DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY
FOR
LATVIA

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Executive Summary

Latvia continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Latvia has made substantial progress in transition in terms of price and trade liberalisation, enterprise privatisation and financial sector reforms. Latvia has been a member of the WTO since early 1999 and is scheduled to join the EU in May 2004. Since the previous strategy was approved, economic performance has been among the best of the EU accession candidate countries. However, important challenges still remain, such as improvements in the business environment, further commercialisation and deregulation in the infrastructure sphere and increased financial intermediation. The proposed strategy has been developed to help address a number of these challenges, and to support Latvia's transition in the context of its accession to the EU.

Since the last strategy was approved, Latvia's economic performance has been among the best of transition and EU accession candidate countries. Real output grew by 7.9 per cent in 2001 and 6.1 per cent in 2002 due to strong growth in domestic demand. The exchange rate peg to the SDR remains the cornerstone of monetary policy and has enabled continued price stability. While Latvia is forecast to sustain annual growth rates of 6 per cent over the medium term, continued high unemployment levels, high fiscal deficits (at 3 per cent of GDP in 2002), fast domestic loan growth and high current account deficits (of close to 8 per cent of GDP in 2002) remain key risks to the economy.

Since the previous strategy, ongoing progress with structural reforms has enabled Latvia to be invited to join the EU and NATO, which have been the key priorities of successive governments. Recent efforts have been made in improving the business climate and fighting corruption. In addition, the privatisation process regained momentum last year through the sale of a remaining stake in Latvijas Gaze, the privatisation of the Latvian Shipping Company and sale of a minority stake in the Latvian Savings Bank. Investment by strategic investors in core banks has strengthened the country's financial sector and has broadened the range of products available. The Helsinki Stock Exchange has acquired the Tallinn and Riga Stock Exchanges and is in the process of merging with the Stockholm Stock Exchange, thereby creating a larger and more liquid capital market that spans the Nordic and Baltic countries.

However, there still remain important challenges to increase the competitiveness of the economy. The key transition challenges are as follows:

- Keeping the external position sustainable, attracting continued high inflows of FDI and achieving high growth rates in order to enable rapid real convergence to EU income levels will require more prudent fiscal policies, continued monitoring of potential vulnerabilities in the financial sector, and ongoing progress with structural reforms.

- In this context, a key priority should be to further progress with public sector reforms to improve the efficiency and transparency of public administration. This should include further progress in implementing medium-term budget planning, in enhancing monitoring and control systems and in further rationalising local government.

- Continued efforts are needed to fully implement the new commercial code, to achieve further results in reducing corruption and to improve transparency and corporate governance.

- Other key priorities should be to complete the privatisation of the remaining state owned stakes in a number of large enterprises.
- In the energy sector, Latvia's role in the pan-Baltic market needs to be strengthened and further operational efficiencies and transparency need to be achieved in the Latvenergo electricity utility. Moreover, the Public Utilities Commission needs to be further strengthened, its full independence needs to be assured and remaining energy price distortions need to be addressed.
- Priority should also be given to promote the commercialisation of municipal and transport infrastructure and to improve regulatory frameworks in order to prepare the grounds for an efficient use of EU structural funds as well as co-financing by the private sector.
- SME development forms the foundation of growth in the private sector and access to suitable finance, more efficient registration and reporting procedures and increasing SME competitiveness remain key challenges.

As of 30 September 2003, the Bank had signed 24 projects with a total project cost of €1,016 million, including EBRD financing of €344 million, or 34 per cent, from the Bank. The private/state sector portfolio ratio stands at 74/26, indicating a significant proportional increase of the private sector in the portfolio. At the time of the previous strategy the private sector accounted for only 47 per cent of the portfolio.

With a focus on those areas where the Bank continues to be additional in Latvia, the Bank's activities in the coming years will be based on the following operational objectives:

Infrastructure

The Bank will focus on financing state-owned and municipal entities, to support priority investment needs, while facilitating private sector participation. Financing would be provided where feasible on a non-sovereign public or private basis to help reduce fiscal pressures. Priority areas will be the transport sector and municipal infrastructure. The Bank is committed to assisting national and local authorities to prepare, co-finance and implement projects for EU Cohesion and Structural Funds.

Energy

In order to improve transparency within the energy sector, the Bank will work with Latvenergo to encourage the establishment of separate entities for power generation, transmission and distribution. This will be achieved in the context of supporting Latvenergo in its participation and expansion in the regional energy market. The Bank will work with Latvijas Gaze to strengthen Latvia's position in the domestic and regional gas distribution market.

Financial Sector

The Bank's activities in the financial sector will focus on developing products that are currently not well supplied to the financial sector, such as equity, and a broader range of SME finance. Given the current state of the financial sector, the Bank will put particular emphasis on supporting SMEs with the aim of fostering regional development. The

Bank will target the development of non-bank financial institutions that are still in their infancy in Latvia (such as pension funds, insurance companies and equity funds).

Enterprise Sector

In order to facilitate foreign direct investment, the Bank will seek to support large-scale foreign direct investment projects as well as investments in the manufacturing and service sectors by medium sized foreign and local companies. The Bank's involvement will focus on projects that need more extensive structuring and cross-border investments, particularly into or from Russia and other CIS countries. Attention will be given to improving corporate governance, transparency and accountability, and increasing Latvia's competitiveness.

The Bank will continue to ensure that all EBRD operations in Latvia are subject to the Bank's Environmental Procedures and incorporate, where necessary, Environmental Action Plans.

LIST OF ABBREVIATIONS

BAS	Business Advisory Service
EU	European Union
EIB	European Investment Bank
ERM II	The EU's Exchange Rate Mechanism II
EMU	European Monetary Union
FCMC	Financial and Capital Market Commission
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
KfW	Kreditanstalt für Wiederaufbau
NIB	Nordic Investment Bank
TAM	Turnaround Management Programme

1. THE BANK'S PORTFOLIO

1.1 Overview of Bank Activities to Date

By the end of September 2003, the Bank had signed 24 operations in Latvia with a total project cost of €1,016 million, including EBRD financing of €344 million, or 34 per cent, from the Bank. From the Bank's financing, €50 million, or 15 percent, has been provided as equity and €240 million, or 70 per cent, had been disbursed. The Bank's core sectors currently active in Latvia include the financial sector and infrastructure. SME development activities are included within the financial sector. The table below summarises the Bank's activities to the end of September 2003.

€ millions

Sector	No. of Ops	Total Project Cost	EBRD Finance	% EBRD from Total	% EBRD Disbursed
Energy	2	111	54	49%	96%
Financial Institutions	12	338	142	42%	55%
Infrastructure	6	373	87	23%	90%
Specialised Industries	4	195	60	31%	63%
Total	24	1,016	344	34%	72%

1.2 Implementation of the previous country strategy

Achievements against the main objectives from the previous Strategy are as follows:

Actively support the privatisation of the remaining large-scale enterprises. Contrary to the Bank's advice, the Latvian government chose to sell the Latvian Shipping Company in 2002 via the Riga Stock Exchange to financial investors rather than to a strategic investor. Consequently the Bank did not participate in the privatisation. For the Ventspils Nafta oil terminal, the government has postponed the company's privatisation until at least the end of 2003. Since the underlying oil transit business is under significant competition from the Primorsk oil terminal in North West Russia, the future prospects of Ventspils Nafta are weaker now than at the time of the previous strategy.

Expand the volume and spectrum of funding instruments for SMEs (credit lines, leasing, equity) through local financial institutions. SME credit lines have been provided successfully to Unibanka, Rietumu Banka, Unilizings and Hansa Capital. In 2002 an equity commitment of up to €20 million was provided to the €80 million Askembla Growth Fund, a regional equity fund for the Baltics. Consequently the Bank is actively contributing to increasing the volume and spectrum of the medium-term financing for SMEs and this approach is expected to continue.

Promote limited or non-recourse financing for service utilities and state-owned or municipal-owned infrastructure enterprises. Long-term co-financing has been approved that will enable the Riga Water utility to access much-needed EU structural funds to renovate further sections of the city's water mains. Similar financing is being developed with Liepaja Water on Latvia's west coast.

Support banks to assist in the further consolidation of the sector and the development of non-bank financial institutions. An equity investment in Rietumu Banka is being developed in order to further strengthen the banking sector. The Bank is an active minority shareholder in Balta Insurance, the largest insurer in Latvia, majority owned by Codan (Denmark). Credit lines to fund mortgage loans are being developed with two banks, and the Bank is considering supporting a mortgage-backed securities issue by a regional Baltic mortgage institution. Pension funds development to date has proven to be too small for direct participation by the Bank.

Maintain an active policy dialogue to promote the completion of large-scale privatisation, SME development and structural reforms. Policy dialogue with the Ministry of Economy has been productive in relation to SME development, however less productive in relation to restructuring of Latvenergo, the state-owned electricity utility, or the privatisation of Ventspils Nafta. Restructuring and commercialisation of the state-owned Latvian Railways has also been much slower than anticipated. These are on-going transition challenges.

Environmental development reforms. Latvia has achieved considerable progress in aligning with the *environmental acquis*, in particular in relation to water quality, waste management, nature protection, and noise as well as in developing the necessary administrative capacity to implement the *acquis* in this area. Concerning administrative capacity, attention has been devoted to implementation issues and institutional strengthening. A new Nature Protection Board has been created. Latvia has ratified the Kyoto Protocol on greenhouse gas emissions.

1.3 Transition impact of the Bank's portfolio and lessons learned

1.3.1 Transition impact in the infrastructure and energy sectors

In the municipal infrastructure sector, the Bank's first project involved a sovereign-guaranteed loan to the municipal enterprise Riga Water for rehabilitation investments as well as performance and regulatory improvements. The project has had substantial impact on commercialisation and self-financing, by introducing full cost recovery through user fees and the "polluter pays" principle, and by separating core from non-core activities[1]. Importantly, the project also has had substantial impact in terms of improving the regulatory framework by getting agreement on the establishment of a regulatory unit that would monitor tariffs and act as an appeal body for customer complaints, and by developing service indicators and reporting requirements. The Bank's second project with Riga Water was the first direct corporate loan to a local service utility in Latvia without recourse to a sovereign or municipal guarantee.

The Bank has supported Latvian Railways in the development of a modern rail shunting yard in the port of Ventspils which provides vital access to foreign markets for Latvian exports and transit trade from Russia and other CIS countries. Rail traffic through Ventspils includes commodities such as crude oil, oil products, timber, chemicals and metals.

[1] In 2002 the Bank's Project Evaluation Department conducted an assessment of the Riga Water project and rated it as "successful", with all project objectives having been met. However the assessment noted that on-going policy dialogue with the local authorities would be required to ensure sustainability of the reform achievements.

The transition impact of the project has been the needed improved productivity of the Ventspils rail terminal during a period of increasing exports and transit trade.

The Bank has had two power projects with Latvenergo, the state owned power company, one an emergency rehabilitation of the power generation system, and the other an investment in the Daugava River hydroelectric stations. Among the transition objective in both these cases was to raise tariffs and increase collection rates. There were substantial real tariff increases since the investment, and collections improved from 85 per cent in 1994 to almost 100 per cent by 1999. More radical sector reform (restructuring and privatisation, in particular) is moving very slowly, however.

1.3.2 Transition impact in the financial sector

The Bank has had a substantial impact in the Latvian financial sector. The Bank contributed to the privatisation in 1999 of the second largest bank - Latvijas Unibanka – to a foreign strategic investor (Skandinavska Enskilda Banken (SEB)). Following problems with its investment in Rigas Komercbanka, related to financial insolvency following the Russia crisis, by investing new equity capital and encouraging the commitment of the Bank of Latvia and foreign creditors, the Bank played a central and constructive role in the bank's restructuring and subsequent sale in 2000 to Nord/LB (Germany). The Bank has been the leading IFI in providing long-term funding to strong local banks and has supported consolidation of the banking sector through participation in mergers (e.g. Hansabanka with Zemes Banka in 1998).

In the non-bank sector, the Bank's involvement includes an equity investment in Balta Insurance, the largest insurer in Latvia, and providing long-term funding to Unilizings, the second largest leasing company, and Hansa Capital, to finance SME development.

Working with local financial intermediaries, the Bank has successfully financed more than 2,600 SMEs in Latvia. Although the early credit lines had mixed results, primarily due to the early stage of the market, more recent projects with the EU SME Finance Facility (Unibanka and Rietumu Banka) are proving highly successful. A key component of the SME Finance Facility is the long-term consulting support to banks, which is financed by EU Phare. SMEs have also benefited from substantial TAM and BAS assistance. In addition the Bank has invested €70 million in six regional equity funds targeting SMEs in the Baltics.

1.3.3 Transition impact in the enterprise sector

The Bank's experience in the enterprise sector has been mixed. Due to a lack of suitable candidates, the Bank so far has not provided direct financing to manufacturing enterprises. Note that 70 per cent of Latvia's GDP is in the service sector and 99 per cent of all companies in Latvia are SMEs, in most cases too small for direct financing from the Bank.

However, in 1994 the Bank participated in the first hotel privatisation, initiating expansion of the private sector in hotel services. Moreover this was the first project in the sector to be co-financed by an export credit agency, which agreed to take on the project risk. In 1996 the Bank financed the first class A office building in Riga; although the project suffered due to harsh tax regulations applying to new buildings and low occupancy of local and foreign firms following the Russia crisis in 1998.

In the telecoms sector, in 1997 by investing equity, providing long-term loans and implementing international standards of corporate governance, the Bank supported the market entry of Baltcom GSM, a privately owned Latvian mobile company. The company was acquired by Tele2 (Sweden) in 2000. Its subscriber base has grown rapidly, the company is now a Tele2 brand and it covers 40 per cent of the national territory. The competition between Tele2 and Latvijas Mobilais Telefons (LMT), the larger of the two mobile operators, has led to more innovative and competitive tariff structures. The Bank has not been involved in the fixed line sector, as TeliaSonera (Sweden), as the strategic minority owner of Lattelekom, the main fixed line telecommunications provider, is willing to provide the long-term investment capital without needing to share the risk with the Bank.

1.4 Financial performance, mobilisation of co-financing and portfolio ratio

With a portfolio in Latvia of €175 million, and disbursed operating assets of €111 million, the Bank's performing assets represent 99 per cent, or €109 million, of operating assets.

In providing financing of €344 million to projects with a total cost of €1,016 million, the Bank has mobilised €672 million in co-financing with a mobilisation ratio of 1.9.

During the strategy period there has been a significant increase in the proportional share of the private sector in the Bank's portfolio, to 74 per cent currently from 47 per cent in 2001. This was due primarily to increased activities in the financial sector, which is wholly private sector, and having a large loan to Latvenergo, the state-owned electricity utility, pre-paid in 2002.

2 OPERATIONAL ENVIRONMENT

2.1 The General Reform Environment

Since its independence in 1991, Latvia has been a parliamentary democracy based on the rule of law, with a 100-member parliament, a Prime Minister as head of government, and a President as head of state. Following parliamentary elections in October 2002, Einars Repse came to power as Prime Minister at the head of a four-party coalition. Human and political rights of Latvia's citizens as well as of its large non-citizen Russian-speaking community are respected. The Constitution provides for an independent judiciary, but despite some recent improvements in the quality of the judiciary, significant problems (including inefficiency and allegations of corruption) remain. Latvia's progress in its transition to a functioning market economy has been rapid, with the privatisation of firms now virtually complete and the private sector's share in GDP in excess of 70 per cent.

