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Assessment of the 2014 national reform programme and stability programme for LATVIA

Accompanying the document

Recommendation for a COUNCIL RECOMMENDATION

on Latvia's 2014 national reform programme and delivering a Council opinion on Latvia's 2014 stability programme

{COM(2014) 415 final}

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EXECUTIVE SUMMARY

Latvia remains among the fastest growing economies in the EU. It has a sound macroeconomic and fiscal basis, but it is vulnerable to external risks. Latvia's economy grew by 4.1% in 2013 and is forecast to grow by 3.8% in 2014. The unemployment rate is forecast to drop to 10.7% in 2014 from 11.9% in 2013. Nominal budget deficits are projected to remain around 1% of GDP in 2014-15, despite several income tax cuts planned, while debt is expected to remain below 40%.

Overall, Latvia has made some progress in addressing the 2013 country-specific recommendations. As regards fiscal policies, some progress was made in reducing taxation of low-income earners, in shifting taxation to other tax bases including environmental taxes and in strengthening the fiscal framework. Substantial progress has been made in addressing vulnerabilities in the financial sector, in particular through implementing additional macro-prudential measures to supervise non-resident banking. Latvia has made some progress in addressing the recommendation on tackling long-term and youth unemployment and implementing reforms in the field of vocational education and training, including by developing the Youth Guarantee plan and improving the quality and accessibility of work-based training. There has been some progress in reforming social assistance and tackling child poverty; in particular various child-related benefits were increased and other support measures implemented. There was no progress in higher education and science, but some progress was made as regards energy efficiency measures, gas market opening and improving the quality of the judicial system.

In the medium to long term, Latvia faces a number of challenges, in particular to improve the quality of higher education and science output, reform social assistance, build energy links to EU networks and further improve efficiency of the judiciary. European structural funds for 2014-2020 will provide an important source of public investment to support Latvia in meeting these challenges. The national reform programme submitted by Latvia addresses most of the challenges identified in this staff working document, however, planned measures are sometimes unspecified and rather unambitious, in particular as regards further measures to address poverty and social exclusion and higher education and science reforms.

- **Labour market**: Unemployment has decreased but remains at high levels: e.g., the proportion of long-term unemployed remains high at around 50% of all job seekers. There are concerns that vocational education and training is inadequate to provide sufficient and appropriate skills for the workforce and the availability of quality work-based learning and training is insufficient. Limited progress has been made to establish comprehensive career guidance and counselling system.

- **Poverty**: Some 35% of the population is at risk of poverty or social exclusion and inequality as well as working age poverty remains high. Unemployed people and families with children are particularly vulnerable, as social benefits are not sufficiently targeted. Designing an effective social safety net including social assistance remains a challenge. The cost of healthcare presents a challenge to fair access — not only for the lowest income quintile, but also for the second lowest.

- **Higher education and research**: Latvia's challenge is to implement ambitious and credible higher education reforms — reforming the accreditation system, introducing a quality-rewarding financing model, consolidating study programmes and institutions, etc.

— and to rationalise and modernise research activities in line with the objectives of the European Research Area and the international assessment of research institutes. Latvia's business R&D intensity is one of the lowest in the EU, making specialisation in innovation-driven sectors a challenge.

- **Energy**: Electricity connections with Estonia are inadequate and challenges remain to ensure the smooth functioning of the regional electricity market. Crucial gas-market issues, including the renegotiation of the Incukalns gas storage contract and completing the regional LNG terminal project, need to be addressed together with neighbouring Lithuania and Estonia. Latvia's energy and carbon intensity is significantly higher than the EU average, particularly in household and transport sectors; continuing ambitious energy efficiency projects in multi-storey buildings and heating systems will be important.

- **Judiciary and public administration**: The efficiency and quality of the judicial system remains a weakness, though positive steps have been taken. Lengthy civil and commercial case proceedings in lower courts and rather low clearance rates have led to a significant backlog of court cases. Court decisions often take years, and there are loopholes in the application of insolvency law. In the public administration, reforms related to improving incentives within a unified wage grid, common standards for hiring senior staff, developing a comprehensive training strategy and career development have been slow and inadequate.

1. INTRODUCTION

In May 2013, the Commission proposed a set of country-specific recommendations (CSRs) for economic and structural reform policies for Latvia. On the basis of these recommendations, the Council of the European Union adopted seven CSRs in the form of a Council Recommendation in July 2013. These CSRs concerned public finances and taxation, financial sector stability, labour market, social assistance, higher education and research, energy efficiency and connectivity, and judicial reforms. This staff working document (SWD) assesses the state of implementation of these recommendations in Latvia.

The SWD assesses policy measures in light of the findings of the Commission's Annual Growth Survey 2014 (AGS)[1] and the third annual Alert Mechanism Report (AMR),[2] which were published in November 2013. The AGS sets out the Commission's proposals for building the necessary common understanding about the priorities for action at national and EU level in 2014. It identifies five priorities to guide Member States to renewed growth: pursuing differentiated, growth friendly fiscal consolidation; restoring normal lending to the economy; promoting growth and competitiveness for today and tomorrow; tackling unemployment and the social consequences of the crisis; and modernising public administration. The AMR serves as an initial screening device to ascertain whether macroeconomic imbalances exist or risk emerging in Member States. The AMR found positive signs that macroeconomic imbalances in Europe are being corrected. To ensure that a complete and durable rebalancing is achieved, 16 Member States were selected for a review of developments in the accumulation and unwinding of imbalances. These in-depth reviews were published on 5 March 2014 along with a Commission communication.[3]

Against the background of the 2013 Council Recommendations, the AGS, and the AMR, Latvia presented a national reform programme (NRP) and a stability programme on 29 April 2014. These programmes provide detailed information on the progress made since July 2013 and on the government's plans. The information contained in these programmes provides the basis for the assessment made in this staff working document. The programmes submitted went through an inclusive consultation process involving the national parliament, local and regional authorities and other stakeholders.

2. ECONOMIC SITUATION AND OUTLOOK

Economic situation

In 2013 and early 2014, growth and employment in Latvia remained strong despite the challenging external environment and continuous deleveraging. Latvia's economy grew by 4.1% in 2013 and 2.8% y-o-y in the first quarter of 2014, slowing from 5.2% in 2012. Private and public consumption as well as net exports supported the overall economic growth, but declines in investment and in inventories were a drag on growth. On the supply side, services and construction were the main growth drivers, while industrial production was adversely

[1] COM(2013) 800 final.

[2] COM(2013) 790 final.

[3] Aside from the 16 Member States identified in the AMR, Ireland was also covered by an in-depth review, following the conclusion by the Council that it should be fully integrated into the normal surveillance framework after the successful completion of its financial assistance programme.

affected by a suspension of operations at the largest metallurgical plant in Liepaja. Consequently, export performance relative to growth in trading partners deteriorated in gross terms, but net exports improved. The country's external sustainability indicators also improved as the current-account deficit fell from 2.5% of GDP in 2012 to 0.8% in 2013.

Economic growth was accompanied by a solid improvement in the labour market. Unemployment fell to 11.9% in 2013 from 15% in 2012 and youth unemployment went down from 28.4% to 23.2% over the same period. Long-term unemployment as a percentage of the active population also started falling and reached 5.2%, around the EU average of 5.1% (third quarter 2013). Despite increases in employment and wages, HICP inflation was close to zero in 2013, mainly due to falling energy prices, which offset the gradual increase in core inflation.

Economic outlook

According to the Commission 2014 spring forecast, growth is projected to remain strong at 3.8% in 2014 and 4.1% in 2015 as investments are set to rebound on the basis of improving business sentiment and higher external demand. Positive business reactions to the recent adoption of the euro are seen as beneficial to investment. On the other side, tensions over the Ukraine-Russian crisis stand as a downside risk to the outlook. Corporate profits and EU funding are likely to remain major financing sources for investors as banking sector deleveraging is still under way. Overall, domestic demand and exports are projected to increase at similar rates. However, investment in capital goods is expected to result in imports growing faster than exports, resulting in a slightly negative net external contribution to GDP. The current-account deficit is forecast to remain below 3% of GDP up to the forecast horizon. Net inflows in the capital account, linked mostly to EU structural funds, are set to exceed the current-account outflow, keeping net external debt on a downward path.

The rise in the minimum wage in 2014 and some shortages of skills in specific labour market segments are likely to accelerate wage growth and restrain job creation. Nevertheless, unemployment is expected to fall below 10% by 2015, a marked improvement on the peak of 19.5% in 2010 but still well above the record low of 6.1% in 2007. The steady rise in service prices and the forthcoming deregulation of household electricity prices are set to push up inflation to 1.2% in 2014 and 2.5% in 2015.

The Latvian NRP and SP provide an overall realistic assessment and outlook of the economic situation in the country and existing risks, linked mainly to the geopolitical situation over the Ukraine-Russian crisis. The country's macroeconomic projections are similar to the Commission 2014 spring forecast with GDP expected to rise by 4% in both 2014 and 2015. The growth estimates do not include any impact from structural reforms as the measures presented in the NRP are not quantified.

The macroeconomic forecast underpinning budgetary projections in the 2014 Stability Programme has been developed in consultation with experts from the Ministry of Economics, Bank of Latvia and experts from commercial banks and international organisations, but it has not been formally endorsed by an independent institution.

3. Challenges and assessment of policy agenda

3.1. Fiscal policy and taxation

Budgetary developments and debt dynamics

The budgetary strategy of the 2014 Stability Programme is to reduce gradually the nominal general government deficit and to respect the Medium-Term Objective (MTO), taking into account the impact of the systemic pension reform. The targeted general government deficit gradually declines, reaching 0.7% of GDP by the end of the programme period. According to the authorities' calculations, this ensures that the structural budgetary position continues meeting the MTO, taking into account the impact of the systemic pension reform. The MTO itself has been revised from -0.5% in the 2013 Convergence Programme to -1.0% in the 2014 Stability Programme; the new MTO reflects the objectives of the Stability and Growth Pact[4]. However, calculations by the Commission based on the information in the programme show that the targeted nominal deficit might not ensure meeting the MTO over the programme horizon, as explained in more detail below.

2013 turned out better than expected in the previous programme and Latvia's structural balance was at the MTO. The budgetary outcome of -1.0% of GDP in 2013 is slightly better than expectations in the 2013 programme (-1.1% of GDP) despite an unanticipated guarantee call of 0.3% of GDP that the government had to meet in July 2013. The lower budget deficit reflects stronger economic recovery – notably somewhat higher wage growth and private consumption growth, which led to higher tax revenue – while total expenditure (including expenditure on EU programmes fully matched by EU funds revenue) remained below the level planned in the 2013 Convergence Programme, even including the above-mentioned guarantee call. In 2013, the Council recommended that Latvia should reinforce its budgetary strategy to ensure that the deviation from the MTO only reflects the incremental impact of the systemic pension reform, as Latvia was found to be eligible to a pension reform clause. Latvia's structural balance[5] stood at -1% of GDP in 2013. As Latvia's MTO is -1.0%, Latvia was compliant with the requirements of the Preventive arm, and based on the ex-post assessment the country did not deviate from the MTO, while the pension reform clause would allow a temporary deviation from the MTO of 0.5% of GDP in 2013 (see Box 2).

Box 1. The Latvia's status vis-à-vis the Stability and Growth Pact

Latvia is subject to the preventive arm of the Pact and was at its Medium Term Objective in 2013. Therefore, it should preserve a sound fiscal position which ensures compliance with the Medium Term Objective.

The nominal deficit is expected to remain stable in 2014, while the structural deficit deteriorates. The programme projects a nominal deficit of 1.0% of GDP in 2014, slightly

[4] The Stability Programme explains that the MTO for the purposes of the Stability and Growth Pact has been changed to match the minimum requirement, taking into account differences in the assessment of the cyclical position of the economy between the national authorities and the European Commission, in order to avoid risk of sanctions stemming from a possible divergence from the MTO which is more stringent than the minimum requirement. The national framework will at the same time continue relying on the target of a structural deficit of 0.5% of GDP, which is embedded in the national Fiscal Discipline Law.

[5] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the programme, using the commonly agreed methodology.

worse than the target of a balance of -0.9% of GDP in the 2013 programme[6]. The nominal deficit projection for 2014 corresponds to expectations in the Commission's forecast, although there are some differences in levels of expenditure and revenue, as well as individual categories[7]. Main policy changes affecting budgetary projections relate to taxation (described in more detail in the respective section below and in Box 2), an increase of the minimum wage and a gradual increase in the statutory retirement age from 2014. Taking into account cyclical developments in the economy, as the output gap turns positive in 2014, the (recalculated) structural balance is set to deteriorate by ½% of GDP[8] and stand at -1.4% of potential GDP in 2014.

