcement by national stakeholders. The opposite is evident with regard to the membership leverage in policy domains of national competence where the EU produces mainly recommendations which are not binding and therefore are not accompanied by sanctions (*soft leverage*) and most often neglected by national decision-makers, which makes them *non-significant* in terms of impact and therefore *non-effective* (e.g. the Open Method of Coordination in education and social inclusion).

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E

xecutive Summary

Since joining the European Union in 2004, Latvia has faced a number of political, institutional, regulatory and ideational challenges in the process of adjustment to full-fledged membership. Although the authors identify the importance of EU membership for the country's development and make an overall positive assessment of Latvia's achievements in coping with membership challenges in a transforming environment, the process of adaptation has been complex, with mixed results.

Firstly, Latvia has performed quite well in adopting new legislation and regulatory frameworks in such domains as migration, and justice and home affairs, which led to the country's joining the Schengen zone. The absorption of EU funds has been prioritised by the government, and some constraints and shortcomings notwithstanding, has been generally efficient. Progress in areas, such as education, science, social security, health or regional reform, has been mixed – with adoption of new regulations and attraction of additional funding but with remaining pre-accession problems such as a confusing institutional framework and ever-present long-term shortage of financing. The economy has seen double-digit GDP growth, on the positive side, and double-digit inflation and a considerable current account deficit, on the negative side. The imbalances of overheated economic development have created an unfavourable environment and preconditions for the deepest economic recession among all EU member countries. Political developments receive the authors' negative evaluation, as public disappointment with the political elite's non-transparent practices, lack of accountability, reluctance to combat corruption and conspicuous disregard for public opinion led to the so-called "umbrella revolution" in 2007, subsequent change of government and ever lower confidence ratings.

Secondly, Latvia has performed quite well in adopting the formal institutional, legislative, regulatory requirements of membership. On the other hand, this has contributed considerably to an expansion of the bureaucratic apparatus and has confused the pre-accession institutional framework even further in most domains. Hence, a certain kind of re-assessment and revision of the whole newly transformed institutional

framework is required. Moreover, Europeanisation has been mixed on political and ideational aspects. Latvia has paid "lip service" to and implemented the relevant legislation, but political and business culture and practices in the country remain rooted in the Soviet and post-Soviet approaches. Thus, although in general the "membership business" has led to positive changes and developments in Latvia, so far it clearly remains "unfinished".

A **Analysis of the Post-Accession State of Affairs in Selected Policy Areas**

Subsection B.1:
Political Development and Governance

Subsection B.2:
Economic Development

Subsection B.3:
Welfare System and Social Inclusion

Subsection B.4:
Health System

Subsection B.5:
Educational System

Subsection B.6:
Justice and Home Affairs

Subsection B.7:
Migration

Subsection B.8:
Research and Innovation

Subsection B.9:
Agriculture and Rural Development

Subsection B.10:
Regional Development

Subsection B.11:
Level of Absorption of EU Funds and Their Impact

Political Development and Governance

Summary

After joining the European Union, Latvia has experienced important political developments with clearly long-term implications. In general, post-accession Latvian politics may be divided into two major periods: 2004-2006 and 2007-2008. The formative events in terms of reassessing political culture, political practices, formation of political elites and their responsibility in society took place during the latter period and will continue, especially in the context of forthcoming EP (2009), municipal (2009) and parliamentary (2010) elections.

Mistrust in the ruling political elite led to political turmoil and eventual resignation of the government in the autumn of 2007. Although the appointment of a nation-wide respected PM has alleviated immediate tensions, the government has yet to prove its determination and capacity to increase transparency and accountability and fight corruption.

Issue: Recent political developments and dynamics of party development

In the aftermath of EU accession in 2004-2006 Latvia held EP (2004), municipal (2005) and parliamentary elections (2006). The elections generally represented and confirmed a continuous presence and influence of political parties largely dominant in the pre-accession period: the conservative People's Party (Tautas partija), the Union of Greens and Farmers (ZZS), the conservative-liberal First Party/Latvia's Way (Pirmā partija/Latvijas Ceļš), the moderate nationalist party TB/LNNK and the centrist-liberal New Era (Jaunais Laiks). Harmony Centre (Saskaņas Centrs) and PCTVL, both of which obtained together around a quarter of the parliamentary seats, are associated with primarily representing the interests of the Russian-speaking minority in Latvia and so far have not been invited to join any

ruling coalition. Since Latvia regained independence in 1991, the Social Democrats have remained mostly, with periodical exceptions (such as 1998-2002), a rather marginal political force and after accession to the EU they have gained only some seats in local bodies, though importantly – also in the capital city of Riga, where they participate in the governing coalition. Since EU accession, the governmental coalition has experienced only minor

modifications and has consisted of the People's Party, Union of Greens and Farmers, First Party/Latvia's Way, TB/LNNK and, initially (2004-2006), New Era.

Recent political developments have revealed the weaknesses of the current party system and have created preconditions for reshaping the political environment and emergence of new parties. The major weakness of the current party system derives from the lack of clear and competitive ideological and organisational platforms. Apart from the somewhat populist, superficial and misleading division into "Latvian" and "Russian" parties, otherwise most of Latvia's political parties are basically seen as creations and representations of particular political or business figures. Parties only partly attempt to follow some fundamental programmatic guidelines and their pre-election pledges, and are frequently perceived as "voting machines of oligarchs". In recent years, this has created a deep societal mistrust in parties, in particular, and the parliamentary multiparty system, in general. Indicatively, the People's Party, which won the 2006 parliamentary elections with almost 20% of the vote, had less than 3% support rating in October 2008. The existing vacuum of confidence has created a stimulus for the emergence of new parties. The names of the two recently emerged and potentially important political forces are indicative: Civic Coalition (Pilsoniskā Savienība) and Society for Other Politics (Sabiedrība Citai Politikai). Although these political parties claim to represent an absolutely transformed political culture and policy practices with a clear set of fundamental values and orientations, their leadership consists mostly of former politicians (including a number of former government ministers) from the traditional parties. The scope, character and prospective directions of the reshaping of Latvia's political environment as well as particular parties will be largely demonstrated and influenced by political competition in the context of the forthcoming EP (2009), municipal (2009) and parliamentary (2010) elections.

Issue: Major veto players and their relations

Latvia is a parliamentary republic with a multiparty system. The parliament, Saeima, enacts laws, elects the President and approves the Prime Minister. Parliament, however, has been recently criticised strongly for being just an instrumental extension of the ruling coalition and particular political and business heavyweights or popularly dubbed "oligarchs", such as Andris Skele (former PM and founder of the People's Party), Ainars Slesers (successful businessman and founder of the First Party, and currently minister of transportation) and Aivars Lembergs (long-standing mayor of the transit hub Ventspils city and sponsor of the Union of Greens and Farmers, who has been under investigation on corruption charges). As a result, parliamentary ratings have been exceptionally low and a referendum was held in the summer of 2008 to extend the right of the nation to dissolve parliament. Although it failed to reach the necessary turnout for the prospective constitutional amendments (instead of the

necessary 50%, or around 750 000, of all eligible voters, around 40%, or 600 000, voted in favour of the proposed amendments), the referendum was indicative of omnipresent mistrust towards the current parliament and ruling coalition.

The Prime Minister is the head of government, which exercises executive power. In the autumn of 2007 Prime Minister Aigars Kalvitis (People's Party) was forced to resign under immense pressure from society. The prime ministerial post was taken by well-respected "crisis manager" Ivars Godmanis (First Party/Latvia's Way), who was the first prime minister of independent Latvia (1990-1993). Although he has clearly succeeded in alleviating some previously existing tensions between the political elite and society by more actively engaging in public discussions, dialogue and compromise-seeking efforts, his political independence has been questioned and his activities to address transparency, accountability and economic sustainability issues increasingly criticised.

The President formally holds mostly a representative function. However, the President's role in political life must not be underestimated. The President is head of state and represents the country internationally. The President nominates the PM candidate. The President has legislative initiative and may effectively influence, if not directly veto, parliamentary decisions. The President has a formal right to dismiss parliament (though never attempted, not least due to the difficulty of carrying it through a referendum). The President may endeavour and achieve the status of nation-wide moral and political leader and arbitrator. This was effectively achieved by the former Latvian president Vaira Vike-Freiberga (1999-2007), whose ratings remained considerably higher than those of any other political figure in Latvia. Although she consolidated her status and popularity mostly through international activities, (especially in the context of NATO and EU integration), she did not shy away from demonstrating her independent position on domestic developments. The presidential institution effectively checked and balanced the legislative and executive branches. The election of the new President, Valdis Zatlers, a politically inexperienced medical doctor, in June 2007 created suspicions of a deliberate attempt to reduce the role of the presidential institution and contributed to increasing mistrust in the Latvian parliament and ruling coalition. The first year of Zatlers' presidency may be characterised by endeavour to identify the major presidential priorities and attempts to demonstrate political independence.

Issue: Stability of government and capacity to reform

As noted, in 2007-2008 Latvia experienced events which called into question not only the stability of the governmental coalition but the stability of the whole political system. This political instability and tension was basically caused by society's disapproval and distrust of the coalition's behaviour in various domains. Among them were the following:

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endium the coalition's parliamentary majority retracted its own previously enacted legislation).

Secondly, in May/June 2007 a new President was elected; despite previous promises to advance a politically known person, the coalition got parliamentary backing for an absolutely inexperienced and generally rather unpopular presidential candidate, Valdis Zatlers. Since then the President has only started to consolidate his positions; however, he is not rarely perceived as the coalition's puppet and as being far from the level of authority, influence and popularity of the previous President Vaira Vike-Freiberga.

Thirdly, continuous attempts to replace the chair of the Anti-Corruption Bureau, who was critical of and active in fighting high-level corruption (eventually, the coalition succeeded in replacing him on the excuse of inefficient management).

Public disappointment with the political elite's alleged insider deals, practised non-transparency, reluctance to combat corruption and conspicuous disregard for public opinion led to the so-called "umbrella revolution" in October and November 2007, and eventual change of government and ever lower confidence ratings. In 2008, the situation was also aggravated by increasing economic difficulties, which led to several referendums and strikes. Several new parties were established and included some politicians and MPs of the ruling coalition parties. Although the coalition has not changed since 2005, in the context of high unpopularity the forthcoming elections will clearly contribute to a transformation of the composition and substance of the political party system.

Issue: Relative influence of populism and nationalism

Populism and, especially, nationalism have been continuous trends in Latvia's political and public life. After the restoration of Latvia's independence, Russia, and to a large extent, the Russian-speaking population in Latvia, became the "constituting other" in Latvia's identity formation process. Russians in Latvia, not rarely identified as Russia's "fifth column", became a significant element in official discourse formation. This representation justified an initially exclusive definition and legislation of citizenship. However, it must be noted that the Latvian case has not been exceptional with regard to the elite's temptation to use foreign policy as

well as minority issues for shaping the identity of the nation and mobilising it for reforms and nation-building tasks. The Latvian national elite formed their own legitimacy by addressing existing insecurity perceptions and simultaneously explicitly and implicitly cultivated such perceptions.

The success of the dominant identity-building paradigm, a consensus on domestic and foreign policy issues, and more importantly, requirements for integration into the Transatlantic and European structures contributed considerably to a transforming legislative and perceptual framework regarding the issues of nation and nationalism. Since the end of the 1990s, the Latvian leadership have begun actively to promote the integration of society by enacting amendments to the citizenship legislation and elaborating the national integration programmes. The adoption of a more inclusive citizenship policy was facilitated by a growing understanding of the need to integrate society, increasing attention to economic and social welfare, aspirations towards EU and NATO membership and the increasing imperative to normalise political relations and take advantage of economic interaction with Russia. This has also continued after Latvia became a full-fledged member of the Euro-Atlantic community. However, at the same time, a certain political and perceptual entrapment in the previously formed policies exists regarding relations with Russia and the status of the Russian-speaking community and non-citizens (around 20% of Latvia's population). Hence, the issue of nationalism, integration of society and avoiding formation of a two-community state will remain on the political and public agenda for years to come.

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Issue: Major issues of public opinion, including corruption perceptions

Corruption has been one of the major issues of public opinion. The public perceptions of rather widespread corruption among the political and business elite and reluctance of the ruling coalition to fight actively corruption have had direct implications for the country's political stability and increasing distrust about political deals. According to the Transparency International Corruption Perception Index, Latvia was ranked 50th in the world in 2008. In the European Union Latvia occupied 20th place together with Slovakia and ahead of Italy, Greece, Lithuania, Poland, Romania and Bulgaria. Latvia has experienced certain progress after EU accession in terms of CPI Score, which relates to perceptions of the degree of corruption as seen by business people and country analysts and ranges between 10 (highly clean) and 0 (highly corrupt). Some progress notwithstanding, expectations for increased political will and determination to fight corruption have not been met.

Issue: Euro-scepticism

In the context of dynamic domestic political developments and a number of important problems addressed by society, Euro-scepticism has largely become a secondary issue.

The numbers of Euro-optimists and Euro-sceptics, with minor and temporary alterations, reveal that the pre-accession trend of their being almost equal has continued. This was demonstrated by a public survey in October 2008. Around 25% (29% in September 2008) of the surveyed assessed positively Latvia's membership of the EU. Twenty-three percent (20% in September 2008) were negative on Latvian membership, while 47% (previously 46%) answered that EU membership was neither negative nor positive. The negative opinions came mostly from people above 55 years of age, non-Latvians, unemployed and low-income employees. The EU has been perceived as a threat to Latvian agriculture and industry as well as blamed for an increased inflation and unemployment.

Issue: Participation at EU level

There is an understanding that the scope of representation and influence of such a small country as Latvia in the EU decision-making structures is somewhat limited. At the same time, there is growing public and political interest in the activities of the European Commission and European Parliament. Andris Piebalgs holds the important post of Energy Commissioner. Energy security has become a "flagship issue" for both the Barroso Commission and Latvia's ruling coalition since EU accession. Andris Piebalgs has been frequently consulted and addressed and his opinions have considerable influence on Latvian public discourse on energy security as well as relations with Russia. Indicatively, Andris Piebalgs was voted "European Person of the Year 2007" in Latvia.

Considerable interest and attention has been attracted by the activities of the European Parliament and Latvian MEPs. Firstly, in the context of a dynamic international environment and more active Russian role, Latvian society is interested in the European position on such issues as interpretation of history, minority treatment, and the Russian-Georgian conflict. This position has been perceived as most resolutely and vocally expressed in various ways in the European Parliament, including by Latvian MEPs. Secondly, Latvian MEPs have been active in the context of Latvian domestic politics and transforming the political party system. Out of nine Latvian MEPs, some have obtained party chairperson positions (Zile in TB/LNNK), others have engaged in establishing new parties (Kristovskis, Krasts, Vaidere), while still others have participated actively in domestic public debate on the economy (Dombrovskis) and integration of society (Zdanoka).

Conclusion

In politics, Latvia has faced the challenges of the state- and nation-building and maintaining process, and of dealing with communist and post-communist legacies. In general, Latvia has proved to be quite successful, if compared to the other former Soviet republics, and Euro-Atlantic full-fledged membership has been indicative in this respect. However, the political culture, practices and governance structures, which were formed in the early post-communist period, have remained ubiquitous after accession to the European Union. And EU membership has effectively exposed the need for more transparent and responsible politics and efficient and accountable institutional governance structures. As a result, the post-communist political culture and practices effectively collide with the transformed post-EU accession realities and societal expectations.

Economic Development

Summary

The fastest economic growth in the European Union was observed in Latvia for several years. Nevertheless, since the middle of 2007 there is no room for much optimism as growth rates have started to fall dramatically. The decrease in growth rates was determined both by the internal and external processes. One of the main economic development risks in Latvia is the high inflation rate and the high current account deficit caused by high domestic demand. Still, general government debt in Latvia is among the lowest in the EU, and its level in the medium term is expected to remain considerably lower than the Maastricht criteria.

Issue: GDP per capita

In the period from 2005 to 2007, GDP grew on average by 11%. This significant GDP growth has indisputably contributed to the reduction of the economic gap between Latvia and the old EU member states. Notwithstanding the considerable rise in prices, the income of the population has also risen substantially. In the first quarter of 2008, GDP grew by only 3.3%. The decrease in the growth rate was determined both by internal (weakening of domestic demand incentives), and external processes (decrease in the global growth rates). Taking into account the current economic development tendencies in both the world and in Latvia, the government has set the main tasks – to

prevent rapid decline in growth and ensure conditions for sustainable growth.