Political developments

Following elections on 5 October 2002, a new coalition government led by Einars Repse, Central Bank Governor from 1993 to 2002, came to power. Repse, leader of the new centre-right New Era Party formed a few months before the elections, had campaigned on a pro-reform, anti-corruption platform. His four-party coalition controls 55 out of 100 parliamentary seats. The other three parties are: the right-wing For the Fatherland and Freedom Party (LNNK) and two relatively new parties with a power base in the provinces and among the minorities - the Union of Greens and Farmers and Latvia First Party. The government is reform-minded, with smooth entry into the EU and NATO as its main policy priorities. General political stability in the country was enhanced by the smooth election in June 2003 of President Vaira Vike-Freiberga for her second four-year term. For further detail refer to Annex 1.

Regional integration

In November 2002, Latvia received an invitation to join NATO and in December it was invited to join the EU in May 2004. A referendum confirming Latvia's EU accession was held on 20 September 2003. Although Latvia has over the last few years significantly re-orientated its trade towards the European Union, economic and financial links with Russia continue to be crucial to the Latvian economy. Despite progress made in Latvia's domestic policy towards its mainly Russian minorities, relations with Russia remain problematic. For example, the Russian oil pipeline monopoly Transneft is currently withholding crude oil deliveries to Latvia's port of Ventspils and the oil terminal operator Ventspils Oil Terminal[2].

Integrity issues

According to the Regular Report by the European Commission on Latvia's progress towards EU accession published in October 2002, corruption remains a serious issue in Latvia.[3] However, the Report noted that the government recently had made important progress in the fight against corruption. This included improvements to the legislative framework, strengthening of the institutional set-up, increased public as well as civil society awareness. Some recent developments were the implementation of the Corruption Prevention Programme of 2001, the passing of a new Law on the Prevention of Conflict of Interest in Activities of Public Officials in April 2002, the setting up of the Anti-Corruption Bureau in May 2002, the adoption of amendments to the Law on Financing of Political Organisations in June 2002, as well as the adoption of a new national anti-corruption strategy in December 2002. The anti-corruption Bureau has the power to initiate criminal proceedings and to conduct investigative and operational activities. It is also responsible for checking officials' income declarations and auditing party finances.

Despite these recent steps, however, the Report stressed that further efforts are still needed to clarify and consolidate the institutional set-up and to provide the new Anti-Corruption Bureau with the necessary means to effectively ensure its independence. Most importantly, the Bureau is still without a head. A further challenge is the lack of convictions against obvious cases of corruption that erodes public confidence in the efficacy of the legal system. The Report called on the government to remain committed to fight high-level corruption and state capture. The EU Report concluded that the effective implementation of the existing anti-corruption legislation would be vital for overcoming the public's continuing mistrust of the judiciary and the public administration and for gaining the confidence of private investors.

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[2] In early October 2003, Ventspils Nafta, an industrial holding company, reorganised its business activities and established the Ventspils Oil Terminal company as a 100% subsidiary. Ventspils Nafta also owns subsidiaries involved in publishing, shipping, stevedoring and shoe manufacturing.

[3] Separately, in the 2002 Transparency International Corruption Perceptions Index of 102 countries, Latvia was ranked 52nd with Morocco, the Slovak Republic and Sri Lanka. In 2001 it was ranked 59th. The Index, which draws on 14 surveys from seven independent institutions, reflects the perceptions of businesspeople, academics and country analysts. It focuses on corruption involving public officials and does not reflect secret payments to finance political campaigns, the complicity of banks in money-laundering or bribery by multinational companies.

Labour issues

A new Labour Code and a complementary Labour Protection Law entered into force on 1 June 2002 and provides for a mandatory 40-hour maximum working week, with at least one 42-hour rest period weekly; four weeks of annual holiday; and a programme of assistance to working mothers with small children. Laws establishing health and safety standards for the workplace are ignored in some cases, primarily for economic reasons. Under the present law on trade unions, workers, except for the uniformed soldiers and police, have the right to form and join trade unions of their own choosing. Union membership is about 30 per cent of the workforce. The main-trade union body is the Latvia Confederation of Free Trade Unions (LBAS), with 28 branch trade unions and professional employees unions representing over 250,000 workers. Free elections for trade union leadership are held every four years. The right to strike is not limited, but there have been no major strikes during recent years.

At the beginning of 2003 the monthly minimum wage has been raised from 60 lats to 70 lats, but compared to an average gross monthly wage in 2002 of 173 lats. The government hopes to be able to gradually increase the minimum wage to 50 per cent of the average gross wage in the next seven years. Unemployment (calculated as the share of job seekers in the economically active population) remains high, standing at around 12 per cent in 2002 (although down from 21 per cent in 1996), suggesting that Latvia continues to have high structural unemployment[4]. The share of the unemployed that are not able to find a job for more than one year constituted around 46 per cent of all unemployed in 2002. Moreover, there are wide variations in unemployment levels between Riga and other regions.

Social conditions

According to Eurostat data, per capita GDP calculated in purchasing power terms in 2002 was only 35 per cent of the EU average, one of the lowest in accession countries. Slightly more than one fifth of the population live under the minimum poverty threshold as defined by the Central Statistical Bureau of Latvia and in rural areas this is close to one-third.[4] Demographic indicators also continue to be unfavourable, with the population still declining[5], the average life expectancy only 71 years[6] (considerably less than in the EU and among the lowest in candidate countries), and infant mortality rates at 9.8 per 1,000 live births in 2002 (although this is a reduction from the high of 18.5 in 1995 it compares with 5 in the EU). Since independence there has been a rise in poverty-related diseases, such as tuberculosis. Trafficking in women and girls for the purpose of prostitution is a serious problem. Alcoholism and poor nutrition are also major problems – especially in rural areas. However, the overall health situation is gradually improving. In 2002 Latvia was placed 53rd out of 173 in the UN Human Development Index, reflecting improvements in health and living standards. Healthcare expenditure has recently increased but is still less than 5 per cent of GDP (the European average is 7-9 per cent of GDP). The government has declared it a priority to establish a well-functioning

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[4] Also, many people, especially in the countryside, do not register as unemployed, as the low level of welfare benefits do not justify registration.

[4] In February 2003 the government introduced a guaranteed minimum level of income of Lats 15 for the first time.

[5] Latvia's population at the beginning of 2003 was 2.33 million, representing a decline of 14% from 1989. The main causes of the population decline have been falling birthrates and emigration.

[6] More specifically, 77 years for women and 65 years for men.

healthcare system: it has already established the Ministry of Health Care and it plans improve the minimum state guaranteed health care services. It gradually aims to raise annual expenditure on healthcare to 7 per cent of GDP.

Furthermore, regional differences in Latvia remain significant and income inequalities are increasing. The Gini coefficient has gone up from 0.30 in 1996 to 0.34 in 2002.[7] The outskirts of Riga and remaining parts of Latvia are characterised by low population density, weak production and poor infrastructure, while standards of living, unemployment rates, per capita income and development of social infrastructure are generally much worse than in the capital. Riga accounts for over a third of the population, with a GDP per capita around twice that for that of the Latgale region in eastern Latvia. In fact, the Latgale region will be among the poorest regions in the enlarged EU. Unemployment levels also reflect this uneven development – while the Latgale region had an unemployment rate of 17.1 per cent in 2002, Riga's unemployment rate was around 5 per cent. The Latgale region has the lowest average gross monthly wages of only LVL 115 compared to LVL 173 on average for the whole country. In this region, Daugavpils, the second largest city in Latvia and with a population of 120,000, accounts for just over 3 per cent of registered enterprises compared to Riga's 49 per cent.[8]

Legal Issues

Latvia has continued to make significant changes to its legal framework, including as part of preparation for its expected accession to the EU in May 2004, which have led to major improvements in the legal environment (see also Annex 2 on Legal Transition). Recently amended or newly adopted laws include: the Commercial Code, the Law on the Financial and Capital Market Commission, the Companies Insolvency Act, the Investor Protection Law, the Law on Insurance Contract, the Law on Customs Duties and the Law on Telecommunications. In response to perceived weaknesses in Latvia's insolvency laws, a new Insolvency Law is currently being drafted and is expected to be adopted in 2004. It will be important to see how the implementation of all of these new laws will occur in practice and how any conflicts between new and previously existing laws will be resolved, especially in the field of insolvency.

An overall assessment reveals that Latvia has a developed legal system that is comparable to that of advanced transition countries and, in many areas, approximates international standards. Building on this success in moving towards the establishment of a market-oriented economy and stable democratic institutions, further efforts are needed to face the challenges of effective implementation, harmonisation of legislation including from the European Union and the reduction of bureaucratic and corrupting influences. The judicial system remains a particular cause for concern due to the lack of qualified judges and the slow pace of judicial procedures.

Environmental issues

According to European Commission's Regular Report on Latvia's Progress towards Accession published on 9 October 2002, Latvia has continued to make good progress in alignment with the environmental *acquis*. In order to complete preparations for mem-

[7] The index ranges from 0 (absolute income distribution equality) to 1 (absolute inequality).

[8] The majority of the inhabitants of Daugavpils are native Russians, Belarussians, Poles and Ukrainians. This may create additional constraints to the development of the area as many do not speak Latvian.

bership, Latvia now needs to focus on finalising transposition (in the areas of air quality; nature protection; waste management; water quality; chemicals and genetically modified organisms; and nuclear safety and radiation protection), improving co-ordination and co-operation between national, regional and local levels and strengthening the overall administrative capacity. Environmental investments should be enhanced.

2.2 Progress in Transition and the Economy's Response

2.2.1 Macroeconomic conditions for Bank operations

Since the last strategy was approved, Latvia's economic performance has been among the best of transition and EU accession candidate countries. Real output grew by 7.9 per cent in 2001 and 6.1 per cent in 2002 due to strong growth in domestic demand, particularly private consumption and investment. The exchange rate peg to the SDR, which was introduced in 1994, remains the cornerstone of monetary policy and has enabled continued price stability. Inflation has remained at or below 3 per cent since 1998. FDI inflows have averaged 4.7 per cent of GDP per annum since the Russian crisis, exceeded only by the Czech Republic and Estonia amongst transition countries. However, unemployment levels and regional income inequalities within Latvia remain significant. While Latvia is forecast to sustain annual growth rates of 5-6 per cent over the medium term, the recent fast domestic loan growth and continued high current account deficit (of close to 8 per cent of GDP in 2002) remain key risks for macroeconomic stability. Despite strong growth, annual fiscal deficits over recent years have been significantly higher than recommended by IMF staff. The modest pace of fiscal consolidation, the rapid expansion in household credit and the concomitant deterioration in the external position imply that the government that took office in November 2002 faces several key economic challenges going forward. The authorities would be advised to postpone further tax cuts and reduce public expenditures. The Bank of Latvia and FCMC[9] should also continue to closely monitor bank lending and tighten policy when necessary. For a more detailed discussion of macroeconomic performance and risks, refer to Annex 3.

2.2.2. Transition success and transition challenges

Latvia has made significant progress in transition towards a market economy since the last strategy was approved. Following several recent privatisations[10], the privatisation process is now virtually complete. Important improvements have been made to the business environment. Commercial, competition and securities legislation has been further aligned with the EU *acquis communautaire*. Efforts have also been stepped up to fight corruption, with the adoption of new laws and the creation of the Anti-Corruption Office. In the power sector, restructuring has progressed and regulatory frameworks have been strengthened. Following the establishment in July 2001 of the FCMC regulator, privatisation, restructuring and improved supervision have strengthened the banking sector. Last year, the owner of the Helsinki Stock Exchange, HEX Group, acquired a majority holding in the Riga Stock Exchange. As a result of these efforts, Latvia ranks well among the CEB countries (Central Europe and Baltic states) with respect to the implementation of market reforms across most reform dimensions (see Annex 3 on Comparative Statistics).

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[9] FCMC - Financial and Capital Market Commission, the unified financial sector regulator established in July 2001.

[10] Although not without controversy, these included the sale of the Latvian Shipping Company and Latvijas Krajbanka.

Although accession to the EU constitutes a major turning point, the transition process is far from complete. Many issues associated with the move from central planning to an economy based on free market principles still need to be addressed. In the energy sector, the main outstanding tasks are accelerating progress in restructuring Latvenergo, strengthening the independence of the Public Utilities Commission, commercialising municipal services and raising infrastructure prices towards at least cost-recovery levels. Further support should be given to smaller municipalities and SMEs outside the capital in order to overcome regional income disparities. Another challenge will be to strengthen non-bank financial institutions. While the authorities have made efforts to improve the investment climate, continued efforts are needed to strengthen public administration and judicial capacities and continue the fight against corruption. The main challenges for the current strategy period are highlighted below:

Infrastructure: *further restructuring, commercialisation and private sector participation in infrastructure services and further strengthening of regulatory frameworks are needed to enhance efficiency.*

Municipal and environmental infrastructure

Compared to many of the other advanced transition countries, Latvia's general budgetary capital expenditures as a percentage of GDP have been relatively small (see Annex 3). Given the fiscal challenges involved in potential EU and NATO accession[11], it is important that authorities maintain a balance between undertaking necessary capital investments in order to implement the EU *acquis* and fiscal prudence. Most importantly this will require public sector reforms and medium-term budget planning. However it will also require a reprioritisation of expenditures by, for example, reducing the public sector wage bill, improved targeting of social costs, and effective cuts in expenditures on goods and services. In addition, a significant effort is required by the authorities to accelerate preparations and increase institutional capacity for the management of EU cohesion and structural funds. To improve efficiency of municipal services, the authorities should seek ways to encourage private sector investments into the infrastructure and environment sectors, including for those activities and investments that fall under the jurisdiction of municipalities.

- *The priority should be to increase control over local government budgets and improve the planning and prioritisation of capital investment programmes.* Amendments to the Law on Local Government Budgets that became effective in November 2002 have so far not strengthened the control over local government fiscal deficits. In 2002 local government fiscal deficits amounted to LVL 33 million (or 0.6 per cent of GDP), exceeding the LVL 15 million limit under the budget law by a wide margin. In addition, Riga financed its deficit of 0.5 per cent of GDP through borrowing from commercial banks outside of the framework for local government borrowing, which sparked large criticism. In order to prepare for the

[11] According to estimates by the IMF, the fiscal costs of EU accession for Latvia will be around 4.5-6 per cent of GDP per annum in 2004-2006. Furthermore, defence expenditure related to NATO accession will be maintained at 2 per cent of GDP per annum over the medium term. Moreover, Latvia will start to have to make significant contributions to the EU budget starting in 2004, equivalent to 0.8-1.2 per cent of GDP. The net cash flow from the EU (grants minus budgetary contributions) has been estimated to amount to only 2.2-3.4 per cent of GDP per annum in 2004-2006. As a result, there remains a significant financing gap for necessary EU related expenditure. Accession will therefore be accompanied by a significant negative fiscal impact. Source: IMF, 2003 Article IV Consultation, April 2003.

additional EU-related expenditure requirements, the government will have to improve budgetary planning and the control over local government finances.

- *Priority should also be given to enhancing private sector participation in the municipal services sector to improve efficiency of public services.* To improve efficiency, municipalities should consider public-private partnerships to meet their investment needs. Involvement of the private sector could be sought either through the privatisation of municipal-owned service companies, contracting out certain elements of municipal services, or through concessions. Further reform of the regulatory framework should encourage greater private sector participation. In addition, "bundling" measures of similar investment projects across the smaller municipalities may increase their attractiveness to potential private investors.

Energy sector

Hydroelectricity is the main generating source of electricity in Latvia, as approximately 73 per cent of the country's 2.1-GW power-generating capacity is hydroelectric. Hydroelectric power plants on the Daugava River are Latvia's main power producers, however their output, along with the TEC-1 and TEC-2 power plants that constitute 97 per cent of Latvia's thermal power-generating capacity, is insufficient to cover the country's power needs. When water levels in hydroelectric reservoirs are low, Latvia must import between 30 per cent and 40 per cent of its electricity. A comparison with other accession countries shows that the efficiency of the sector continues to be low in the areas of generation, transmission, distribution and consumption.