The targeted nominal deficit declines further in outer years of the programme, reflecting sizeable expenditure restraint against several revenue-reducing measures. For 2015-2017, the programme envisages a gradual decline in nominal deficits to 0.8% in 2015 and to 0.7% on 2016-2017. These projections, however, imply a pronounced decline in the share of total revenue and total expenditure to GDP, by around 4 percentage points between 2013 and 2017 (excluding decline in expenditure related to EU programmes and fully matched by EU funds revenue). For the revenue side, this decline reflects several discretionary measures already in the law, as well as a projected decline in property income (see Box 2 for main policy changes). The expenditure projections in the programme are made on the basis of the national no-policy-change definition, which implies that headline targets are set according to the top-down approach of the Fiscal Discipline Law, and expenditure is determined on the basis of this target, taking into account revenue forecasts and other relevant information. It is also assumed in the programme that any positive gap ("fiscal space") between this top-down approach and pure bottom-up budgetary estimates of the cost of current policies will be filled with new initiatives. This "fiscal space" is estimated at 0 in 2015, 0.7% of GDP in 2016 and 1.5% of GDP in 2017. The current approach, however, implies that several programmes – as they expire – are not replaced, leading to expenditure restraint below GDP growth and, correspondingly, a shrinking share of government in the economy. Given the already relatively low level of expenditure to GDP against acute needs in many policy areas (discussed in further details in chapters 3.3-3.5), this might be difficult to achieve, representing therefore risk to the targets, especially if the envisaged revenue-reducing measures are implemented as planned. Recognising these risks, the Commission forecast expects a deficit of 1.1% of GDP in 2015, against the programme projection of a deficit of 0.8%.

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[6] As Latvia became a full member of EMU on 1 January 2014, it did not submit a Draft Budgetary Plan in 2013.

[7] For example, the Commission projects an increase in the ratio of indirect taxes to GDP, reflecting the implementation of the new energy tax and some consumption and natural resources tax increases, while the ratio remains unchanged in the programme's scenario. On the other hand, the Commission projects a more gradual decline in the ratio of government investments to GDP (and of some other expenditure categories affected by the absorption of EU funds), as projects related to the 2007-2013 financial perspective are being finalised: as of end 2013, absorption at national level of funds related to the 2007-2013 financial perspective was around 70% in Latvia.

[8] Projections presented by the authorities in the programme, however, indicate a smaller positive output gap in 2014 and correspondingly a smaller deterioration of the structural balance, by ¼ percentage points. Moreover, the authorities project the output gap to remain stable in 2015-2016 and even to narrow in 2017, whereas according to Commission's recalculations based on the information in the programme and using the common methodology, the positive output gap continues widening, reaching 3.5% of potential output by the end of the programme period.

Box 2. Main budgetary measures

Revenue	Expenditure
2013	
• Systemic pension reform[(i)] (-0.5% of GDP)	N.a.
2014	
• Reduction in social security contributions rate from 35.09% to 34.09% (-0.2% of GDP) • Increase in PIT non-taxable thresholds (-0.2% of GDP) • Tax on subsidised electrical energy (tax on energy producers) (0.1% of GDP) • Higher tax revenue due to increase in minimum wage (0.1% of GDP) • Higher tax revenue due to raising efficiency of tax control and administration (0.2% of GDP)	• Increase in retirement age (impact not specified)[(ii)] • Change in pension indexation formula (impact not specified)
2015	
• Systemic pension reform (-0.3% of GDP)[(i)] • PIT rate cut from 24% to 23% (-0.2% of GDP)	• Increase in retirement age (impact not specified)[(ii)]
2016	
• Systemic pension reform (-0.3% of GDP)[(i)] • PIT rate cut from 23% to 22% (-0.2% of GDP)	• Increase in retirement age (impact not specified)[(ii)]
2017	
• N.a.	• Increase in retirement age (impact not specified)[(ii)]

Notes: The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A plus sign indicates that revenue/expenditure increases as a consequence of the measure.

(i) A part of social security contributions is being diverted from the central government budget to privately managed funds and revenue at the disposal of the government correspondingly declines. This share increases from 2% of gross wages in 2012 to 4% in 2013, to 5% in 2015 and to 6% in 2016.

(ii) As of 2014, the statutory retirement age (at 62 in 2013) is increased by 3 months annually, reaching 65 by 2025. In parallel, the early retirement age and the minimum period of insurance are also raised.

The projected deviation from the MTO reflects the impact of the systemic pension reform in 2014-2016 and goes beyond that impact in 2017 according to the programme scenario, while the Commission's forecast points to a risk of an earlier and more substantial deviation. The (recalculated) structural balance deteriorates gradually starting from 2014, as the targeted nominal deficit reduction is less than the cyclical component due to the widening positive output gap. According to the programme scenario, the (recalculated) structural deficit reaches 1.8% of potential GDP in 2017, against the MTO of a structural deficit of 1.0%. This deterioration, however, includes the impact of the systemic pension reform. The reform is being implemented in 2013, 2015 and 2016 and it involves a gradual increase in the share of social security contributions diverted from the budget to privately managed fully-funded schemes, with an incremental cost of 0.5% in 2013 and about 0.3% of GDP in both 2015 and 2016. Each of the impacts is allowing a temporary deviation from the

MTO for up to three years, provided that an appropriate safety margin with respect to the deficit reference value is preserved. Taking into account the allowed deviation from the MTO, the planned structural deficit is in line with the requirement of the Pact until 2016, but leads to a deviation from the required adjustment path towards the MTO in 2017. There are, however, risks to the budgetary scenario, as noted above, stemming from a very pronounced decline in the ratio of expenditure to GDP. Based on the Commission 2014 Spring Forecast, deviation from the MTO might exceed what is justified by the pension reform already in 2015.

The debt-to-GDP ratio is on a declining path. According to the programme scenario, general government debt hovers around 38-39% of GDP in 2013 and 2014 and starts declining noticeably from 2015, reaching 31% by the end of the programme period. This reflects redemption of Latvia's obligations under the 2009-2011 financial assistance programme: in March 2014, Latvia repaid EUR 1 bn to the EU, and another repayment of a similar magnitude is scheduled for early 2015. In order to finance these repayments, the Latvian authorities have made in 2014 two successful benchmark-size bond issues with 7- and 10-year maturity. After major repayments to the EU will be made in 2015, the need to keep large precautionary buffers[9] will expire, allowing the debt ratio to decline. The full implementation of the programme would decrease debt even further by 2030. Since the debt-to-GDP ratio is below the reference value, the debt reduction benchmark is not applicable.

Fiscal framework

The adoption of the Fiscal Discipline Law (FDL) and creation of the Fiscal Council lay the foundation for framing a rules-based fiscal policy. The law was adopted in March 2013 and most of its provisions — establishing a structural balance rule, expenditure rule and medium-term planning — are now in force, with transitional rules still applying for more technical aspects. The 2014 budgetary process was fully based on the new law. The timing of annual updates to the medium-term budgetary law is, however, yet to be aligned with the European Semester by shifting it from autumn to spring. The law's provisions setting up an independent Fiscal Council came into force on 1 January 2014 and the Council held its inaugural meeting on 25 February. The Council will formally monitor policy compliance with the Fiscal Discipline Law through regular and ad hoc reports, and provide independent opinions regarding macroeconomic forecasts, including the cyclical position of the economy. While the recommendation to strengthen the national fiscal frameworks has been addressed, creating a culture of prudent fiscal policy-making is a long-term task, especially given the deeply rooted practices of ad hoc decision-making. For example, the Fiscal Council already faced its first test in March 2014, when it presented an ad hoc report due to a legislative proposal which did not meet the requirements of the FDL.

Long-term sustainability

Latvia appears to face low fiscal sustainability risks, but sufficient primary surpluses need to be ensured. The medium-term sustainability gap[10], showing the adjustment effort up

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[9] As of end-2013, the authorities held 6% of GDP in currency and deposits.

[10] See Table V. The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady improvement in the structural primary balance to be introduced until 2020, and then sustained for a decade, to bring debt ratios back to 60% of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is assigned low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 p.p. of GDP per year until 2020 after the last year

to 2020 required to bring debt ratios to 60 % of GDP in 2030, is at -2.4 % of GDP, primarily related to the low level of government debt (33.4% of GDP in 2015) and the projected decline in ageing costs (contributing with -1.2 pp. of GDP until 2030). In the long-term, Latvia appears to face low fiscal sustainability risks, primarily related to the projected decline in ageing costs contributing with -1.6 pp. of GDP over the very long run. The long-term sustainability gap[11] shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path, is at -0.1 % of GDP. Risks would be higher in the event of the structural primary balance reverting to lower values observed in the past, such as the average for the period 2004-2013. Moreover, these projections imply a steep fall in the replacement rate of statutory pensions, representing a risk to the adequacy of future pensions or a risk of current policies being reviewed, which could have an impact on future sustainability. It is therefore appropriate for Latvia to ensure sufficient primary surpluses in order to maintain the sustainability of public finances.

The privately managed funded pension scheme will gradually take over part of the pension obligations of the public pension scheme and thereby reduce risks related to future pension sustainability. In order to finance future expenditure related to population ageing, Latvia increased contributions to the funded pension scheme from 2% to 4% of gross wages in 2013 and, under current plans, the rate will increase further to 5% in 2015 and to 6% in 2016. The retirement age was increased by three months from 62 years in 2014 and will be further increased by three months each year to reach 65 years in 2025; however, it is not intended to link the pensionable age or benefits with life expectancy. The minimal contribution period to reach a full pension was increased from 10 to 15 years.

Healthcare has moved to the focus of public debate as a sector where higher and more efficient financing could bring significant improvements in the quality of life. Headline population health status indicators such as life expectancy remain very weak and high mortality rates among the working-age population aggravate demographic challenges. Latvia's poor performance on healthcare is confirmed by assessments of health outcomes that are less likely to be compounded by lifestyle factors such as early-life outcomes and vaccine-avoidable diseases. At first sight, the healthcare sector does not seem to pose fiscal sustainability challenges in Latvia and the share of public expenditure on health is modest: 3.9% of GDP in 2012, compared with 7.3% in the EU on average. However, a closer analysis may suggest that additional financing for healthcare would need to be considered in the medium term to meet the healthcare needs of the population, in particular the needs of more vulnerable groups. This has to be considered in view of fiscal capacity and implemented in a cost-effective manner to ensure that health outcomes improve. In this context, Latvia plans to introduce a new model of healthcare financing by implementing a mandatory state health

covered by the autumn 2013 forecast (year 2015) is required(indicating an cumulated adjustment of 2.5 pp.), it is assigned medium risk; and, (iii) if it is greater than 2.5 (meaning a structural adjustment of more than 0.5 p.p. of GDP per year is necessary), it is assigned high risk.

[11] See Table V. The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: i) the initial budgetary position (IBP) which gives the gap to the debt stabilising primary balance; and ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that in an infinite horizon, the growth in the debt ratio is bounded by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds for the S2 indicator were used: (i) if the value of S2 is lower than 2, the country is assigned low risk; (ii) if it is between 2 and 6, it is assigned medium risk; and, (iii) if it is greater than 6, it is assigned high risk.

insurance. The objective of the reform is to set a formula for increasing public financing of the healthcare system possibly up to 4.5% of GDP in coming years, while ensuring a more stable financing base. The main reform parameters are still to be defined, thus possible impacts in terms of financing, overall efficiency and accessibility of healthcare services cannot be assessed at this stage.

Tax system

Latvia's tax-to-GDP ratio, at 27.6% of GDP in 2013, remains one of the lowest in the EU and the structure of taxation is quite growth-friendly. The proportion of consumption taxes in total taxation is relatively high, but the proportion of taxes on capital and business income is one of the lowest in the EU. Recent tax reforms focus on areas identified in the 2013 recommendations; the analysis in this SWD leads to the conclusion that Latvia has made some progress on measures taken to address these recommendations.

The tax wedge on low wage earners for families with dependants has decreased significantly, while the tax wedge on single earners decreased marginally and remains high. As part of the 2014 budgetary package, the authorities partially replaced the previously planned universal personal income tax rate cut with increased non-taxable thresholds, especially for dependants, and reduced social contributions[12]. As a result, the tax wedge on families with dependants was decreased significantly (from 39.6% in 2012 to 35.7% in 2014 for a two-earner family, each earning 67% of the average wage, with 2 dependent children) but the tax wedge for single workers earning 67% of the average wage improved only marginally (from 43.6% to 42.1%). The overall reduction of labour taxes is planned to continue in the coming years, as the personal income tax rate will be reduced by 1 percentage point in 2015 and again in 2016. A more focused approach on single low-income workers could be expected to lead to stronger employment impacts, as the high tax wedge has been identified as contributing to poor employment outcomes for low-skilled workers and undeclared work in Latvia[13].