The increase in GDP in Latvia was mainly fostered by productivity growth and, to a smaller extent, by increase in employment. The growth of productivity over the last two years has decreased a little in comparison with the preceding years (2004-2005) and was 6.9% in 2006 and 5.8% in 2007. Productivity has increased faster in agriculture and the fishing industry, the electricity, gas and water supply sector, as well as in the trade and commercial services sectors. Productivity in manufacturing and construction has increased poorly, where GDP growth was fostered mainly by an increase in employment over the last two years. It should also be noted that the productivity level of these sectors is still lagging behind the indicators of several service sectors. For example, the productivity level in financial services is 2.7 times higher than in manufacturing. The main impulse to

the fast growth over the last periods was the substantial increase in domestic demand (which was maintained by great financial support), whereas in 2007 a gradual decline in domestic demand growth rates was observed. That is related to several factors, mainly to a more cautious attitude of banks towards mortgage lending affected by the global financial crisis, as well as the measures implemented by the government for restriction of lending.

In recent years, the significant growth of the economy was ensured mainly by the increase in domestic demand, which was directly influenced by the rapid development of several service sectors

Issue: Structure of the economy

From 2000 to 2004, the structure of the sectors in the Latvian economy changed in favour of the service sectors. Their proportion in the added value increased to 74.7% in 2007, up from 71.8% in 2000. However, the structure of the economy according to employment significantly differs from that of the sectoral added value due to explicitly different productivity levels in various sectors of the economy.

Issue: Economic growth, including sectors driving economic growth

In recent years, the significant growth of the economy was ensured mainly by the increase in domestic demand, which was directly influenced by the rapid development of several service sectors. The increase in industrial manufacturing volumes was mainly based on an increase in exports. After EU accession, around half of the increase was ensured by the growth of the trade sector (wholesale and retail) and other commercial services. Considerable input came from the construction and transport and communication sectors. The contribution of the manufacturing sector to economic growth has been considerably smaller. The rapid pace of development of the service sector and relatively slower growth of the exportable manufacturing sector has been one of the major reasons behind the imbalances in and disproportion of the Latvian economy. As a result, Latvia has experienced a high inflation and large current account deficit in the balance of payments.

Issue: Inflation rate

The level of inflation has been increasing globally, facilitated by a rapid growth of food and energy resource prices. In Latvia, inflation exceeded 6% annually by 2006. However, in 2007 inflation reached 10.1%. The level of inflation is determined by several, often mutually unrelated, factors. They are determined by changes of a structural nature in the context of EU member-

ship, an overall rise in energy resource prices, changes in administratively regulated prices, and most importantly – rapidly growing domestic demand. Nevertheless, starting from 2004, the growth of inflation has accelerated significantly, becoming one of the highest among EU member states. One can distinguish several reasons for the high inflation rate in 2007/2008:

- The secondary effect of the considerably high level of inflation (inflation momentum) in the preceding year, stimulated by high volumes of mortgage lending and significant increase in employment salaries;
- The leap in food prices, determined by the significant acceleration of the price growth pace in comparison with the changes in the three preceding years;
- The growth of administratively regulated prices. The prices for public utilities grew in 2007: water supply (+29.3% during last year) and sewerage (+28.9%), thermal energy (+27.4%) and rent (+21.5%);
- Growth of world oil prices, which significantly influenced the growth of fuel prices inside the country (+21.6%).

Issue: Employment and unemployment rates

Latvia's rapid economic development over the last four years has had a positive effect on the situation in the labour market – employment has increased, the unemployment rate has decreased and the number of economically active persons has increased. From 2005 to 2007, the number of employed persons increased on average by 2.9%, while the unemployment rate fell from 10.4% in 2004 to 6% in 2007. As a result, in 2007 the employment rate in Latvia reached 68.4%, which exceeds the EU-27 average by 2.9%. The majority of all unemployed persons are representatives of simple, low-skilled professions. The highest employment rate is among persons with tertiary education (87.1% of all persons with higher education were employed in 2007). The majority of the unemployed in 2007 were among persons in the 35-54 age group. The rate of registered unemployment in Latvia has gradually decreased in recent years: it was 8.5% at the end of 2004, 7.4% at the end of 2005, 6.5% at the end of 2006 and 4.9% at the end of 2007. The rapid decrease in unemployment since Latvia's accession to the EU is not only due to the increased employment rate. Since 2004, there has been a labour outflow to some of the old EU member states. Therefore, a labour shortage in several sectors of the Latvian labour market has developed. Changes have taken place only in the unemployment level – it increased from 5.3% in the fourth quarter of 2007 to 6.5% in the first quarter of 2008. Such a situation has come about because at the beginning of 2008 there was a substantial wage increase along with increase in cost of living.

Issue: Salaries

Unit labour costs (ULC) are one of the indicators which characterise both the state in general and competitiveness of certain sectors. The dynamics

of the ULC indicator signifies that Latvia's competitiveness position in the EU is decreasing. During the period from 2004 to 2007, real ULC in Latvia increased by 20.3% while real ULC in the EU decreased by 3.7%. Growth of real ULC occurs if labour costs increase faster than productivity. The pace of labour cost increase in Latvia was seven times higher than the average in EU member states. The dynamics of salaries and productivity signify an unevenness of the convergence process that can be partly explained by a very low salary level in comparison to the average indicators in the EU. In 2003, the salary level in Latvia was on average 17% of the EU level but in 2007 it reached 33%. The rapid increase in labour costs is a consequence of Latvian labour force emigration and capital inflow, which is the result of deeper integration into the EU and world markets. The unit labour cost dynamics vary among the different sectors. In all industries the pace of productivity increase is behind the pace of labour cost increase and the unit labour costs (both nominal and real) in 2007 exceeded the 2003 level. In general, it must be concluded that in the previous two years unit labour costs were impacted not only by the significant increase in salaries, but also by the decrease in the productivity growth pace.

Issue: State of the labour force

At the beginning of 2008, the Advisory Council of Labour Market Forecasting of the Ministry of Economics started its work, in which the representatives of concerned institutions and social partners are involved. The task of the Council is to ensure inter-institutional cooperation, assessing the prepared forecasts and searching for solutions in further action. The main factors influencing the situation in the labour market in the medium term period by 2013 are the following:

- Dynamics and character of the growth of the national economy, which will determine the increase and structure of the total labour market demand;
- Unfavourable demographic development as a result of which the working-age population is decreasing;
- Increase in the level of population involvement affected both by economic growth rates, and the national employment policy.

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

- Corrections in the educational system, especially at the level of secondary and secondary vocational education, as well as in training of unemployed people and job seekers;
- Implementation of the measures for increasing the level of economic activity of the population must be continued;
- Operative and regular assessment of the labour market situation must be carried out for establishment and timely prevention of topical labour market problems;

Since the restoration of Latvia's independence, foreign direct investment (FDI) has had substantial importance in the growth of the Latvian economy

- Measures for fostering re-emigration of Latvian population must be implemented.

Issue: FDI flows

Since the restoration of Latvia's independence, foreign direct investment (FDI) has had substantial importance in the growth of the Latvian economy.

According to data for 2006, the range of goods and services produced by companies with participation of foreign capital amounted to 54.5% of GDP, and formed 55.4% of the Latvian exports volume, as well as accounted for 12.5% of the number of employed persons. Hence, successful attraction of foreign direct investment has a direct positive impact on Latvia's macroeconomic stability and competitiveness. After Latvia's accession to the EU, the intensity of foreign direct investment increased. Over the last four years (2004-2007), investments of foreign entrepreneurs into the Latvian economy in the form of direct investment exceeded the 2000-2003 level by almost three times. According to the balance of Latvian international investment, the FDI stock in the Latvian economy amounted to almost 38% of GDP at the end of 2007. The structure of the FDI stock origin in Latvia has not changed substantially since 2004: it is mostly investment from EU member states. The biggest volumes of foreign investment are still attracted by two sectors – financial mediation and real estate transactions. In 2007, FDI in these sectors constituted almost 70% of the FDI received within a year.

Latvian entrepreneurs have also begun to actively invest abroad. At the end of the first quarter of 2008, FDI stock of Latvia abroad reached LVL 432.4 million, increasing by 74% in comparison with the same period of the preceding year. Almost half of all Latvian investments are made in Switzerland (mostly in the trade sector) and Lithuania (trade and financial intermediation). Recently, Latvian entrepreneurs have become more active also in Russia. Latvian investments in the Russian economy amounted to 10% of the Latvian FDI at the end of the first quarter of 2008.

Issue: Public finances – budget surplus/deficit and public spending/distribution of wealth; government debt

The decline in domestic demand, starting from the third quarter of 2007, has decreased the external imbalance. The current account deficit is shrinking – in the first quarter of 2008 it was 19.3% of GDP (down from 26.6% in the same period of the previous year). In the short term, the current account deficit will continue to go down, as domestic demand will decrease. It is positive that the growth rate of exports has not fallen at the

same time. Exports of Latvian goods and services show good growth rates, despite the fact that the growth rates of the economy are slowing. The total amount of exports of goods and services in the first quarter of 2008 was 6.5% higher than in the first quarter of 2007.

In order to achieve balanced development of the national economy, the government has committed to ensure a budget surplus in 2008, as well as in 2009 and 2010. The envisaged weak economic growth may hamper fulfilment of the government goal – to ensure a budget surplus in 2008. This may be hampered for instance by the currently observable tendencies (declining levels) in tax collection, particularly in relation to the value added tax.

The central government debt accounts for a modest 9.2% of GDP. Although the trend has been downwards in recent years (CGD was 14.9% in 2004, 12.4% in 2005, 10.7% in 2006, and 9.7% in 2007), economic difficulties and financial demands will likely precondition additional borrowing and contribute to accumulation of debt.

Issue: Regulatory business environment and rating of the country in terms of business environment, economic freedom, competitiveness

The business environment in Latvia is being consistently improved through development of the relevant legal framework, harmonisation with EU requirements and monitoring of the effects of administrative procedures on business activities. Considerable reforms and improvements have been achieved in registration of enterprises, taxation policy, customs legislation, procedures, border crossing, construction, real estate and other areas.

Latvia holds a comparatively high, 22nd, place in the world among 178 countries, according to the World Bank report *Doing Business 2008: How to Reform* published in 2007. The business environment is evaluated in ten aspects, and Latvia is ranked as follows: 3rd in enforcing contracts; 13th in loan availability; 19th in trading across borders; 20th in paying taxes; 30th in starting a business; 51st in protecting investors; 64th in closing a business; 82nd in dealing with licenses; 85th in registering a property; 96th in employing workers.

Issue: Adoption of the Euro and issues of economic convergence with the EU

In order to ensure the technical and legal base for introduction of the Euro at national level, an appropriate organisational structure of the Euro introduction project was established in summer 2005 and the Cabinet of Ministers approved *Latvia's National Euro Changeover Plan* in 2006, which prescribes implementing several measures to adjust the normative base and ensure technical operation of the money and payment system, financial system, public debt management, budgetary accounting and

According to Ministry of Finance information, introduction of the Euro in Latvia is possible in 2011-2013

statistics, business environment and consumer protection, taxes and social security, as well as informing society. An *Action Plan for Introduction of the Single European Currency in Latvia* was also approved, setting out general and practical measures for changeover

to the Euro, the responsible institutions and terms for implementation of the defined activities. The timetable for introduction of the Euro, approved by the Cabinet of Ministers, envisaged that Latvia would join the EMU on 1 January 2008. Taking into account that the set target has become unachievable due to high inflation, the Latvian government reviewed the previous plans in September 2007 and decided to announce the target date for introduction of the Euro not later than 24 months before the expected introduction of the Euro – when the three-year forecasts included in the *Convergence Programme of Latvia* will approach fulfilment of the Maastricht criteria. According to Ministry of Finance information, introduction of the Euro in Latvia is possible in 2011-2013.

It should be noted that introduction of the Euro in Latvia will be an issue of EU multilateral relations, affecting the common interests of all EU member states. Therefore the timetable for introduction of the Euro, approved by the Cabinet of Ministers, will get official status only after completion of all negotiations and other formal procedures. As soon as the European Council passes the decision on Latvia's readiness to participate in the EMU, the national currency of Latvia will be replaced with the Euro and the Bank of Latvia will terminate implementation of an independent monetary policy. Until then the Latvian Lats (LVL) will remain the national currency of Latvia.

Issue: Export, import and competitiveness

At the beginning of 2008 (January-May), exports of commodities considerably exceeded those in the same period of the preceding year (by 18.3% in current prices). In January-May 2008, the growth of imports was considerably more moderate than that of exports (by 2.8%). In 2007, commodity exports were influenced favourably by the changes in trade conditions, and the export unit value index increased by 13%, but the import unit value index – by 5.7%. The growth of export unit value was affected most substantially by the rise in export prices in the groups of wood processing and metal processing goods. Commodity exports in 2007 went up in almost all groups of goods, especially agricultural and food products. The growth of exports of metalworking and machinery products in January-May 2008 ensured more than two fifths of the total growth; the growth of agricultural and food products accounted for 15% of the total growth. Similarly to total Latvian exports, exports to the EU-27 increased in almost all groups of commodities. An increase in commodity imports in 2007 was observed in all groups of commodities, the biggest increase being

in the groups of machinery (25.8% of the total increase in imports) and transport vehicles. Accession to the EU has considerably facilitated regional trade interaction. Since EU accession, Latvia's foreign trade with Lithuania and Estonia has continued growing rapidly and already constitutes more than 30% of the country's total trade with EU member states.

Conclusion

The main problem of the current economic situation in connection with the EU is that the EU recommendations are post-factum and *soft*, and do not even provide for regular reviews. The national Lisbon programme that is formed to fulfil targets of the Lisbon Strategy is a result of the direct initiative of the EU aimed at stabilising fiscal policy on the basis of balance between expenditure and revenue. However, one of the major obstacles is that in implementing its national Lisbon programme, Latvia is integrated into the dynamic market of Europe, but governmental decisions are predominantly based on analysis of national dynamics. The Lisbon Strategy targets are indicative, without clear-cut definition of sanctions in case of a country's failure to reach them. It is absolutely necessary to elaborate and implement an EU common policy on economic crisis management – both at the national level and at the level of a common action plan for all-Europe crisis management.

Welfare System and Social Inclusion

Summary

The welfare and social inclusion system in Latvia strongly depends on the current economic situation. There are indicative targets and benchmarks on the EU level within the Lisbon Strategy. However, without a solid economic basis those targets will be unachievable. Deficit of labour because of workforce emigration has been replaced by unemployment threats in the conditions of economic crisis. The current crisis also has an impact on the social security system – the deficit of positive expectations in the economy and bank system prevents the accumulation of the planned amount of finances.

The discussions about using the pension funds for economic stabilisation demonstrate the instability of the system. Social service quality is not high because of the low competitiveness of the sector.

Moreover, the poverty question is becoming more and more relevant, especially given the threats of potential unemployment and continuing inflation.

Issue: Employment

The employment rate of the population is gradually growing year by year and in 2006, for people aged 15 to 64, it was 66.3% (up from 63.3% in 2005). The employment rate for women in Latvia is higher than in the European Union; furthermore, the difference has a tendency to increase – in 2006, the employment rate for women was 5.2 percentage points higher than the EU average, reaching 62.4%. In 2006, the employment rate for men reached 70.4%, lagging behind the EU average by 1.2 percentage points. As with the indicators of economic activity, there still remain significant regional differences with regard to employment rates. Thus in 2006, for example, the employment rate for inhabitants aged 15 to 64 in the Riga region was 72%, but in the Vidzeme region it was 63% and in the Latgale region 56.8%. Lifelong learning has an ever increasing role in ensuring competitiveness in the labour market, but according to Eurostat data, in 2006 only 6.9% of the population aged 24 to 64

participated in courses, seminars or training (the average indicator for the EU-27 is 9.6%). In 2005, this indicator was 7.9%, which shows that investments are necessary in order to update and develop the lifelong learning system. In 2006, 23.3% of the employed persons aged 15 to 64 had higher

The number of unemployed young people out of the total number of unemployed is still high

education, 37.3% had vocational education or secondary vocational education, 25.9% general secondary education, and 13.5% elementary education or no education at all. In 2006, the distinct labour market segregation into "male" and "female" professions was preserved. Thus, for instance, in 2006, 13.6% of women but only 2.8% of men were employed in the sphere of education. At the same time, 17.5% of men but only 1.1% of women were employed in building. According to Eurostat data, the unemployment rate (job seekers vs. total economically active residents) decreased almost twice from 2002 to 2006 – from 12.2% in 2002 to 6.8% in 2006, which is 1.1% lower than the European Union average unemployment rate. Viewing the unemployment data broken down by gender, we see that the unemployment rate for men is higher than that for women. In 2006, the unemployment rate for men in Latvia was 7.6% (1.5 percentage points lower than in 2005), but for women – 6.1% (by 2.6 percentage points lower than in 2005). There are several problems that characterise Latvia's welfare system in connection with employment:

- The number of unemployed young people out of the total number of unemployed is still high;
- The number of unemployed persons of pre-retirement age is increasing due to the rise in the retirement age;
- There are substantial regional differences in unemployment rates;
- Migration of the population in search of work to several EU member states has increased;
- Latvia is short of available workforce in many enterprises (especially in small and medium-size enterprises);
- The requirements of the regulatory enactments defining legal labour relations are breached; both employers and, in particular, employees are not sufficiently informed about the issues of legal labour relations;
- Lack of capacity on the part of the State Labour Inspection to ensure effective state control and monitoring mechanisms in the area of labour rights, labour protection, labour remuneration, or to limit illegal and undeclared employment;
- The rise in the minimum monthly wage lags behind the rate defined in the State Conception, and this may result in inability to reach the aim set for 2010 – to have the minimum monthly wage at 50% of employees' monthly average gross wage for the preceding year; illegal wage payments, or the so-called "envelope payments", are still practiced, having a negative impact on the state budget and reducing the social guarantees of the population;
- The requirements for labour protection are not properly observed at enterprises;
- Lack of systematic scientific research information and support to the institutions which plan labour protection policy and perform its monitoring.