The energy sector remains dominated by the vertically integrated 100 per cent state-owned Latvenergo, which still controls generation, transmission, most of distribution and sales. Latvenergo was scheduled to be privatised in 2000, but public opposition to foreign ownership forced the parliament to amend the country's energy law to prevent the company's privatisation. Latvenergo and Eesti Energia also announced merger plans in summer 2000, but the parliament decided to retain state ownership over the utility. Although some Latvian privatization officials have warned that Latvenergo's energy distribution system may deteriorate unless there is a new influx of investment, the Latvian government is proceeding with a plan for the utility's reorganization in preparation for Latvia's accession to the EU (see below).

- *Further progress needs to be achieved in the commercialisation and restructuring of Latvenergo, by establishing separate companies for power generation, transmission and distribution.* In May 2003 Latvenergo concluded a syndicated loan (led by Parex Bank) for LVL 21 million to finance the reconstruction of substations, the renewal of electricity lines, the purchases of equipment for power stations and the part reconstruction of the Riga CHP-1. A similar loan agreement was already extended to the company last year and it expects to raise another LVL 9 million next year in order to prepare the company for EU accession. The reorganization, which will be guided by the EU directive with regard to energy market liberalization, is geared to prepare the utility for free market conditions. However, plans to separate generation, transmission and distribution are moving very slowly.

- *The energy market needs to be steadily opened and third-party access should be gradually ensured.* The new EU directive for the EU's internal market in electricity was approved on June 2003. The most important provision of the directive is the requirement to ensure the independence of the Transmission System Operator (TSO) and to ensure non-discriminatory access to the transmission grid. The new directive also foresees the opening of the electricity market by July 1, 2004. So far the opening of energy market in Latvia is still incomplete. Even though the market for electricity is formally open to competition according to the Energy Law: (i) none of the Qualified Customers eligible for direct power purchase arrangements with producers has entered into such an agreement; (ii) no decision has been taken on the Electricity Market Model; and (iii) legal obstacles remain in effect to establish the Transmission System Operator (TSO). More importantly, policy reversals have led to the situation where Latvia's TSO has been effectively integrated back into Latvenergo. In order to comply with the directive, Latvia faces several important challenges in amending the Energy law and other related laws.

- *Moreover, the Public Utilities Commission needs to be further strengthened, its full independence needs to be assured and remaining energy price distortions need to be addressed.* Electricity tariffs have remained unchanged since 1998 and are the lowest among accession countries at just 4.9 US cents per kWh. Latvenergo has recently been given approval by the Public Services Regulatory Commission for an increase in electricity tariffs by an average of 14.2 per cent starting in January 2004. This tariff increase would be the first since 1998, since previous increases have been denied. The largest tariff growth – by 20 per cent – is planned for households, whereas for industrial consumers the tariffs could remain unchanged or even decrease.
- *In the gas sector market, the priority also concerns increased market opening and adjustment of tariffs.* Market opening is blocked by a single dominant supplier, Latvijas Gaze, which is now 100 per cent in private hands (it is owned by Ruhrgas, E.On, Gazprom and Itera). Amendments to the Energy Law regarding introduction of third party access to gas networks were rejected by the new Parliament in November 2002. In October 2002, Latvijas Gaze reached an agreement with Russia's Gazprom on natural gas supplies to Latvia for the period from 2003 to 2005, providing for a 15 per cent to 20 per cent increase of supply price. Analysts have suggested that Latvijas Gaze agreed to the supply price increase in order to force the Latvian government to allow the company to hike its prices--unchanged since 1997--to consumers. Despite increases in natural gas tariffs from July 2003, which foresee a total increase in natural gas tariffs of 16.5 per cent within three years, gas tariffs still remain below those in the other Baltic and accession countries.

Financial sector reforms: *more sophisticated product development and strengthening of non-bank financial institutions will be necessary.* Since the last strategy was approved, the banking sector has been further strengthened. There are currently 22 banks incorporated in Latvia and one branch office of Nordea bank Finland. Privatisation is now largely complete following the sale of Latvijas Krajbanka[12] and the state's involvement is limited to the Mortgage Bank and Savings Bank. The fact that so many banks still survive in such a comparatively small country is a reflection of the high number of niche banks servicing mainly non-resident CIS clients. Overall, foreign ownership is less pronounced than in its other Baltic neighbour countries, with only around 54 per cent of total bank capital foreign owned. Parex Bank, the largest bank in Latvia, remains the only big bank without a western strategic investor. A unified financial sector supervisory authority, the FCMC, started operations in July 2001.

[12] The bank was sold to an offshore company registered in the British Virgin Islands, Doxa Fund Limited, in May 2003, although the privatisation was marked by serious infighting among existing shareholders, government officials and the FCMC.

Regulations are compliant with the Basle core principles and Latvia fulfils almost all EU and OECD anti-money laundering conventions (a final set of amendments for anti-money laundering is still being reviewed by the parliament). A December 2002 EU Peer Report identified no major weaknesses in the financial system. Capital adequacy levels have been remarkably stable since the middle of 2000, and stood at 13.1 per cent in 2002. The share of non-performing loans at around 2 per cent in 2002 is among the lowest in CEB countries. There are some concerns about deposit stability (as such a large share of deposits is non-resident deposits) and the rapid pace of credit growth, but the Bank of Latvia and the FCMC continue to monitor the situation closely.

- *Although the banking sector is well developed, it requires more sophisticated product development in order to increase corporate lending and regional development.* Although domestic credit to the private sector has increased by around 50 per cent annually since 1997, financial intermediation is still low. Domestic credit to the private sector was still only around 33 per cent of GDP at the end of 2002 and broad money to GDP stood at 36 per cent of GDP. Moreover, most of the recent high credit growth is accounted for by the doubling in mortgage lending in 2002 and the 80 per cent increase in total household credit, while loans to enterprises grew by only 27 per cent. In addition, risks are becoming apparent from the increasing reliance on foreign funding for loans and the high share of lending in foreign currency (over 50 per cent). SMEs continue to face significant constraints in raising appropriate financing, particularly in the poorer regions outside Riga, due mainly to the need for substantial collateral for loans, poor quality financial accounts, and insufficient availability of local SME finance.
- *While leasing has developed rapidly (albeit from a low base) the insurance sector continues to be small.* Leasing in the Baltics has been an important alternative to bank loans as a result of the high transaction costs associated with ineffective collateral laws and the liquidity constraints of low income households. The leasing market has almost doubled every year since 1999, and the stock of leased assets has now reached almost 6 per cent of GDP. More than 90 per cent of leases continue to be financial leases. Almost 50 per cent of lease assets were used to purchase commercial and private vehicles. There are still only 13 licensed non-life and 6 life insurance companies in Latvia, with total insurance company assets amounting to only 2.5 per cent of GDP. Within insurance the life insurance sector is the least developed, although recent legal changes have helped to stimulate growth.
- *Recent reforms to the pension system should give a boost to private pension funds.* In July 2001, a compulsory funded pension scheme ("second pillar") was introduced, which is mandatory for wage earners younger than 30 years old and voluntary for those between 30 and 49 years. Contributions to the second pillar are planned to rise gradually from 2 per cent of income to 10 per cent by 2010, with the first pillar being reduced accordingly. Contributions to the compulsory funded pension scheme ("second pillar") started in July 2001. From January 2003 the management of the pension assets had been entrusted to licensed private pension fund managers. There are now five domestically registered asset managers, Hansa Fonds, Optimus Fonds, the Parex Investment Company, Baltikums Asset Management and the Latvian Leading Insurers Investment Company, competing for market share. Currently tight investment restrictions apply with the only permitted investments for second pillar funds being Latvian state bonds and deposit accounts. However the variety of permitted investment types is expected to broaden over the medium term.

The current value of second pillar assets exceeds LVL 6.5 million (€9.8 million). The introduction of this mandatory privately managed pillar for pensions will help to deepen the non-banking market and will provide alternative sources of financing for local enterprises, making the country less dependent on high inflows of foreign direct investment.

- *The integration of the Helsinki Stock Exchange with the Riga Stock Exchange and improvements in regulation should enhance the strength of the capital market and its integration into pan-European associations.* The equity market as a source of financing is still in its infancy in Latvia. Stock market capitalisation and turnover remain small, at 8 per cent and less than 2 per cent of GDP respectively in 2002. However, the acquisition of the Riga Stock Exchange by the Helsinki Exchange in August 2002 (following its acquisition of the Tallinn Stock Exchange a year earlier) should pave the way for the creation of a pan-Baltic securities exchange and trading platform.
- *Domestic debt securities are also still in their infancy.* The general government is still the major issuer of debt in Latvia. In contrast to Estonia and Lithuania, the Latvian government has in the past issued securities in excess of fiscal needs to help establish the domestic bond market and promote long-term financing in domestic currency. Notwithstanding, corporate issues are still practically non-existent and issues by financial institutions are also insignificant. Although the maximum maturity for domestic currency bonds has been 10 years since early 2003, almost all of the securities of corporations and around 40 per cent of securities of financial institutions remain short-term. As such, companies still rely largely on internally generated cash or bank credits to finance new investment projects.

Enterprise sector: *In the enterprise sector the challenge will be to privatise the few remaining large-scale enterprises, to continue improvements to the business environment and to support SMEs.* Since the last strategy was approved, privatisation has regained momentum. After several failed attempts, the government finally succeeded in the middle of 2002 to privatise the Latvian Shipping Company, albeit on different terms than those recommended by the Bank. The government also sold the remaining state-owned shares in Latvijas Gaze and Latvijas Krajbanka (Savings Bank). The private sector now accounts for more than 70 per cent of GDP and three-quarters of employment. Recent improvements have been made to the business environment, including notably the introduction of an EU-compatible commercial code and the creation of the Anti-Corruption Office. Productivity increases in the industrial sector have been rapid when compared to other CEB countries in recent years.. Despite having attracted amongst the highest per capita net FDI inflows in CEB over the recent years, it will be crucial to further attract greenfield and brownfield FDI in order to maintain robust growth and to achieve rapid real convergence with the EU.

- *Remaining challenges include the privatisation of the state's minority stake in Ventspils Nafta, the divestiture of state-owned shares in Lattelekom (once the arbitration case is settled), and restructuring and commercialising Latvian Railways.* However, the privatisation of these last remaining enterprises is probably going to be delayed. The privatisation of the state’s remaining 38.6 per cent share in Ventspils Nafta has been complicated by the Russian state-owned pipeline operator Transneft’s decision to stop supplying oil via the pipeline to the terminal since the start of 2003. Transneft is allegedly seeking to increase its leverage in a potential takeover of Ventspils Nafta or its oil terminal subsidiary. In line with the original privatisation agreement, the government in June 2003 had to concede an additional 5 per cent stake to the private Latvian company Latvijas Naftas Tranzits (LNT), making it the largest shareholder with 48 per cent. However, the government is currently investigating the legality of the original privatisation and whilst court proceedings are ongoing the privatisation process is delayed. In addition, the recent firing by the mayor of Ventspils Mr Lembergs, of the President and Vice President of Ventspils Nafta, is further complicating matters. There has also not been any progress regarding divestiture of state shares in Lattelekom due to an ongoing arbitration case. While TeliaSonera has recently offered to buy out the state's 51 per cent stake, the Government is still to respond.

- *Continued efforts will be required to improve the business environment.* In October 2002 the government approved a revised Action Plan to Improve the Business Environment. This plan includes measures aimed at improving tax policy and administration, central and local government procurement procedures and confidence in the rule of law. Judicial capacity is currently being improved by introducing higher remuneration, better qualification criteria, training and social guarantees for judges. Following the creation of the new Corruption Prevention Bureau in May 2002 (whose tasks are to investigate corruption, conflict of interest and political party finance), the government approved a new strategy to fight corruption in December 2002. However, according to a FIAS survey published in January 2003, enterprises in Latvia continue to complain about difficulties in the area of tax and customs administration, lingering problems at the municipal level, and administrative corruption in construction, customs and the police. The enterprise register, bankruptcy procedures and legislation on collateral, while being satisfactory, would benefit from further improvement, relating particularly to implementation and enforcement. The enforcement of new legislation needs to be enhanced and the administrative capacity of local courts needs to be strengthened, in particular concerning the backlog of cases, the quality of decisions and appropriate enforcement.

- *Support to SMEs needs to be enhanced.* SMEs account for 99 per cent of the total number of enterprises in Latvia, and half of all SMEs operate in Riga. SMEs provide more than 70 per cent of total employment and generate 65 per cent of GDP. However entrepreneurial activity is still considered low with only 17 active SMEs per 1000 inhabitants, compared with approximately 50 active SMEs per 1000 inhabitants in the EU. The Ministry of Economy has drafted a new National Programme for the Development of SMEs, and has initiated the establishment of business support instruments and information centres. A survey conducted in 2002 on the business environment for SMEs points to the lack of financial resources, the difficulties with access to credits (although this is decreasing), the shortage of skilled workers and inadequate information about available business support mechanisms. According to the BEEPS[13], Latvia scores worst amongst accession countries in terms of access to capital for new investments.

- *Quality and technological improvements are needed to increase the productivity and competitiveness of the agricultural sector and to address the challenges in rural regions*. Agriculture is one of the sectors that have seen the biggest changes over the transition period in Latvia. By 2000, the agriculture sector accounted for only 4.5

[13] BEEPS – Business Environment and Enterprise Performance Survey.

per cent of GDP and 11.5 per cent of employment (down from 9.5 per cent of GDP in 1994). This reflects the production inefficiencies and hidden unemployment in rural areas. More than two-thirds of the people employed in the sector work part-time. Around 60 per cent of farms produce only for self-consumption. The average farm size is only 12.4 hectares. Only around 5 per cent of tractors currently in operation are less than 6 years old. The small scale of farming and the low level of specialisation have a negative impact on the growth of production efficiency.

2.3 Access to Capital and Investment Requirements

Local banks are well capitalised and highly liquid from growing deposits. With EU accession imminent and reducing credit risk, banks are willing to lend to 10 years for corporate loans and to 20 years for mortgage loans, with interest rates typically at 5 to 7 per cent per annum. With total bank assets to GDP in Latvia at around 70 per cent, financial intermediation still has a long way to go to reach the EU average of 190 per cent. Local banks are generally still unwilling to lend to start-ups and newly established companies. Consequently small companies continue to cite the lack of access to reasonably priced long-term financing as the most significant barrier to growth. As part of the National Programme for SME Development, the Ministry of Economy is drafting a policy paper that channels EU grant monies from the Regional Development Fund, with co-financing from private sector investors, into local equity investment funds that aim to stimulate the development of start-ups, technology companies and regional development.

Small and illiquid, the domestic capital market has played a very limited role as a means to attract and allocate savings into capital investment. The domestic bond market continues to be dominated by government securities and a sizeable fraction of bonds outstanding are international Eurobonds. Latvia for 2004 is planning a Eurobond issue of Euro 300-400 million. The equity market is also still underdeveloped, and stock market capitalisation is only around 10 per cent of GDP.

In terms of credit ratings, Latvia was upgraded by Standard and Poor’s in August 2002 to BBB+ from BBB and by Moody’s in November to A2 from BAA2 (the same was done by Moody’s for all EU accession countries).