Environmental taxation has been strengthened to a degree, but its capacity to affect peoples' behaviour seems limited, and some environmentally harmful subsidies remain in place. As recommended in 2013, some excise duties and environmental taxes were raised,[14] although the budgetary impact of these tax increases was modest and led to only a

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[12] The 2013 Convergence Programme envisaged that the personal income tax (PIT) rate would be cut by 2 percentage points in 2014 and by 2 pps in 2015. The amended strategy adopted as part of the 2014 budget package envisages a more gradual lowering of the PIT rate: by 1 pp in 2015 and by 1 pp in 2016. In 2014, the emphasis shifted from the rate cut to increasing PIT non-taxable thresholds: raising the universal threshold from EUR 64 to EUR 75 and the allowance for dependants from EUR 114 to EUR 165, after an increase from EUR 100 to EUR 114 from 1 July 2013. In addition, the social security contributions (SSC) rate was reduced by 1 pp in 2014, from 35.09% to 34.09%, and 'a cap' was introduced to limit the maximum annual SSC tax base to EUR 46 400 from 2014.

[13] The IMF considers the labour tax wedge in the three Baltic States as a major driver of structural unemployment. It finds that reductions in the tax wedge explain about 30% of the variation in structural unemployment and that a reduction in the tax wedge by 10pps would lead to a reduction in structural unemployment by 2 to 4 pps, all else equal. See IMF (2014): 'Baltic Cluster Report – Selected Issues: Unemployment in the Baltics', pp. 69-90, Washington, May 2014.

[14] From 1 January 2014, the excise tax rate was increased for natural gas not used in agriculture and industry, other gaseous hydrocarbons and tobacco products. In addition, the environment tax base was broadened and for a number of natural resources, the rate was raised by 20-25%. A new road toll tax (euro vignette) will be introduced from 1 July 2014.

limited shift in the tax burden. Environmental indicators continue to pose significant challenges, as discussed further in section 3.4. In particular, despite being the only Baltic country to have relatively sophisticated vehicle taxation, including a vehicle registration tax which is linked to CO_2 emissions, emissions from newly registered cars remain the highest in the EU.[15] Taxes related to waste management similarly appear ineffective in diverting waste from landfill to recycling. Moreover, there is no indexation rule for excise or environmental taxes, and their real value is projected to fall over time. The most prominent environmentally harmful subsidies are the fuel excise exemption for diesel used in agricultural production and for petrol, diesel or diesel oil used for heat generation, and the reduced VAT rate applied to heating energy.

Revenue from property taxes could provide room for a growth-friendly tax shift. Taxes on property in Latvia yielded revenues of 0.9% of GDP in 2012, well below the 2.3% average in the EU28. In 2013, the property tax regime was changed in Latvia, giving considerable flexibility to local governments to adjust property tax rates. Although it is still too early to draw conclusions on the effectiveness of the reform, there are some indications that local governments might opt for lower tax rates and/or providing exemptions, with a view to encouraging taxpayers to register on their territory, competing for the share in personal income tax revenue. At the same time, gradual improvements in cadastral values lead to a modest increase in the base of property taxation.

The authorities have made some progress in improving tax compliance and reducing the proportion of undeclared economic activity, notably by improving risk assessment and increasing penalties for fraudulent behaviour. Nevertheless, challenges in this area remain. In particular, despite representing a significant share of total taxation, revenue from consumption taxes could be significantly raised if tax compliance was improved: the implicit tax rate on consumption at 17.4 % in 2012 is among the lowest in the EU, despite relatively high VAT rates (a standard of 21 % and a reduced rate of 12 %). The overall VAT gap was the second highest in the EU in 2000-2011, driven before the crisis by a rather broad application of the reduced rate, and in recent years by a sharply increased VAT compliance gap.[16] Other available estimates for the proportion of the shadow economy and undeclared work, especially cash salaries, confirm these findings.[17] Strengthening tax and customs authorities, improving VAT collection efficiency and effectiveness[18], as well as strengthening the role of judiciary and appropriate application of sanctions for tax crimes, would help in addressing this challenge.

The corporate tax bias towards debt financing is set to increase from 2014. On the one hand, among changes to the corporate income tax law introduced as part of the 2014 budget package, the deductibility of notional interest on retained profits — a measure designed to encourage equity capitalisation — has been abolished, and the limit for maximum interest

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[15] http://www.eea.europa.eu/publications/monitoring-co2-emissions-from-new-cars.

[16] http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat-gap.pdf. When interpreting indicators in the study, due consideration should be given to significant changes in the economic structure of Latvia in the adjustment phase.

[17] European Commission (2014a) Employment and Social Developments in Europe 2013, http://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=7684&visible=1 Chart 5, Chart 10.

[18] European Commission (2014b) Report from the Commission to the Council and the European Parliament Seventh report under Article 12 of Regulation (EEC, Euratom) No 1553/89 on VAT collection and control procedures, COM(2014) 69 final.

deductibility has been raised. On the other hand, from 1 January 2014, the application of tax relief for investments in new production technologies and certain projects approved by the Government is extended until 2020, as well as a tax relief for certain research and development costs is introduced from 1 July 2014. Thus, certain retained profits invested in the development of company still receive favourable tax treatment. A comparative analysis of the effectiveness of the above measures in practice would be useful to choose the most appropriate instruments.

3.2. Financial sector

In 2013, Latvia received a CSR concerning the use of micro- and macro-prudential policies to prevent vulnerabilities that could arise from future credit growth and non-resident banking activities. The analysis in this SWD leads to the conclusion that Latvia has made substantial progress on measures taken to address this recommendation.

In the context of the assessment of Latvia's readiness to join the euro area, financial supervision has been tightened and the corresponding resources increased, in particular as regards monitoring the growing non-resident banking sector. Additional liquidity and capital adequacy requirements for non-resident banks were introduced in 2013, regular on- and off-site checks are performed, and the Deposit Guarantee Fund has been further strengthened. Restructuring the Mortgage and Land Bank to perform development lending activities remains a challenge, but the establishment of the Single Development Institution is in progress. The authorities are assessing the conditions for selling Citadele Bank and considering additional financial and human resources to tackle complex financial and tax evasion crimes. As deleveraging in commercial banks continues, access to finance remains a challenge, in particular for households, SMEs and start-ups.

3.3. Labour market[19], education and social policies

Although unemployment has fallen considerably, it is still above 11%, implying considerable economic and social costs. Youth employability remains a challenge and the unemployment rate of persons with disabilities[20] and of pre-retirement age is significantly above the EU average. Likewise, targeted social services, the coverage and adequacy of social assistance and activation of benefit recipients are issues that remain to be addressed. Skills mismatches and the quality of vocational and higher education require continuous attention. The higher education network is too large and fragmented given the decline in population. It offers too many overlapping study programmes, and has limited attractiveness for foreign students and teaching staff. The accreditation system does not meet international standards and the financing system does not provide incentives to improve quality. One of the biggest social challenges is related to income inequalities, as well as access to healthcare services and the high proportion of the population with unmet healthcare needs; these factors also create barriers to labour market participation. In addition, cross-border access to health care and professional education should be improved.

In 2013, Latvia received a CSR concerning tackling long-term and youth unemployment, establishing comprehensive career guidance, implementing reforms in the field of vocational

[19] For further details, see the 2014 Joint Employment Report, COM(2013)801, which includes a scoreboard of key employment and social indicators.

[20] The unemployment rate of persons with disabilities (29%) is above the EU average of 17.4% (2012).

education and training, and improving the quality and accessibility of apprenticeships. They also recommended tackling the high rates of poverty by reforming social assistance, reducing child poverty, and implementing reforms in higher education and science sectors. The analysis in this SWD leads to the conclusion that Latvia has made some progress in measures taken to address labour market recommendations, limited progress regarding reforms of social assistance, and it has made substantial progress as regards addressing child poverty. Latvia has made no progress as regards higher education reforms and limited progress regarding the modernisation of research institutions (for the full CSR assessment see the overview table in Section 4).

Labour market

Unemployment fell to 11.9% in 2013 and long-term unemployment rates are also falling. Youth unemployment has been on the decrease but remains above the EU average at 23.2% in 2013. The coverage of active labour market policies (ALMPs) increased in 2013 as compared to the previous year, however the proportion of financing for public works in the total ALMP package remains too high at around 30%. Profiling of the unemployed was finally introduced at the end of 2013. Latvia has also amended its legislation to define criteria governing what should be considered a ‘suitable job’ (a job that cannot be refused without the risk of losing unemployment benefits) and provided a legislative framework to improve job search assistance. A pilot project was introduced to provide more support to the long-term unemployed and to step up cooperation between public employment services and social services. Based on this experience, similar measures will be implemented in 2014. It is too early to assess whether the ALMP measures taken so far will help bring back the long-term unemployed into the labour market.

Box 3. The delivery of a Youth Guarantee in Latvia[21]

Important challenges to deliver a Youth Guarantee (YG)[22] in Latvia are:

- Insufficient administrative capacity to provide effective services;

- Develop sufficiently ambitious outreach measures to non-registered, inactive young people.

Social situation and healthcare

Families with children, the unemployed, people with disabilities, elderly women and people living in rural areas are at a particularly high risk of poverty and social exclusion. In 2013, 35.1% of the population was estimated to be at risk of poverty or exclusion and 24% were estimated to suffer from severe material deprivation. Latvia’s spending on social protection as a percentage of GDP has been one the lowest in the EU over the past several years: around 12% of GDP in 2011 and 11.2% of GDP in 2012 (the EU average was then close to 20% of GDP). The coverage and adequacy of social assistance is low and the incentives to work for some groups of social assistance recipients could be

[21] Latvia presented a Youth Guarantee Implementation Plan, entitled "The national Youth Guarantee Implementation Plan 2014-2018" in December 2013.

[22] Pursuant to the Council Recommendation of 22 April 2013 on establishing a Youth Guarantee (2013/C 120/01): "ensure that all young people under the age of 25 years receive a good-quality offer of employment, continued education, an apprenticeship or a traineeship within a period of four months of becoming unemployed or leaving formal education".

improved. Many benefit recipients face barriers to employment such as poor health, low skills, caring obligations, addictions, low regional mobility, and low motivation. The weak capacity of social services limits the success of bringing benefit recipients into active employment.

Addressing the recommendation to reform social assistance, Latvia completed a large-scale assessment of the social security system, including social assistance, in June 2013 (carried out by the World Bank). In December 2013, the government agreed on the thrust of the reform, but implementation of the key measures is not planned until 2016. The government also plans to improve quality and coverage of social work. The government has not reversed the decisions adopted in 2012-13 to reduce the guaranteed minimum income benefit and abolish central government co-financing of this benefit.

Addressing the recommendation to reduce child poverty, Latvia significantly increased a number of child-related benefits, and raised the PIT non-taxable thresholds for dependants. Latvia also legislated that the responsibility to provide school supplies (books, working books) lies with the state or municipality, thus relieving parents from these costs. To provide formal childcare for children less than five years old, the government introduced childcare vouchers as of September 2013. All parents of children aged 1.5–4 who do not have a place in a kindergarten can buy childcare services from private providers. Also, the co-payments for children for reference drugs were abolished as of January 2014. The impact of these measures in terms of access, affordability, and quality of childcare should be further monitored.

Latvia has taken some steps to tackle poverty. The disability related benefits were substantially increased. Low wage earners with dependants will benefit from increased PIT non-taxable minima. The increases in minimum wage may reduce in-work poverty but could at the same time reduce the job creation potential for low-skilled in some regions. The pension indexation was partially (up to EUR 285) reinstated.

Latvia has one of the highest proportions of the population with unmet healthcare needs in the EU. The cost of healthcare is the main barrier to equitable access — not only for the lowest income quintile, but also for the second lowest.[23] The excessive reliance on out-of-pocket payments for almost all types and levels of healthcare services and prescribed pharmaceuticals, coupled with prevalent informal payments,[24] is a particular cause of concern. Long waiting lists for non-emergency care are common, the health workforce is ageing and poorly remunerated, and the availability of certain specialists outside Riga is problematic. Furthermore, there is room to enhance health promotion and disease prevention activities, including by strengthening disease screening. To address these and other issues, the authorities are moving, inter alia, from cost-containment-induced global hospital budgets towards the implementation of a Diagnosis-Related Group payment mechanism by 2015, developing clinical guidelines, making improvements in the e-health system, elaborating long-term health workforce strategy, and implementing alcohol and tobacco consumption reduction activities.

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[23] Latvia has the highest levels of unmet medical needs in the EU, in marked contrast to its neighbours.

[24] According to the 2014 Special Eurobarometer on corruption, informal payments in healthcare are quite widespread in Latvia (http://ec.europa.eu/public_opinion/archives/ebs/ebs_397_en.pdf).

Vocational education

Several measures are ongoing to improve the labour-market relevance of vocational education and training (VET) and increase the availability of quality work-based learning, including modernising infrastructure and redesigning curricula with the close involvement of social partners. A pilot project on a dual VET/apprenticeship-type system involving around 150 students and 30 medium-sized and large firms, in cooperation with German partners, started in September 2013. If properly implemented, it could be transformed into a more permanent and widespread mechanism and could be a first step towards promoting effective work-based learning in Latvia. As there is a limited number of large enterprises, finding ways of involving SMEs in work-based learning provision is needed. Amendments in legislation to clarify the framework for career guidance services provision were adopted in July 2013. Support measures to increase their coverage are under development but a precise timetable for implementation has not been defined.