Issue: Pensions and social security system

In Latvia, the administration of pensions and benefits is performed by the State Social Insurance Agency but the administration of health care services is performed by the Health Compulsory Insurance State Agency. On the national level it is possible to distinguish several problems that are not directly addressed by a solution from the EU side. Low birth rates and the growth of average life expectancy are conducive to ageing of Latvian society, which may cause ever increasing budget deficits in the state social insurance system in the future. The amount of pensions dependent on social insurance contributions is often very low. Persons who have worked in unhealthy and heavy working conditions are dissatisfied with the fact that additional payment is granted only to those persons whose insurance record is not shorter than 30 years. Persons who have requested early old-age pensions but have continued to work and have not received them, demand, upon reaching the statutory retirement age, that the amount of their pensions be calculated according to the procedure of calculating the pension for the first time and not recalculated, taking into account the additionally accumulated pension capital. The new system of child care benefits does not correspond to the essence of state social benefits – to provide universal state support in the form of cash payments for persons in situations where additional expenditure is needed or where these persons are incapable of obtaining any income – and has a negative impact on the state social benefit system; the amount of family benefits is too little to provide substantial help to families with children older than two years of age and cannot cover their additional expenditure on child raising.

Issue: Social services

Less than half of all municipal social work specialists have the necessary education and a great number of social work specialists employed at social care institutions do not have adequate education, either. The workload, especially of those who are employed in cities, significantly exceeds the statutory workload. Municipal social work specialists are poorly equipped with information and communication technologies and with special software for collecting and storing data concerning their clients. The procedure of granting the guaranteed minimal income (GMI) benefit is not sufficiently linked with the social work services, and the low activity in concluding agreement contracts does not promote the integration of able-bodied social assistance recipients into the labour market. In 2006, the guaranteed minimal income level was only 53.3% of the income and material situation level below which a family or a single person is identified as poor. Furthermore, municipalities seldom use their rights, delegated to them by legislation, to set a higher GMI level. Demand for social rehabilitation services exceeds supply, therefore the waiting lists for such services are growing ever longer. The demand for care at long-term social care

institutions for adults with severe mental disorders significantly exceeds the capacity for accommodating them at such institutions.

Issue: Roma/other minorities' integration and citizenship issues

Today there are no serious issues of concern regarding the integration of the Roma. Roma have been present in Latvia since the sixteenth century. According to statistics provided by the Office of Citizenship and Migration Affairs, in 2006 there were 8 498 Roma living in Latvia (0.3% of the total population). Leaders of Roma NGOs and researchers, however, suggest that the total number of Roma in Latvia may be estimated to be between 15 000 and 18 000. The National Programme "Roma in Latvia" was drafted in accordance with Decree No. 43 of Prime Minister Aigars Kalvītis, issued on 1 February 2006, "On the Establishment of a Working-Group for Drafting the National Programme 'Roma in Latvia, 2007-2009'", by an inter-institutional working group. The working group comprised representatives of government institutions and Roma NGOs as well as human rights experts and ethno-psychologists. The Programme "Roma in Latvia" is a medium-term policy paper covering the three-year period from 2007 to 2009. The overall goal of the programme is to promote the inclusion of the Roma community in Latvian society and to ensure that Roma are not discriminated against and, instead, are granted equal education and employment opportunities and human liberties.

The Russian minority question is a politically sensitive issue in Latvia. Russian is the most widespread minority language in Latvia, and it is also the most widely used foreign language. For about 28% of the country's schoolchildren, at more than 270 state-supported schools, Russian is the language of instruction; such schools are found in practically all districts and cities of Latvia. In Latvia, around 50 local papers are published in Russian. Almost 200 books in Russian are published every year, with a total circulation of around 300 000. Several TV channels and radio stations also broadcast in Russian.

Although the Latvian authorities have generally followed the EU criteria and recommendations for language, education and citizenship legislation, the issue of integration of society, in general, and citizenship, in particular, remains. Latvian citizenship was granted automatically to most of the Russian-speaking population in the country (those who had any links to citizens of pre-war independent Latvia). A certain proportion (around 100 000) of the minority obtained citizenship through the naturalisation process. At the same time, a considerable proportion of the Russian-speaking minority in Latvia (around 400 000 or almost 20% of the total population) have remained without any citizenship. This considerable number of Russian-speaking minority members have not taken the opportunity to obtain citizenship through the naturalisation process arguably due to a multitude of reasons: resentment and disassociation from

the “nationalising” state, lack of Latvian language knowledge, financial and practical reasons (for instance, non-citizens are allowed to travel to Russia without a visa). This denotes that a large group of Latvia’s inhabitants are politically excluded from the decision-making process.

The Russian-speaking minority is a divided community in terms of legal status and consists of diverging orientations and attitudes towards Latvia’s statehood, in general, and governmental minority policies, in particular. Generally, the Russian-speaking community demonstrates both considerable support for its home country and is simultaneously largely influenced by its kin state’s, i.e. Russia’s media. There are virtually no assimilated (Latvianised) Russians in Latvia: all the Russians, including the younger generation, are fluent in spoken and written Russian, with the exception of some children in mixed families living in rural Kurzeme or Vidzeme.

There is no need, however, for a particular additional regulation at the EU level on the integration politics of Latvia. The effective contribution to integration of the Russian minority was a by-product of Latvia’s EU integration in some sense. EU citizenship has increased the motivation for non-citizens to become Latvian citizens. Remaining problems notwithstanding, the latest trends reveal that the Russian minority is showing increasing support for the state, which may be interpreted partly as the result of an effective integration process.

Issue: Housing and poverty

Within the period of rapid economic growth after EU accession until the economic crisis in 2007/2008, housing characteristics reached the highest level in 2006 and have since remained at the same level. According to data from the Household Budget Survey, in 2005 the 20% of the poorest households had only 10% of all household incomes at their disposal; compared to 2004, this figure had grown by 0.4%. At the same time, the 20% of the wealthiest households (18% of the population living in households) had 38% of all household incomes at their disposal. Considering also the figures for 2003 and 2004, one may conclude that the disproportion in the distribution of incomes in society is decreasing to some extent. Though every year the monthly disposable income per household member is growing, the at-risk-of-poverty rate has remained the same since 2000 (16%); according to the survey “Community Statistics on Income and Living Conditions” (EU-SILC), in 2005 it had even grown, reaching 19%. Analysing the data from the Household Budget Survey, one may conclude that the increase in the average household disposable income is based on the highest income levels.

Conclusion

The solutions to the above-mentioned problems are strongly connected with the targets of the Lisbon Strategy. The problem is that the Lisbon

Strategy goals are indicative – the implementation instruments depend on each member state's solution strategy. Although the problems are at a different stage of solution in the different member states, generally most of the countries have similar problems. In order to ensure long-term stability of the state social insurance system and compensate for the fluctuations of the demographic burden of pensioners on the working population, state social insurance special budget funds have to be gradually accumulated. The importance of the insurance record has to be stressed in calculating the pension for persons with an insurance record of 40 years or more. There is a need to raise the state social maintenance benefit for persons with disabilities from childhood. The amount of state family benefits has to be raised, taking into account the growth of GDP (family benefits and derogations from income tax for having children), to 1.5% of GDP, as provided for in the European Code of Social Security. Under the pressure of the current situation, all negative aspects have remained in place, while positive possibilities for progress are diminishing. The income increase in rural areas was caused by EU direct payments for agricultural land as well as by other subsidies, therefore the EU should continue existing policies on support of rural areas, as that also decreases poverty.

H Health System

Summary

At the present moment the health care system in Latvia is in a transition period. During Soviet times medical treatment was free of charge, but today many of the health care services are paid. This means that patients have to cover partial or even full costs of medical care.

The transition process is slow and ineffective: the state has used a considerable amount of finances for reorganisation of medical care, but systemic optimisation has not yet been accomplished. Moreover, Latvia spends the lowest percentage of its GDP on health care among the ten new EU member states.

State of Affairs in the Sector

Latvia's territory is divided into seven regions, with one State Compulsory Health Insurance Agency. Every inhabitant of Latvia has to choose a so-called family doctor – internist (therapeutics). Every internist is working under the State Compulsory Health Insurance Agency. Therefore every inhabitant of Latvia is under a State Compulsory Health Insurance Agency sub-fund. Through its eight regional branches, the State Compulsory Health Insurance Agency administers all state health care funding. The funds consist of three components: general income tax (28.4% of which is earmarked for health

care), subsidies from general state revenues, and patient contributions. At the beginning of every year, the state distributes between the sub-funds quotas corresponding to the number of population in each sub-fund. Further quotas are distributed between family doctors. The quotas comprise a certain number of free-of-charge manipulations (medical tests, operations, and visits to specialists). If the quotas are exhausted, patients must pay for further examinations or operations or wait in queue until the relevant doctor receives new quotas. Medical institutions later receive money according to their aggregate quotas. The existing system leads to queues of patients who have to wait for as long as a year to receive the necessary treatment. The Ministry of Health is currently developing two strategic documents, one for compulsory state health insurance and the other for a minimum basket of health care services to be provided by the state.

Issue: Financing

There are two different models of financing primary health care in Latvia – one for the capital Riga and another for rural areas. The main difference lies in the way of controlling finances. GPs are the main budget holders in rural areas, but in Riga it is the State Compulsory Health Insurance Agency that controls the financing schemes for GPs. Some years ago government municipalities covered 80% of all expenses but now this coverage is 75% and part of them, 25%, have to be covered by patients themselves. Compulsory insurance could be a partial solution to the current situation, but problems will undoubtedly remain.

Issue: Private health insurance funds

The health insurance market is growing from year to year. Health insurance is organised as follows: insurance companies have agreements with medical institutions. At the end of every month, medical institutions report to the insurance company about services received by insured people. Insured people can receive free medical care only in these special medical institutions or they can pay for services approved by their family doctor and then be reimbursed by the insurance company. At the moment, income replacement insurance, long-term care insurance or critical illness insurance do not exist or exist on a limited scale.

Issue: Quality of health services

Primary health care services are provided in a wide variety of institutional settings, some a legacy from the old system and others the result of efforts to restructure primary care. The health centres in the larger cities originated as polyclinics. They are owned by the municipalities and run by private entities. General practitioners (GPs) rent facilities and work independently. Even though the number of GPs has been constantly increasing since 1999, their number is still not sufficient in some parts of the country. There are also so-called “doctorates” – group or single (usually internist) practices. Providers are self-employed and contracted by the State Compulsory Health Insurance Agency. In 2002, GPs constituted 52% of all primary care physicians; the others are predominantly paediatricians and internists. The GP gate-keeping function was formulated at the end of 1999. Patients are free to choose their primary care physicians, but they need a referral in order to receive specialist or secondary care. Direct access, without a referral from a GP, is granted to gynaecologists, psychiatrists, specialists on sexually transmitted diseases or endocrinologists. A national public support fund supports primary care professionals in retraining and establishing practices. There are two types of public hospitals – state (accountable to the Ministry of Health) and municipal (with half of the country’s hospital beds).

Secondary and tertiary care in Latvia faces a key problem: hospitals (and even specialised facilities) take care of many patients whose needs are social rather than medical, because social care services are still not fully developed

Specialised hospitals are concentrated only in the capital and in the largest cities. Public hospitals are contracted by the regional branches of the State Compulsory Health Insurance Agency. Most hospitals are non-profit-making entities or joint-stock companies. Secondary and tertiary care in Latvia faces a key problem: hospitals (and even specialised facilities) take care of many patients whose needs are social rather than medical, because social care services are still not fully developed.

Issue: Hospital privatisation and reform of the health sector

The government has implemented the following steps in the context of the reform of the health sector:

- (a) a series of structural changes in the health care system;
- (b) officially identified the general-practitioner-based model of health care as a strategic priority in 1996;
- (c) centralised the resources for health system financing;
- (d) made clear the need for national coordination of public health services;
- (e) publicised and recognised the need to constantly improve the quality of the health care system;
- (f) began developing the institutional capacity of the Ministry of Health and the insurance institutions;
- (g) formulated equal access to health care and improved population coverage as key priorities;
- (h) started identifying health priorities that require state-led procurement (such as HIV/AIDS, substance abuse, mental health, tuberculosis, disaster response and emergency care).

At the same time, there are some serious problems which require prospective solution:

- (a) The health sector was under-funded for many years;
- (b) Health care costs and expenditure on pharmaceuticals have increased rapidly;
- (c) Lifestyle-related risk factors prevail. Health promotion and disease prevention can be more adequately funded;
- (d) The different levels of the health system should coordinate better;

(e) The health sector experiences some imbalance of human resources;

(f) Although the last two governments have firmly engaged in fundamental health reforms, the Ministry of Health is still in the process of further strengthening its role, to lead the sector regulation and policy development.

The private sector is rapidly increasing the range and number of services it provides, and in the last four years, the number of private doctors has tripled. However, at the moment only 6% of all the hospitals in Latvia are private. Although dentists are self-employed and work on a private basis, the State Compulsory Health Insurance Agency contracts them for the provision of dental service for children up to the age of 18. Pharmacies are entirely private.

The source of the problems in the dimension of privatisation, however, is a somewhat fragmentary and contradictory approach to the whole process of reforms. After 1997, rapid privatisation of ambulances was implemented. They were transformed into private practices, which led to a rapid price rise. The specifics of the system predefined the unsuccessful result of this reform – an obstacle to the effective functioning of private units is the lack of state support, insufficient finances for free medicine and services. Eighty percent of society have problems to buy needed medicine, so they avoid going to ambulances till the disease becomes acute.

Conclusion

Among the ten new EU member states, Latvia spends the lowest percentage of its GDP on health care. There is no direct leverage at the EU level in the area of the health system. There is a lack of EU regulation in the institutional part of the health system. As a result, there is a deficit of regulation in the sphere of health – local legislation faces the necessity of changes, but there are no clear-cut targets from the EU how those reforms should be realised. More influential in this sphere is the World Health Organisation – Latvia follows the recommendations of the WHO. The main problem is that the WHO focuses on particular problems of health of society, not on the institutional system that provides health services for society.

Health policy implementation should be directly connected with welfare policy (integrated guidelines) in order to guarantee a certain level of society's safety – social stability and common health guarantees. In Latvia, the reforms are leading to exclusion of the health system from the state-guaranteed welfare package. In an unstable economic system, however, this has mostly negative repercussions for the disadvantaged part of society, as it needs social security and access to health care the most.

Educational System

Summary

The education sector in Latvia has been undergoing continuous and long-term reform since the country regained independence. In this process, Latvian governments have faced and endeavoured to address a number of challenges: institutional restructuring and rationalisation, adjustment and improvement of study content and the respective requirements, optimisation of financial support and ensuring minority education. EU accession has provided Latvia's education sector with both new opportunities and challenges in the context of integration into transforming European common educational space. So far the results of coping with those challenges have remained mixed as long-term goals not infrequently collide with short-term institutional and financial constraints.

Issue: Reform of the education sector (all levels of education from primary to higher)

Latvia's educational sector has been determined and reformed by the Law on Education, Law on General Education, Law on Vocational Education, Law on Higher Educational Establishments, Law on Scientific Activities, Law on Sports, and Law on Official Language. Legislation on higher education is being drafted and debated recently, motivated largely by Latvia's becoming a full-fledged member of the EU. This demonstrates a continuous need for adjustment and optimisation of Latvia's education sector.

Since EU accession, a certain process of reconsideration of educational priorities has already taken place. Now, in terms of prioritised education content, less emphasis is put on humanities and social sciences

and more on engineering and natural sciences. This has been explained by Latvia's need to search and find its professional comparative advantages in a wider European employment market. Although the European dimension has been present in the Latvian higher educational system for some time already, since EU accession, the trend of Europeanisation has been strengthened significantly, especially at the higher education level. Euro-faculty exists as a long-term project. Following entry into the EU, university networks and common master degree programmes have been created. The Erasmus exchange programme has been expanding and involving more Latvian students and teachers.