3. STRATEGIC ORIENTATIONS

3.1 Bank's Priorities for the Strategy Period

Given its mandate and the challenges outlined above, during the next strategy period the Bank will focus on those sectors in which the Bank continues to be additional in Latvia, comprising primarily the following main operational priorities:

- **Infrastructure.** Further development of infrastructure, including the transport sector, municipal infrastructure and the energy sector, in order to foster competition and attract private investment and commercial operations for long-term sustainability. While significant amounts of EU Structural funds and Cohesion funds will be available for large infrastructure projects, a 15-25 per cent co-financing portion is still required, and the Bank stands ready to provide such co-financing. Note that in some cases the EIB and NIB also plan to provide co-financing for infrastructure projects. In addition to providing funding, the Bank is able to add real value by assisting the client locally with know-how during project preparation, structuring and implementation phases. Commercial operations of infrastructure include for example, public-private partnerships for infrastructure design, construction and operations, operational concessions and the privatisation of state-owned or municipal-owned assets.

- **Energy sector.** In order to improve efficiency and competition within the energy sector, the Bank will work with Latvenergo to encourage the establishment of separate entities for power generation, transmission and distribution. This will be achieved in the context of supporting Latvenergo in its participation and expansion in the regional energy market. The Bank will work with Latvijas Gaze to strengthen Latvia's position in the domestic and regional gas distribution market.

- **Financial sector.** Given that local banks are willing to finance at an affordable cost companies' working capital and short to medium-term financing needs, the Bank will focus its activities on providing longer-term financing for SMEs and the provision of risk capital for local corporates. Sources of equity capital for SMEs, and particularly risk capital for small companies, continue to be very scarce. By investing in equity funds, the Bank expands the sources of equity capital for SMEs. The Bank will also aim to support non-bank financial institutions such as insurance companies and pension funds where possible. In select cases the Bank may also aim to provide long-term funding in the form of equity and credit lines to banks. Most banks continue to lack sources of long-term funding, with maturities exceeding five years. However the larger foreign owned banks in most cases provide back-up liquidity lines, or subordinated debt facilities, in order to assist their Latvian subsidiary to manage asset/liability maturity mismatches cost effectively. In some cases parent banks prefer that their subsidiaries diversify their sources of funding, and consequently the Bank will aim to provide funding, where appropriate.

- **Enterprise Sector.** In order to facilitate foreign direct investment, the Bank will seek to support large investment projects as well as investments in the manufacturing and service sectors by medium sized foreign and local companies. The Bank’s involvement will focus on projects that need more extensive structuring and cross-border investments, particularly into or from Russia and other CIS countries. Attention will be given to improving corporate governance, transparency and accountability, and increasing Latvia's competitiveness.

The Bank stands ready to assist the authorities in defining priorities, procedures and responsibilities to ensure effective access to EU structural and cohesion funds. The Bank has valuable experience in working with the EU on designing and jointly implementing financing operations to support a variety of sectors, including SME development, transport infrastructure and municipal infrastructure. This experience will be deployed in supporting Latvia's access to committed EU funds.

All EBRD operations in Latvia are subject to the Bank's Environmental Policy and incorporate, where appropriate, Environmental Action Plans into the legal documentation in order to address issues raised during due diligence. This will be done in line with the Bank's mandate to actively support environmentally sound and sustainable development through its investment projects.

3.2 Sectoral Challenges and Bank Objectives

3.2.1 Infrastructure Sector

In response to the transition challenges identified in Section 2.2, the Bank's operational objectives in the infrastructure sector will be the following:

In the **municipal infrastructure** sector, the Bank will focus on developing lending on a sub-sovereign basis for improving and commercialising municipal services. The Bank stands ready to support environmental projects (mainly water, wastewater, and solid waste) as well as urban transport and district heating projects, both for Riga and smaller municipalities, in cooperation with the EU and other donors, and local banks where appropriate. In particular:

The Bank will work to encourage the development of environmental projects by small and medium-sized municipalities. Due to restrictions in Latvia on municipal borrowing from commercial banks and the small size of the projects, communities find it extremely difficult to attract funding for their projects. The Bank will also investigate ways in which both EBRD and EU funds, as well as other donor funding, can be efficiently channelled on a joint basis to smaller municipalities in the water and wastewater sector.

The Bank will encourage the development of borrowing by municipal and privatised utilities, both of which are eligible to receive commercial bank financing. By promoting co-financing with commercial banks in this area, the Bank will seek to attract additional capital and at the same time provide utilities with the significantly longer tenors needed for their capital investment programmes. By developing the financing capabilities of utility companies, the Bank will further promote the improvement in service levels, commercialisation and market pricing of municipal services.

In the case of Riga, where the Bank has already provided funding for the Riga Water Company, the emphasis will be in the municipal transport sector, with potential projects to include traffic management, public transport facilities, street lighting and urban road projects. Where appropriate, the Bank will encourage the use of public-private partnership structures and operational concessions to improve the cost-efficiency of the municipal operations.

For other municipalities the emphasis will be on improving the efficiency of water supply and waste water treatment plants, solid waste management and the generation and distribution of district heating. EU funds will be mobilised to support a large portion of the capital costs, and local banks will be used in some cases to channel funds efficiently for the smaller projects.

In the **transport sector** the Bank will continue to work with the state-owned Latvian Railways company to support their on-going track upgrade programme, renovation of rolling stock and signalling systems. The rail freight business is continuing to develop strongly, due primarily to the increasing flow to Latvian ports of transit cargo from Russia to western Europe, and the main east-west freight routes on the national rail network require further capital investment to ensure reliable service under increasing volumes. The bank will work with EIB in this sector to secure EU funds for these large projects.

The Bank will also work with EIB and EU funds in identifying suitable and economically viable road projects, primarily to improve north-south road freight routes, road by-passes around major towns and access roads to ports. The project concept of the Daugava River crossing is yet to be defined, however the Bank stands ready to assist with project preparation and implementation once the Latvian authorities agree on the scope of the project.

3.2.2 Energy Sector

In the energy sector the Bank is prepared to support the restructuring (including unbundling and selective privatisation over the medium-term) of the power sector and dam safety upgrading, potentially provide funding to new CHP projects, and finance energy efficiency improvement projects. The Bank will also support the development of the Common Baltic Electricity Market (CBEM). More specifically and in line with the transition challenges identified in this Strategy document, the Bank will:

Be ready to offer Latvenergo long-term finance for (i) dam safety upgrading (a TC project is already being executed to assist the State Inspectorate for Dam Safety to implement the new national law on dam safety), and (ii) CHP, substation and distribution network rehabilitation investments to secure efficient, safe and environmentally sound operation of the electricity system. The Bank is willing to consider financing CHP projects with full, limited or non-recourse to the owners and with no recourse to the Government, subject to suitable power purchase and fuel supply agreements being entered into.

The Bank stands ready to support any potential privatization of Latvenergo or its restructuring into separate companies for power generation, transmission and distribution. The Bank is ready to assist the company in preparing for eventual participation in a liberalised EU energy market.

The Bank is willing to support the CBEM project with (i) TC financing in the planning phase and (ii) loans to Latvenergo to finance the necessary investments in metering, data collection, and energy balance management systems.

The Bank is willing to work with Latvijas Gaze to strengthen Latvia's position in the domestic and regional gas distribution market, including the expansion of the company's national and regional supply and distribution network, underground storage facilities and construction of CHP plants for end-users.

3.2.3 Financial Sector

In response to the transition challenges identified in Section 2.2, the Bank’s operational objectives in the financial sector will be the following:

The most important priority will be providing further support to SMEs. This will be done in the form of equity and credit lines to banks and leasing companies and investments in equity funds. In addition to providing financing, the Bank will aim to encourage an entrepreneurial culture. One of the Bank's main objectives will be to support regional development in Latvia by incentivising banks to channel a portion of the Bank's loan proceeds through regional branches. The Bank will look to engage in policy dialogue with governmental and other authorities relating to SMEs, organisations for the promotion of SMEs, and industry associations regarding ways in which the Bank can assist in the development of the sector. Working with banks and other financial institutions, expansion of the EU/EBRD SME Facility and development of the Small and Medium Municipalities Facility will be a priority. EU structural funds will be targeted as a potential local source of funds for the SME Facility. Ensuring the continued availability of capital for the private equity industry is of paramount importance because this industry is not only an important source of capital for the growing SME sector but also has a strong influence on corporate governance standards.

In the non-bank financial sector the bank continues to stand ready to support the emerging insurance sector, through improved corporate governance and operational efficiency, and a wider range of insurance products. However, the domestic insurance market in Latvia continues to be small and the Bank would consider investing only alongside a credible foreign strategic partner. The Bank will continue to support the strong growth in lease financing for SMEs by directing the resources of the SME Facility through selected leasing companies. Furthermore, the Bank is prepared to help develop the private pension fund industry in order to reduce the social welfare burden on the state budget. This could be achieved by investing equity in selected fund management companies to enable the fund managers to expand their operations, and increase the volume of funds under management. The objective is to enable the fund managers to quickly achieve critical mass in capitalisation and operational size. Given the expected small size of these transactions in Latvia, preferred candidates will be those with a credible foreign parent with multi-country operations.

The Bank will promote private ownership of housing and the managed expansion of residential mortgage lending. Although there has been a substantial increase in mortgage lending in recent years, mortgage lending volumes still lag those in Western Europe and banks lack long-term funding. However, sustainability and good asset quality will continue to be the Bank's objectives in this sector. Support to mortgage lending would be achieved by providing long-term loans to selected residential mortgage lenders, so that by on lending the funds they are able to provide medium and long-term loans to homeowners. The mortgage lenders would be expected to have a significant existing portfolio of residential mortgages, demonstrating their ability to lend prudently and to monitor effectively a growing asset base. Local loan documentation and asset quality would provide for securitisation in the future.

3.2.4 Enterprise Sector

In response to the transition challenges identified in Section 2.2, the Bank's operational objectives in the enterprise sector will be the following:

The Bank continues to stand ready to support large investment projects that encourage FDI in Latvia. One example is the Baltic Pulp project, with the Metsaliitto Group of Finland as the lead sponsor, however this project is still under discussion between Metsaliitto and the Latvian government. Assuming the project materialises, at an estimated project cost of around €1 billion, the project would be the largest foreign direct investment in the Baltic States to date. The Bank's recent input has been to assist the Government to access grant funding for technical assistance assignments, including important environmental assessments. If Metsaliitto and the Government reach agreement on the main terms of the project, the Bank could consider having a key role. The Bank's verification, inter alia, of the project's financial viability, environmental compliance and economic benefit could enhance the structuring of the project according to international best practice.

The Bank stands ready to support any other direct investment projects, such as in the manufacturing, agribusiness or service sectors by medium sized foreign or local companies. For example the Bank could consider supporting the privatisation of the remaining state-owned stake in Ventspils Nafta. The Bank's involvement in direct investment projects will focus on projects that need more extensive structuring and cross-border investments, particularly into or from Russia and other CIS countries, for example in the financial sector, manufacturing, trade or distribution. Attention will be given to improving corporate governance, transparency and accountability, and increasing Latvia's competitiveness.

The Bank will provide debt and equity financing to smaller enterprises in Latvia via financial intermediaries such as banks, leasing companies and equity funds, as outlined in section 3.2.1 (financial sector).

4. OTHER IFIs AND MULTILATERAL DONORS

The Bank continues to closely co-ordinate its activities with the EU, in particular in view of the high investment requirements related to EU accession and progress with transition as well as the sizeable structural funds available to Latvia from the start of next year. The Bank will continue its co-operation on environmental issues with other institutions including the Baltic Marine Environmental Protection Commission (HELCOM), the World Bank and IFC, the environmental activities of which are complementary to those of the Bank. In order to ensure effective synergies with other IFIs operating in Latvia, the Bank will maintain policy dialogue primarily with the following IFIs:

4.1 EUROPEAN UNION (EC-PHARE /ISPA/SAPARD)

Pre-accession assistance:

From 2000, the total financial pre-accession assistance allocated to Latvia amounts to over €100 million per year, consisting of €35 to €47 million from Phare, €22 million from SAPARD, and €36.4 to €57.2 million from ISPA.

Phare: From 1992 to 2002 a total of €355 million was allocated to Latvia under Phare. In the early years, Phare supported the transition to democracy and to a market economy; as of 1998 it was exclusively reserved for EU accession preparation. As of 2000, most of the funds were in support of continuing "Institution Building" by which public administrations and institutions were strengthened, so to be in a position to apply and enforce the acquis. A smaller part of the funds could also be used for strengthening "Economic and Social Cohesion" in the country.

ISPA: ISPA started as of the year 2000 and can be seen as a forerunner of the Cohesion Fund to finance major environment and transport infrastructure projects. In Latvia, the priorities for environment infrastructures concern drinking water, waste water and waste management and for transport they concern upgrading of the Via Baltica (Road Corridor I) and of the East-West railway link. The measures approved between 2000 and 2002 have a total value of about €390 million with an ISPA contribution of €277 million.

SAPARD: SAPARD was set up in 2000 to assist candidate countries in preparing for the application of the Common Agricultural Policy and in addressing in a sustainable way agricultural and rural sector problems. The indicative SAPARD allocations for Latvia for the four years 2000-2003 amount to €91.6 million. Projects financed include: investment in agricultural holdings, improvement of agricultural and fisheries product processing and marketing, development and diversification of economic activities providing alternative income, improvement of general infrastructure and environmentally friendly agricultural methods.

Post-accession assistance:

It has been estimated that during the first three years of accession (2004-2006) Latvia will receive net payments from the EU budget of around €830 million (€1,117 million receipts from the EU budget less €287 million contributions to it), most of which will come from the structural funds. In addition, Latvia has been allowed to top-up direct payments to farmers, some of which can be financed from EU funds. The IMF has calculated that post-accession financial flows through the Structural and Cohesion funds, the CAP and special budgetary support will begin in May 2004 and rise to 3-4.5 per cent of GDP per annum by 2006, while Latvian contributions to the EU budget would be around 1.2 per cent of GDP per annum. Although the net inflows into Latvia would therefore rise to around 3.5 per cent of GDP per annum, EU accession-related expenditures, most of which will be subject to co-financing requirements, have been estimated to reach 5.5 per cent of GDP, leaving a sizeable funding gap over the medium term. The funding gap also includes the liquidity management challenge in that Latvia will need to arrange financing for all projects eligible for EU grant monies, and then be reimbursed the grant portion (up to 85 per cent) only after each project phase has been satisfactorily implemented.

4.2 European Investment Bank (EIB)

Since the EIB began operating in Latvia in 1992, it has approved projects for Latvia in an aggregate amount of €341 million. These included, for example, several transport projects, such as the upgrading of the Riga International Airport, the Ventspils Port, the East-West railway line, and priority road sections of Via Baltica. In addition, the EIB has financed several energy and environmental projects, such as the upgrading and rehabilitation of water supply and wastewater treatment facilities for Riga, the Daugava River hydroelectric power plants, municipal and environmental infrastructure, and power generation and distribution. In telecommunications, the EIB financed the digitalisation and expansion of the fixed line network and the fibre optic network. Moreover the EIB approved several facilities under its Global Loans for financing smaller scale projects, including facilities with the former Investment Bank of Latvia, Vereinsbank Riga, and Nord/LB Latvija.

In the context of preparation for EU membership, and subsequent to Latvia's accession to the EU, the EIB's activities in Latvia will be closely co-ordinated with the EU Structural and Cohesion Funds. Transport infrastructure is likely to remain a major area of EIB's operations, with emphasis on support to the Trans-European networks. The EIB is also willing to continue its support for projects aimed at environmental protection, especially those relating to the implementation of the Acquis Communautaire. In October 2003 EIB provided a state-guaranteed credit line for 12 years to the state-owned Latvian Mortgage and Land Bank for €30 million for lending to SMEs.

4.3 Kreditanstalt für Wiederaufbau (KfW)

Kreditanstalt für Wiederaufbau has provided financing in Latvia primarily for SME development, and more recently, for improving energy efficiency in apartment blocks. In 2000, KfW provided a €10 million credit line for 10 years to the Latvian Mortgage and Land Bank to support SME development. Then in 2002 KfW provided a €15 million credit line for the same purpose to Hansabanka. In March 2003 KfW provided a €5 million credit line to the Latvian Mortgage and Land Bank for improving energy efficiency in residential apartment blocks.