Higher education

So far, higher education reforms have largely stalled. The current plans are significantly less ambitious in terms of content and timetable for implementation than those presented in 2012-2013 and appear insufficient to address the challenges faced by the higher education sector. The opportunity to use independent international institutions for accreditations of study fields in 2013 has been missed, as accreditation was done in a very short period of time by the Ministry of Education and Science and most study fields were accredited for six years.[25] The government plans to create an independent national accreditation agency, to be included in the European Quality Assurance Register for Higher Education no later than in 2018. A new financing model based on European best practice is currently being prepared in cooperation with the World Bank experts to improve the accessibility and performance-orientation of higher education, but its implementation is not planned until 2016. Original plans to consolidate higher education institutions have been weakened; the only concrete steps now envisaged are to develop joint doctoral programmes and integrate some colleges into universities. Legislative restrictions on the use of foreign languages in study programs remain unchanged and universities have little incentive to attract foreign teaching staff. Encouragingly, changes to state-financed study places will be continued with an increased proportion going to STEM (science, technology, engineering and mathematics) fields.

3.4. Structural measures promoting sustainable growth and competitiveness

Box 4: Potential impact of structural reforms on growth – a benchmarking exercise

Structural reforms are crucial for boosting growth. It is therefore important to know the potential benefits of these reforms. Benefits of structural reforms can be assessed with the help of economic models. The Commission uses its QUEST model to determine how

[25] As from 2014, higher education institutions have two options: either continuing with the current accreditation system managed by the Ministry of Education and Science or choosing a foreign agency included in the European Quality Assurance Register. However, they have little incentive to choose the latter option, as it is more costly.

structural reforms in a given Member State would affect growth if the Member State narrowed its gap vis-à-vis the average of the three best EU performers on key indicators such as the degree of competition or labour market participation. Improvements on these indicators could raise GDP by about 9.3% in a 10-year period. Some of the reforms could have an effect even within a relatively short time horizon. The model simulations corroborate the analysis of Sections 3.4 and 3.5, according to which the largest gains would likely stem from improving competition, in particular in the electricity and gas markets. In addition, the simulations support the priority placed by the authorities on reforming active labour market policies and social welfare payments. As discussed in Section 3.3, moreover, improvements to the education system could also have a noticeable long-term impact on GDP of 2.3% over a 50-year horizon (see note).

Table: Structural indicators, targets, and potential GDP effects[26]

Reform areas		LV	Average 3 best EU performers	GDP % relative to baseline	
				5 years	10 years
Market competition	Final goods sector markups (price-cost margin)	0.29	0.13	3.1	5.9
Market regulation	Entry costs	2.60	0.13	0.0	0.1
Tax reform	Implicit consumption tax rate	17.2	28.6	0.5	0.7
Skill enhancing reforms*	Share of high-skilled	6.5	10.7	0.1	0.2
	Share of low-skilled	10.9	7.5	0.0	0.1
Labour market reforms	Female non-participation rate (25-54ys):			0.6	0.9
	- low-skilled	34.7	26.4		
	- medium-skilled	17.3	10.5		
	- high-skilled	6.8	4.3		
	Low-skilled male non-participation rate (25-54ys)	18.4	7.7	0.1	0.1
	Elderly non-participation rate (55-64ys):			0.4	0.8
	- low-skilled	15.3	13.4		
	- medium-skilled	10.1	4.8		
	- high-skilled	3.6	3.3		
	ALMP (% of GDP over unemployment share)	4.1	37.4	0.3	0.4
	Benefit replacement rate**	56.6	52.6	0.1	0.1
Total				5.1	9.3

Source: Commission services. Note: Simulations assume that all Member States undertake reforms which close their structural gaps by half. The table shows the contribution of each reform to total GDP after five and ten years. If the country is above the benchmark for a given indicator, we do not simulate the impact of reform measures in that area; however, the Member State in question can still benefit from measures taken by other Member States.[27] * The long-run effect of increasing the share of high-skilled labour in the population could be 2.0% of GDP and of decreasing the share of low-skilled labour could be 0.3%.** EU average is set as the benchmark.

Latvia's main challenges include pursuing the transition to higher value-added products and more innovation in all phases of the business cycle, and ensuring energy security. The shortage of qualified staff, poor and fragmented infrastructure and the lack of cooperation between research institutions and businesses are preventing improvements in R&D and result

[26] Final goods sector mark-ups is the difference between the selling price of a good/service and its cost. Entry cost refers to the cost of starting a business in the intermediate sector. The implicit consumption tax rate is a proxy for shifting taxation away from labour to indirect taxes. The benefit replacement rate is the % of a worker's pre-unemployment income that is paid out by the unemployment scheme. For a detailed explanation of indicators see Annex.

[27] For a detailed explanation of the transmission mechanisms of the reform scenarios see: European Commission (2013), "The growth impact of structural reforms", Chapter 2 in QREANo. 4. December 2013. Brussels; http://ec.europa.eu/economy_finance/publications/qr_euro_area/2013/pdf/qrea4_section_2_en.pdf

in inadequate commercialisation of research results. Latvia remains isolated from EU energy networks and is highly dependent on gas supplied by Russia. Further efforts to improve connectivity with the EU's electricity and gas networks are needed to improve competitiveness and the functioning of the energy market. Latvia also lacks a stable and cost-efficient regulatory framework to support renewable energy, especially in the heating sector. There are considerable challenges to closing infrastructure gaps and improving the regulatory framework to fulfil EU obligations on collection and recycling.

In 2013, Latvia received a CSR on improving energy efficiency, connectivity with EU energy networks, and taking steps towards liberalisation of the natural gas market, including clear rules for third-party access to storage capacity. The Council recommended that Latvia take further steps to modernise research institutions based on the ongoing independent assessment. The analysis in this SWD leads to the conclusion that Latvia has made limited progress on measures taken to address connectivity to EU energy networks and some progress on measures to address energy efficiency. The analysis shows that Latvia has made limited progress in addressing the recommendation on the modernisation of research institutions.

Research, development and innovation

The effectiveness of public funding was until recently undermined by a lack of independent, external evaluation of scientific institutions. The results of the first independent assessment undertaken by the Nordic Council became available at the end of 2013 and showed that only 10% of the research units evaluated can be considered high level international research centres. The government has announced that, on the basis of this assessment, by July 2014 it will prepare specific measures for structural reforms in the research and innovation system.

The cabinet of ministers approved a new regulation on state funding distribution for basic science financing in November 2013, under which scientific performance and the number of doctorates and master's degrees will be used as criteria for allocating funding. The government has established a Research and Innovation Strategic Council under the direct supervision of the Prime Minister. Its effectiveness in ensuring better coordination and performance assessment between the state, academic and business sectors in priority areas will need to be monitored.

Latvia's public R&D intensity was only 0.66% of GDP in 2012 and it is not on track to reach its Europe 2020 objective of devoting 1.5% of GDP to R&D by 2020. Public R&D investment in recent years came largely from major programmes funded by EU structural funds, so dependency on tender-based, project-oriented EU financing has increased. It will not be possible to further develop the public research system without increased national support for the basic functions of scientific institutions. In this context, it is odd that the authorities have proposed a substantial reduction of EU and national public financing in 2013.[28]

[28] Following the change to the operational programme 'Entrepreneurship and Innovations' (adopted by the Commission on 19 December 2013), ERDF funding for priority 2.1, Science and Innovations, has been reduced by EUR 14.2 million, and national public funding has been reduced by EUR 65.2 million, but national private co-financing increased by EUR 57.8 million. Latvia has introduced national budget over-commitments for this priority as the project failure rate within these activities is quite high.

Business R&D intensity has fallen and reached only 0.15% of GDP in 2012 (putting it 26th in the EU). However, from July 2014 an amendment to corporate taxation will apply to certain R&D costs and may have a positive effect on corporate R&D expenditure. Other R&D&I investment incentives include corporate income tax rebates on large-scale investment projects and EU funds supported program for high value added investments.

Energy markets and infrastructure

The Commission has supported the Baltic Energy Market Interconnection Plan (BEMIP) to achieve full market liberalisation in 2013-2015. Since November 2012, the market for industrial users is fully liberalised, while the household sector will follow in early 2015 after delays in setting up a support scheme to protect vulnerable consumers. Latvia also joined the regional Scandinavian–Baltic Nord Pool Spot market for electricity contracting in June 2013; however, the participation of Latvian market players was limited, particularly in summer 2013. The Estonian and Latvian electricity cross-border connection is mostly congested, aggravated by leasing the capacity of one of the high-voltage transmission lines to a Russian operator. Wholesale prices in the Baltic region should fall when the three interconnector projects, financially supported by the EU, become operational: Estlink 2, inaugurated in March 2014, the third Estonian-Latvian electricity interconnector and the Lithuanian-Swedish (Nord-Balt) connection, to be unveiled by 2016–2017. Overall, cooperation between transmission system operators and the development of necessary infrastructure has been inadequate to improve the functioning of wholesale electricity markets.

Latvia has adopted legislation to gradually open up the gas market from April 2014 that gives third-party access to the distribution infrastructure. However, partial unbundling of the distribution infrastructure from April 2014 as required under EU legislation and stipulation of measures to fully open up the gas market were postponed until 2017. Preparatory works for ending gas market isolation and supply diversification have not progressed substantially. As soon as one of the Baltic States will be connected to diverse gas supply sources, Latvia will be required by the EU legislation to ensure a fully functioning gas market. In this respect, a preliminary agreement has been reached on the regional liquid natural gas (LNG) terminal to be operated on both sides of the Gulf of Finland, with exact locations still to be determined in Finland and Estonia. The situation will be reassessed with regard to the way forward in the upcoming months. The LNG terminal in Lithuania is expected to start operation in late 2014. Lastly, the issue of Inčukalns gas storage ownership and management has become particularly important as the economic and geopolitical risks related to Russian gas supply have come to the fore.

Energy efficiency, renewable energy and GHG emissions

Latvia's second National Energy Efficiency Action Plan put forward a rather balanced mix of policy measures for the main sectors of economy, partly with a view to prompt transposition and effective implementation of the Energy Efficiency Directive by June 2014. In particular, further investments to increase energy efficiency and the uptake of renewable energy are planned in regional heating systems to reduce reliance on imported gas. However, overall details on the implementation of measures are missing, including details on energy efficiency investments in residential buildings, industry and transport sectors. Measures to promote the higher uptake of energy performance contracting (e.g. legal and financial) and training for the building workforce (e.g. with the support of the Build Up initiative) would further support this process.

The proportion of renewables in the final energy consumption mix reached 35.8% in 2012. The renewable energy proportion in the heating sector has slightly increased due to cohesion policy investment in renovating district heating networks and replacing fossil fuels with renewables in some regional co-generation plants. As regards the renewable energy support framework, the authorities are facing difficulties in devising a predictable legal environment and sufficient incentives for cost-efficient investment in clean energy.

Greenhouse gas emissions from transport accounted for 27% of total emissions in 2011. The transport sector represents around 30% of total energy consumption, partly due to insufficient development of public transport, the poor record on vehicle fuel efficiency, a relatively low level of excise duties and an ageing car fleet. Latvia has implemented a number of measures to decarbonise the transport sector: increased taxes on fuels, exemptions for biofuels, and registration tax for passenger cars based on differentiated CO2 emissions levels. However, these measures do not appear sufficient to affect behaviour. Latvia has also taken action to promote electric vehicles. In February 2014, the government adopted a short-term Electromobility Strategy 2014–16 focusing on the development of battery-charging infrastructure and the electric vehicle market.

Waste management

Latvia faces considerable challenges in closing infrastructure gaps and in improving its regulatory framework to fulfil EU obligations on collection and recycling. In 2012, Latvia landfilled 84 % of municipal waste against the EU average of 33%. Only 12% was recycled and 4% composted (EU average: 27% and 14%); therefore it is unlikely that Latvia will meet the 2016 (50%) and 2020 (75%) landfill diversion targets. The National Waste Management Plan 2013–2020 does not identify a clear national strategy to achieve these targets and ensure certainty to encourage private investment. Significant investments are required to put in place infrastructure and increase waste recycling capacity (packaging and biodegradable waste), make improvements in market instruments (taxation of polluting products, extended producer responsibility), and adapt administrative and regulatory measures to facilitate recovery, including composting.

Transport

The European-gauge railway infrastructure project Rail Baltic is a high priority project for Latvia and other Baltic States. The project, which is planned to be completed by 2023, will be submitted for funding from the Connecting Europe Facility. As a result of different priorities of the three Baltic States, there have been significant delays in the process, including setting up a joint project company and a tendering procedure for a study to assess the technical feasibility and environmental impacts of the project.

The poor quality of road infrastructure remains a major concern for Latvia, hindering the competitiveness of the economy and ports and contributing to a high level of road accidents. Structural and Cohesion funds are gradually improving the situation, but there is still the need to increase national funding and develop a viable long-term funding mechanism for road maintenance. Latvia has adopted a 2014–2020 plan to improve national roads, but it still largely relies on EU funding.