Issue: External evaluation, inspection and quality of education

Several institutions exist to inspect and evaluate quality of education. The Centre for Educational Content and Examinations is responsible for introducing and ensuring standards for study content at primary and secondary education level. However, the primary responsibility for external evaluation of the quality of education has been given to the State Agency for Evaluation of Educational Quality, which was established in 2005. The agency evaluates adherence to the education standards, quality of teachers as well as the material basis (such as libraries, IT).

Issue: Teacher training and career

Teacher training has been regularly coordinated by and financed through the Ministry of Education. Teachers' training and quality improvement centres have been established and particular courses are conducted. Every year approximately 1 000 teachers participate in such courses. Since Latvia joined the EU, additional financing has also been attracted from the European Social Funds. For instance, the State Agency for Evaluation of Educational Quality coordinated a programme aimed to improve teachers' professional knowledge and skills and hence contribute to improvement of the general level of educational quality. The programme was scheduled for 2006-2008 and attracted LVL 800 000 (or around €1.1 million). Clearly, this and other European funding provides additional opportunities in terms of mobility, experience exchange and new methods of teaching, and contributes to improving the general level of teachers' training and educational quality. At the same time, it is still rather difficult to precisely measure the scope and character of the EU input.

Issue: Governance and school management

The Ministry of Education and Science is the central state administration authority in the field of education and science, as well as in the fields of sports and official language policy. The ministry is responsible for the development of draft legislative acts regulating the relevant fields and of draft policy planning documents, and for supervision of the implementation of the policy in the state administration institutions and agencies subordinated to the ministry, such as the Academic Programme Agency, Education Contents and Examination Centre, State Agency of General Education Quality Assessment, Administration of Vocational Education, State Inspection of Education.

The Ministry coordinates the education-related cooperation of state education institutions with foreign institutions, supervises state institution reorganisation and liquidation, accepts programmes and teachers' registers, recruits and dismisses the heads of educational institutions (apart

Latvia's educational system generally tends to represent a rather centralised approach

from higher education institutions), cooperates with respective municipalities to confirm the regulations of colleges, initiates dismissing of the heads of municipal education institutions, and in coordination with municipalities leads

the recruitment and dismissal of the heads of the municipal educational boards. The State Inspection of Education is the central agency which controls and ensures that each education institution complies fully with state-set norms and regulations. It analyses school management and may recommend dismissing school managers or teachers if normative acts have been violated. Although local municipalities possess certain leverage with regard to schools' financial and administrative management, Latvia's educational system generally tends to represent a rather centralised approach.

Issue: Financing of education

According to Latvian legislation, education in pre-school, primary and secondary education institutions, established either by the state or municipalities, is financed from state or municipal budgets. Simultaneously, private education institutions exist and decide themselves on the amount of the tuition fee.

A considerable challenge for the state is to optimise and restructure the financing of higher education. Generally, financing for higher education in Latvia constitutes 0.7% of GDP while in European countries the average equals around 1.5% of GDP. Most of the students pay for their studies – slightly over 20% of all students are state-financed, whereas almost 80% study for a fee. In 2006 there were approximately 130 000 students in Latvia. Out of them 70% were students at the 20 state higher education institutions and 30% at the 14 private higher education institutions in the country. Full-time students constituted 60%, and part-time students 40%. As mentioned above, slightly over 20% of all students are state-financed, whereas almost 80% study for a fee. This has created certain problems and questions on the relevance of justification regarding state-supported higher education institutions. The state provides financial support for a certain number of study programmes. However, state financing reveals frequent institutional confusion and the contradictory nature of this financing. Although general responsibility for coordination of state financial support is taken by the Ministry of Education, there are higher education institutions which fall under the responsibility of other ministries. For instance, Riga Stradins University (former Medical Academy) traditionally falls under the responsibility of and is financed through the Ministry of Health. Although it has become an officially recognised state university with a wide spectrum of medical and social science programmes, the previous channels of financing remain. As a result, the Ministry of Health insists that it cannot provide any financing for social sciences as it coordinates and finances only

medical studies, whereas the Ministry of Education insists that it cannot provide financing for social sciences as the above-mentioned university falls under the responsibility of the Ministry of Health.

Another important challenge faced by the state is to provide adequate financial support for minority education.

Minority education has been a challenging and politically sensitive issue for years. More than 70% of all schoolchildren (around 185 000 out of approximately 250 000 in 2007/2008) attend Latvian schools, while others attend minority (mostly Russian) schools. According to Latvian legislation, the state provides financial support for eight minority (Russian, Jewish, Belarusian, Ukrainian, Polish, Lithuanian, Estonian, Roma) schools at primary level of education. The minority schools may opt for a particular model of combined-language instruction, which includes both Latvian and a minority language. The initial legislative draft stipulated an absolute switch to Latvian-language instruction in non-Latvian schools. However, this caused considerable resistance from the Russian-speaking community in 2004 and a compromise was accepted, which specified 60% of Latvian language presence in minority schools at the secondary level. The language of instruction in state-supported higher education institutions is Latvian. Private higher education institutions may use a language of instruction other than Latvian. The rather strict regulations in state-supported and financed higher education institutions have actually created some minor challenges and questions regarding the use of foreign languages – for instance, in the context of the Erasmus teacher and student exchange programme.

Financing for higher education in Latvia constitutes 0.7% of GDP while in European countries the average equals around 1.5% of GDP

Issue: Student performance and outcomes

Student performance largely correlates with the scope of quality, efficiency and cohesion of the national education system. Although the existing institutional and financial constraints have some implications, students in Latvia generally follow the average patterns of the European Union in terms of reading literacy and proficiency in mathematics and science. For instance, Latvia ranks behind the Scandinavian countries but generally ahead of some Mediterranean countries, such as Italy, Greece or Portugal.

However, student comparative performance is declining somewhat at the higher education level. The proportion of university students among young people in post-secondary education is lower than the EU average. There is also a significant number of dropouts. The dropout rate of students has ranged from 20% to 30%, caused largely either by inability to meet academic standards or/and financial constraints and necessity to search for full- or part-time employment.

Conclusion

The success of the reform of the education sector has been mixed. This is due to structural legacies, limited scope of financing, and continuous and changing national and international challenges. Moreover, educational reform has become intermixed with principles and specifics of the nation-building process and macro-economic transition. Although the average and comparative quality of education has been generally adequate and reputable, room for further reform and improvement remains. Clearly, EU accession has provided Latvia's education sector with both new opportunities and challenges in the context of Europeanisation. The result of coping with those challenges has so far remained mixed, as long-term goals not infrequently collide with short-term institutional and financial constraints in the process of restructuring and Europeanisation of Latvia's educational sector. At the same time, there is a general consensus on the necessity to proceed with a closer institutional integration of Latvia's education system into the common European educational space and to apply the best standards and practices in education.

Although Latvia has declared adherence and made considerable steps towards implementation of the priorities of the Bologna and Copenhagen processes (three-cycle degree system, work on Bologna and Copenhagen relevant national legislation, thorough reassessment of quality assurance institutions), a number of improvements must be envisaged. As implementation of the Bologna process in Latvia is monitored and promoted by the Ministry of Education and Science and the Rectors' Council, a national working group for Bologna follow-up must be established. Latvia still must adjust and enact its legislative and administrative basis for further Europeanisation of the educational system. For instance, the concept of adult education and lifelong learning must be more actively institutionalised and realised. The results of analyses of labour market demands (for instance, the analysis funded by the European Social Fund in 2007) must be correlated with respective readjustment of vocational and university education, especially by promoting science, engineering, technology and medical studies and involving social and business partners.

J

ustice and Home Affairs

Summary

In general, Latvia has not had any crucial problems with the Justice and Home Affairs (JHA) sector reform and introducing the European Union (EU) norms and principles in the judicial, police or border control sphere.

The country has shown one of the fastest rates of adaptation to EU norms of its legal and domestic security system. The problems identified are related to the actual implementation of regulations. Yet Latvia's achievements in external border management and Schengen agreement implementation are remarkable: Latvia is the only EU-12 state to have introduced fully operational biometric passports as from September 2008.

Issue: Internal security situation and ordinary crime

The overall internal security situation in Latvia does not show any considerable problems or changes directly related to the country's accession to the European Union in May 2004. Some analysts and state institutions point to a recent rise in crime caused by economic and some structural societal problems in Latvia. At the same time, official data show that Latvia's crime rate is still six-seven times lower than, for instance, Finland's (with an average 54 000 registered offences in 2000-2006 among Latvia's population of 2.3 million, against 350 000 registered offences in the same period among Finland's population of

5.2 million). The existence of alternative elites at the time of transition, of independent media, previous experience in democracy and statehood, the absence of violent conflicts and EU conditionality, have all been factors that partly explain why the Baltic states are less affected by organised crime than other former Soviet republics.

Issue: Organised crime

Much of the improvement since the beginning of the 1990s has been directly related to the cooperation with Interpol structures and introduction of legal norms on organised crime, corruption, economic and various trafficking crimes during the accession negotiations with the EU. Nevertheless, Latvia still remains a desirable route for organised drug smugglers looking for ways to enter the Scandinavian market in particular.

The main administrative problems in the JHA area are related to human resources

The main problems in fighting organised crime are structural problems and issues caused by lack of qualified personnel in state security services and police. Though police have overall capacity to react to crimes, some of the relevant mechanisms are not fully

developed (e.g. supervision of pre-term released prisoners) and this partly contributes to a possible increase in criminality in Latvia.

Issue: General JHA sector reform

General JHA sector reform has been implemented according to the principles and requirements of the *acquis*. Remaining problems are basically related to implementation of the laws, regulations and norms in practice and are caused by several structural administrative and human resource aspects. First is the financial aspect that is related to the solution of present judicial problems in Latvia. Infrastructure issues, court, police, fire-station premises, technical equipment and other administrative resources especially in the regions outside Riga are factors obstructing the ability of the judiciary, police and firefighters to work effectively.

The main administrative problems in the JHA area are related to human resources. First, low wages both in the state interior and justice structures are frequently considered to be the main structural and administrative problem of Latvia's JHA sector reform after EU accession. For instance, the gross monthly wage of police officers is around €580 and of assistants to judges around €650, which facilitates and sustains grounds for corruption and low level of willingness to perform duties, creates more tensions between colleagues and especially between lower-level officers and better-paid heads of units and other superior structures, and ultimately results in lesser concentration on priority duties, lower work performance and efficiency. The salaries in the JHA sector have generally been comparable to the average salary in Latvia, which has been around €500-600 per month in the last few years. Low wages create a situation where many of the police and court staff at various levels have second or even third occupations and workplaces, or at least work extra hours if their job specification allows it.

Additionally, low wages reduce the number of applicants for the higher and professional educational facilities with interior and police work orientation. Law school graduates tend to look for jobs in law firms and the private sector instead of in Latvia's justice system. As a result, shortage of workers in JHA structures has become a permanent characteristic. Lack of personnel, together with reduced willingness and capacity to perform duties, also affects cooperation and coordination between the police and the prosecuting and judicial bodies, and diminishes the overall productivity of the system and its ability to improve its work.

In spite of the problems still existing in the JHA sector in Latvia after the country joined the EU, one may identify also various improvements. The most remarkable improvement is the increase in the importance of the JHA sector in overall state policy. Investments in infrastructure (including the construction of a new facility complex for the interior civil and operative structures according the latest EU and international security and technical criteria) and technical equipment have increased since Latvia's accession to the EU. Increase in wages has also been introduced, but unfortunately it still cannot adequately cover the escalating costs of living.

The functioning and general reform of the justice system is closely related to the human resource and financial problems mentioned above. In the areas that require lesser costs – law-making and introduction of norms – overall performance has been close to excellent. In September 2008, there were only 23 more directives to be transposed to the Latvian legal system (making the country the fourth best in terms of EU directive adoption). Some analysts, in their turn, conclude that this kind of fast implementation is only one side of the coin. Cases can be identified where these transposed norms are transposed only partly or they are done in poor language; moreover, norms are being transposed, but their efficient and professional appliance in everyday judicial disputes and proceedings still faces hardships. But problems like correct interpretation and implementation of EU law are typical issues when a state's justice system faces new principles of law, especially those not being made at the national level. This learning process takes time and various structural mechanisms exist to prevent any misapplication of EU regulations. Preventive measures are also being taken by organising seminars and professional courses as well as by introducing EU law as an obligatory subject in law schools.

Moreover, Latvia's court system was applying the EU norms and also the European Court of Justice (ECJ) judicature on a more or less regular basis even before EU accession. Another aspect that should be mentioned is the ruling of the Constitutional Court of Latvia (Satversmes tiesa) of 17 January 2008. For the first time, the Constitutional Court stated that after Latvia's entry into the EU, the Union's legal norms have become not just a positive learning and improvement source for the country's justice system, but also that the interpretations of the ECJ judicature should be taken into account in applying national normative acts. Thus, the Constitutional Court has created a strong judicial basis for the future development of Latvia's justice system and its reforms.

The problems that should be highlighted are related first to the overload of Latvia's justice and court system, which has created long queues for court proceedings. Some court hearings are being appointed for the end of 2009 and even the beginning of 2010, of course not following the procedural terms. This situation is again caused by the lack of personnel – judges, assistants of judges, in some cases even prosecutors. This entails again a need for some procedural reforms; for instance, reduction of the number of

judges present in some cases or permission to proceed with civil hearings if the respondent has not arrived at a sitting of the court.

The second problem remains the prison system. Prison facilities, for instance, have not gone through much change in the last decades. Conditions are being worsened also by the over-crowdedness of prisons. The latest estimates show that the restructuring of the prison system, including building of new prisons, could cost around €700 million. The solution to this problem will be politically tough, as taxpayers are unwilling to accept spending so much money on penitentiaries in the context of an economic crisis where there are many other priorities in helping people in need.

Issue: External border management and Schengen agreement implementation

Unlike the justice system in Latvia where there still are some transitional post-EU-accession issues to be solved and the insufficient budget resources slow down the transitional restructuring process, the situation with external border management and Schengen agreement implementation is the opposite. Regular and substantial aid from the EU Schengen Facility programme (overall financing is estimated at around €79 million with an additional €12 million co-financed from the state budget to cover VAT expenses) has guaranteed money resources for fast and effective restructuring of the border guarding system by relocating available human, technical and material resources to the external EU borders, ports and airports. Twenty-five border checkpoints are fully equipped with the latest security technology, including introduction of the Schengen Information System databases etc. New biometric passport and Schengen visa issuance systems are also fully operational, allowing Latvia to join the Schengen zone together with most of the other new EU member states on 21 December 2007.

Issue: Cooperation on EU level (justice, police)

No visible and/or fundamental problems have been detected in Latvia's cooperation on the EU level in justice and police issues with other member states or the EU institutions. Some sources draw attention to the need for further improvement of the analytical and technical capacity of the state police, especially in solving IT and economic crimes. But most of those shortcomings can be explained by the recent lack of funding and, consequently, of adequate human resources with proper education.

Conclusion

Most of the problems in JHA sector reform, in addressing which Latvia is performing well or lagging behind other EU member states, are related

to lack of resources to enact the relevant norms. Therefore the existing problems of administrative capacity in Latvia are directly related to the post-Soviet transitional period and the adaptation of the country's legal and interior system to EU leverage. Latvia's basic assumption has traditionally been acceptance of EU leverage and seeing the implementation of EU law and norms as a positive way to carry out the transitional reforms of the post-Soviet period. The existing EU leverage therefore has not created fundamental problems that could be considered significant and there is no need to revise the current EU policy. Even during the accession negotiations, Latvia's main concerns in the JHA sector were additional financial resources that implementation of the EU leverage would bring. Of course, reforms in Latvia's justice and interior systems could be accelerated by additional seminars and experience-exchange programmes, as well as by attraction of resources for supplementary enhancing of EU law studies not just in the judicial system but also in the police bodies, especially in the most problematic sections. Therefore increased cooperation and possible exchange programmes between police staff of Latvia and the EU-15 member states could be an advantage.

Migration

Summary

After Latvia regained independence and especially since it joined the European Union, the country's biggest concern in the migration area has been not immigration (whether legal or illegal) but emigration. Negative migration indices become even more acute in the context of the overall demographic trends in Latvia. Two main aspects can explain the situation in the field of migration: traditionally strict immigration rules and the overall economic and social conditions.

Issue: Demographic trends

One of the major problems Latvia has had to deal with since 1990 are the negative demographic trends. Gradual depopulation, caused by low birth rates and steadily high migration rates, has not stopped after 1 May 2004. Birth rates remain low, with additional emigration prompted by the free movement of labour and opening of the labour markets to new member state citizens – especially emigration to the United Kingdom and Ireland. Official data show that while at the beginning of 2004 the over-

all number of people permanently living in Latvia was 2 319 203, in 2008 the country's population was 2 270 894 (or down by 48 309). The main reason is natural depopulation of Latvia, as the average annual death rate is higher than the birth rate by about 11 500 persons.