4.4 International Monetary Fund (IMF)

Latvia joined the IMF in May 1992. Throughout the course of the 1990s and until last year, Latvia requested from the IMF a total of seven Stand-By Arrangements as a precautionary measure. The latest of these was approved in April 2001 for the amount of SDR 33 million and expired successfully in December 2002 with all performance criteria met. There are no further current or projected obligations to the IMF. At the latest Article IV consultation, which was concluded in April 2003, it was decided to hold the next Article IV consultation on the standard 12-month cycle.

4.5 Nordic Investment Bank (NIB)

The Nordic Investment Bank is a multilateral financial institution owned by the five Nordic countries: Denmark, Finland, Iceland, Norway and Sweden. In 2001 NIB developed a financing programme for supporting women entrepreneurs, part of which included a loan of €300,000 to Hansabanka in Latvia for selective on lending. NIB has financed with €20 million an energy efficiency programme with municipalities and has provided a €7 million credit line to the Latvian Mortgage and Land Bank to finance mortgage loans. NIB has provided financing of €1.8 million to the Jelgava city water utility, and €3.8 million towards the renovation of the Riga Graduate School of Law. In 2002 NIB provided a 15-year credit line of €40 million to Latvenergo for renovating and upgrading power generation facilities. Also in 2002 NIB provided a €10 million credit line to the Latvian Mortgage and Land Bank to on lend to SMEs. Then in August 2003 NIB provided a second 15-year credit line to Latvenergo for €57 million, also in support of Latvenergo's capital investment programme. Latvia has recently been invited to become a member of the NIB and a detailed proposal is now being developed.

4.6 World Bank and IFC

Latvia joined the World Bank in August 1992. The Bank's current program is defined by the Country Assistance Strategy (CAS) for FY02-05. The World Bank's lending program seeks to enhance private sector development, improve public sector management, build sub-national Government capacity, finance human development, and develop a more efficient social welfare system. To date the World Bank has approved projects in the amount of US$380 million. Of this, US$316 million has been disbursed and US$48 million has been repaid. The current amount of outstanding obligations is US$263 million. The most recent project is the PSAL II, which was approved in September 2002, and continues the objectives of PSAL I, namely (i) correcting macro-imbalances; (ii) strengthening credibility of the public sector; (iii) improving institutional capacity to deliver public services; (iv) rationalizing a transparent relationship with the private sector. Recent initiatives included work on public expenditure management, financial sector reforms, public sector reforms, pensions, energy sector reforms, improving regulatory frameworks, privatisation, and anti-corruption.

The International Finance Corporation (IFC) has supported Latvia's transition to a market economy through financing and technical assistance since Latvia became a member in 1992. In 1996, IFC provided a US$4 million loan to Vika Wood, a joint venture with Scandinavian partners, to build and operate a sawmill. IFC has also invested in Tilts Communications (Denmark), created to assist in the modernisation and privatisation of Lattelekom, the former state-owned fixed-line telecommunications company. In 1996, IFC and Vereins- und Westbank AG of Germany established Vereinsbank Riga, a joint-venture commercial bank. In 1999, IFC supported a project to renovate and operate the Grand Palace Hotel, a hotel in a historic building in Riga's Old Town. In 2002 IFC provided financing to construct and renovate retail shopping malls in Riga owned and operated by Linstow Varner SIA, a wholly-owned subsidiary of Norwegian Linstow Varner SA. Furthermore IFC supported the establishment in early 2003 of Hanseatic Capital, a mezzanine financing facility targeting a wide range SMEs in the Baltics. Lastly, the IFC is working together with the EBRD, the Government of Latvia and Finnish partners on the potential construction of a 600,000 ton capacity pulp mill, which, if it materialises, is expected to make a major contribution to economic growth in Latvia.

ANNEX 1: POLITICAL AND SOCIAL ASSESSMENT

Internal political situation

Latvia is a functioning parliamentary democracy, with a 100-seat Parliament, and a President elected by Parliament. The Prime Minister and the Cabinet are responsible for government operations. The Constitution provides for an independent judiciary. Frequent changes of government have been a feature of Latvia's politics since it regained independence. One of the factors contributing to the Latvian governments' short life-span since independence has been the pre-war system of proportional representation, re-introduced after 1991, under which a large number of parties compete for power, some of whom are new and politically inexperienced. However, despite frequent changes of government there has been a majority consensus over the two main foreign policy aims – membership of NATO and the European Union.

The current right-of-centre four-party coalition government, which came into power following the October 2002 election, is headed by Mr Einars Repse, a physicist by training and former Governor of the Bank of Latvia (central bank), from 1992 until 2001. Repse campaigned on an anti-corruption platform and has both during the election campaign and since gone out of his way to distance himself and his party from political personalities and groups that had been in power over the last few years and are popularly perceived to be tainted with corruption. The Cabinet is made up of Repse's New Era Party, which has the largest number of seats in parliament; the Latvia First Party, led by a Lutheran pastor, Mr Eriks Jekabsons; the populist Union of Greens and Farmers; and For Fatherland and Freedom-Latvian National Independence Movemement (FFF-LNIM). The first three of the above parties were formed in early 2002, with the result that the government is dominated by inexperienced newcomers who do not agree on a number of significant issues.

Due to the PM's and the cabinet's lack of hands-on governmental experience, the coalition had taken some time to begin to function properly. The Prime Minister managed to assert his leadership over the controversial preparation for the austerity 2004 budget. So far, he has also withstood strong opposition both from the right-wing People's Party, led by former Prime Minister Mr Andris Skele, and from the left-wing For Human Rights in a United Latvia Party, led by Mr Janis Jurkans, the second largest to emerge from the October 2002 election. On 12 June 2003, the Latvian parliament rejected a motion of no-confidence in the Prime Minister, which had been proposed by the People's Party. All the 55 members of the ruling coalition voted against the motion, with 27 votes for and 17 abstentions. The motion was supported by all the members of the People's Party and the For Human Rights in a United Latvia Party, but 17 MPs from the People's Harmony Party, another left-wing political formation, abstained. Repse's New Era remains the country's most popular party. However, in view of the continuing tensions among the coalition partners and criticisms of Repse's leadership style, it is too early to speculate whether Repse's government will match, let alone surpass, the length of office of his immediate (also right-of-centre) predecessor in the post of Prime Minister, Mr Andris Berzins. Mr Berzins served as PM from May 2000 to October 2002, the longest time in Latvia's post-1991 history. However the general political stability was enhanced by the fact that Latvia's popular President, Mrs Vaira Vike-Freiberga, whose first election by parliament in 1999 took seven votes lasting 14 hours, was re-elected on 20 June 2003 with 88 votes against 6 in a single voting session.

EU accession issues

Latvia applied to join the EU in 1995. It opened membership negotiations with Brussels only after the Helsinki summit in 1999 but then made rapid progress in completing the negotiating chapters of the EU's acquis communautaire. The Regular Report on Latvia's progress towards EU accession prepared by the European Commission and published in October 2002 concluded that Latvia had met all the main entry criteria. Latvia was accorded the status of a fully functioning market economy, able to withstand the competitive pressures of the single market, provided it continues with structural reforms. However, the Report noted that Latvia needed to speed up judicial and administrative reforms. At the EU's Copenhagen summit in December 2002 Latvia was accepted for membership in May 2004, along with nine other applicants, and signed the EU Accession Treaty in Athens in April 2003. The referendum on Latvia's EU membership was on 20 September 2003, immediately after Estonia (14 September). Despite Latvia's reputation as the second (after Estonia) most Euro-sceptic country among the 10 prospective new members, the result was positive. Altogether 67% voted for EU accession and 32% against (with a turnout of 72.5%, the second highest among candidate countries after Malta).

International relations

Latvia maintains close neighbourly relations within a number of regional bodies with neighbouring Estonia and Lithuania, with which it also maintains strong defence links. Its cooperation with the Nordic countries is also very close. From the Nordic countries has come considerable political and material support for Latvia since independence - but even before. The key post-independence goal of Latvia's foreign policy - EU membership – has been strongly supported by the other two Baltic Republics and all the Nordic countries. Joining NATO continues to be one of Latvia's key foreign policy objectives.

Latvia, an independent democratic republic in the period between the two World Wars, came under Soviet rule in 1940 and again, following the end of the 1941-44 German occupation, in 1944. It regained independence in 1991. An important long-term consequence of the Soviet policy of seeking fully to amalgamate Latvia (together with the other two Baltic states) into the Soviet Union was a dramatic change in the country's ethnic make-up. From 1935 to 1989 the Latvian share of the population dropped from 77% to 52% while the share of the Russians and other Slavs rose in the same period from 10.2% to 42%. In the 1980s under Mikhail Gorbachev the movement for independence began to grow in Latvia. The Soviet Union at first opposed it but eventually it gave in and formally recognised Latvia as an independent state in September 1991. Russia had misgivings about the EU's eastwards enlargement and, even more, NATO's expansion towards the east to include the three former Soviet republics. However Moscow's opposition to the EU's enlargement disappeared by the late 1990s while that towards NATOs eastward enlargement abated (and eventually also disappeared) following President Vladimir Putin's decision in the wake of the 11 September 2001 attacks on the US to accommodate good working relations both with the EU and with NATO. However, progress in Latvia's bilateral relations with Russia has been slow. Russian soldiers stayed in Latvia until in 1994 (and some even right up to October 1999 in order to dismantle the Russian anti-missile radar station at Skrunda). The withdrawal of Russian military personnel and their families accounted for the large reduction in Latvia's population in the early 1990s.

Latvia's language laws were the object of much criticism by Russia, which maintained that they were discriminatory towards the country's large Russian-speaking minority. The issue continued to trouble Latvian-Russian relations even after the language law was amended in 1998 with the help from the Organisation for Security and Cooperation in Europe (OSCE). The OSCE closed down its mission in Riga at the end of 2001 following the OSCE Chairman-in-Office's statement that 'its tasks under the missions' guidelines concerning citizenship, language (in particular, language provisions in the election law), education, the integration programme and the ombudsman institution had been completed, were being completed or could be achieved by other more appropriate instruments'. The European Court of Human Rights in Strasbourg is the international body to which members of Latvia's Russian-speaking minority, or any citizen or resident of Latvia with a grievance, is entitled to turn for redress of that grievance.

A new bilateral issue of considerable economic significance to Latvia in view of the importance to it of the transit trade as a key element of its economy has arisen. It is the Russian decision, first to reduce the amount of oil being pumped through the Latvian port of Ventspils in 2002 and then, in 2003, to stop the operation completely. The reason being given by Russia is that it is concentrating on building its own pipeline system to Primorsk near St. Petersburg. In the meantime, Russian companies have been sending oil and other goods through Latvia by rail and road, however at higher cost and in lower volumes than oil via the pipeline. Another old but still outstanding issue between Russia and Latvia is that of the border treaty signed in 1997 but not yet ratified by the Russian State Duma.

Minority rights

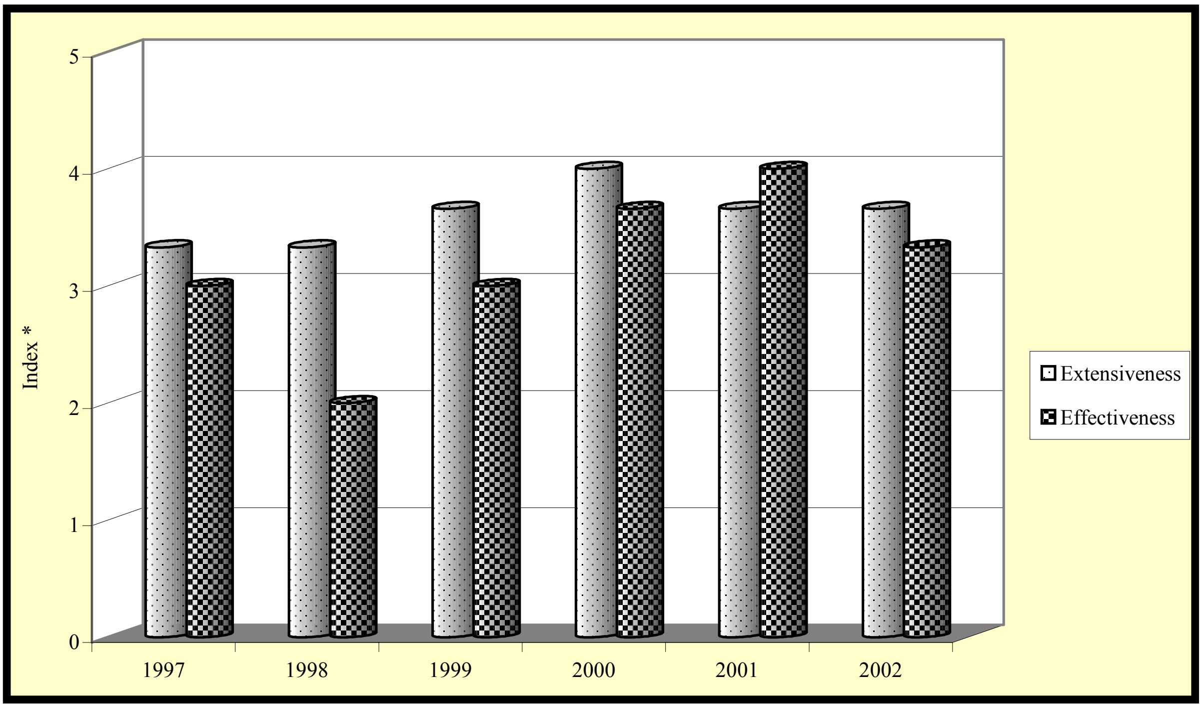
Two major factors altered Latvia's population structure in the second half of the twentieth century up to 1991: under Soviet rule, in 1940-41 and after 1945 the mass deportations of Latvians to Siberia; and the mass immigration to Latvia of Russians and other Slavs during the same period. Before Latvia became a part of the Soviet Union, 77 per cent of the population was Latvian, but by 1989 that had dropped to 52 per cent. By 2002, the share of ethnic Latvians went up to 58.2 per cent, chiefly due to the emigration of non-Latvians, primarily Russian military. Following the restoration of independence in 1991, citizenship was accorded immediately only to citizens of Latvia before 1940 and their direct descendants. The status of 670,000 persons (mostly ethnic Russians) changed from citizens of the Soviet Union to non-citizen residents of Latvia. In response to Western and Russian pressure, a more liberal approach was adopted by parliament reflected in an amended new law adopted in 1998. According to the law, children born in Latvia after August 1992 were automatically entitled to citizenship, while language and other naturalisation procedures and tests (especially for the old) were simplified. Nevertheless by December 2002, 21 per cent of the country's population were still stateless. The biggest barrier to naturalisation is the lack of ability in speaking the Latvian language – especially in Russian-speaking majority areas. International observers including the OSCE Mission have credited the government with establishing a competent and professional Naturalisation Board with offices throughout the country to implement the law and generally applying the law fairly. However, international experts, government officials and domestic human rights monitors agree that the country must continue to place high priority on, and devote sufficient resources, to implementing the citizenship law in a fair and impartial manner as well as seek ways to expedite naturalisation and promote social integration.

ANNEX 2: LEGAL TRANSITION

COMPARATIVE ASSESSMENT OF LATVIA'S COMMERCIAL LAW

1. Assessment Over Time

Extensiveness and Effectiveness of Latvia's Commercial Law[14]



Source: OGC Legal Indicator Surveys; 1997 - 2002
**Note:* Indicators along the y axis range from 1 (little progress) to 5 (substantial progress)

According to the annual EBRD Legal Indicator Surveys the perception of commercial laws in Latvia has been stable in the last years and approximates standards generally acceptable internationally.