In 2013 the State Audit Office published a critical report on the performance of Riga port, according to which it could improve its competitiveness through better cost and revenue management, more efficient land allocation, improved land connectivity and supply chain functioning. This is also in line with the findings of the December 2013 World Bank study on the competitiveness of the three biggest Latvian ports. In view of the recent events in Ukraine, it is becoming increasingly important to reduce the overly high dependence on Russian goods in port turnover.

3.5. Modernisation of public administration

Latvia continues to face challenges in strengthening the judiciary and modernising public administration to improve the business environment. Lengthy civil and commercial case proceedings in courts of first instance and rather low clearance rates have led to a significant backlog of court cases; court decisions often take years and there are notable deficiencies in insolvency proceedings. Tackling complex economic and financial crimes is a particular challenge. State owned asset management and public administration efficiency and motivation could be greatly improved with targeted reforms. In the customs area, Latvia has significant potential to improve its performance in terms of time taken to process imports and exports to reduce business costs and facilitate trade.

Judicial reforms

In 2013, Latvia received a CSR on the efficiency and quality of the judiciary and reducing the backlog and length of proceedings, including insolvency proceedings. Latvia was also invited to put in place a comprehensive human resources policy and to take steps to implement the mediation laws and streamline the arbitration court system. The analysis in this SWD leads to the conclusion that Latvia has made some progress on measures taken to address this recommendation (for the full CSR assessment see the overview table in section 4).

Work is ongoing to strengthen the regulatory framework and improve the administrative capacity of the judiciary sector. The main challenges include implementing amendments proposed by the Ministry of Justice to civil, administrative and criminal procedural laws, establishing a comprehensive human resource policy linked to the professional evaluation of judges that started in January 2013, reforming the system of arbitration courts, and implementing the Law on Mediation that would alleviate the workload of courts. Several provisions in the Code of Civil Procedure have been amended to streamline the legal process and others are under preparation, i.e. for auctions of immovable property and enforceable titles, introducing electronic processing of documents. Work in parliament is ongoing on the insolvency law (third reading). The amendments under discussion aim to prevent problems observed in practice: e.g., setting a two-month deadline for the debtor to submit an application for insolvency proceedings; providing for the director's or board's liability for insolvency; enhancing the role of insolvency practitioners in identifying 'prima facie' false claims and reducing the discharge periods for natural persons[29]. Insolvency procedures, including appointment of insolvency administrators, have faced a number of weaknesses such as lack of transparency and accountability.

[29] See the Commission Recommendation on a new approach to business failure and insolvency of 12 March 2014: http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf.

There is a positive trend as regards the length of proceedings and the capacity of courts to handle workload.[30] It has been decided to allocate additional judges and administrative staff to courts in the Riga region in 2014 to help level out court workload, reduce the backlog and shorten the length of proceedings. A professional evaluation process for judges, including the training modules attended, started in January 2013. The use of ICT tools has improved as regards registering and managing cases, and for communication between courts and parties in judicial proceedings. Further involvement of the Judicial Council in the reforms and in strengthening the management of courts is key. Significant EU funds financing will be allocated to the judiciary in the 2014-2020 financing period.

Public administration reforms

There are no plans to implement a comprehensive public administration reform based on an independent needs assessment. Although Latvia has a strategic framework for human resource development in public administration since 2013, it only applies to the central public administration and has so far failed to ensure credible reforms related to, inter alia, hiring and career development. Overall, to reduce the exit of best-performers from public service and improve the quality of policy-making, it is becoming more important to align the unified wage grid with efficiency and quality considerations, even if it requires additional budget financing. Unfortunately, proposed reforms as regards professional hiring of senior staff have not yet been implemented. Also, a comprehensive national training strategy for public administration - that could be implemented by the Public Administration School if a more centralised financing was made available - is lacking. Positively, additional financing has been granted within the 2014 budget to the lowest paid wage grid categories (policemen, firemen, cultural experts, social staff), as well as for further equalisation of salary levels for similar work across different ministries/institutions.

A comprehensive reform of establishing a centralised State Owned Enterprise (SOE) manager under the Prime Minister, the gradual transfer of ministries’ stakes in SOEs to this manager, minority and non-core-activity share divestments and an independent selection of board and council members of SOEs is significantly delayed. SOE reform may be one of the key conditions for acceding to OECD, so the government may at least decide in short term on independent selection of board and council members of SOEs. However, currently SOE management board members' salaries are capped and low compared to the private sector making it difficult to attract professional, high-level experts; besides, there are limitations on combining board position responsibilities with other engagements. The authorities are also expected to revisit privatisation plans for some bigger state assets (e.g., Mobile Company or Lattelecom) and continue divestments of minority shares, as initiated by the Privatisation Agency in case of State Social Insurance Agency holdings.

The authorities have not devoted adequate attention and resources to tackling complex economic and financial crimes. Some institutions like the Financial police and the Economic crimes police need more staff, training, and resources to perform their tasks effectively, especially when dealing with complex, cross-border crimes. According to the Deputy Director-General of the State Revenue Service, former SRS officials often participate in

[30] The time taken to bring civil and commercial disputes before the first instance courts fell from 330 days in 2010 to 252 days in 2012. The clearance rate for civil and commercial disputes before the courts of first instance increased from 86% in 2010 to 111% in 2012. *Source:* The 2014 EU Justice Scoreboard: http://ec.europa.eu/justice/effective-justice/scoreboard/index_en.htm.

elaborate VAT fraud schemes; slow court proceedings, top lawyers defending alleged criminals and mild penalties for people convicted of tax crimes encourage such crimes.[31]

Amendments to the Code of Administrative Violations are now in force, establishing administrative penalties for breaching procedures in public procurement, public-private partnerships and the award of concessions. This is likely to bring a greater degree of discipline and accuracy to public procurement decisions. In addition, local governments are now obliged to use centralised procurement, the consequences for suppliers who fail to deliver according to procurement contracts are more severe and small procurement contracts must be published online.

Commendably, the Competition Council has prepared amendments to the Competition Law as regards greater institutional and financial independence. The proposed amendments should strengthen the Council's capacities to prevent experienced staff from leaving and intervene effectively against actions of public and private bodies restricting competition. One of the key proposals refers to independent budgeting of the institution, which would ensure greater financial independence similar to other regulators (e.g., financial, utilities regulators).

4. CONCLUSIONS

Macroeconomic, fiscal and political stability has allowed Latvia to achieve one of the fastest GDP growth rates in the EU. The outlook for 2014 and 2015 is mostly encouraging, but the recent Russian-Ukrainian crisis may have a strong negative bearing. Latvia met its medium-term budgetary objective in 2012 and in 2013. The Spring Forecast projects low deficits around 1% of GDP in 2014-15. The level of government debt is projected to fall to 33% of GDP in 2015 as repayments to the EU take effect. However, there are some indications that big-item reforms like electricity market liberalisation, reforms of higher education and science, social assistance, and management of state-owned enterprises have slowed down or been put on hold primarily due to the upcoming October 2014 general elections. Overall, a greater sense of urgency seems warranted. Lastly, since Latvia joined the euro area on 1 January 2014, it is all the more important to maintain the pace of reforms and maintain competitiveness and fiscal prudence.

The analysis in this staff working document leads to the conclusion that Latvia has made some progress in addressing the country-specific recommendations issued in 2013. Substantial progress has been achieved as regards meeting the budgetary targets and fiscal governance has been strengthened with the establishment of the Fiscal Council. The tax measures implemented by the authorities go in the right direction but they will bring only a moderate improvement in the tax burden for low-income earners, with the situation improving more significantly for families with children. Latvia has slightly shifted taxation to other tax bases, including environmental taxes.

Substantial progress has been achieved to strengthen financial stability linked to non-resident banking business and some progress has been made to improve the employability of young people, in particular under the Youth Guarantee Implementation Plan. Reforms have been

[31] Presentation by K. Čerņeckis, Head of Financial Police, during the public discussion ‘Fight against financial crime and corruption: success stories in Europe and lessons for Latvia’ held by the European Commission in Riga on 14 March 2014.

implemented in the field of vocational education and training, mainly through improved quality and accessibility of work-based learning. Limited progress was made to reform the social assistance system, in which ambitious reforms based on the June 2013 World Bank study are needed to address poverty and social exclusion. No progress was made as regards higher education and science reforms, as several good reform initiatives have been scaled down or postponed. It remains to be seen how the independent assessment of research institutions will be used for quality-based financing allocations (limited progress).

Some progress was made on energy policy, although full liberalisation of the electricity market was abruptly postponed until 2015, as further action was deemed necessary to support vulnerable households. Energy efficiency performance is being improved but a stable and cost-effective support scheme for renewable energy needs to be devised. The gas market has been partially liberalised as of April 2014, but market opening is planned for 2017 at the earliest. Some progress was achieved with significant amendments to judicial procedures and the Insolvency Law, but it is too early to assess the results. Credible public administration reforms have not been implemented.

The policy plans submitted by Latvia address most of the challenges identified in this staff working document. The national reform programme confirms Latvia's commitment to address shortcomings in the areas of the labour market, higher and vocational education and science, energy efficiency and judicial reforms, while the stability programme demonstrates Latvia's commitment to maintaining a structural budgetary position which is based on the mid-term objective, with any deviation limited to the incremental impact of systemic pension reform. Sometimes, however, planned measures are unspecified and unambitious, in particular as regards further improvements in social assistance to address poverty and social exclusion and higher education and science reforms.

OVERVIEW TABLE (CSRS, 2020 TARGETS)[32]

2013 commitments	Summary assessment
CSR 1: Reinforce the budgetary strategy to ensure that the deviation from the MTO only reflects the incremental impact of the systemic pension reform. Within this strategy, reduce taxation of low-income earners by shifting taxation to areas such as excise duties, recurrent property taxes and/or environmental taxes. Maintain efforts to improve tax compliance and combat the shadow economy. Continue strengthening the fiscal framework through effective implementation of the Fiscal Discipline Law and multi-annual budgeting.	Latvia has made some progress in addressing CSR 1: • Substantial progress as regards the MTO. • Some progress in reducing taxation of low-income earners, as the tax wedge has been brought closer to the EU average. However, the focus on low-income earners has been only partial. • Some progress in shifting taxation to other tax bases and environmental taxes: a new excise tax on liquefied petroleum; euro vignette as of July 2014; a new tax on water use for hydroelectric power plants; an increase in environmental taxes for non-eco-friendly products (packaging); landfill tax increased as of January 2014. • Some progress in improving tax compliance and combating the shadow economy. • Substantial progress in strengthening the fiscal framework.
CSR 2: Continue to use micro and macro prudential policies to prevent possible vulnerabilities that could arise from future credit growth and non-resident banking activities.	Latvia has made substantial progress in addressing CSR 2: • Substantial progress in implementing additional macro-prudential measures to supervise non-resident banking, in particular in the context of the assessment of Latvia's readiness to join the euro area. These include additional liquidity and capital adequacy requirements for non-resident banks, regular on- and off-site checks, strengthening the Deposit Guarantee Fund, etc. Latvia has aligned monetary policy and supervisory tools with those in the euro area.
CSR 3: Tackle long-term and youth unemployment by increasing coverage and the effectiveness of active labour market policies and targeted social services. Improve the employability of young people, for example through a Youth Guarantee, establish comprehensive career guidance, implement reforms in the field of vocational education and training, and improve the quality and accessibility of apprenticeships.	Latvia has made some progress in addressing CSR 3: • Some progress in increasing coverage and the effectiveness of the ALMPs (profiling, quality evaluation, strengthened job search assistance). • Limited progress in providing targeted social services. Steps were taken to strengthen cooperation between PES and social services and to increase capacity of social work. • Some progress in improving the employability of young people. The Youth Guarantee Implementation Plan was developed and submitted

[32] The following categories are used to assess progress in implementing the 2013 country-specific recommendations: No progress: The Member State has neither announced nor adopted any measures to address the CSR. This category also applies if a Member State has commissioned a study group to evaluate possible measures. Limited progress: The Member State has announced some measures to address the CSR, but these measures appear insufficient and/or their adoption/implementation is at risk. Some progress: The Member State has announced or adopted measures to address the CSR. These measures are promising, but not all of them have been implemented yet and implementation is not certain in all cases. Substantial progress: The Member State has adopted measures, most of which have been implemented. These measures go a long way in addressing the CSR. Fully addressed: The Member State has adopted and implemented measures that address the CSR appropriately.