Issue: Emigration

The other aspect that has influenced demographic trends in Latvia the most is emigration. Although exact official data on emigration are not available, the most common estimates place the number of emigrants at around 50 000. The official number of emigrants after 2004 is only 2 000 to 2 500 people a year (in the mid-1990s, for instance, the annual number of emigrants averaged 13 000). At the same time, most people that have left Latvia to work in other EU countries have not been registered, as they have left for good. Therefore the available data are overall estimations only, with some studies even mentioning that around 200 000 people had left Latvia by 2008 or are planning to leave in the coming years. The return rate also varies in the different studies, some mentioning that only about one-third of all emigrants could possibly return to Latvia in the future.

Labour emigration to other EU member states after May 2004 is related to the free movement of labour inside the European Internal Market. The United Kingdom and Ireland, in particular, have become the main destinations for both skilled and less qualified workforce from Latvia because of two main reasons: the language

aspect (most of Latvia's population have studied English in primary and secondary school at minimum) and the fact that the two countries did not introduce any transitional periods. Other countries (except Sweden, due to its proximity to Latvia) are less popular because of the language barrier and the transitional periods introduced by such huge potential migration countries as Germany.

The basic reasons for emigration from Latvia (and also for the low immigration rates) have been the differences in living standards, low salaries compared to rising prices, lack or insufficiency of social benefits, poor working conditions and unemployment. High unemployment together with slow economic development especially before joining the EU contributed and encouraged particularly people living outside the capital, Riga, to decide to leave in order to look for better job and income opportunities outside their native country.

Issue: Illegal immigration and asylum policy

The strict immigration laws are related to Latvia's defined national interests, especially national security after regaining independence. Substantial immigration flows during Soviet rule and the changes in the Latvian population's ethnic composition caused negative attitudes towards any immigration trends after 1990. Therefore the present immigration laws and the overall attitude among various political groups and in Latvian society are against opening the labour market to other country nationals. Hence, employers keep asking the government to re-evaluate the state's immigration policy, especially concerning regulated immigration possibilities. The political situation and high unemployment rate, particularly in the eastern regions, prevents the government from adopting a different kind of policy. Regarding regulated immigration, the strict immigration laws are not aimed at attracting immigrants, but at ensuring full employment of the domestic labour force.

Thus, Latvia has not had any fundamental problems with immigration issues after EU accession. No substantial illegal immigration or asylum trends have occurred. Since the asylum procedure was launched in 1998, only 203 persons have applied for asylum. The situation has not changed after May 2004 (in 2004 only seven persons were registered as asylum seekers, in 2005 twenty, in 2006 eight, and in 2007 thirty-four). Since

The current shortage of labour in several areas has given rise to discussions on the opening of the Latvian labour market to non-EU nationals

1998, refugee status has been granted to 15 persons, and alternative status to 20 persons.

Traditionally, Latvia and the Baltics in general have been considered as a possible place of residence by citizens of post-Soviet countries – Ukraine, Belarus, Russia. Migrants from Africa or Asia do not consider Latvia as a possible destination, because of its geographical location, climate, non-existing cultural, language, political, historical or family ties. The comparatively lower social benefit level and possibly language and citizenship policy makes Latvia less attractive for illegal immigration.

Issue: Visa policy

Latvia has been considered as a transit country for immigrants to Western European countries. Schengen visa policy allows immigrants who have received a visa for one of the Schengen countries to travel throughout the entire Schengen Zone, because of non-existing border control between countries. Therefore it creates additional pressure on visa-issuers not only in Latvia but in other EU countries as well. In addition, as an EU external border country, Latvia has greater responsibility for effective border control.

The EU has developed a wide range of leverage to regulate immigration issues inside the Union. At this point Latvia has complied with all of the EU leverage, as the latter has been more or less protective of the national labour market. The so-called Dublin Regulation of 2003 is especially beneficial with regard to Latvia's immigration situation. The small number of asylum seekers and illegal immigrants allows Latvia to be less concerned with this kind of EU leverage. At the same time, if Latvia is used as a transit country for migrants willing to travel further into other European Union member states, the country could face some essential problems. In spite of the movement options for migrants introduced by the Schengen agreement, Latvia could be made responsible for immigrants receiving visas for travelling to Latvia. Therefore, it is extremely important not just for Latvia but also for all EU member states and visa-issuers to understand the need and responsibility for a common, strict approach against providing permission to enter the Schengen zone, regardless of the target country.

Another potential threat to Latvia's national interests regarding immigration issues could be the common asylum policy, especially Council Directive 2001/55/EC on common standards to provide temporary help for mass asylum seekers. Given the country's economic situation, Latvia's ability to provide protection could face serious challenges if it has to deal with large numbers of asylum seekers. Readmission agreements should be mentioned as maybe the most important aspect for Latvia in the context of migration policy. Therefore common policy and agreements with third countries on repatriation of their citizens would be welcomed in Latvia. At the moment Latvia, as many other EU member states, is looking for concluding bilateral readmission agreements with countries considered

to be most important in this respect (Russia and Ukraine in Latvia's case). A common EU strategy and approach to the problem could speed up the process, though.

Some of the principles of EU policy on migration could also be beneficial for Latvia

Some of the principles of EU policy on migration could also be beneficial for Latvia. Taking into account the recent decrease in the labour force in Latvia, an introduction of the Blue European Labour Card or other common immigration approaches for the member states could be considered as an option in attracting more high-skilled workers for Latvia's economy. This means that in spite of the strict immigration laws, Latvia has weighted out the possibility of attracting labour force from other member states, while the country has not applied any transit period restrictions on free labour movement after joining the EU. Additionally, in case of emergency and with the Commission's approval, Latvia could use the mechanism of closing its labour market. Therefore the EU leverage is on the whole efficient for Latvia because considering its strict immigration laws, the country can "opt out" from the common immigration policy if this is necessary for the protection of its national interests.

Conclusion

Latvia is experiencing emigration and depopulation trends that have continued after 1 May 2004 because of the additional options provided by the free movement of labour inside the EU. No EU-level legislation that would be compatible with human rights norms could prevent workforce from leaving Latvia. Latvia's depopulation and emigration problems could be basically solved only at the national level, by attracting and returning the workforce that has left Latvia, and by improving the country's economic and social security level. Solution for Latvia's present problems needs to come as a political decision first. At the same time, two ways of preserving the strict political stance on immigration and repatriation problems can be identified. One could be adoption on the EU level of an emigration policy that would promote the idea of repatriation of the labour force to their home countries and application mainly for seasonal jobs in other EU member states. The underlying motive then would be the need to secure equal or similar development of all the Union's regions. This would include also attracting labour from other EU member states to move to the "regions in need". Another solution could be a continued adoption of common EU legislation on immigration on the basis of the need for all countries to take responsibility and even out the inflow of immigrants. Therefore for Latvia discussions and rules adopted on the EU leverage could be a way to escape national discussion on the "immigration" solution for the increasingly problematic lack of labour force in the country's economy.

R

Research and Innovation

Summary

The research and innovation sector in Latvia is characterised and determined by long-established (though frequently inefficient) practices and institutions, deliberate efforts to address the new challenges, including the need for Europeanisation and optimisation in the sector, and financial constraints and insufficient funding. Latvia has made considerable progress in the R&D sector since joining the EU. The EU has been instrumental in contributing to the development of the quality of Latvia's R&D sector by providing standards, benchmarks and good practices, ensuring network-building and granting financial support. Some results notwithstanding, further Europeanisation, increased governmental support and sectoral restructuring are needed to ensure a sustainable, efficient and practically applicable R&D sector.

State of Affairs in the Sector

The Ministry of Education and Science and the Science Council are primarily responsible for policy formation, finance distribution, project expertise and assessment in the research and innovation sector. Alongside these institutions, other ministries and scientific institutions, such as the Latvian Academy of Science, participate in shaping and implementing activities in the sector. With the active involvement of these institutions, formally important documents have been elaborated, such as the Law on Scientific Activities (2005), Latvian National Lisbon Strategy (2005-2008), Basic Guidelines for Scientific and Technological Development (2006-2013), and Latvia's National Development Plan (2007-2013). These strategic documents have accentuated the importance and identified more precisely the role of research and development for the

country's well-being. Latvia has particularly accentuated its adherence to the goals of the Lisbon agenda, such as knowledge-based economy, further emphasis on innovations and importance of environmental issues in ensuring sustainable economic growth. However, in March 2008 the Council of the EU accentuated specifically the importance of innovations and research for Latvia's future development.

The following priorities have been put forward for the research and development sector: Letonics (Latvian and Baltic culture, language, and

history), information technology, material sciences, forestry and timber technology, organic synthesis and biomedicine, medicine, agro-biotechnology, energy, environmental sciences. Apart from Letonics, strong emphasis has been put on hard sciences and technological development. This has been done against the background of growing criticism that prior to EU membership too much attention was paid to social sciences and humanities without sufficient support and funding for applicable sciences, production-oriented projects and new technologies. Hence, now support has been increased for fundamental and practical projects, market-oriented research (together with entrepreneurs), state research programs, co-financing support for participation in the EU programmes.

Financing for science and education in Latvia has been one of the smallest in the EU – three times lower than the EU average, and has constituted 0.3% of GDP

Financing for science and education in Latvia has been one of the smallest in the EU – three times lower than the EU average, and has constituted 0.3% of GDP. At the same time, some progress has been observed after Latvia joined the EU and especially in the context of high GDP growth. The Law on Scientific Activity (2005) envisages state-covered base financing for science institutions (wages, infrastructure) and stipulates financial increase for research and development by 0.15% of GDP annually until it reaches 1% of GDP. In real terms, financial support has grown considerably.

This growth, however, has been possible due to the high GDP growth and attraction of EU structural funds. Latvian scientists are involved in more than 450 projects financed by the EU and altogether Latvian partners so far have received more than €35 million in the framework of EU-financed science projects. Latvian scientific institutions have expressed and demonstrated their considerable interest in actively participating in the next phase of the Seventh Framework Programme, which overall envisages €55 billion in financing for 2007-2013.

The budget deficit and need for budgetary cuts in the context of economic recession and considerable GDP growth slowdown, however, caused the government to retreat from the stipulation to increase financing for R&D annually. Furthermore, the government has proposed reduction of financing for science by 10% in the new 2009 budget. The government plans to “freeze” Science Council grants (around LVL 6 million or around €9 million) and annual financial support (almost LVL 6 million) for scientific activities at universities (achieved in 2007) by 2009. The VAT of 18% will be imposed on scientific grants in 2009. The existing state support for co-financing of EU scientific projects (15%) would be reduced by three times (to only 5%). This policy has provoked significant criticism.

Issue: Model of R&D investment

The dominant model of R&D investment and generation has also been largely determined by long-established practices and culture as well as financial constraints. In general, scientific activities have been carried out in potentially three types of institutions: the Academy of Science and its institutes, scientific centres at universities, and autonomous science institutes. Traditionally all of them have been supported and financed by the state budget. Although the EU Barcelona Council set the goal that financing for R&D should reach 3% of GDP and two thirds (2%) should be covered by private companies, in Latvia this goal would be difficult to achieve, especially regarding private-company involvement. Firstly, taking into account the limited scope of industry- and technology-related businesses, there is a limited number of private companies which would be interested in results of scientific projects. Secondly, so far the post-Soviet businesses have largely gone through a capital accumulation and consolidation phase, without having financial resources to invest in costly scientific projects. Thirdly, and related, the culture of "science investments" and awareness of their importance has been appearing slowly. This has led to a situation where scientific research has been mostly considered as the responsibility of the state.

Issue: Brain drain

A certain threat of a brain drain exists in Latvia and it has both indirect and direct dimensions. Although it is difficult to identify precisely, a number of technologically, industrially and scientifically oriented experts and scientists have clearly left the country. Paradoxically, the recent EC document on facilitating scientist mobility can only contribute to such a trend in the context of financial constraints in Latvia. An indirect brain drain might be observable among potentially potent scientists who prefer some other professional activities to science. The state financially supports more than 1 000 doctoral students, but annually only a few doctoral degrees are granted. The Latvian scientific community is considered to be one of the oldest in the EU. Recent unfavourable signals in the context of budgetary constraints can clearly facilitate this direct and indirect brain drain in the sector of science and innovation. For instance, critics of the governmental plan to reduce the science budget have indicated that there was a quite active application process (500 project applications in R&D for LVL 17 million or around €25 million) in 2008 and the financial reduction may reverse this recently emerging positive trend.

Conclusion

In Latvia there is a declarative adherence to development of science, research and innovation. There is formal support for Latvia's full integration into the European research space with its practices, financial proportions

and priorities. Although Latvia has followed to a certain extent the OMC method in terms of adopting normative guidelines, indicators, benchmarking and sharing best practices, the overall practices and structures remain eclectic and sometimes confusing, and optimisation of existing structures and attraction of private involvement is necessary. This appears to be even more difficult in the context of economic slowdown and increasing budgetary constraints.

Agriculture and Rural Development

Summary

The OECD identifies local areas (municipalities) as rural if the population density is below 150 inhabitants per square kilometre. As Latvia has a very low population density, most of its territory can also be considered as rural according to the OECD definition. Rapid growth in rural areas started parallel with the accession to the EU. Meanwhile, most of the problems in agricultural and rural development are related to national-level decision-making. At the same time, the national level is a mirror of EU problems as, for instance, the administrative burden in the EU's particular branch reflects much more intensively on national level.

Issue: Socio-demographic trends in rural areas

Pursuant to the Law on Agriculture and Rural Development, rural territory is all the territory of Latvia, except cities of republican importance and district centres.

There are several spheres in the agricultural and rural sector that are specific for Latvia within the EU:

- EU support has increased the quality of management in rural areas parallel to the decrease in the range of uncultivated lands. Since Latvia joined the EU, there has been growing common financial support for the reconstruction of the state land amelioration system.
- Environmental EU requirements have improved the national legislation. However, this has created obstacles for the EU financial support to small and medium farmers, because of fast-developing requirements in environment regulation. There is also a need to improve the information system and further education of farmers.
- Along with the positive EU effect for agricultural machinery (higher standards for machinery, larger supply of the latter etc.), there are certain negative effects because of the "price rise".
- Food safety, animal health and welfare have been reinforced through EU regulations for all members of the food cycle that strongly increase food safety. The shortage of discussions during formation of long-term plans (for instance, Community Action Plan 2006-2010 for animal protection and welfare sector) causes a situation where adoption of new proposals leads to results that are different from the expected ones.

Issue: Economic significance of agriculture and rural areas (vitality of the agricultural sector and consolidation of land)

There have been problems related to the effective implementation of the CAP in Latvia

The contribution of value added of agriculture and hunting to GDP at current prices in 2007 was 1.8% (in comparison with 2.2% in 2005 and 1.9% in 2006). According to the land survey of the State Land Service of the Republic of Latvia, as of 1 January 2008, Latvia had a total 2 361 582 ha of agricultural land (AL), including 1 731 083 ha of arable land (constituting 73.3% of the total), 24 803 ha of orchards (1.05%), 210 034 ha of meadows (8.9%), and 395 661 ha of pastures (16.8%). In 2007, 66.5% of the real estate use target group "Area of agricultural land" were declared for the purposes of the single area payment. Sixty-six percent of the area of AL declared for the SAP in 2007 were used for agricultural production. There is no information as to the management of about 0.79 million ha of agricultural land not applied for support payments. Of the total area of AL undergoing transformation in 2007, 76% were meant to be afforested. The area of land undergoing transformation for construction purposes in 2007 increased by 255 ha in comparison with 2005.

The Common Agricultural Policy is the legislative instrument of the EU that is applied to develop the agricultural sector of member states. Positive aspects of the CAP are:

(a) The EU and state supporting payments (single area payment, extra direct payments of state etc.) are an effective instrument to stimulate cultivation in rural areas and competitiveness of small and medium farmers. Under stimulation of particular payments, not only the range of applicants has increased but so has the diversity of agriculture activity;

(b) One year after Latvia joined the EU, the selling value of agricultural (incl. processing) products increased in the common EU market by 87%; milk product volume distributed in the common market increased by 62%; and grain export by 10%. Practically in all categories of agricultural products growth is notable. Therefore enlargement of the EU has produced a positive effect on distribution of food products.

However, there have been also problems related to the effective implementation of the CAP in Latvia:

(a) Necessity to submit support payment programmes to the European Commission for approval delays the decision-making process;

(b) CAP provides a different support system for different member states on the basis of statistically old data that deforms the competitiveness of the common market;

(c) Support conditions for single area payments and less beneficial area payments create over-compensation for those farmers who act with minimal activity – just to meet conditions to gain compensation.

Issue: Effectiveness of EU funds and subsidies

The latest statistics show that Latvia has used 97.7% from the available EU funds in the agricultural sector. There are several reasons for such effectiveness. The Ministry of Agriculture of Latvia and other institutions regularly monitor the use of finance using. As a result, there have been several changes in conditions of financing programmes, making them more acceptable to applicants. Moreover, the non-governmental sector has been very active, thus helping to identify the weakest points of finance flow.