As the above reveals, the perceived gap, which has existed since 1998 (albeit at a decreasing rate), between laws on the statute books and their implementation has reduced considerably. Perceived effectiveness is now almost equal to perceived extensiveness.

[14] Since 1997, the EBRD has conducted a Legal Indicator Survey each year to measure the progress in legal reform in Central and Eastern Europe, the Baltic States and the Commonwealth of Independent States, as viewed by local lawyers and academics. The results of such survey are based on responses to the questionnaire sent out to lawyers practising in any given country. The survey represented their perception of the country's legal system and, in particular, the degree to which key commercial and financial laws have reached internationally acceptable standards (extensiveness) and to which extent these laws are implemented and enforced (effectiveness). The survey is based purely on local lawyers' perception of their own country legislation and does not represent EBRD's own view on these legal systems. In addition, it must be noted that each respondent is asked to answer the questionnaire for his/her country only, and not on a comparative basis.

2. Situation in Other Transition Countries

Latvian law compares well with that of other transition countries. Based on the 2002 EBRD Legal Indicator Survey, which measured the perception of lawyers familiar with Latvian law, the commercial laws of Latvia can be characterised as nearly adequate for supporting investment and other commercial activity.

LEGAL SECTOR ASSESSMENT

Bankruptcy

The primary legislation governing bankruptcy proceedings is contained in the 1996 Law on Insolvency of Enterprises and Companies and the 1995 Law on Credit Institutions, both as subsequently amended. A new Commercial Code (the "Code") entered into force on 1 January 2002 providing for extensive changes to the pre-existing business legislation. However, this Code did not make any provision for insolvency related issues and, as the pre-existing insolvency laws were perceived to be inconsistent with the Code, harmonisation of the relevant legislation has been necessary. A noteworthy recent development in this respect has been the adoption, on 13 June 2002, of amendments to the Companies Insolvency Act aimed at improving the overall insolvency administration process. These amendments became effective on 1 January 2003 with the establishment of a new State Agency for Insolvency Administration and changes in the status and activities of insolvency administrators. This Agency is the central public institution recommending administrators for appointment by the court and supervising their work.

The recent regional EBRD Insolvency Sector Assessment[15], which included Latvia, revealed court supervision of 'restoration' proceedings, appellate procedures for bankruptcy cases, provisions relating to cases of cross-border insolvency and adequate provision of information for, and independent assessment of, a restoration plan as particular areas falling short of the required standard at the time of assessment.

Proposals to amend the Law on Insolvency of Enterprises and Companies have recently been submitted to parliament, though these would appear to relate only to minor changes. Moreover, a new Insolvency Law is currently being drafted and it is expected to be adopted in 2004.

Capital Markets

The capital markets of Latvia are regulated by the Financial and Capital Market Commission (FCMC), established on 1 July 2001 in accordance with the Law "On the Financial and Capital Market Commission" (the "Law on FCMC"). The Law on FCMC came into force on 1 July 2000. The FCMC is an autonomous state institution, which has the authority to supervise the entire financial sector, covering banking, securities market, insurance companies and pension funds. The FCMC also manages the depository guarantee fund. Under the Law on FCMC, the political independence of the FCMC is ensured through a variety of strict provisions on appointment and dismissal of its chairman. The operational independence of the FCMC is guaranteed

[15] EBRD's Insolvency Sector Assessment assesses the "law on the book", but not the level of implementation of the relevant legislation

through specific definition of its regulatory objectives, the availability of regulatory powers and self-sufficiency in its financing. In this respect, it is worth noting that in April 2002, a group of experts from the European Commission visited Latvia to assess whether all financial and capital market participants in Latvia are supervised in conformity with international norms and best practice. The overall evaluation from this peer review was positive with the relevant report indicating that the FCMC had succeeded in combining the functions of the three former supervisory authorities of the Latvian financial and capital market, which previously had operated separately.

Key legislation governing the Latvian securities market includes the 1995 Law on Securities, the 1998 Law on Investment Companies and the 2002 Investor Protection Law. The Law on Securities has been amended several times, most recently in November 2001. The Law on Securities determines the procedures for public issue, registration and circulation of securities, the activity and liability of securities market participants and provides for the protection of investors' interests, aiming at ensuring transparency and equal opportunity for all persons to act in the securities market, and ensuring equal access to information related to public issue, registration and circulation of securities. In October 2002, the FCMC approved a set of Regulations for Calculating Capital Adequacy of Banks and Brokerage Companies in order to ensure compliance with relevant EU capital adequacy and report preparation/submission requirements. These Regulations also specify the minimum initial capital of brokerage companies, depending on the type of authorised intermediary transactions.

The insurance sector in Latvia is primarily governed by the Law "On Insurance Companies and their Supervision" and the Law "On Insurance Contract", both in force since 1 September 1998. Both laws were adopted in order to harmonise the Latvian framework with relevant EU directives. The Law on Insurance Contract was amended in 2002, obliging insurers to inform their insurance policy holders of the procedures for out-of-court settlements of complaints and disputes, prior to entering into insurance contracts. Insurance contracts are also required to specify the term for taking a decision to pay or refuse insurance indemnity, as well as the grounds for any refusal to pay insurance indemnity.

Company Law and Corporate Governance

The primary legislation governing corporate governance related issues includes the Law on Joint Stock Companies (the "JSC Law"), the Commercial Law and the Law on Securities. The JSC Law came into force in 1993 and was amended in 2001. The Commercial Law became effective in 2002, strengthening shareholder rights, particularly for companies with limited liability. The Commercial Law will replace the JSC Law on 1 January 2005 and compliance with it is mandatory for all companies established after 1 January 2002. For companies established prior to 1 January 2002, there is a transition period until 1 January 2005 to comply with all requirements set forth in the Commercial Law.

Companies are required to file the following information with the Enterprise Register: (1) annual financial statements, (2) management and supervisory board members, (3) name of the auditor, and (4) copies of company by-laws and amendments. All such information is then published in the Latvian Government's official gazette. A general meeting of shareholders should be held at least once a year. According to the Commercial Code, the notice for a general meeting of shareholders should be given at least

30 days in advance in case of annual meetings and two weeks in the case of extraordinary ones. Shareholders may appeal to the court if procedures for convening a meeting have not been followed, within three months of the required date. Shareholders may vote by proxy where power of attorney has been provided for in the proxy. The Commercial Law provides for a two-tier board structure with a supervisory board, management board and, where applicable, an auditing commission instead of, or as a supplement to, the supervisory board. Supervisory board members are elected by the annual general meeting. Non-residents and foreigners may serve on the management and supervisory boards.

In terms of protecting minority shareholders' rights, extraordinary general meetings may be convened at the request of the holders of 5% of issued shares. Under the Commercial Code, holders of 5% of the voting capital may require other items to be added to the agenda. Shareholders with at least 5% of issued shares in a company may nominate one supervisory board member. Amendments to a company's by-laws and issuance of new capital must be approved by a 75% majority of the votes of shareholders participating in the relevant meeting. Shareholders are entitled to pre-emptive rights with respect to any share issue. In addition, according to the Law on Securities, merger proposals require a 75 percent majority of votes present at the relevant general meeting of shareholders. In accordance with the Commercial Law, a group of shareholders who jointly represent 5% or more of the company's paid-in capital (or whose participation in the company's capital is at least LVL 50,000) may bring action against the supervisory board on behalf of the company. These shareholders must submit the claim to the supervisory board; if the supervisory board fails to act within 30 days, the minority shareholders may bring the action themselves. If so, the minority group may appoint its own representatives and the court must allow the representatives to act on behalf of the company if these shareholders establish for the court that there is due cause for the action. When their rights are violated, shareholders can initiate legal action in their own name, but cannot do so in the name of the company as a derivative action. In cases of conflicts of interest issues concerning management board members (and their second degree family relations), the Commercial Law requires that the board member shall not have voting rights on the given issue. Board members failing to provide notice to the board are liable for losses the company incurs. Any shareholder who has acquired 10% or more of the issued shares must disclose it within seven days to the company and the FCMC. Further disclosures are required upon acquisition of 25%, 50% and 75%. When a shareholder has accumulated more than 90% of issued shares in a company, the remaining minority shareholders may request that their shares be purchased by the majority owner. If a minority shareholder rejects the price proposed by the majority shareholder, the price will be determined by a court.

According to the results of the 2002 EBRD's Corporate Governance Sector Assessment Project[16], Latvia's existing corporate governance related laws were rated among "high compliance" countries when compared to the OECD *Principles of Corporate Governance*. General reform priorities for countries in the "high compliance" category are to improve effective implementation and enforcement of existing legislation. In particular, the regulator should be given sufficient independence and resources to

[16] EBRD's Corporate Governance Sector Assessment Project assesses the "law on the books" but not the level of implementation of the relevant legislation

carry out its mandate; the competence of judiciary system in adjudicating corporate governance related disputes should also be enhanced.

Concessions

Latvia introduced its Law on Concessions (the "Concessions Law") in 2000. Among other laws, general and special, applicable to the Public Private Partnership (PPP) legal framework in Latvia are the Law on State Control and Local Governments Support to Entrepreneurial Activity, the Law on Ports, the Law on Energy, the Law on Railways, the Law on Radio and Television, and the Law on Waste Management. The Concessions Law defines a concession as the assignment of rights to provide services or exceptional rights, established by contract between a grantor and a concessionaire, to use resources for a specific period of time, not exceeding 30 years.

Where state property is to be granted, the Cabinet of Ministers acts as a grantor of the concession and authorises the relevant sector ministry to sign a contract. When local government property is granted, the relevant local government is the concession grantor. Both domestic and foreign entities or associations may bid for a concession contract, though, where a foreign entity successfully bids for a concession a corporate presence will need to establish in Latvia before the concession will be issued.

The Concessions Law provides that concessions may be granted by way of tender or auction and also specifies the procedure for the announcement of results of the tender or auction. It is not clearly from the Law whether a concession may be granted by a direct negotiation/contract. The results of the tender/auction may be appealed within a 15-day period to the Cabinet of Ministers or the Council of the local government, as appropriate. No option for a court appeal or international arbitration is currently provided. Nor does the Concessions Law provide for a so called "stability clause" which would guarantee the application of law effective on the day of the agreement in the event of subsequent change in the laws.

Secured Transactions

Secured transactions legislation in Latvia was reformed in 1998-99 to introduce a market-oriented, flexible and transparent system. The current legislation provides for two types of pledges: non-registered pledges, governed by the Civil Code, and registered pledges governed primarily by the Law on Commercial Pledge. The Law on Commercial Pledge applies to pledges over movable (tangible or intangible) assets belonging to a company, whether specifically or generally described. An entire enterprise/business company can be pledged, however it will not comprise the enterprise's real estate or vessels. The pledgor must be an enterprise or a business company, otherwise only commercial pledges over aircraft, vehicles, an enterprise defined as a pool of assets, capital shares of an enterprise, shares, stocks and bonds of a closed issue can be made.

Commercial pledges must be registered with the Commercial Pledge Register, part of the Registry of Enterprises. Parties must present a signed registration statement and include copies of the loan document and the pledge agreement. Registration usually takes 5-10 days and details of commercial pledges over registered assets are available on-line after agreement with the Register[17]. Separate registries exist for different types

[17] see www.kr.gov.lv.

of assets, accordingly, in the case of a pledge over the whole enterprise, registration statements must be filed with different institutions.

Generally speaking, the legal framework appears to serve commercial needs well. There are however a few areas of uncertainty or complexity:

- The requirement for separately identifying components subject to registration in the registration statement could create problems where a charge is over a fluctuating pool of assets;
- Where there is a pledge over an enterprise, difficulties could arise because of the obligation to amend the registration statement where 'movable items which are subject to specific registration' are acquired or added to enterprise.

A pledgee can take possession of the pledged assets when his right to enforce arises (art 36 (1) Commercial Pledge Law, Art. 1319 CC). Enforcement of commercial pledges without judicial proceedings appears to be always possible, after the lapse of 30 days from the submission of a notice to the Registrar of the Commercial Pledge Register. A pledgee can realise the security by selling himself the pledged assets if so was agreed with the pledgor and has been registered. The most recent EBRD Legal Indicator Survey (2003) assessed practical enforcement in this regard in Latvia as quick and effective.

Telecommunications

The telecommunications sector in Latvia is currently governed by the Law on Telecommunications of 2001 (the "Telecoms Law") and regulated by the Public Utility Commission (PUC). The Telecoms Law provides the legal basis for full liberalisation of the telecommunications market as of January 2003 and aligns Latvian legislation with most EU *acquis* requirements. In addition, the Telecoms Law has since been supplemented by a number of regulations transposing EU regulations covering, *inter alia*, control of significant market power, licensing, dispute resolution, tariffs and universal service.

In 1993, the Sonera-controlled Tilts consortium took a 49% stake in Lattelekom (the state-owned incumbent) and, in 1994, signed an umbrella agreement with the government, committing itself to investments of US$160.3m over the following three years and establishing exclusive basic telephony rights until 2013. However, the reduction of this exclusivity to 1 January 2003 has led to a yet to be resolved dispute over compensation between the state and Tilts, now owned by TeliaSonera. Although this dispute has not delayed the opening up of the fixed-line sector, it has delayed sale of the state's remaining 51% stake in Lattelekom and resulted in slower than expected progress in modernising the public network.

Latvia has made good progress in aligning with most of the EU *acquis* requirements. Negotiations on the EU telecommunications chapter have been closed, ahead of expected accession to the Union in 2004 and Latvia has not sought any transitional arrangements.

While all of the main elements of the Latvian telecoms market have been liberalised on 1 January 2003, real competition is likely to take some time to emerge because of a somewhat uncertain regulatory environment, particularly regarding implementation of tariff rebalancing, universal service obligations and negotiations between former incumbent Lattelekom and new entrants over interconnection charges. While PUC has already issued a number of licences since the opening of the market, the market remains dominated by Lattelekom and interconnection and tariff rebalancing issues will need to be overcome before alternative operators can begin delivering meaningful competition in the marketplace. Latvia's efforts now need to focus on adopting any remaining implementing legislation, fully implementing the remaining pieces of the regulatory framework and improving the capacity of the PUC to deal with the increased demands to be placed upon them as competition takes hold in the sector.

ANNEX 3: MACROECONOMIC DEVELOPMENTS AND INDICATORS

Output: ***investment-led growth.*** In the first half of 2003 real GDP growth was 7.5% year-on-year with growth likely to reach 6.5% in the year as a whole, slightly up from the 6.1% recorded in 2002. Growth in 2004 and over the medium term should remain strong at around 5-5.5% per annum. As in the other Baltics, the sustained robust economic performance has resulted from strong growth in gross fixed capital formation and private consumption, which grew by 10.4% and 7.2% respectively in 2002. Investment growth has been spurred by large inflows of FDI and historical low interest rates. Consumption has been growing as a result of considerable increases in real wages (including pre-election increases of public sector wages by the outgoing government). However, external demand also strengthened in the second half of 2002, and in the first half of 2003 exports increased by 19% in value terms, almost matching a 20% increase in imports.

Manufacturing, construction, mining and quarrying and fishing all reported strong growth rates in the first half of 2003. Despite the Russian oil pipeline monopoly Transneft's decision to withhold all deliveries to Latvia's port of Ventspils via the oil pipeline from the beginning of 2003 (with the volume of oil and oil products transported via the pipeline down by 14% in the first half), overall value added in the transport, storage and communications sector also increased by 14.9% in the first half of the year. This resulted from the diversion of some of the oil transit via the pipeline to cargo shipment via rail, road and at the ports of Riga and Liepaja, but it is unclear when capacity constraints will set in. A successful EU referendum and an anticipated recovery of the Eurozone in the second half of 2003 should give a boost to continued export growth and foreign direct investment inflows this year, even though the outlook for transit trade remains weak.