	to the Commission. • Some progress in implementing reforms in the field of vocational education and training and improved quality and accessibility of apprenticeships. Nevertheless, there is still ample scope for expanding work-based learning in VET. Implementing other VET reforms remains a longer-term challenge. • Limited progress in establishing comprehensive career guidance.
CSR 4: Tackle high rates of poverty by reforming social assistance for better coverage, by improving benefit adequacy and activation measures for benefit recipients. Reinforce the delivery mechanisms to effectively reduce child poverty.	Latvia has made some progress in addressing the CSR 4: • Limited progress in reforming social assistance. Reform proposals based on sound evidence are being prepared; however, their implementation is uncertain. • Substantial progress in addressing child poverty. Latvia has significantly increased various child-related benefits and implemented other measures (childcare vouchers, relieving parents of the costs associated with school supplies etc.).
CSR 5: Implement the planned reforms of higher education concerning, in particular, the establishment of a quality-rewarding financing model, reform of the accreditation system, consolidation of the institutions and promotion of internationalisation. Take further steps to modernise research institutions based on the ongoing independent assessment.	Latvia has made no progress in addressing the education and training part of CSR 5 of the Council Recommendation: • No progress in establishing a quality-rewarding financing model. • No progress in reforming the accreditation system (the opportunity to use independent international accreditation agencies was not used, and no concrete steps taken to bring the accreditation system in line with international practice). • Limited progress in consolidating institutions. • Limited progress in promoting internationalisation (the legislative restrictions to the use of foreign languages in teaching remained unchanged). Latvia has made limited progress in addressing CSR 5 of the Council Recommendation regarding the modernisation of research institutions: • The results of the international independent assessment were available only at the end of 2013. Only 10 % of the research institutions were assessed as high level international research centres and structural changes are needed to improve the competitiveness of the system. The government has announced that proposals for structural reforms will be presented by 1 July 2014.
CSR 6: Continue improving energy efficiency, especially of residential buildings and district heating networks, provide incentives for reducing energy costs and shift consumption towards energy efficient products. Improve connectivity with EU energy networks and take steps towards liberalisation of the natural gas market, including provision of clear rules for third-party access to storage capacities.	Latvia has made some progress in addressing CSR 6 of the Council Recommendation as regards energy efficiency: • Some progress was achieved to improve energy efficiency in the residential buildings sector, including partial transposition of the Energy Performance of Buildings Directive. Latvia has made limited progress in addressing CSR

	6 of the Council Recommendation as regards connectivity with EU networks: • Limited progress was achieved in area of energy markets and infrastructure, in particularly in the gas sector. Latvia is encouraged to introduce liberalisation and market opening in parallel to efforts to build interconnectors. In particular, Latvia should make efforts to integrate its electricity and gas markets better with Lithuania and Estonia. In this regard, implementation of the BEMIP plan should continue.
CSR 7: Complete pending reforms to improve the efficiency and quality of the judiciary and reduce the backlog and length of proceedings, including as regards insolvency. Put in place a comprehensive human resources policy and take steps to implement the mediation laws and streamline the arbitration court system.	Latvia has made some progress in addressing CSR 7: • Measures include legislative amendments to the Code of Civil Procedure, Law on Judicial Power, insolvency law, arbitration law and mediation law. It is too early to assess the results as some amendments are still undergoing the legislative procedure. The evaluation of the effectiveness of court proceedings and their cost continues. The backlog and length of proceedings have been reduced in 2012-2014.
Europe 2020 (national targets and progress)	
Policy field target	**Progress achieved**
Early school leaving target: 10%	The early school leaving rate was 13.3% in 2010, 11.6% in 2011, 10.6% in 2012 and 9.8% in 2013. Significant progress has been made and the target has been achieved. Women perform more than twice as well as men: 5.8% against 13.6% in 2013.
Tertiary education target: 34-36%	The tertiary attainment rate was 32.3% in 2010, 35.9% in 2011, 37.2% in 2012 and 40.7% in 2013. Significant progress has been made and the target has been achieved. Women perform almost twice as well as men: 53.1% against 28.3% in 2013.
R&D target: 1.5% of GDP	The R&D target is proving to be very ambitious. Taking into account the current decline in R&D intensity, Latvia seems unable to reach its target for 2020. The business R&D intensity decreased in 2012 by 23% compared to 2011, attaining 0.15% of GDP in 2012 (ranked 26th in EU). Public R&D increased only by 1.3% compared to 2011, reaching 0.51% in 2012.
Change in non-ETS greenhouse gas emissions	Change in non-ETS greenhouse gas emissions between 2005 and 2012: 1%. According to the latest national projections submitted to the Commission and taking into account existing measures, it is expected that the target will be missed by 1% in 2020 as compared with 2005.
2020 Renewable energy target: 40% Proportion of renewable energy in all modes of	RES share of final energy consumption in 2012: 35.8% RES share of energy used in transport: 3.3%

transport: 10%	
Energy Efficiency target: 0.67 Mtoe (28PJ) By 2020 level of 5.37 Mtoe primary consumption and 4.47 Mtoes final energy consumption	Latvia notified the policy measures it plans to adopt to implement Article 7 of the Energy Efficiency Directive.
Employment rate target set in the 2012 NRP: 73%	Employment rate: 66.3% in 2011, 68.1% in 2012. The employment rate increased further in 2013 and reached 70.5% in 3Q2013. Latvia is on track to reach its Europe 2020 target.
Target on the reduction of population at risk of poverty and/or living in jobless households: — 121 000	Reduction of the number of people at risk of poverty and/or living in jobless households in 1 000 was -134 in 2011, -146 in 2012 and -154 in 2013. Thus, Latvia has already reached its poverty target. The challenge will be to prevent the at-risk-of-poverty rate from increasing as the economy recovers.

ANNEX

Standard Tables

Table I. Macro-economic indicators

	1996-2000	2001-2005	2006-2010	2011	2012	2013	2014	2015
Core indicators								
GDP growth rate	5.5	8.2	-0.2	5.3	5.2	4.1	3.8	4.1
Output gap [1]	0.7	1.4	0.5	-6.3	-2.1	0.0	1.4	2.6
HICP (annual % change)	4.3	4.1	6.8	4.2	2.3	0.0	1.2	2.5
Domestic demand (annual % change) [2]	6.2	9.8	-1.1	10.8	2.5	2.3	3.9	4.9
Unemployment rate (% of labour force) [3]	15.6	11.9	11.6	16.2	15.0	11.9	10.7	9.6
Gross fixed capital formation (% of GDP)	21.0	26.6	27.3	21.3	22.8	21.1	20.9	21.2
Gross national saving (% of GDP)	15.9	19.7	20.8	22.7	22.5	22.0	21.3	20.7
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-1.1**	**-1.5**	**-4.6**	**-3.5**	**-1.3**	**-1.0**	**-1.0**	**-1.1**
Gross debt	**11.8**	**14.0**	**24.2**	**42.0**	**40.8**	**38.1**	**39.5**	**33.4**
Net financial assets	**9.3**	**8.3**	**-1.7**	**-14.8**	**-11.5**	**n.a**	**n.a**	**n.a**
Total revenue	37.2	34.0	35.5	34.9	35.1	35.1	34.3	33.2
Total expenditure	38.3	35.5	40.1	38.4	36.4	36.1	35.3	34.3
of which: Interest	0.9	0.7	0.9	1.5	1.3	1.7	1.6	1.3
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-4.8**	**-6.3**	**-0.4**	**5.9**	**5.5**	**5.4**	**5.3**	**4.8**
Net financial assets; non-financial corporations	**-50.5**	**-89.1**	**-93.4**	**-103.8**	**-84.6**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**-4.8**	**-1.0**	**3.1**	**11.3**	**3.2**	**n.a**	**n.a**	**n.a**
Gross capital formation	19.8	24.6	21.2	19.2	18.8	16.0	15.7	16.1
Gross operating surplus	26.0	33.3	30.3	33.6	34.7	33.6	33.4	33.7
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**-0.5**	**-1.1**	**-2.5**	**-2.4**	**-3.5**	**-2.9**	**-3.1**	**-3.3**
Net financial assets	**29.5**	**36.1**	**11.1**	**14.9**	**23.6**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	34.4	34.6	41.4	36.5	36.5	37.0	36.8	36.5
Net property income	8.8	11.5	5.6	5.0	5.2	5.6	6.7	6.8
Current transfers received	17.4	18.0	17.9	18.0	17.3	17.0	16.3	16.1
Gross saving	0.7	1.0	1.5	-0.8	-1.1	0.1	0.0	-0.1
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-6.5**	**-8.8**	**-7.5**	**0.0**	**0.5**	**1.6**	**1.2**	**0.5**
Net financial assets	**17.6**	**46.6**	**82.1**	**94.5**	**71.4**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	-8.5	-12.4	-11.6	-4.8	-3.9	-1.9	-2.0	-2.6
Net primary income from the rest of the world	0.1	-0.6	0.5	0.7	-0.1	-0.2	-0.4	-0.6
Net capital transactions	0.2	0.8	1.8	2.1	3.0	2.5	2.5	2.4
Tradable sector	52.7	51.9	47.0	52.4	52.6	51.0	n.a	n.a
Non tradable sector	36.0	37.6	42.2	37.2	36.8	38.3	n.a	n.a
of which: Building and construction sector	5.3	5.8	7.5	4.9	5.5	5.7	n.a	n.a
Real effective exchange rate (index, 2000=100)	95.0	94.8	139.4	131.8	133.1	136.5	138.8	139.6
Terms of trade goods and services (index, 2000=100)	97.1	98.7	101.6	105.2	102.2	102.6	102.7	102.7
Market performance of exports (index, 2000=100)	90.8	91.7	102.2	108.5	115.3	113.5	112.7	112.6

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source:

Commission 2014 spring forecast (COM)

Table II. Comparison of macroeconomic developments and forecasts

	2013		2014		2015		2016	2017
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	4.1	4.1	3.8	4.0	4.1	4.0	4.0	4.0
Private consumption (% change)	5.4	5.4	4.8	5.1	5.1	4.6	4.0	3.9
Gross fixed capital formation (% change)	-4.3	-4.3	3.2	3.8	6.8	5.0	5.7	5.8
Exports of goods and services (% change)	1.0	1.0	3.6	4.0	5.6	4.6	5.0	5.3
Imports of goods and services (% change)	-1.7	-1.7	3.9	4.5	6.8	5.1	5.2	5.4
Contributions to real GDP growth:								
- Final domestic demand	3.0	2.4	4.0	4.4	5.0	4.4	4.2	4.1
- Change in inventories	-0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	1.7	1.7	-0.2	-0.4	-0.8	-0.4	-0.2	-0.2
Output gap[1]	0.0	-0.1	1.4	1.2	2.6	1.8	2.7	3.5
Employment (% change)	2.3	2.1	1.6	1.2	1.7	0.8	0.5	0.3
Unemployment rate (%)	11.9	1.9	10.7	10.5	9.6	9.7	9.0	8.7
Labour productivity (% change)	1.8	2.0	2.1	3.1	2.4	3.5	3.4	3.6
HICP inflation (%)	0.0	0.0	1.2	1.1	2.5	3.0	2.5	2.5
GDP deflator (% change)	1.4	1.4	1.7	1.6	2.7	2.8	2.5	2.5
Comp. of employees (per head, % change)	5.4	4.6	4.1	5.6	4.6	5.3	5.5	5.5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.6	1.6	1.2	1.2	0.5	1.1	0.8	0.3

Note:

[1] In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Commission 2014 spring forecast (COM); Stability programme (SP).

Table III. Composition of the budgetary adjustment

(% of GDP)	2013	2014		2015		2016	2017	Change: 2013-2017
	COM	**COM**	**SP**	**COM**[1]	**SP**	**SP**	**SP**	**SP**
Revenue	**35.1**	**34.3**	**33.9**	**33.2**	**32.0**	**30.9**	**30.1**	**-5.0**
of which:								
- Taxes on production and imports	11.6	11.9	11.6	12.0	11.5	11.3	11.1	-0.5
- Current taxes on income, wealth, etc.	7.7	7.5	7.6	7.4	7.3	7.0	6.9	-0.8
- Social contributions	8.3	8.1	8.2	7.7	7.7	7.4	7.2	-1.1
- Other (residual)	7.6	6.8	6.5	6.2	5.5	5.2	4.9	-2.7
Expenditure	**36.1**	**35.3**	**34.9**	**34.3**	**32.8**	**31.6**	**30.8**	**-5.3**
of which:								
- Primary expenditure	34.4	33.7	33.3	33.0	31.6	30.4	29.7	-4.7
of which:								
Compensation of employees	9.2	9.3	9.2	9.3	8.7	8.3	8.0	-1.2
Intermediate consumption	6.4	6.5	6.5	6.5	6.2	5.6	5.2	-1.2
Social payments	10.6	10.3	10.1	10.1	9.9	9.4	9.0	-1.6
Subsidies	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.1
Gross fixed capital formation	3.9	3.7	3.6	3.4	3.2	2.7	2.5	-1.4
Other (residual)	3.7	3.3	3.4	3.1	3.1	3.8	4.4	0.7
- Interest expenditure	1.7	1.6	1.6	1.3	1.2	1.2	1.1	-0.6
General government balance (GGB)	**-1.0**	**-1.0**	**-1.0**	**-1.1**	**-0.8**	**-0.7**	**-0.7**	**0.3**
Primary balance	**0.7**	**0.6**	**0.6**	**0.2**	**0.4**	**0.5**	**0.4**	**-0.3**
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	**-1.0**	**-1.0**	**-1.0**	**-1.1**	**-0.8**	**-0.7**	**-0.7**	**0.3**
Output gap[2]	0.0	1.4	1.2	2.6	1.8	2.7	3.5	3.5
Cyclically-adjusted balance[2]	-1.0	-1.4	-1.4	-1.9	-1.4	-1.5	-1.8	-0.8
Structural balance (SB)[3]	**-1.0**	**-1.4**	**-1.4**	**-1.9**	**-1.4**	**-1.5**	**-1.8**	**-0.9**
Change in SB	*-0.8*	*-0.5*	*-0.4*	*-0.4*	*0.0*	*-0.2*	*-0.3*	-
Two year average change in SB	*0.2*	*-0.6*	*-0.6*	*-0.5*	*-0.2*	*-0.1*	*-0.2*	-
Structural primary balance[3]	0.7	0.2	0.2	-0.6	-0.2	-0.3	-0.7	-1.4
Change in structural primary balance		*-0.5*	*-0.5*	*-0.8*	*-0.4*	*-0.2*	*-0.4*	-
Expenditure benchmark								
Applicable reference rate[4]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-
Deviation[5] (% GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-
Two-year average deviation (% GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-

Notes:

[1] On a no-policy-change basis.