It is possible to distinguish some negative aspects of the EU fund and subsidies programmes:

(a) A long confirming process of legislative acts, including the SAPARD programme on the EU level. The length of the SAPARD accreditation process was the reason for the late start of the programme's active stage;

(b) There were additional limitations in order to increase equality between all applicants but this diminished the demand for financing on the part of small and medium farmers;

(c) Particular sub-programmes (for example *Education*) were formed unsuccessfully and were ignored by applicants;

(d) The administrative burden within SAPARD was high, therefore modifications were complicated and time-consuming.

Issue: Fisheries issues

Fisheries issues in Latvia directly depend on the EU Common Fisheries Policy. Because of the lack of effective legislation in the fisheries sector till 2004, the EU CFP gives an impulse for creating a totally new normative system. So the fisheries legislation is more created than re-created under the influence of the EU CFP. After Latvia's entry into the EU, one may outline the following positive effects:

(a) Access to the common EU market increases Latvia's potential exports of fish-made products;

(b) The common legislative standards increase Latvia's competitiveness, because Latvia is one of the countries in the EU with a very well-developed fisheries sector;

(c) Possibility to use the EU financial capacity for successful development of local fishery enterprises.

The challenges are the following:

(a) Slow process of common fishery policy formation on the EU level. In Latvia, the effectiveness of the sector depends on EU-level regulations;

(b) There is a certain gap between requirements of the EU fishery policy on protection of fish resources and financial support for these activities from the EU;

(c) Expenses of owners of fishing vessels have grown rapidly as a result of the EU requirements on safety of sea traffic.

Conclusion

The solutions to the described problems should be sought at the Community and, primarily, at the national level. The national positions should be defined as a result of a broad consultative process with all parties concerned – national experts in ministries, the non-governmental sector, small and medium-size enterprises as they are influenced most by the dynamics of the EU transforming legislation. At the same time, there is a need to continue the EU common policy with the same intensity.

It is necessary to speed up administrative procedures and minimise the administrative burden. To achieve those goals, better regulation initiatives should be implemented both on the national and on the EU level. The problem of statistics is common for all sectors in a fast-moving environment. The solution initiative here belongs to the national level – within the process of forming Latvia's position, it is possible to correct inaccurate information. The "over-compensation factor" is a totally local-level problem that can be solved without direct participation of the EU (local governance within the auditing process should take full responsibility for eradication of "fake farmers"). The growth of land prices depends on the common economic trends.

In order to improve administrative development, there is a need for more accurate defining of the requirements for particular programmes at the EU level. On the national level it is important to take into account the logical framework analysis methodology adopted by the EU. The impact assessment procedure should not be regarded as an administrative burden, as in some cases it is the only bond with the real situation that guarantees avoided use of outdated statistics. There is a need for regular exchange programmes between the EU and the national level to increase qualification of employees in particular sectors.

Regional Development

Summary

The regional specifics of Latvia lie in the mono-centric population with a powerful centre, Riga, and an internally equalised and balanced network of other cities. In a long-term perspective, such a situation is seen as an obstacle for development of regions; nevertheless, it has potential for a polycentric approach. Development is possible only if other cities increase their competitiveness, which is more a plan than a reality under the current economic circumstances. There is a marked difference between Riga and other regions of Latvia in terms of economic activities.

Issue: Trends in social and economic development of the country's regions; cohesion and convergence

A year after EU accession, the biggest part of Latvian GDP (57.3%) was produced in the Latvian capital, Riga. The second biggest region by contribution to GDP was Pierīga (vicinity of Riga) (11.1%). In 2005, GDP per capita in Riga was 1.8 times higher than the average in the country. The number of active statistical units (self-employed persons, sole proprietors, commercial companies, agricultural and fishing farms) is growing gradually in Latvia (per 1 000 inhabitants it increased

by about four units in 2007). This indicator is above the country average in the Riga and Vidzeme regions, although it should be noted that in the Vidzeme region it is higher mainly due to the big proportion of agricultural farms and self-employed persons. The contribution of these units to the formation of GDP is markedly smaller than the contribution of commercial companies. A decline in the number of unemployed people was observed in 2007. Demand for labour force increased substantially in the rapidly growing economy after accession to the EU. As a result, the unemployment rate fell to a record low level. During a period of three years (2005-2007), the share of job seekers decreased by 4.4 percentage points to 6% on average in the country. The unemployment rate in the eastern part of Latvia, Latgale region, remains high in comparison with the other regions. In 2007 it amounted to 8%. Salaries kept growing rapidly in 2007 in all regions. Wages in 2007 were on average by one third higher than in the preceding year in the country. In the first quarter of 2008, there was still a high rise in wages in all regions, amounting to approximately 28-30% as against the

first quarter of the previous year. Due to the rapid increase in 2007, the average gross wage has almost doubled over the last three years.

The existing administrative system is over-fragmented

The data of the Household Budget Survey on self-assessment of the financial situation of households, conducted by the CSB, show that the situation is quite different in the different regions. The greatest share of households which defined themselves as not rich but living well is in Riga and Pierīga (17.4% and 15.6% respectively). The highest share of households expressing the opinion that they are poor or on the threshold of poverty is in Latgale (31.1%). The share of households in Vidzeme, Kurzeme and Zemgale, who consider themselves as neither rich nor poor is considerably higher.

Issue: Decentralisation and sub-national governance

The previous decentralisation and sub-national governance initiatives were implemented without a clear vision of long-term implications. According to the recent law on administrative territorial reform, the reform of the existing regional system has to be finalised by 2009, the main purpose being to create economically more stable, independent and active regions with own self-governments. The existing administrative system is over-fragmented. Establishment of the new region system with larger regions will make it possible for all self-governments to become more self-sufficient, professional and capable in applying for national and EU financing. In short, the competitiveness of each region could be increased.

Issue: Ability to absorb SF on local and regional level, and administrative capacity

The evaluation of the ability to absorb SF on local and regional level in connection with administrative capacity identifies a core problem: ministries are planning inadequately large budget finances to be absorbed and in most cases ignoring limited absorption capacity. According to EC information, Latvia had absorbed only 45% of SF in the 2000-2006 period, which was the second worst result in Europe. More recently, the absorption rate has increased due to a growing institutional capacity. However, a number of considerable obstacles remain. Most ongoing projects do not comply with the timetable. Planning of state financing for SF absorption is organised for each ministry independently. As a result, planning is fragmented, with further problems to over-divide finances in the case of mistakes. The quality of documentation influences the output also – projects are slow and ineffective because of a slow decision-making process based on low quality of working papers. The reason for this situation is low capacity of administration in institutions. After 2004, the number of employees in ministries rapidly grew. Meanwhile, those were *unprofessional professionals*

Since 2004, the Ministry of Economics and the Investment and Development Agency of Latvia (LIDA) have promoted the implementation of potential PPP projects

with client-oriented attitudes, without real experience in administration. The absorption activity in the regions is similar to the economic activity in the state. Finances were divided unequally in the regions (regions which needed more intensive support received finances according to traditional finance flows).

Issue: Ability to establish public-private partnerships

Public-private partnership and the opportunities it may provide for the development of the national economy have been increasingly discussed in Latvia in recent years. Since 2004, the Ministry of Economics and the Investment and Development Agency of Latvia (LIDA) have promoted the implementation of potential PPP projects, as well as organising meetings and providing consultations for representatives of the public, private and non-governmental sectors regarding issues related to implementation of PPP projects, thereby facilitating the development of PPP in Latvia.

In addition, several other institutions, including the Ministry of Finance, the Treasury, ministries and local governments, are involved in the PPP process and have substantial influence on the opportunities to use PPP. The latest PPP initiative is *Action Plan for Implementation of the Latvian Public Private Partnership Development Guidelines in 2006-2009*, approved by the Cabinet of Ministers on 15 November 2005, which sets forth the directions of action for promotion of PPP until 2009. Development of the concept of establishment of a joint and coordinated state investment planning process and introduction in the public administration started in 2007; this concept envisages PPP as a state development instrument. Therefore, all concerned local governments of Latvia have the opportunity to use a building design free of charge for construction of a pre-school in their administrative territory, while only having to fund the adjustment of the plan for their particular territory from the local government budget.

Eight local governments had taken this opportunity by May 2008, two of which plan to use this option for construction of new pre-schools in accordance with the PPP models. In 2008, the Ministry of Economics and the LIDA continued providing *advisory support* to implementers of potential PPP projects by informing them of the applicable type of PPP business, the applicable procurement procedures, financial and economic calculations, possible legal solutions for projects and other issues related to PPP, as well as by organising informative seminars for public institutions on the methodology of PPP project management and standard documents. Until the end of March 2008, over 15 consultations were provided to both the public and private sector on topical issues of implementation of PPP projects.

Conclusion

After the EC recalculation of prospective financing for the 2007-2013 period, there is an extra allotment to Latvia – €529 million. Within this allotment a new priority is outlined – *Infrastructure and services – city-environment (poly-centric development)* that amounts to €263 million. Thus, financially the EU contributes significantly to regional development. The problem is the lack of a common policy on regional reforms – how should sub-regions of a state within the EU look like. The implementation of regional reform is carried out with no direct political participation from the EU level. According to national advisors from the Ministry of Regional Development and Local Government, there is no need for EU leverage in this sphere. At the same time, there is a lack of a long-term vision based on empirical data how exactly regions should be developed. There are risks that finances may flow to the economically more stable regions, which could lead to weakening of regions with problems of capacity.

Level of Absorption of EU Funds and Their Impact

Summary

The first year after Latvia joined the EU shows the ambitions of the state to absorb SF. Latvia's goals regarding the planned use of support from the Structural Funds are set out under the Development Plan or the Single Programming Document (SPD). From the point of view of legislation development, the EU funds absorption process is totally new, with all the consequences of that – it is a process created on the basis of experience of success stories and mistakes. On the success side, Latvia has avoided any larger corruption scandals related to the absorption of EU funds. At the same time, SF finance flow in Latvia is not equally intensive in all regions and structural dimensions.

Issue: Effectiveness of the public administration in managing the SF; capacity to generate and manage projects

The Single Programming Document for the Structural Funds Objective 1 programme 2004-2006 for Latvia was approved by European Commission Decision C(2004) 2121 of June 17, 2004. The total funds accessible within the framework of the Structural Funds, which beneficiaries can apply for, consist of financing from the EU Structural Funds and national financing (co-financing from the state budget and budgets of local governments). Financing from the EU Structural Funds amounts to 75%, while 25% comes from the state budget and budgets of

the local governments. In order to apply for support from the Structural Funds, beneficiaries have to provide own financing. The total financing accessible to Latvia under the framework of Structural Funds programmes in 2004-2006 amounts to €845 million (€625 million from the EU Structural Funds and €220 million from the state budget). The €625 million in financing from the EU Structural Funds consists of resources from the following funds:

- European Regional Development Fund (€369 million);
- European Social Fund (€139 million);
- Guidance Section of the European Agricultural Guidance and Guarantee Fund (€93 million);
- Financial Instrument for Fisheries Guidance (€24 million).

The breakdown of support from the Structural Funds by sector shows that the largest part of the financing (32.6%) is envisaged for infrastructure projects and projects for promotion of business development (25%). According to the informative report of the Minister for Special Assignments in Managing EU Resources on implementation of activities of the Single Programming Document and use of financing, by 31 March 2008, LVL 304 million or 69% of the total accessible SF financing were paid to the beneficiaries of financing from the EU Structural Funds or project implementers.

By 31 March 2008, expenses of the Structural Funds declared by the European Commission amounted to 61.2% of the total SF financing granted to the state. It should be specified that in the first quarter of 2008, only ERDF resources were declared by the EC to the amount of 2.7% of the total ERDF financing, therefore the total amount of declared resources of the Structural Funds in the first quarter of 2008 was low – 1.6% of the total financing from the Structural Funds. The EC has made repayments to the state budget of Latvia within the framework of ERDF to the amount declared by the EC. In addition, the EC repaid 4.1% of FIFG financing in the framework of FIFG in the first quarter of 2008, therefore the total increase in repayments made by the EC in the first quarter of 2008 was 1.8 percentage points.

In order to ensure repayment into the budget of Latvia of all SF resources allocated to Latvia, the EC must by the end of 2008 declare €175.1 million in ERDF financing, €47.1 million in ESF financing, €16.4 million in EAGGF financing, and €4.5 million within the framework of FIFG. In order to level out the differences between the EU member states after accession to the EU, access to resources from the Cohesion Fund has replaced the ISPA funds, which were available for Latvia before accession. Assistance from the Cohesion Fund is available to those EU member states where GDP per capita is below 90% of the EU average. The main goals of the Cohesion Fund are to provide support for environmental protection measures and improvement of transport infrastructure.

Similarly as in case of the Structural Funds, resources from the Cohesion Fund are only granted as co-financing for measures supported financially by the member state. The EU co-financing from this fund was set at 80-85%. Furthermore, the contribution from the EU may even reach up to 90% of the total project costs if financing is also received from the Structural Funds. The total project costs have to reach at least €10 million.

Utilisation of resources from the Cohesion Fund is set out within the Reference Framework Document coordinated with the European Commission in December 2003. In contrast to the Single Programming Document, which only sets out the priority areas of support, the Reference Framework Document defines specific projects for which financing will be granted. The Cohesion Fund has a broader range of financing in comparison with ISPA:

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

Altogether €435.9 million or 61.3% of the total financing from the Cohesion Fund were requested from the EC by 31 March 2008. €415.5 million or 58.5% of the financing from the Cohesion Fund were approved for Latvia within the 2004-2006 programming period, while €365.9 million or 51.5% of the CF financing were paid to the project implementers within the framework of the concluded contracts. Twenty Cohesion Fund projects have been approved in the environmental sector, including 17 infrastructure projects and three technical assistance projects with total CF financing amounting to €217.6 million (the total financing of the projects constitutes €366.2 million).

Fourteen Cohesion Fund projects have been approved in the transport sector, including eleven infrastructure projects and three technical assistance projects with the total CF financing to the amount of €312.2 million (total financing of the projects is €563.6 million).

Implementation of the Cohesion Fund projects is taking place steadily. Some of the projects have been completed while implementation of several projects has been delayed for two years. Implementation of several CF projects is planned by 2008-2009 in accordance with decisions or financial memoranda of the European Commission. The main problems in implementation of projects in the environmental and transport sectors are still arising from the considerable rise in prices in the construction sector, which has increased the costs of the majority of the projects that were planned and started in the previous years. This substantial price rise is explained by the rapid growth of prices of both fuel and construction materials, as well as by increased labour costs due to the total increase in demand in the construction sector. The substantial price rises are also promoted by lack of competition in the construction sector.

Issue: Mismanagement and corruption practices

There have not been any scandals about corruption practices in the absorption process. Still, this does not mean that the process is perfect – SF absorption in reality is developing on the basis trial and error. Nevertheless, proposals of society how to improve the process are not ignored. From the point of view of mismanagement, there is a flaw in the development forming process – the weakest link is between the state sector and the applicants for projects (applicants are still those who know the main problems in the system and can propose solutions). Potential areas for corruption in the absorption practices are:

- Gaps in competitions for projects and grant schemes: they include incomplete information about competition requirements; *the first come-first serve rule* means that information about competitions is available prior to their official opening and entrepreneurs with higher capacity can prepare

better even before others officially know about a particular competition; problems of quality of evaluation criteria;

- The lack of information on national programmes prevents effective monitoring, as there are no progress reports on national programmes;
- Huge influence of mediator institutions on project applicants;
- Defects of the decision-making process – NGOs engage too late in the process of decision-making; most questions must be submitted in written form and because of the administrative burden, usually reach their addressees after the deadlines.

Conclusion

Although Latvia's absorption capacity and results show an ascendant trend during the last few years, considerable administrative, financial as well as political hurdles exist and room for improvement remains. Problems of EU fund absorption occur mainly at the local level. The EU provides enough financial support and political control over programme fulfilment, which would not be necessary if the assumption is that member states are stable and politically responsible. Hence, there are several recommendations for governmental activities. Firstly, the Ministry of Finances, Ministry of Economics and State Chancellery should considerably increase the efficiency of preparation and verification of documents necessary for absorption of funds – the administrative phase takes too much time and the whole process is delayed by approximately 1.5 years. Secondly, there is a need to simplify the still too complicated fund implementation mechanism. It depends on the local level to fulfil the simplified guidelines of the European Commission for 2007-2013 with special relief to small projects. Thirdly, on the national level, the state has to maximally open the process for audits by non-governmental organisations and mass media. Regular seminars of applicants would be an effective instrument for view exchange and result-oriented management.