Fiscal policy: ***strong revenues offset expenditure increases.*** The general government deficit reached 2.7 per cent of GDP in 2002 and the government approved a budget deficit of 3 per cent for 2003. Expenditures have risen sharply in 2002 as a result of substantial supplementary spending and increases in public sector wages towards the end of the year. The lack of fiscal consolidation under the 2003 budget law is due to the authorities' decision to proceed with the reduction in the corporate income and social tax rates from January 2003 and significant increases in some spending categories such as for wages. In the summer the authorities also approved a supplementary budget to be spent on agricultural subsidies, higher wages for teachers and increased medical services. However, revenue performance in the first half of 2003 has been very strong despite the tax reductions. This could lead to a slightly lower deficit than foreseen under the budget (provided that the authorities refrain from adopting a second supplementary budget later this year).

Although the government has reiterated its commitment to achieving balanced budgets over the medium-term, the pace of fiscal consolidation is slow. The 2004 budget, which was approved by the Cabinet in late September 2003, includes a central government deficit of 2% of GDP, and a general government deficit of 2.5%. The relatively slow pace of fiscal consolidation could put Latvia in a difficult position to meet future spending needs related to EU and NATO accession within the constraints of the Maastricht criteria and the Stability and Growth Pact. The key challenges continue to be improving medium-term budgetary planning, imposing tighter controls on local government, and increasing tax collection rates while moving cautiously with further tax reductions. However, Latvia should also receive significant fiscal support from the EU over the medium term (which has been estimated by the IMF to amount to close to 1% of GDP in the run-up to accession until 2004 and close to 3.5% post-accession).

Monetary policy and inflation: ***competitiveness of the currency peg supported by productivity gains.*** Latvia's monetary base is mostly fully covered by net foreign assets and the Bank of Latvia aims to maintain the lat within a +/- 1% band of its peg to the SDR, which in practice is similar to a currency board arrangement. A recent IMF study has shown that the currency peg continues to be appropriate since competitiveness is still strong following sharp increases in productivity in recent years. According to recent statements by the authorities, Latvia is likely to seek ERM II membership shortly after EU accession in January 2005 and ultimately adopt the Euro in January 2008. This implies an exit from the current SDR peg, since pegs against anchors other than the euro are incompatible with ERM II. The authorities are likely to adopt a narrower band than that allowed under ERM II since the current band under the SDR is +/- 1%. The Latvian authorities would have to agree with the EU authorities on a central parity based on an assessment of Latvia's competitiveness and sustainability of the new peg. The current expectation is therefore that the switch from the SDR to the euro peg will take place at the exchange rate between the SDR and euro that prevails at the time of switching.

Annual average inflation is low (at 3.7% in June 2003 year-on-year) and average interest rates on domestic interbank loans have fallen from a peak of 8.3% in November 1998 to 2.8% in June 2003 as a result of increased confidence and greater competition in the banking sector. The Bank of Latvia's refinancing rates have remained unchanged at 3% since September 2002. The annual growth rate of broad money decreased from 21% in December 2002 to 17% in June 2003, but the annual growth rate of domestic credit stayed the same at around 40% in June 2003. Private sector credit growth slowed to 37% in 2002, following the 50% growth in 2001, with household credit growth up by 80%, albeit from a low base and mortgage lending accounting for a quarter of total credit growth. Meanwhile lending to enterprises grew only 27% in 2002, down from 50% a year earlier. The high growth rates of household credits and mortgages are potentially a source of concern, especially if the external environment worsens markedly and given the fact that almost one half of deposits are from non-residents. However, these deposits have remained remarkably stable in past times of crises and are likely to remain so even considering Russia's rising repatriation of capital.

Balance of payments and reserves: ***high FDI-driven current account deficits over the medium term***. Although the current account deficit fell by close to 2% in 2002 from a year earlier (to reach 7.8% of GDP in 2002), the change primarily reflected improved statistical coverage of private transfers and previously unrecorded textile exports (this new methodology has not been applied retrospectively). As a result, the underlying current account deficit actually remained practically unchanged from the level recorded in 2001. A recovery in exports in the second half of 2002, primarily of foods, textiles and machinery to Lithuania, Russia and Scandinavian countries, helped to some extent offset the continuing strong growth in imports. The redirection of Russian oil transit from Ventspils already had a noticeable effect on transport receipts last year, although fast growth in oil transit via road, rail and the other ports managed to compensate for this to some extent. Given the continued bleak outlook for transit trade, the current account deficit is likely to worsen somewhat this year and remain in the range of 8-9% over the medium-term. Exports growth is likely to remain strong, but so is import growth, driven by the high investment needs, while the outlook for transit trade remains unclear.

Fortunately, the financing of the current account deficit is unlikely to be a problem since net FDI inflows (including both equity flows and inter-company borrowing) cover a large part of the deficit. Indeed, in 2002 net FDI inflows covered three-fifths of the current account deficit. While net FDI flows have remained strong, net external borrowing has also increased, with the largest growth stemming from non-resident deposits in the banking sector. This trend is likely to continue but at a slower pace going forward. Latvia has plans to issue a $300-400 million sovereign Eurobond, although the exact timing might slip from the original end-of the year schedule to early next year. Importantly, medium-term non-debt inflows are expected to increase further as more accession-related financing will start to flow in, including transfers from the EU. Official reserves are conservatively projected to decline slightly but still remain at close to three months worth of imports. .

External debt and debt servicing capacity: ***steady rise in gross external debt.*** Although net FDI inflows and inter-company borrowing have been large in recent years, they have failed to cover the full current account deficit and have thus led to a rapid build-up of gross external debt. The rapid rise in the overall debt stock has mainly been driven by private sector borrowing but also reflects Latvia's status as an offshore financial centre for CIS depositors (non-resident deposits amount to about 36% of the total external debt). However, given the rapid expected growth of output and, to a certain extent exports, total external debt is projected to remain at around 74% of GDP and 190% of exports of goods and services in 2003 and 2004. Moreover, as a result of the need to offset rising non-resident deposits with matching assets, Latvian banks' foreign holdings have also risen sharply over the past years. Therefore, net external debt (gross debt minus official reserves and banks' liquid foreign assets) remains around 30% of GDP or slightly more than half of current account receipts.

More than half of total debt is short-term, mainly non-resident deposits from CIS countries, but a sudden outflow is unlikely at this stage given the continued weaknesses of banking systems in CIS countries. General government debt has remained at around 11-13% of total debt, or around 10% of GDP (most of which is owed to multilateral creditors, although the share of private creditors is rising). The public sector's share of total debt is likely to increase slightly over the medium term, as a result of the upcoming Eurobond and since the government will have to fund infrastructure and environmental projects in preparation for EU membership. Debt service is projected to remain stable at 14-15% of current account revenues in 2002 and 2003. The debt servicing capacity in the event of devaluation is mitigated by the modest amount of net external debt. Key ratings agencies have started to upgrade Latvia in late 2002 and 2003, including most recently an upgrade by Fitch of the long-term foreign currency rating to BBB+ in July 2003.

Annex 3 Table 1. Comparative indicators of structural reforms in accession countries

	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Slovak Republic	Slovenia
Enterprises								
Budgetary subsidies & current transfers (in per cent of GDP) [2]	7.9	1.1	na	6.0	0.2	2.5	2.7	1.1
Private sector share in GDP (in per cent)	80.0	80.0	80.0	70.0	75.0	75.0	80.0	65.0
Share of trade with non-transition countries (in per cent)	80.7	71.8	84.5	67.7	61.5	81.3	63.5	77.6
Share of industry in total employment (in per cent)	30.7	24.7	34.1	19.5	20.9	20.6	26.7	38.5
% change	53.9	18.5	48.3	15.5	93.2	33.0	16.1	-8.3
Investment rate/GDP (in per cent)	34.0	28	26.8	29.5	na	19.2	na	na
EBRD index of enterprise reform [3]	3.3	3.3	3.3	3.0	3.0	3.3	3.0	3.0
EBRD index of competition policy [3]	3.0	2.7	3.0	2.7	3.0	3.0	3.0	2.7
EBRD index of small-scale privatisation [3]	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation [3]	4.0	4.0	4.0	3.3	3.7	3.3	4.0	3.0
Infrastructure								
Government capital expenditure as % of GDP	na	3.9	3.5	4.1	3.1	na	na	na
Fixed line (mobile) penetration rate (per 100 inhabitants)	37.8	35.1	36.1	30.1	27.1	29.5	26.1	40.7
Internet penetration rate (per 10,000 inhabitants)	219.6	465.9	194.5	155.7	150.8	170.0	159.3	179.0
Railway labour productivity (1989=100)	68.2	287.4	130.3	108.6	54.4	93.1	61.7	133.6
Electricity tariffs, USc kWh (collection rate in per cent)	7.96(na)	5.6(>90)	8.7(>90)	4.9(99.5)	7.9(>90)	8.75(>90)	7.5(95)	8.0(95-98)
EBRD index of infrastructure reform	3.0	3.3	3.7	2.7	2.7	3.3	2.3	3.0
Electric power [3]	3.3	3.0	4.0	3.0	3.0	3.0	4.0	3.0
Railways [3]	3.0	4.0	3.3	3.3	2.3	4.0	2.3	3.0
Roads [3]	2.3	2.3	3.3	2.3	2.3	3.0	2.3	3.0
Telecommunications [3]	4.0	4.0	4.0	3.0	3.3	4.0	2.3	3.0
Water and wastewater [3]	4.0	4.0	4.0	3.3	3.3	3.3	2.3	4.0
Financial institutions								
Number of banks (foreign owned) [4]	37(26)	7(4)	38(27)	23(9)	14(7)	59(45)	19 (12)	22(6)
Asset share of state-owned banks (in per cent)	4.6	0.0	10.8	4.0	0.0	26.6	4.9	48.6
Non-performing loans (in per cent of total loans)	9.4	0.8	4.6	2.1	5.8	24.6	24.3	10.0
Domestic credit to private sector (in per cent of GDP)	20.0	29.8	34.0	33.4	14.2	15.2	27.6	41.0
Stock market capitalisation (in per cent of GDP)	21.0	33.6	17.4	8.0	9.5	14.3	7.0	19.1
EBRD index of banking sector reform [3]	3.7	3.7	4.0	3.7	3.0	3.3	3.3	3.3
EBRD index of reform of non-banking financial institutions [3]	3.0	3.3	3.7	3.0	3.0	3.7	2.7	2.7

1 Data for 2001 on budgetary subsidies and current transfers, number of banks, asset share of state-owned banks, and domestic credit to private s

2 For the Czech Republic: subsidies to enterprises and financial institutions, including Konsolidacni Banka Agency

3 Data for 2003 for all countries

4 For Estonia: includes Merita-Nordbanken branch and investment bank

Annex 3 Table II. Selected Economic Indicators for Latvia

	1994	1995	1996	1997	1998	1999	2000 Estimate	2001 Estimate	2002 Projection	2003
Output and expenditure	*(Percentage change in real terms)*									
GDP	2.2	-0.9	3.7	8.4	4.8	2.8	6.8	7.9	6.1	6.0
Private consumption	3.2	0.6	9.9	4.9	1.6	3.7	7.4	7.8	7.2	
Public consumption	-0.9	7.7	1.8	0.3	6.1	0.0	-1.9	0.3	1.4	
Gross fixed investment	0.8	8.7	8.2	14.4	52.4	1.7	0.6	24.8	3.4	
Exports of goods and services	-8.4	3.3	20.2	13.1	4.9	-6.4	12.0	6.9	6.3	
Imports of goods and services	-0.7	1.3	20.5	6.8	19.0	-5.2	4.9	12.6	4.5	
Industrial gross output	-7.1	1.6	2.5	12.5	3.5	-5.7	3.2	6.9	5.8	
Agricultural gross output	-15.0	11.7	-7.1	6.6	-3.5	-3.4	11.3	8.2	4.2	
Employment 1/	*(Percentage change)*									
Labour force (annual average)	-1.5	-1.9	-0.3	-2.4	-1.6	-1.6	-2.7	0.6	1.5	
Employment (annual average)	-10.1	-3.5	-9.3	4.4	-0.4	-1.8	-2.8	2.2	2.8	
	(In per cent of labour force)									
Unemployment (annual average)	16.7	18.1	20.6	15.1	14.1	14.3	14.4	13.1	12.1	
Prices and wages	*(Percentage change)*									
Consumer prices (annual average)	35.9	25.0	17.6	8.4	4.7	2.4	2.6	2.5	1.9	3.3
Consumer prices (end-year)	26.3	23.1	13.1	7.0	2.8	3.2	1.8	3.2	1.4	4.9
Producer prices (annual average)	16.9	11.9	13.7	4.1	1.9	-4.0	0.6	1.7	1.0	
Producer prices (end-year)	10.7	15.9	7.7	3.6	-1.9	-1.1	1.0	1.8	0.8	
Gross average monthly earnings in economy (annual average)	52.2	24.5	13.3	21.6	11.1	5.8	6.1	6.5	8.5	
Government sector 2/	*(In per cent of GDP)*									
General government balance	-4.4	-4.0	-1.8	0.3	-0.8	-3.9	-3.2	-2.0	-2.7	-3.0
General government expenditure	40.5	41.5	39.5	41.0	43.3	44.1	42.0	37.2	38.8	
General government debt	14.1	16.3	14.5	12.0	10.4	13.1	13.1	14.8	14.6	
Monetary sector	*(Percentage change)*									
Broad money (M2, end-year)	47.4	-23.1	19.9	38.7	5.9	8.0	27.9	20.8	21.0	
Domestic credit (end-year)	72.3	-28.2	-6.0	39.3	30.6	15.2	43.6	35.6	39.8	
	(In per cent of GDP)									
Broad money (M2, end-year)	33.4	22.5	22.4	26.6	25.7	25.6	29.3	32.0	35.9	
Interest and exchange rates	*(In per cent per annum, end-year)*									
Refinancing rate	25.0	24.0	9.5	4.0	4.0	4.0	3.5	3.5	3.0	
Interbank market rate 3/	37.8	21.1	9.7	3.9	7.0	2.7	3.3	5.4	2.7	
Deposit rate (short-term, under one year)	18.8	15.0	10.0	5.3	6.5	4.2	4.2	5.7	5.2	
Lending rate (short-term, under one year)	36.7	31.1	20.3	12.1	16.4	12.5	11.8	9.9	7.4	
	(Lats per US dollar)									
Exchange rate (end-year)	0.55	0.54	0.56	0.59	0.57	0.58	0.61	0.64	0.59	
Exchange rate (annual average)	0.56	0.53	0.55	0.58	0.59	0.59	0.61	0.63	0.62	
External sector	*(In millions of US dollars)*									
Current account	201	-16	-279	-345	-650	-654	-493	-732	-659	-879
Trade balance	-301	-580	-798	-848	-1,130	-1,027	-1,058	-1,351	-1,444	-1,589
Merchandise exports	1,022	1,368	1,488	1,838	2,011	1,889	2,058	2,216	2,576	2,833
Merchandise imports	1,322	1,947	2,286	2,686	3,141	2,916	3,116	3,567	4,020	4,422
Foreign direct investment, net	279	245	379	515	303	331	400	151	388	350
Gross reserves (end-year), excluding gold	545	506	622	704	728	840	851	1,149	1,241	
External debt stock 4/	na	na	2,091	2,756	3,098	3,821	4,702	5,570	6,974	
	(In months of imports of goods and services)									
Gross reserves (end-year), excluding gold	4.0	2.8	2.5	2.5	2.2	2.8	2.6	3.2	3.2	
	(In per cent of current account revenues, excluding transfers)									
Debt Service	3.9	8.1	10.0	10.5	10.1	13.5	15.5	19.9	14.3	
Memorandum items	*(Denominations as indicated)*									
Population (end-year, millions)	2.5	2.5	2.5	2.5	2.4	2.4	2.4	2.3	2.3	
GDP (in millions of lats)	2,043	2,329	2,807	3,269	3,592	3,890	4,348	4,813	5,195	
GDP per capita (in US dollars)	1,442	1,764	2,054	2,289	2,538	2,792	3,032	3,269	3,605	
Share of industry in GDP (in per cent)	25.4	24.5	23.2	23.9	20.2	17.4	16.4	16.4	16.6	
Share of agriculture in GDP (in per cent)	9.5	9.9	8.2	5.6	4.4	4.3	4.9	4.7	4.5	
Current account/GDP (in per cent)	5.5	-0.4	-5.5	-6.1	-10.7	-9.8	-6.9	-9.5	-7.8	-8.5
External Debt - Reserves, in US$ millions	na	na	1,469	2,052	2,370	2,981	3,851	4,421	5,733	
External Debt/GDP (in per cent)	na	na	41.0	49.0	50.9	57.5	65.6	72.6	83.0	
External Debt/Exports of goods and services (in per cent)	na	na	80.0	96.0	99.3	131.1	143.7	163.6	182.2	

Note: Data for 1992-99 represent official estimates of outturns as reflected in publications from the national authorities,the International Monetary Fund, the \
the OECD, PlanEcon and the Institute of International Finance. Data for 2000-2001 reflect EBRD evaluations, partly based on information from these s

2/ General government includes the state, municipalities and extrabudgetary funds. Privatisation revenues are not included in revenues. General governmen

3/ Weighted average interest rates in the interbank market.