[2] Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

[3] Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

[4] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A lower rate applies as long as the country is adjusting towards its MTO, including in year t.The reference rates applicable to 2014 onwards have been updated in 2013.

[5] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source:

Stability programme (SP); Commission 2014 spring forecast (COM); Commission calculations.

Table IV. Debt dynamics

(% of GDP)	Average 2008-2012	2013	2014		2015		2016	2017
			COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**36.8**	**38.1**	**39.5**	**38.8**	**33.4**	**32.9**	**34.2**	**31.3**
Change in the ratio	6.4	-2.8	1.4	0.7	-6.1	-5.9	1.3	-2.9
Contributions[2] *:*								
1. Primary balance	**4.0**	**-0.7**	**-0.6**	**-0.6**	**-0.2**	**-0.4**	**-0.5**	**-0.4**
2. "Snow-ball" effect	**0.6**	**-0.5**	**-0.4**	**-0.4**	**-1.3**	**-1.3**	**-0.8**	**-1.0**
Of which:								
Interest expenditure	1.3	1.7	1.6	1.6	1.3	1.2	1.2	1.1
Growth effect	0.2	-1.6	-1.4	-1.4	-1.5	-1.5	-1.2	-1.3
Inflation effect	-0.8	-0.5	-0.6	-0.6	-1.0	-1.0	-0.8	-0.8
3. Stock-flow	**1.7**	**-1.6**	**2.4**	**1.8**	**-4.6**	**-4.2**	**2.6**	**-1.5**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

	2013	2014		2015		2016	2017
		COM	SP	COM	SP	SP	SP
Gap to the debt benchmark[3,4]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Structural adjustment[5]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
To be compared to:							
Required adjustment[6]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes:

[1]End of period.

[2]The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

[3]Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[4]Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[5]Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[6]Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP/CP) budgetary projections for the previous years are achieved.

Source :
Stability programme (SP); Commission 2014 spring forecast (COM); Commission calculations.

Table V. Sustainability indicators

	Latvia			European Union		
	2013 scenario	**No-policy-change scenario**	**Stability programme scenario**	**2013 scenario**	**No-policy-change scenario**	**Stability programme scenario**
S2*	-1.8	-0.1	-0.2	2.4	2.4	0.7
of which:						
Initial budgetary position (IBP)	0.2	1.5	1.2	0.5	0.4	-1.3
Long-term cost of ageing (CoA)	-2.0	-1.6	-1.4	1.9	2.0	2.0
of which:						
pensions	-2.0	-1.5	-1.2	0.7	0.8	0.9
healthcare	0.4	0.4	0.4	0.9	0.9	0.8
long-term care	0.2	0.2	0.2	0.6	0.6	0.6
others	-0.7	-0.7	-0.7	-0.4	-0.4	-0.3
S1**	-4.3	-2.4	-3.1	1.5	1.7	-0.2
of which:						
Initial budgetary position (IBP)	-1.6	0.5	0.3	-0.2	-0.4	-2.0
Debt requirement (DR)	-1.2	-1.7	-2.3	1.5	1.8	1.5
Long-term cost of ageing (CoA)	-1.5	-1.2	-1.1	0.2	0.3	0.3
S0 (risk for fiscal stress)***	0.19	:		:		
Debt as % of GDP (2013)	38.1			88.9		
Age-related expenditure as % of GDP (2013)	17.4			25.8		

Source *: Commission; 2014 stability programme.*

Note : The 2013 scenario depicts the sustainability gap under the assumption that the budgetary position evolves until 2013 in line with the Commission's 2014 spring forecast. The 'no-policy-change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves until 2015 in line with the Commission's 2014 spring forecast. The 'stability programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented. Age-related expenditure as given in the 2012 Ageing Report.

* The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: (i) the initial budgetary position (IBP), which gives the gap vis-à-vis the debt-stabilising primary balance and (ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that, in an infinite horizon, the growth in the debt ratio is bound by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60 % debt threshold. The following thresholds were used for the S2 indicator: (i) if the value of S2 is lower than 2, the country is classed as low risk; (ii) if it is between 2 and 6, it is classed as medium risk; and (iii) if it is greater than 6, it is classed as high risk.

** The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady improvement in the structural primary balance in the period to 2020 and then sustained for a decade, to bring debt ratios back to 60% of GDP in 2030, including financing for any additional expenditure by the target date, arising from population ageing. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is classed as low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 pp of GDP per year until 2020 after the last year covered by the 2014 spring forecast (2015) is required (indicating a cumulated adjustment of 2.5 pp), it is classed as medium risk; and (iii) if the S1 value is greater than 2.5 (i.e. a structural adjustment of more than 0.5 pp of GDP per year is necessary), it is classed as high risk.

*** The S0 indicator reflects up-to-date evidence on the role played by fiscal and financial competitiveness variables in creating potential fiscal risks. The methodology for the S0 indicator differs fundamentally from that for the S1 and S2 indicators. Unlike S1 and S2, S0 is not a quantification of the required fiscal adjustment effort, but a composite indicator which estimates the extent to which there might be a risk of fiscal stress in the short term. The critical threshold for the S0 indicator is 0.43.

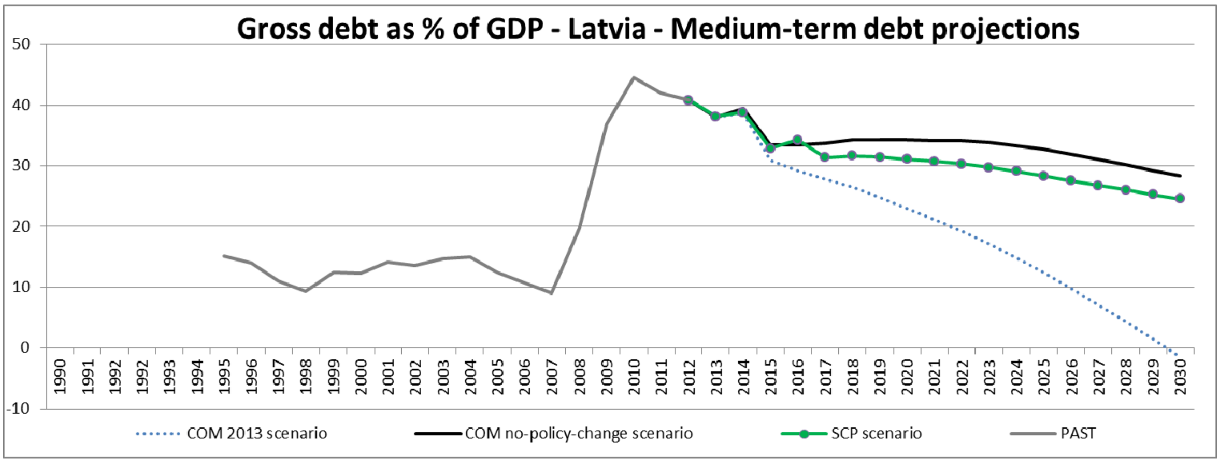

Table VI. Taxation indicators

	2002	2006	2008	2010	2011	2012
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	28.6	30.6	29.2	27.2	27.6	27.9
Breakdown by economic function (% of GDP)[1]						
Consumption	10.5	12.6	10.5	10.6	10.5	10.7
of which:						
- VAT	6.7	8.6	6.7	6.6	6.8	7.1
- excise duties on tobacco and alcohol	1.2	1.3	1.5	1.5	1.4	1.3
- energy	1.8	2.0	1.7	2.0	1.9	1.9
- other (residual)	0.8	0.7	0.6	0.5	0.4	0.4
Labour employed	14.7	14.6	14.4	14.0	13.5	13.4
Labour non-employed	0.1	0.1	0.1	0.3	0.3	0.3
Capital and business income	2.2	2.4	3.3	1.2	1.8	2.1
Stocks of capital/wealth	1.1	0.8	0.9	1.2	1.4	1.5
p.m. Environmental taxes[2]	2.3	2.4	2.0	2.4	2.5	2.4
VAT efficiency[3]						
Actual VAT revenues as % of theoretical revenues at standard rate	48.3	64.6	49.2	42.0	42.0	45.0

Note:

1. Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2014), Taxation trends in the European Union, for a more detailed explanation.

2. This category comprises taxes on energy, transport and pollution, and resources included in taxes on consumption and capital.

3. The VAT efficiency is measured via the VAT revenue ratio. It is defined as the ratio between the actual VAT revenue collected and the revenue that would be raised if VAT was applied at the standard rate to all final (domestic) consumption expenditures, which is an imperfect measure of the theoretical pure VAT base. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). It should be noted that the relative size of cross-border shopping compared to domestic consumption also influences the value of the ratio, notably for smaller economies. See European Commission (2012), Tax Reforms in EU Member States and OECD (2012), Consumption tax trends for a more detailed discussion.

Source: Commission

Table VII. Financial market indicators

	2009	2010	2011	2012	2013
Total assets of the banking sector (% of GDP)	-	169.9	145.1	127.3	125.2
Share of assets of the five largest banks (% of total assets)	69.3	60.4	59.6	64.1	-
Foreign ownership of banking system (% of total assets)	-	67.8	63.8	62.4	-
Financial soundness indicators:					
- non-performing loans (% of total loans)[1)]	14.3	15.9	14.1	8.7	7.5
- capital adequacy ratio (%) [1)]	13.7	13.9	16.5	16.7	17.7
- return on equity (%) [1), 2)]	-50.6	-19.7	5.1	17.8	13.2
Bank loans to the private sector (year-on-year % change)	-	-	-6.3	-0.4	-2.0
Lending for house purchase (year-on-year % change)	-	-	-6.3	-4.5	-4.5
Loan to deposit ratio	-	206.7	193.3	161.7	132.3
CB liquidity as % of liabilities	0.0	0.0	0.0	0.0	0.1
Banks' exposure to countries receiving official financial assistance (% of GDP)	-	-	-	-	-
Private debt (% of GDP)	100.4	95.1	82.6	64.4	-
Gross external debt (% of GDP)					
- Public	25.5	32.4	31.9	32.1	29.0
- Private	47.7	45.7	44.4	40.6	41.0
Long term interest rates spread versus Bund (basis points)*	913.5	759.4	329.9	307.0	177.0
Credit default swap spreads for sovereign securities (5-year)*	702.6	357.8	234.9	213.2	110.3

Notes:

[1)] Latest data 2013Q3.

[2)] After extraordinary items and taxes.

* Measured in basis points.

Source :

Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission (long-term interest rates), World Bank (gross external debt) and ECB (all other indicators).