C

onclusions and Recommendations

Policy Area	Need for EU Leverage	Existing Types of EU Leverage	Recommendations for Problem-Solving on National Level	Recommendations for Problem-Solving on EU Level
Political Development and Governance	Yes	<p>Oversight and management of EU funds</p> <ul style="list-style-type: none"> Active, hard, significant, effective <p>Infringement procedures</p> <ul style="list-style-type: none"> Active, hard, significant, effective 	<ul style="list-style-type: none"> Increase transparency and accountability Fight high-level political corruption Establish clear and transparent legislation on party and election campaign funding Improve the enforcement of legislation 	<ul style="list-style-type: none"> Launch a comparative “Democracy Audit” of the democratic institutions and political practices in EU member states

<p>Economic Development</p>	<p>Yes</p>	<p>Lisbon process</p> <ul style="list-style-type: none"> ■ Active, soft, limited, non-effective <p>Common market rules</p> <ul style="list-style-type: none"> ■ Active, hard, significant, effective <p>Euro Area Accession</p> <ul style="list-style-type: none"> ■ Passive, significant, non-effective <p>European Economic Recovery Plan</p> <ul style="list-style-type: none"> ■ Passive, significant, non-effective <p>Energy-climate packages</p> <ul style="list-style-type: none"> ■ Passive, significant, effective <p>Small Business Act</p> <ul style="list-style-type: none"> ■ Passive, significant, effective <p>Better regulation policy</p> <ul style="list-style-type: none"> ■ Active, soft, significant, effective <p>Stability and Growth Pact</p> <ul style="list-style-type: none"> ■ Active, soft, significant, non-effective 	<ul style="list-style-type: none"> ■ Optimise decision-making to balance and harmonise national and European interests and policies ■ Facilitate the improvement of the business climate and the competitiveness of the Latvian economy 	<ul style="list-style-type: none"> ■ Form common policy on economic crisis management in the EU ■ Act and speak with one voice in external economy-related policies (trade, energy, investment policy) ■ Determine clear criteria for the ERM II membership or automatic entry for NMS
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<p>Welfare System and Social Inclusion</p>	<p>Yes</p>	<p>OMC</p> <ul style="list-style-type: none"> ■ Active, soft, limited, non-effective <p>Lisbon Strategy</p> <ul style="list-style-type: none"> ■ Active, soft, limited, non-effective <p>Integrated Guidelines for Growth and Jobs</p> <ul style="list-style-type: none"> ■ Active, soft, significant, non-effective 	<ul style="list-style-type: none"> ■ Set a clear and achievable welfare system model with respective targets and instruments ■ Meet national targets under the OMC and ensure adequate monitoring and evaluation of progress ■ Optimise and ensure better coordination between policies for economic growth and employment (in the framework of the Lisbon agenda) and social inclusion policies 	<ul style="list-style-type: none"> ■ Define standards for sustainable funding, especially for the most disadvantaged societal groups ■ Enhance coordination on EU level between policies on employment, education and innovation ■ Audit, compare welfare systems and recommend necessary improvements
<p>Health System</p>	<p>Yes</p>	<p>EU Regulations for public health services</p> <ul style="list-style-type: none"> ■ Active, hard, significant, non-effective <p>EU policy on cross-border health care</p> <ul style="list-style-type: none"> ■ Active, soft, significant, potentially non-effective <p>Policies toward e-health</p> <ul style="list-style-type: none"> ■ Active, significant, potentially non-effective 	<ul style="list-style-type: none"> ■ Set clear standards to be achieved in the health sector overall and in particular segments of the health system ■ Audit and take example from the successes and failures of the reform process in other countries ■ Plan health system reform in correlation with problems in other areas ■ Optimise and modernise the hospital system in the country; find the appropriate balance between centralisation and decentralisation ■ Optimise the financial provisions in the health system and, particularly, optimise the insurance system 	<ul style="list-style-type: none"> ■ Actualise the question of the <i>health of Europeans</i> and analyse inputs of each member state in ensuring common health conditions of European society ■ Identify the roots of the problem: look not only for medical and environmental causes for decline of health conditions of Europe's society but also for administrative, economic and social reasons ■ Further develop a common framework and standards for access to care, sustainable financing, and compatible and reliable information/statistics

Educational System	Yes	<p>OMC in education Active, soft, limited, non-effective</p> <p>Bologna and Copenhagen processes Active, soft, significant, effective</p> <p>Horizontal EU programmes Active, soft, limited, effective</p> <p>EU Structural Funds and especially the Social Fund Active, hard, still limited, non-effective</p>	<ul style="list-style-type: none"> ■ Set a clear educational model with effective mechanisms of evaluation, appropriate level of funding and integrated effective mechanisms of transfer of knowledge and competences ■ Enact the necessary legislation and readjust the administrative apparatus ■ Correlate the educational reform with needs in other sectors, such as minority integration, employment promotion and economic development ■ Intensify Latvia's engagement in the Bologna and Copenhagen processes ■ Intensify and optimise institutional coordination of use of European funds/exchange opportunities 	<ul style="list-style-type: none"> ■ Set a common strategy on educational priorities and education cohesion within the enlarged European Union, and if necessary, a more binding common approach ■ Establish effective coordinating mechanisms ■ Set additional "sticks and carrots" for country engagement in the Bologna and Copenhagen process ■ Define standards for sustainable funding, including requirements for allocating a certain minimum share of the GDP
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<p>Justice and Home Affairs</p>	<p>Yes</p>	<p>Police and judicial cooperation in criminal matters Active, soft, significant, effective</p> <p>Schengen membership Active, significant, effective EU leverage</p>	<ul style="list-style-type: none"> ■ Optimise state budget expenses and prioritise goals, such as increasing the professional qualification of JHA staff members and improving their working conditions ■ Increase efficiency and transparency of public procurement procedures in the JHA sector ■ Improve internal monitoring and correlate the results of assessment with respective legislative and administrative adjustments ■ Cooperate with the other EU countries within and beyond the Schengen zone in combating crime and terrorism 	<ul style="list-style-type: none"> ■ Enhance the role of the EU Commission in monitoring and coordinating cooperation in the field of JHA ■ Develop EU standards (new hard EU leverage) for personal data protection and rights of persons under criminal investigation ■ Gradually approximate rules on criminal matters in member states and partly reduce the use of unanimity voting in the Council on criminal matters ■ Intensify cooperation among EU countries, especially to bridge the gap between the new and old members (in terms of information exchange mechanisms, cooperation in cases of emergency and special operations)
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Migration	Yes	<p>EU policy on immigration and asylum – potential common policy</p> <ul style="list-style-type: none"> ■ Active, hard EU leverage in progress 	<ul style="list-style-type: none"> ■ Plan repatriation programmes for Latvian nationals and introduce effective mechanisms for their social and economic reintegration ■ Enhance institutional capacity to deal with migration flows, and to collect and analyse outflow and inflow migration as well as the public accessibility of the data. ■ Prepare and enhance administrative capacity to absorb efficiently European funding for dealing with immigrants and refugees in Latvian society 	<ul style="list-style-type: none"> ■ Enhance coordination of principles and common requirements on visa-issuance, immigration and refugees at the EU level ■ Enhance collective attempts to conclude readmission agreements with third countries ■ Introduce the Blue European Labour Card
Research and Innovation	Yes	<p>OMC</p> <ul style="list-style-type: none"> ■ Active, soft, limited, non-effective <p>Lisbon Strategy</p> <ul style="list-style-type: none"> ■ Active, soft, limited, non-effective 	<ul style="list-style-type: none"> ■ Establish clear and long-term national targets for innovation and research, and foster overall R&D funding base ■ Reform and optimise the funding and coordination of scientific institutions as well as of existing structures and practices ■ Promote conditions for closer interaction between scientific and business communities, as well as other stakeholders; promote PPP 	<ul style="list-style-type: none"> ■ Create more coherent and accessible Community support for scientific activities. This would include “de-bureaucratisation” of the application process and additional emphasis on small and medium-size research projects and networks ■ Make EU financing more accessible for “small” and “medium” scientific institutes and respective projects ■ Create conditions for more active business investments in science

<p>Agriculture and Rural Development</p>	<p>Yes</p>	<p>Quality and health safety products requirements</p> <ul style="list-style-type: none"> ■ Active, hard, significant, non-effective <p>EU subsidies and funds</p> <ul style="list-style-type: none"> ■ Active, hard, significant, non-effective <p>CAP</p> <ul style="list-style-type: none"> ■ Active, hard, significant, non-effective 	<ul style="list-style-type: none"> ■ Optimise administrative capacity, especially on local and regional level, and long-term planning in the agricultural sector ■ Minimise the administrative burden and create initiatives for more active entrepreneurship ■ Curb accumulation of <i>fake farmers</i> ■ Facilitate the bond between the non-governmental sector and the state sector in policy planning and implementation 	<ul style="list-style-type: none"> ■ Minimise the administrative burden in absorbing EU funds ■ Provide more intensive educational possibilities and experience exchange for member states ■ Differentiate policy approaches toward states where a particular area (for instance, fisheries) is crucial in the economy – <i>do not apply a single policy</i> approach toward all member states in areas that are defined as specific because of geographic location etc. ■ Enhance competition and abolish the production quotas, especially for the milk sector
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Regional Development	Yes	<p>Structural Funds (especially the European Regional Development Fund, the European Social Fund and the Cohesion Fund)</p> <ul style="list-style-type: none"> ■ Active, hard, significant, effective <p>EU competition rules (procurement and concession regulations and state aid)</p> <ul style="list-style-type: none"> ■ Active, hard, significant, effective 	<ul style="list-style-type: none"> ■ Complete the regional reform ■ Strengthen the capacity for planning and implementation on sub-national, and especially on municipal level ■ Prevent <i>blind taking</i> of funds without ability to absorb them; at the same time, strengthen the ability of regions to absorb financial support 	<ul style="list-style-type: none"> ■ Minimise administrative burdens and simplify delivery mechanisms for EU funds, and apply clear quality criteria to programmes and projects ■ Promote common policy for PPP in the regions ■ Promote a common Think-about-small-first policy not only toward SMEs but also toward regions (<i>Think about weakest regions first</i>)
Level of Absorption of EU Funds and Their Impact	Yes	<p>Funds blockage</p> <ul style="list-style-type: none"> ■ Active, hard, significant, effective <p>EU monitoring system on the Structural Funds (based on the quarterly reports submitted by all member states)</p> <ul style="list-style-type: none"> ■ Active, soft, significant, potentially effective 	<ul style="list-style-type: none"> ■ Enhance institutional capacity and planning on central and regional level ■ Ensure full transparency of the process and access to information ■ Ensure public consultations and seminars for both potential and existing applicants ■ Simplify application, evaluation and absorption process ■ Enhance communication with European institutions to channel the national position and experiences 	<ul style="list-style-type: none"> ■ Minimise the administrative burden and simplify the existing mechanisms of the Structural Funds

Statistical data

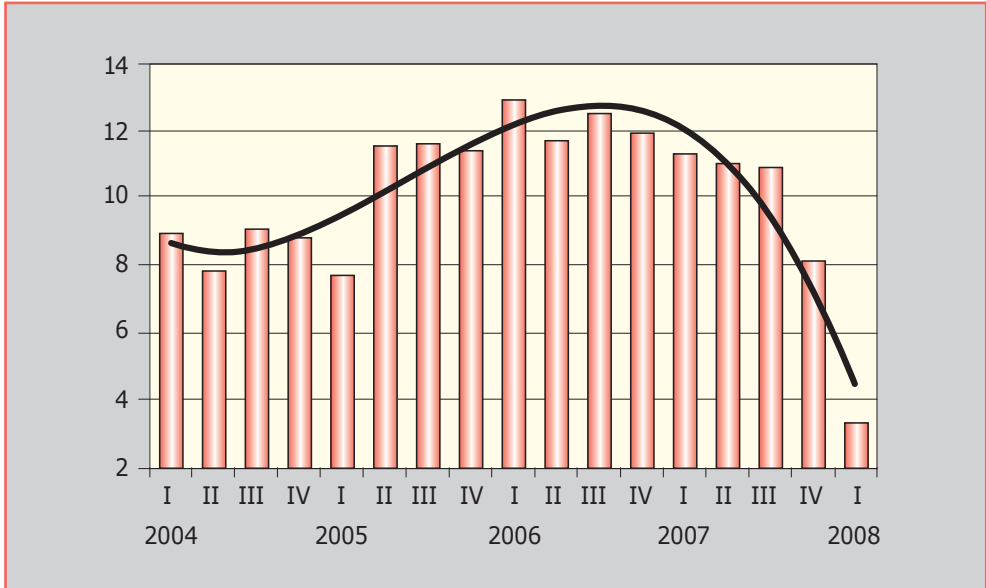
Table: Key Indicators of Economic Development

	2004	2005	2006	2007	2008 f
(growth compared with preceding year, percent)					
Gross domestic product	8.7	10.6	12.2	10.3	2.2
Private consumption	9.8	11.2	21.2	13.9	2.1
Public consumption	2.1	2.7	4.9	4.8	2.3
Gross fixed capital formation	23.8	23.6	16.4	8.4	4.2
Exports	9.4	20.3	6.5	11.1	1.2
Imports	16.6	14.8	19.3	15.0	-8.0
Consumer prices	6.2	6.7	6.5	10.1	16.5
(percent of GDP, unless indicated otherwise)					
Central government budget fiscal balance	-1.0	-0.4	-0.2	-0.04	0.1
Central government debt	14.9	12.4	10.7	9.7	9.2
Current account balance	-12.8	-12.5	-22.3	-23.0	-15.0
Foreign direct investments received within a year in Latvia	4.6	4.5	8.1	7.0	7.0
Employment rate (percent of economically active population, 15-64 years)	62.3	63.4	66.3	68.4	68.5
Unemployment rate (proportion of job seekers percent of economically active population, 15-74 years)	10.4	8.7	6.8	6.0	6.5

f – forecast

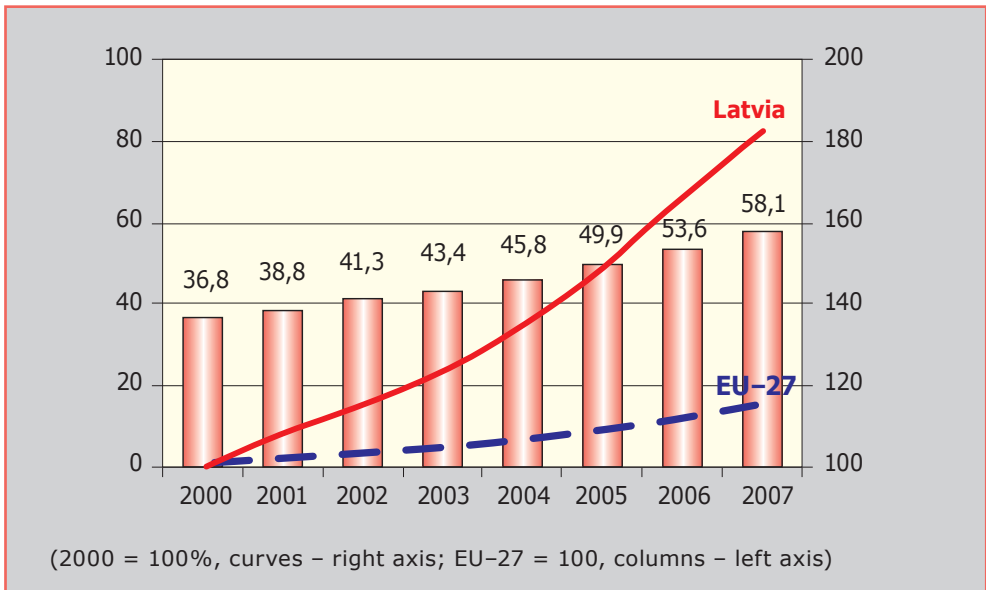
Source: Latvian Ministry of Economics

Graph: GDP Growth by Quarters (percentage change against the corresponding quarter of the preceding year)



Source: Latvian Ministry of Economics

Graph: Dynamics and Level of GDP in Comparison with EU Average (in Purchasing Power Standards)



Source: Latvian Ministry of Economics

Table: Productivity by National Economy Sectors – Value Added per Person Employed

	Annual average real changes in the period of 2004-2007	Level in current prices in 2007
	(%)	(LVL per person employed)
Primary sectors	9.00	3 893
Manufacturing	5.10	8 018
Electricity, gas and water	8.10	21 269
Construction	-0.01	8 090
Trade, hotels and restaurants	8.40	12 390
Transport and communications	7.00	13 046
Other services	8.00	21 516
Public services*	4.20	8 217
Total national economy	7.30	11 061