Table VIII. Labour market and social indicators

Labour market indicators	2008	2009	2010	2011	2012	2013
Employment rate (% of population aged 20-64)	75.8	67.1	65.0	66.3	68.1	69.7
Employment growth (% change from previous year)	-0.8	-14.3	-6.7	1.5	1.4	2.3
Employment rate of women (% of female population aged 20-64)	72.1	66.8	64.9	65.3	66.4	67.7
Employment rate of men (% of male population aged 20-64)	79.7	67.4	65.1	67.5	70.0	71.9
Employment rate of older workers (% of population aged 55-64)	59.4	53.2	48.2	50.5	52.8	54.8
Part-time employment (% of total employment, 15 years and more)	6.3	8.9	9.7	9.2	9.4	8.1
Part-time employment of women (% of women employment, 15 years and more)	8.1	10.2	11.4	10.9	11.6	10.0
Part-time employment of men (% of men employment, 15 years and more)	4.5	7.5	7.8	7.3	7.1	6.1
Fixed term employment (% of employees with a fixed term contract, 15 years and more)	3.3	4.3	6.8	6.6	4.7	4.4
Transitions from temporary to permanent employment	53.0	37.4	35.3	41.4	36.8	:
Unemployment rate[1] (% of labour force, age group 15-74)	7.7	17.5	19.5	16.2	15.0	11.9
Long-term unemployment rate[2] (% of labour force)	2.0	4.7	8.8	8.8	7.8	5.8
Youth unemployment rate (% of youth labour force aged 15-24)	13.6	33.3	36.2	31.0	28.5	23.2
Youth NEET rate (% of population aged 15-24)	11.4	17.4	17.8	16.0	14.9	13.0
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	15.5	13.9	13.3	11.6	10.6	9.8
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	27.0	30.1	32.3	35.9	37.2	40.7
Formal childcare (from 1 to 29 hours; % over the population less than 3 years)	2.0	2.0	1.0	1.0	4.0	:
Formal childcare (30 hours or over; % over the population less than 3 year)	12.0	13.0	15.0	14.0	19.0	:
Labour productivity per person employed (annual % change)	-1.9	-3.9	5.7	3.7	3.7	1.8
Hours worked per person employed (annual % change)	6.6	-2.5	-0.9	0.9	-0.9	-0.3
Labour productivity per hour worked (annual % change; constant prices)	-8.0	-1.5	6.7	2.9	4.7	2.1
Compensation per employee (annual % change; constant prices)	4.7	-10.4	-4.1	-1.0	3.9	3.9
Nominal unit labour cost growth (annual % change)	20.0	-7.9	-10.1	1.2	3.5	:
Real unit labour cost growth (annual % change)	6.8	-6.7	-9.3	-4.6	0.1	2.1

Notes:

[1] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed.

[2] Long-term unemployed are unemployed persons for at least 12 months.

Sources:
Commission (EU Labour Force Survey and European National Accounts)

Expenditure on social protection benefits (% of GDP)	**2007**	**2008**	**2009**	**2010**	**2011**
Sickness/Health care	3.4	3.7	3.9	3.7	3.2
Invalidity	0.7	0.9	1.3	1.3	1.3
Old age and survivors	5.0	5.7	7.9	9.4	8.1
Family/Children	1.2	1.4	1.7	1.5	1.1
Unemployment	0.4	0.5	1.6	1.3	0.7
Housing and Social exclusion n.e.c.	0.1	0.2	0.1	0.1	0.1
Total	11.0	12.5	16.7	17.6	14.8
of which: means tested benefits	0.2	0.2	0.3	0.7	0.7

Social inclusion indicators	**2008**	**2009**	**2010**	**2011**	**2012**
At-risk-of-poverty or social exclusion[1] (% of total population)	34.2	37.9	38.2	40.1	36.2
At-risk-of-poverty or social exclusion of children (% of people aged 0-17)	32.4	38.4	42.2	44.1	40.0
At-risk-of-poverty or social exclusion of elderly (% of people aged 65+)	58.8	55.5	36.8	33.0	33.7
At-Risk-of-Poverty rate[2] (% of total population)	25.9	26.4	20.9	19.0	19.2
Severe Material Deprivation[3] (% of total population)	19.3	22.1	27.6	31.0	25.6
Share of people living in low work intensity households[4] (% of people aged 0-59)	5.4	7.4	12.6	12.6	11.7
In-work at-risk-of poverty rate (% of persons employed)	10.5	10.8	9.4	9.3	8.6
Impact of social transfers (excluding pensions) on reducing poverty	14.2	14.8	26.7	29.1	25.3
Poverty thresholds, expressed in national currency at constant prices[5]	1 816	1 780	1 444	1 367	1 392
Gross disponsable income (households)	10 338	8 716	8 334	8 706	9 341
Relative median poverty risk gap (60% of median equivalised income, age: total)	28.6	29.0	28.9	31.7	28.6

Notes:

[1] People at-risk-of poverty or social exclusion (AROPE): individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).

[2] At-risk-of poverty rate (AROP): share of people with an equivalised disposable income below 60% of the national equivalised median income.

[3] Share of people who experience at least 4 out of 9 deprivations: people cannot afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish, or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour tv, or ix) have a telephone.

[4] People living in households with very low work intensity: share of people aged 0-59 living in households where the adults (excluding dependent children) work less than 20% of their total work-time potential during the previous 12 months.

[5] For EE, CY, MT, SI, SK, thresholds in nominal values in Euros; HICP - index 100 in 2006 (2007 survey refers to 2006 incomes)

Sources:
For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.

Table IX. Product market performance and policy indicators

Performance indicators	2004-2008	2009	2010	2011	2012	2013
Labour productivity[1] total economy (annual growth in %)	5.9	-1.5	5.4	3.8	3.2	1.4
Labour productivity[1] in manufacturing (annual growth in %)	3.2	6.1	17.8	8.1	4.4	0.1
Labour productivity[1] in electricity, gas, water (annual growth in %)	-0.9	0.3	23.0	-0.8	-1.3	n.a.
Labour productivity[1] in the construction sector (annual growth in %)	7.2	1.4	-14.1	5.1	16.2	1.1
Patent intensity in manufacturing[2] (patents of the EPO divided by gross value added of the sector)	14.6	15.9	16.7	19.4	n.a.	n.a.
Policy indicators	**2004-2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Enforcing contracts[3] (days)	279.6	309.0	309.0	369.0	469.0	469.0
Time to start a business[3] (days)	15.9	16	16	16	16	13
R&D expenditure (% of GDP)	0.6	0.5	0.6	0.7	0.7	n.a.
Tertiary educational attainment (% of 30-34 years old population)	21.8	30.1	32.3	35.9	37.2	40.7
Total public expenditure on education (% of GDP)	5.2	5.6	5.0	4.9	n.a.	n.a.
	2008	**2009**	**2010**	**2011**	**2012**	**2013**
Product market regulation[4], Overall (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Product market regulation[4], Retail (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Product market regulation[4], Network Industries[5] (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes:

[1] Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.

[2] Patent data refer to applications to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.

[3] The methodologies, including the assumptions, for this indicator are presented in detail on the website http://www.doingbusiness.org/methodology.

[4] The methodologies of the product market regulation indicators are presented in detail on the website http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html.

[5] Aggregate ETCR.

Source :

Commission, World Bank - *Doing Business* (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).

Table X. Green Growth

		2003-2007	2008	2009	2010	2011	2012
Green Growth performance							
Macroeconomic							
Energy intensity	kgoe / €	0.37	0.32	0.37	0.40	0.34	0.34
Carbon intensity	kg / €	0.90	0.78	0.89	1.00	0.90	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	3.35	2.79	2.62	3.07	3.22	n.a.
Waste intensity	kg / €	n.a.	0.10	n.a.	0.12	n.a.	n.a.
Energy balance of trade	% GDP	-4.4%	-5.4%	-4.0%	-4.6%	-5.1%	-6%
Energy weight in HICP	%	12	11	12	14	16	16
Difference between change energy price and inflation	%	2.84	20.4	6.9	0.6	6.9	7.3
Environmental taxes over labour taxes	ratio	16.9%	13.5%	16.8%	16.8%	17.9%	n.a.
Environmental taxes over total taxes	ratio	8.3%	6.7%	8.8%	8.8%	8.9%	n.a.
Sectoral							
Industry energy intensity	kgoe / €	0.39	0.37	0.43	0.45	n.a.	n.a.
Share of energy-intensive industries in the economy	% GDP	6.5	6.8	7.1	n.a.	n.a.	n.a.
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	0.07	0.09	0.09	0.10	0.11
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	0.03	0.03	0.03	0.03	0.04
Public R&D for energy	% GDP	n.a.	0.01%	0.02%	0.01%	0.01%	0.01%
Public R&D for the environment	% GDP	n.a.	0.01%	0.02%	0.01%	0.01%	0.01%
Recycling rate of municipal waste	ratio	4.9%	6.8%	7.8%	9.4%	9.7%	15.8%
Share of GHG emissions covered by ETS*	%	n.a.	23.7%	22.8%	26.9%	26.2%	24.9%
Transport energy intensity	kgoe / €	0.71	0.70	0.74	n.a.	n.a.	n.a.
Transport carbon intensity	kg / €	2.05	1.97	2.03	n.a.	n.a.	n.a.
Security of energy supply							
Energy import dependency	%	65.1%	58.8%	60.4%	44.3%	59.9%	56.4%
Diversification of oil import sources	HHI	n.a.	0.31	0.25	0.17	0.25	n.a.
Diversification of energy mix	HHI	0.29	0.29	0.30	0.31	0.29	0.30
Share renewable energy in energy mix	%	30.7%	29.3%	34.7%	33.0%	32.4%	36.4%

Country-specific notes:

The year 2012 is not included in the table due to lack of data.

General explanation of the table items:

Source: Eurostat unless indicated otherwise; ECFIN elaborations indicated below

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 prices)

Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)

Carbon intensity: Greenhouse gas emissions (in kg CO2 equivalents) divided by GDP (in EUR)

Resource intensity: Domestic Material Consumption (in kg) divided by GDP (in EUR)

Waste intensity: waste (in kg) divided by GDP (in EUR)

Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP

Energy weight in HICP: the share of the "energy" items in the consumption basket used in the construction of the HICP

Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual %-change)

Environmental taxes over labour or total taxes: from DG TAXUD's database "Taxation trends in the European Union"

Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)

Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP

Electricity and gas prices medium industrial users: consumption band 500 - 2000MWh and 10000 - 100000 GJ; figures excl. VAT.

Recycling rate of municipal waste: ratio of municipal waste recycled over total municipal waste

Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP

Share of GHG emissions covered by ETS: based on greenhouse gas emissions as reported by Member States to EEA (excl LULUCF)

Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transp industry gross value added (2005 EUR)

Transport carbon intensity: greenhouse gas emissions in transport activity divided by gross value added of the transport sector

Energy import dependency: net energy imports divided by gross inland energy consumption incl. energy consumption international bunkers

Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin

Diversification of the energy mix: Herfindahl Index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels

Share renewable energy in energy mix: %-share in gross inland energy consumption, expressed in tonne oil equivalents

* Commission and EEA.

** For 2007 average of S1 & S2 for DE, HR, LU, NL, FI, SE & UK. Other countries only have S2.

*** For 2007 average of S1 & S2 for HR, IT, NL, FI, SE & UK. Other countries only have S2.

List of indicators used in Box 4 on the potential impact on growth of structural reforms.

Final goods sector mark-ups: Price-cost margin, i.e. the difference between the selling price of a good or service and its cost. Final goods mark-ups are proxied by the mark-ups in selected services sectors (transport and storage, post and telecommunications, electricity, gas and water supply, hotels and restaurants and financial intermediation but excluding real estate and renting of machinery and equipment and other business activities[33]).
Source: Commission services estimation using the methodology of Roeger, W. (1995). "Can imperfect Competition explain the Difference between primal and dual Productivity?" *Journal of Political Economy* Vol. 103(2) pp. 316-30, based on EUKLEMS 1996-2007 data.

Entry costs: Cost of starting a business in the intermediate sector as a share of income per capita. The intermediate sector is proxied by the manufacturing sector in the model.
Source: World Bank, Doing Business Database. www.doingbusiness.org. 2012 data.

Implicit consumption tax rate: Defined as total taxes on consumption over the value of private consumption. In the simulations it is used as a proxy for shifting taxation away from labour to indirect taxes. The implicit consumption tax-rates are increased (halving the gap vis-à-vis the best performers) while labour tax-rates are reduced so that the combined impact is ex-ante budgetary neutral.
Source: European Commission, Taxation trends in the European Union, 2013 edition, Luxembourg, 2013. 2011 data.

Shares of high-skilled and low-skilled: The share of high skilled workers is increased, the share of low-skilled workers is reduced (halving the gap vis-à-vis the best performers). Low-skilled correspond to ISCED 0-2 categories; high-skilled correspond to scientists (in mathematics and computing, engineering, manufacturing and construction). The remainder is medium-skilled.
Source: EUROSTAT. 2012 data or latest available.

Female non-participation rate: Share of women of working age not in paid work and not looking for paid work in total female working-age population
Source: EUROSTAT. 2012 data or latest available.

Low-skilled male non-participation rates: Share of low-skilled men of working age not in paid work and not looking for paid work in total male working-age population
Source: EUROSTAT. 2012 data or latest available.

Elderly non-participation rates (55-64 years): Share of the population aged 55-64 years not in paid work and not looking for paid work in total population aged 55-64 years.
Source: EUROSTAT. 2012 data or latest available.

ALMP: Active Labour Market Policy expenditures as a share of GDP over the share of unemployed in the population.
Source: EUROSTAT. 2011 data or latest available.

[33] The real estate sector is excluded because of statistical difficulties of estimating a mark-up in this sector. The sector renting of machinery and equipment and other business activities is conceptually part of intermediate goods sector.

Benefit replacement rate: Share of a worker's pre-unemployment income that is paid out by the unemployment insurance scheme. Average of net replacement rates over 60 months of unemployment.
Source: OECD, Benefits and Wages Statistics.
www.oecd.org/els/benefitsandwagesstatistics.htm. 2012 data.