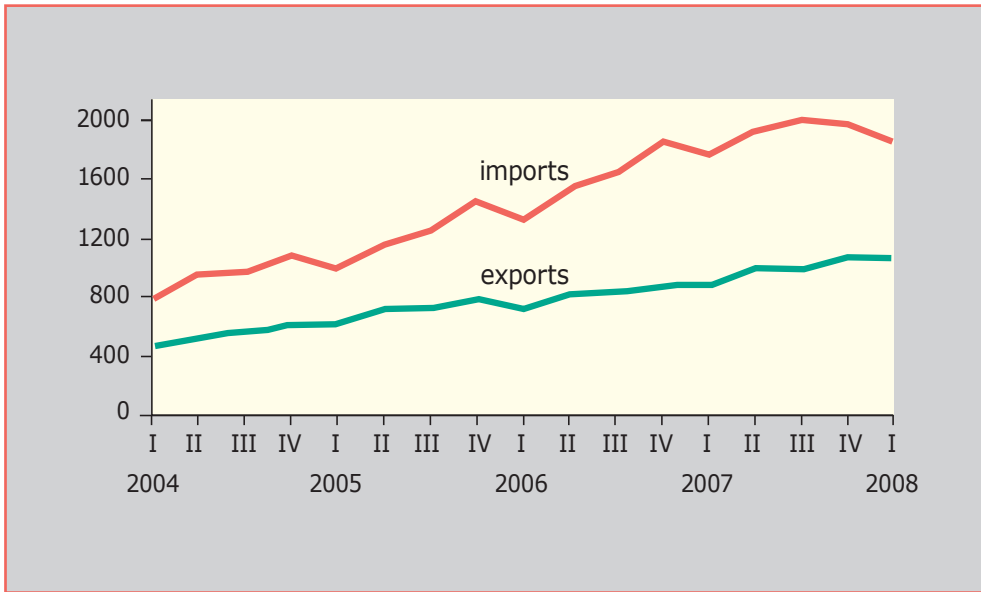
* Public administration with healthcare and education

Source: Latvian Ministry of Economics

Table: Expenditure of Latvian GDP (percentage)

	2006			2007			First quarter of 2008 against first quarter of 2007		
	Structure	Growth rates	Contribution to growth	Structure	Growth rates	Contribution to growth	Structure	Growth rates	Contribution to growth
Gross domestic product	100.0	12.2	12.2	100.0	10.3	10.3	100.0	3.3	3.3
Private consumption	65.2	21.2	13.6	64.8	13.9	9.6	68.1	2.3	1.6
Public consumption	16.6	4.9	0.8	18.2	4.8	0.7	20.1	4.7	0.6
Gross fixed capital formation	32.6	16.4	5.8	32.5	8.4	3.1	28.9	5.1	1.5
Inventories	7.1	-	0.7	4.7	-	1.8	0.1	-	-4.2
Net exports	-21.5	-	-8.6	-20.4	-	-4.8	-17.2	-	3.7
- exports	44.9	6.5	2.9	44.4	11.1	4.7	46.7	6.5	2.7
- imports	-66.3	19.3	-11.5	-64.6	15.0	-9.5	-63.9	-1.6	1.0

**Graph : Commodity Exports and Imports by Quarters
(LVL million)**



Source: Latvian Ministry of Economics

Table: Exports and Imports of Services in 2007

	LVL million			Structure (%)		Changes in comparison with the preceding year (%)	
	Exports	Imports	Balance	Exports	Imports	Exports	Imports
Services – total	1889.2	1375.2	372.3	100.0	100.0	27.9	24.5
including:							
Transport services	950.9	398.2	434.4	50.3	29.0	20.2	11.6
– sea transport	363.1	95.0	228.7	19.2	6.9	15.9	12.4
– air transport	140.1	132.5	-19.8	7.4	9.6	33.9	6.5
– other transport	447.7	170.7	225.4	23.7	12.4	19.9	15.3
Travel	342.8	474.2	-125.0	18.1	34.5	28.3	20.9
Commercial services	571.0	480.1	60.9	30.2	34.9	43.5	42.5
Other services	24.5	22.7	2.0	1.3	1.7	21.3	24.7

Source: Latvian Ministry of Economics

Table: Structure of Economy (%)

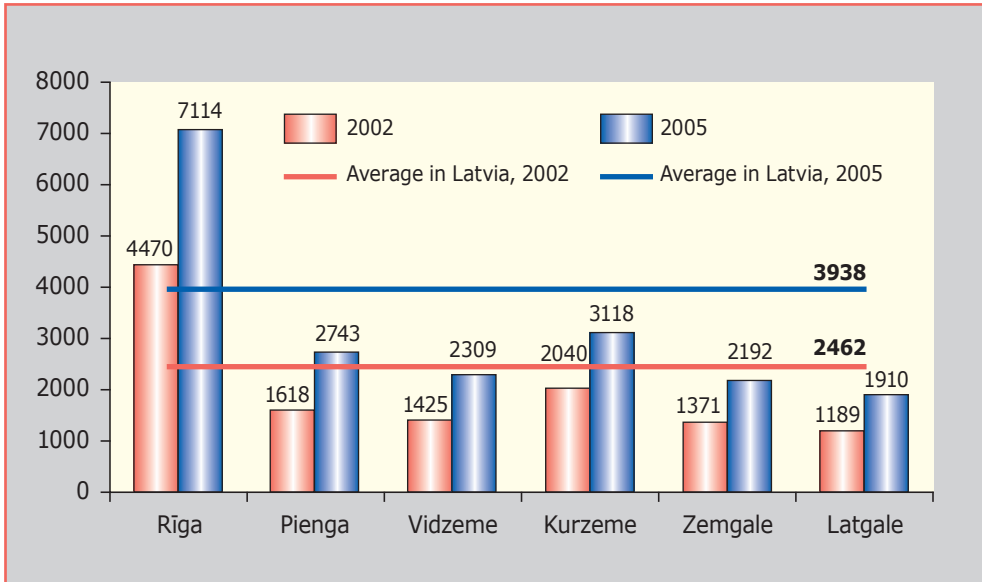
	By value added		By number of employees	
	2000	2007	2000	2007
Primary sectors	4.8	3.6	14.5	10.4
Manufacturing	13.7	10.8	17.9	14.9
Electricity, gas and water supply	3.6	2.4	1.9	1.3
Construction	6.1	8.4	5.9	11.5
Trade, hotels and restaurants	17.9	22.2	17.7	19.8
Transport and communications	14.0	10.8	8.3	9.2
Other commercial services	23.0	27.8	12.4	14.3
Public services	16.9	13.8	21.4	18.6
Total	100.0	100.0	100.0	100.0

Source: Latvian Ministry of Economics

Table: Area, Population and Population Density of the Statistical Regions of Latvia at the Beginning of 2007

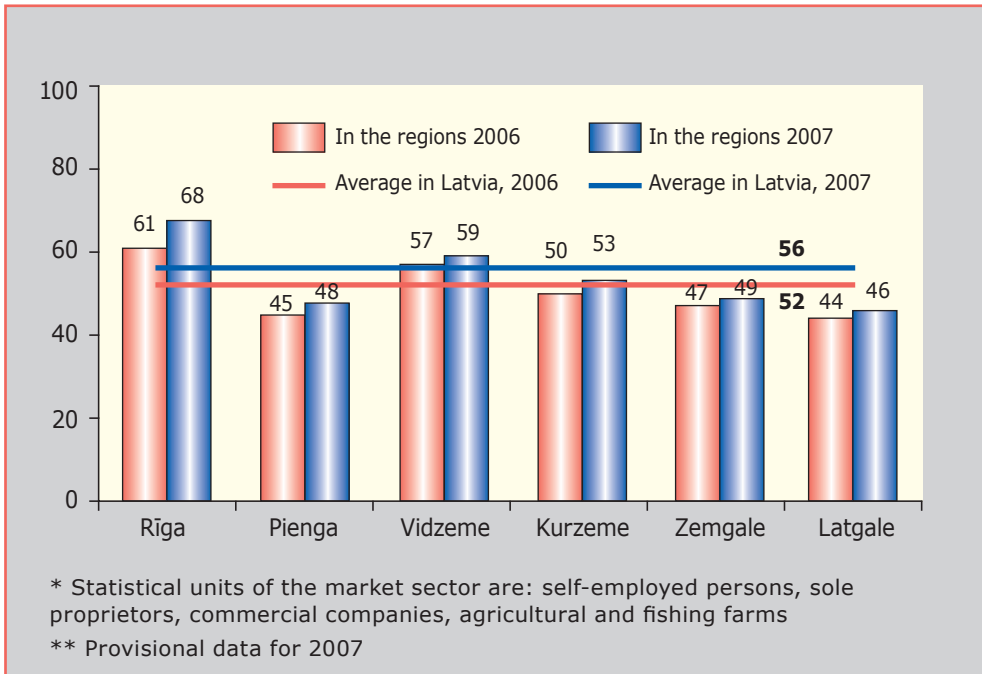
	Area (% of the total)	Population (% of the total)	Number of inhabitants per km ²
Latvia	100.0	100.0	35.3
Rīga	0.5	31.7	2 353.4
Pierīga	15.7	16.4	36.8
Vidzeme	23.6	10.5	15.8
Kurzeme	21.1	13.4	22.5
Zemgale	16.6	12.5	26.5
Latgale	22.5	15.5	24.4

Chart: GDP per Capita (LVL)



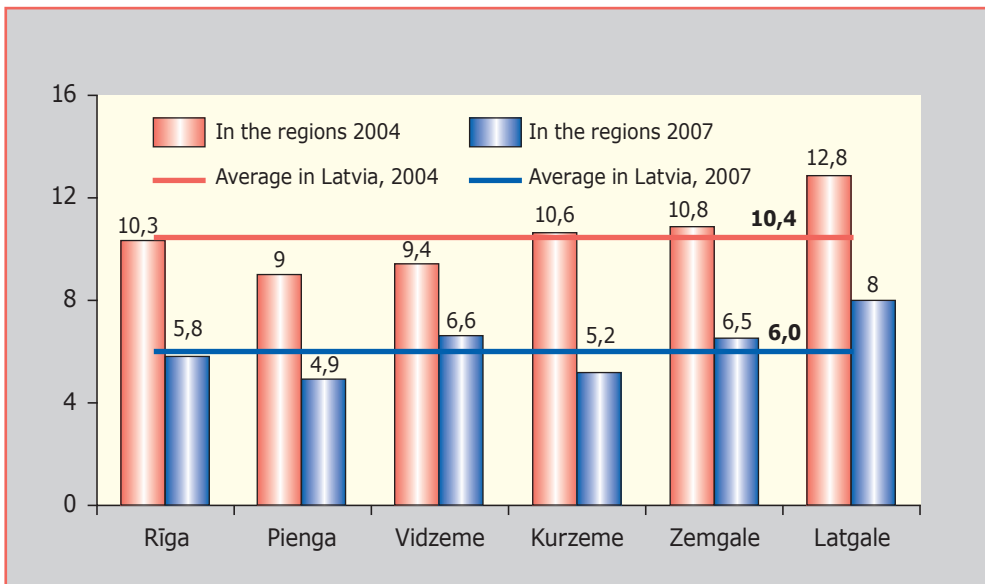
Source: Latvian Ministry of Economics

Chart: Economically Active Statistical Units* of the Market Sector per 1,000 Inhabitants**



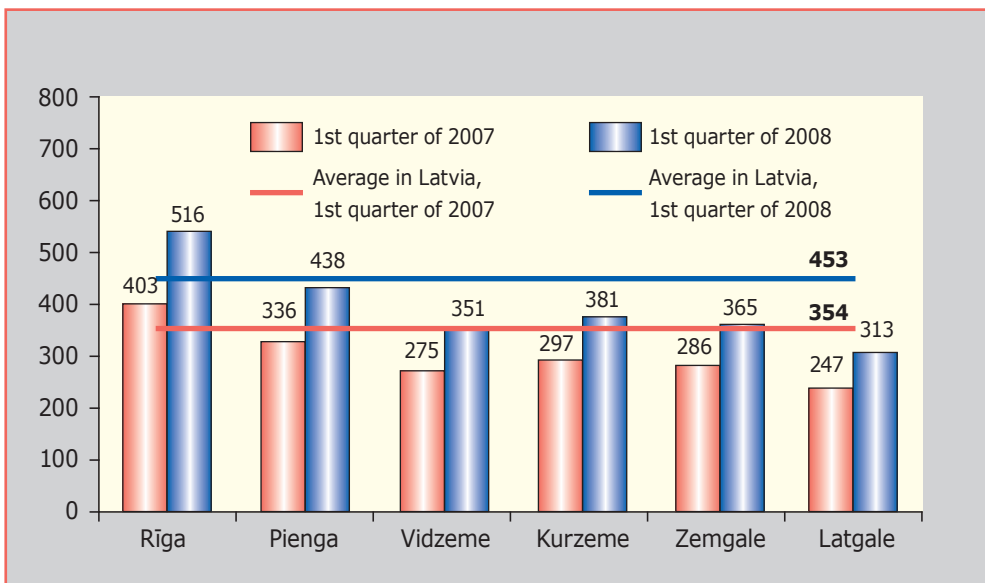
Source: Latvian Ministry of Economics

Chart: Unemployment Rate in 2004-2007
(share of job seekers in % of economically active population aged 15-74)



Source: Latvian Ministry of Economics

Chart: Average Monthly Gross Wages of Employed Persons in the First Quarter of 2008 (LVL)



Source: Latvian Ministry of Economics

Table: Key Indicators of Employment and Unemployment*

Indicators	2000	2005	2006	2007
Population in the 15-64 age group (thousands)	1 600.3	1 583.8	1 580.4	1 573.4
Economically active persons in the 15-64 age group (thousands)	1 074.7	1 100.8	1 126.1	1 146.6
Employed persons (thousands)	917.6	1 003.6	1 047.3	1 075.5
Participation rate (%)	67.2	69.5	71.3	72.9
Employment rate (%)	57.3	63.4	66.3	68.4
Unemployed (job seekers) (thousands)	158.3	99.1	79.9	72.1
Unemployment rate (%)	14.4	8.7	6.8	6.0
Registered unemployed persons (end of period, thousands)	93.3	78.5	68.9	52.3
Registered unemployment rate (end of period, %)**	7.8	7.4	6.5	4.9

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

** Percentage of the registered unemployed persons of the economically active residents since 2002, according to the new methodology.

Source: Latvian Ministry of Economics

Table: Absorption of EU Structural Funds by March 31, 2008

	SF financing		Expenses of the Community declared by the European Commission		Payments received from the European Commission		
	LVL million	LVL million	% of financing	LVL million	% of financing	LVL million	% of financing
ERDF	268.50	163.43	60.9	145.47	54.2	145.47	54.2
ESF	89.50	64.93	72.6	56.43	63.1	50.76	56.7
EAGGF	64.55	59.80	92.6	53.03	82.2	50.83	78.8
FIFG	17.10	15.90	93.0	13.96	81.6	13.51	79.0
Total	439.65	304.06	69.2	268.89	61.2	260.57	59.3

Source: Latvian Ministry of Economics

Table: Absorption of the Cohesion Fund by March 31, 2008

	Available financing	Projects approved by the European Commission (assumed liabilities)		Paid to beneficiaries of CF financing		Payments requested from the European Commission		Payments received from the European Commission	
	EUR million	EUR million	% of available financing	EUR million	% of assumed liabilities	EUR million	EUR million	% of available financing	EUR million
Ministry of Environment		353.2	49.7	163.7	46.4	196.7	55.7	184.0	52.1
Ministry of Transport and Communications		353.9	49.8	201.1	56.8	237.6	67.2	230.1	65.0
Ministry of Finance		3.7	0.5	1.2	33.9	1.5	41.9	1.4	38.1
CF total	710.8	710.8	100.0	366.0	51.5	435.9	61.3	415.5	58.5

Source: Latvian Ministry of Economics

Table: Financing Available for Latvia in the 2007-2013 Financial Period (EUR million)

Fund	Assignment	% of the total assignment
ERDF	2 440	53.9
ESF	551	12.1
CF	1 540	34.0
Total	4 531	100.0

Source: Latvian Ministry of Economics

Other publications of the OSI European Policies Initiative:

- *Not Your Grandfather's Eastern Bloc
The EU New Member States as Agenda Setters in the Enlarged European Union*
 - *Economic and Political Challenges of Acceding to the Euro area in the post-Lehman Brothers' World*
- available at: <http://eupi.eu>
-

“The Unfinished Business of the Fifth Enlargement Countries” publication is comprised of ten national reports and a comparative analysis. The national reports describe and analyze the post accession state of affairs in the ten new member states (NMS) from CEE. The comparative analysis identifies that five years (or two and a half, in the case of Bulgaria and Romania) following accession, the ten central and eastern European states of the fifth enlargement continue to deal with the “unfinished business” from their transition agenda in the context of EU membership and the global economic and financial crises. The biggest challenges in the post accession period concern the political systems, which are characterized by fragmentation of existing political parties and temptation to employ populism and nationalism. The fragmented political parties with short-term political lives are unable to commit to long-term and consistent reforms in the policy spheres that are of crucial importance for the citizens (health, education, social protection etc.) thus leaving those structural reforms largely incomplete. This lack of progress further increases the mistrust in the political establishments thus diminishing the already low citizens’ trust in the institutions of representative democracy, which might cause already fragile political systems to become increasingly vulnerable.