4/ Includes non-resident currency and deposits, liabilities to affiliated enterprises and liabilities to direct investors.

ANNEX 4: CUMULATIVE BUSINESS VOLUME

Sector Business Group (SIC)	Sector Team (SIC)	No. of Projects	Total Project Value	EBRD Finance	Debt	Equity	% Share of
Energy	Energy Efficiency	0.3	12	4	1	3	1%
	Power and Energy	2.0	99	50	50	0	15%
Sub-total Energy		**2.3**	**111**	**54**	**51**	**3**	**16%**
Financial Institutions	Bank Equity	4.0	112	20	0	20	6%
	Bank Lending	5.2	91	64	64	0	19%
	Equity Funds	1.2	64	15	0	15	4%
	Non Bank Financial Institutions	1.3	71	43	33	10	13%
Sub-total Financial Institutions		**11.7**	**338**	**142**	**98**	**45**	**41%**
Infrastructure	Municipal & Env Inf	2.0	219	46	46	0	13%
	Transport	4.0	153	42	41	1	12%
Sub-total Infrastructure		**6.0**	**373**	**87**	**87**	**1**	**25%**
Specialised Industries	Agribusiness	1.2	42	21	21	0	6%
	Property and Tourism	2.0	61	18	17	1	5%
	Telecoms Informatics & Media	1.2	93	21	20	1	6%
Sub-total Specialised Industries		**4.4**	**195**	**60**	**59**	**2**	**18%**
LATVIA TOTAL		**24.4**	**1,016**	**344**	**294**	**50**	**100%**

ANNEX 5: SIGNED OPERATIONS

Op ID	Op Name	Regional/Direct	Signing Date	Total Project Value	EBRD Finance	Debt	Equity	Operation Stage
27130	Askembla Growth Fund	Regional fund investment	29/11/02	6.8	1.8	0.0	1.8	Disbursing
19477	BALTA Insurance Group (equity)	Direct	27/06/01	34.3	9.2	0.0	9.2	Disbursing
353	Baltic Investment Fund	Regional fund investment	30/08/95	6.2	1.6	0.0	1.6	Repaying
9446	Baltic Investment Fund III	Regional fund investment	03/11/00	18.5	3.4	0.0	3.4	Disbursing
3706	Baltic Small Equity Fund	Regional fund investment	15/12/97	2.9	1.4	0.0	1.4	Repaying
4260	Baring Communications Equity	Regional fund investment	05/12/97	2.1	0.4	0.0	0.4	Repaying
14649	DIF - RAF Avia	Direct	09/03/01	2.5	0.7	0.0	0.7	Disbursing
13364	DVI, Inc. (debt)	Regional fund investment	19/03/01	1.3	0.4	0.4	0.0	Repaying
27003	Danfoss Debt Facility for Industrial Energy Project	Regional fund investment	20/12/02	1.3	1.0	1.0	0.0	Disbursing
1062	Daugava Hydro Schemes Upgrade Project	Direct	26/04/96	62.2	21.4	21.4	0.0	Completed
445	Daugava Riga Radisson Hotel	Direct	01/09/94	39.0	10.9	10.9	0.0	Repaying
11624	EU/EBRD Phase I - Ext. - Latvijas Unibanka	Direct	18/07/00	10.0	10.0	10.0	0.0	Disbursing
27514	EU/EBRD Phase II - Ext 2 - Hansa Capital	Regional fund investment	11/06/03	18.0	18.0	18.0	0.0	Signed
27513	EU/EBRD Phase II - Ext. - Unilizings	Direct	18/07/03	15.0	15.0	15.0	0.0	Signed
23972	EU/EBRD Phase II - Latvijas Unibanka	Direct	19/12/01	10.0	10.0	10.0	0.0	Disbursing
27526	EU/EBRD Phase II - Rietumu Banka Loan	Direct	23/09/02	5.0	5.0	5.0	0.0	Disbursing
5422	Energy Efficiency and Emissions Reduction Fund	Regional fund investment	22/12/99	10.7	3.0	0.0	3.0	Disbursing
1920	Eurovision - Latvia	Direct	25/03/96	0.8	0.8	0.8	0.0	Repaying
26467	Fiesta	Regional fund investment	20/12/01	13.7	7.7	7.7	0.0	Disbursing
1829	Hansabanka (Formerly Latvijas Zemes Banka)	Direct	03/02/95	8.7	5.1	5.1	0.0	Completed
3061	Hansabanka (Formerly Zemes Banka (equity))	Direct	12/04/96	2.5	1.8	0.0	1.8	Completed
3880	Hansabanka (sub debt)	Direct	01/12/97	3.6	3.6	3.6	0.0	Disbursing
27587	Heitman Central Europe Property Partners Fund II	Regional fund investment	09/12/02	3.9	1.1	0.0	1.1	Disbursing
5024	Innova/98 LP	Regional fund investment	10/06/98	2.3	0.4	0.0	0.4	Disbursing
338	Investment Bank of Latvia (equity)	Direct	23/02/94	7.9	1.4	0.0	1.4	Completed
15654	Kesko Baltics	Regional fund investment	20/12/01	13.1	5.5	5.5	0.0	Disbursing
335	Latvia Energy Sector Emergency Investment Projec	Direct	23/12/92	36.5	28.8	28.8	0.0	Completed
3630	Latvia GSM Mobile Communications Project	Direct	18/06/97	89.8	19.8	19.6	0.2	Completed
2712	Latvijas Unibanka (credit line)	Direct	07/12/95	11.1	7.8	7.8	0.0	Completed
3062	Latvijas Unibanka (equity)	Direct	11/05/96	9.1	7.7	0.0	7.7	Completed
6784	Latvijas Unibanka (syn loan)	Direct	17/11/99	30.0	10.0	10.0	0.0	Repaying
2148	MBA Loan Project (guarantee)	Regional fund investment	06/03/95	0.2	0.2	0.2	0.0	Disbursing
6176	MBA Loan Project II (guarantee)	Regional fund investment	07/12/98	0.1	0.0	0.0	0.0	Signed
2973	New Europe Insurance Ventures	Regional fund investment	23/10/96	2.4	0.6	0.0	0.6	Repaying
5490	PPF - Baltic - initial capital (Latvian SRP)	Direct	04/03/96	0.0	0.0	0.0	0.0	Completed
8237	Pirma Banka (equity + debt)	Direct	14/09/99	88.6	4.5	0.0	4.5	Completed
3561	Pirma Banka (equity)	Direct	20/11/96	3.9	4.4	0.0	4.4	Completed
4489	Pirma Banka (revolving credit line)	Direct	22/01/98	8.2	8.2	8.2	0.0	Completed
26468	Pleskodale	Regional fund investment	20/12/01	14.8	8.3	8.3	0.0	Disbursing
1301	Riga Environment Project	Direct	06/08/96	83.5	15.1	15.1	0.0	Completed
645	Riga International Airport Rehabilitation Project	Direct	08/10/93	10.5	9.5	9.5	0.0	Repaying
14231	Riga Water Company Corporate Loan	Direct	20/11/00	135.7	30.5	30.5	0.0	Disbursing
1588	Road Project - Latvia	Direct	14/12/94	29.5	9.1	9.1	0.0	Repaying
13827	SME Equity Facility - Baltic SME Fund	Regional fund investment	08/10/01	5.5	1.0	0.0	1.0	Disbursing
4429	Saules Banka (credit line)	Direct	15/10/97	4.2	4.2	4.2	0.0	Completed
6352	TPG Co-Investment	Regional fund investment	21/07/99	21.6	5.7	0.0	5.7	Disbursing
3951	Valdemara Centrs SIA	Direct	18/12/96	17.9	6.1	6.1	0.0	Completed
5920	Ventspils Port Multi-Purpose/Intermodal Terminal	Direct	29/06/99	16.6	3.6	3.6	0.0	Completed
1977	Ventspils Port Rail Terminal Project	Direct	30/11/98	94.3	18.7	18.7	0.0	Repaying
LATVIA TOTAL				**1,016.3**	**344.3**	**294.1**	**50.2**	

Sector	Pre-Review Stock	Structure Review Stock	Final Review Stock	Board Approval Stock	Total Pipeline Stock	Number of Operations
Energy Efficiency		-	-	-	-	-
Natural Resources		-	-	-	-	-
Power and Energy	5.0	-	-	-	5.0	1
Energy	**5.0**	**0.0**	**0.0**	**0.0**	**5.0**	**1**
Bank Equity		-	-	12.4	12.4	1
Bank Lending	20.0	-	-	-	20.0	2
Equity Funds		-	-	-	-	-
Non Bank Financial Institutions		-	-	-	-	-
Financial Institutions	**20.0**	**0.0**	**0.0**	**12.4**	**32.4**	**3**
General Industry		-	-	-	-	-
General Industry		**0.0**	**0.0**	**0.0**	**0.0**	**0**
Municipal & Env Inf	25.0	-	9.0	-	34.0	3
Transport	7.0	-	-	-	7.0	1
Infrastructure	**32.0**	**0.0**	**9.0**	**0.0**	**41.0**	**4**
Agribusiness		-	-	2.2	2.2	1
Property and Tourism	10.0	-	-	-	10.0	1
Telecoms Informatics & Media		-	-	-	0.0	-
Specialised Industries	**10.0**	**0.0**	**0.0**	**2.2**	**12.2**	**2**
Total	**67.0**	**0.0**	**9.0**	**14.6**	**90.6**	**10**

ANNEX 6: BILATERAL ASSISTANCE

The Bank has worked with a variety of bilateral donors who since 1992 have provided grant funding for projects in Latvia for purposes such as institution building, project preparation, support and implementation, and those projects are listed below. The majority of projects financed have been under the Turn Around Management (TAM) Programme and the Business Advisory Service (BAS).

Commitment Number	TC OPID	Commitment Name	TC Euro Disbursed	Fund Approved Year	Cmt. Stage	TCO Type	Sector	Team Name	Business Group	Linked to Inv.	Signed EBRD Op Amount
AGML-98-12-01PS	6165	EBRD 2000 Annual General Meeting - Riga, Latvia	361,428	1998	Closed	Advisory Services	Community/Social Services	SG/Front Office/Manag. & Front Office	Non-Banking	N	
BTAF-1994-02-04	1427	Privatisation programme - accountancy advice	310,785	1994	Closed	Project Preparation	Community/Social Services	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	
BTAF-1994-04-06	1343	Rigas Kommerc Banka (RKB) - operational and financial audit and due diligence	66,990	1994	Closed	Project Preparation	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	Y	
BTAF-1994-04-07	1367	Baltic Investment Programme - training programme in feasibility studies for Latvia	172,388	1994	Closed	Project Implementation	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	Y	
BTAF-1994-05-11	1343	Rigas Kommerc Banka (RKB) - preparation of medium-term strategy	35,000	1994	Closed	Project Preparation	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	Y	
BTAF-1994-06-14	1628	Latvian Investment Bank - board representation	69,221	1994	Closed	Project Preparation	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	Y	1,402,000
BTAF-1994-04-10	1680	TurnAround Management Programme - Juglas Manufaktura	49,997	1994	Closed	Advisory Services	Manufacturing	BG/Op. Teams/Early Stage Equity	Financial Institutions	N	
BTAF-1994-08-20	1680	TurnAround Management Programme - LATVIJAS KERAMIKA	43,363	1994	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1994-09-24	1680	TurnAround Management Programme - BALTIJA	53,542	1994	Closed	Advisory Services	Manufacturing	BG/Op. Teams/Early Stage Equity	Financial Institutions	N	
BTAF-1994-09-25	1680	TurnAround Management Programme - REMUS	55,859	1994	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1994-11-27	1680	TurnAround Management Programme - Grindex	58,289	1994	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1994-11-28	1680	TurnAround Management Programme - Brivais Vilnis	49,777	1994	Closed	Advisory Services	Manufacturing	BG/Op. Teams/Early Stage Equity	Financial Institutions	N	
BTAF-1995-01-02	1680	TurnAround Management Programme - LareLini	27,603	1995	Closed	Advisory Services	Manufacturing	BG/Op. Teams/Early Stage Equity	Financial Institutions	N	
BTAF-1995-03-04	1680	TurnAround Management Programme - Livanu Stikls	44,170	1995	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1995-03-07	1680	TurnAround Management Programme - Asote	42,003	1995	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1995-04-13	1381	Business Advisory Services - operating expenses for Riga	81,283	1995	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1995-06-20	1381	Business Advisory Services - subsidies disbursement	812,349	1995	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1995-07-23	1381	Business Advisory Services - local project director	10,498	1995	Closed	Advisory Services	Manufacturing	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N	
BTAF-1995-08-28	1381	Business Advisory Services - local project officer	6,989	1995	Closed	Advisory Services	Manufacturing	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N	
BTAF-1995-09-31	1381	Business Advisory Services - administrative secretary	5,225	1995	Closed	Advisory Services	Manufacturing	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N	
BTAF-1995-09-32	1381	Business Advisory Services - office equipment and furniture	24,248	1995	Closed	Advisory Services	Manufacturing	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N	
BTAF-1995-10-36	1381	Business Advisory Services - office lease for local Business Advisory Services office	60,713	1995	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	

BTAF-1996-05-07	5254	Business Advisory Services - project officer	14,194	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1996-07-10	5256	Business Advisory Services - national fund director (extension of BTAF-95-07-23)	16,286	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1996-09-13	5257	Business Advisory Services - administrative assistant	7,172	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2000-12-28	5743	Business Advisory Services - Aigars Strautins, Project Officer	19,990	2000	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1995-10-34	1680	TurnAround Management Programme - Cezijs	17,365	1995	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1995-10-39	1680	TurnAround Management Programme - Alfa	55,556	1995	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1996-08-11	5583	TurnAround Management Programme - Velme	49,346	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1996-09-14	5133	TurnAround Management Programme - Tukums Dairy	47,690	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1997-06-11	5133	TurnAround Management Programme - Jana Seta	28,082	1997	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1997-10-17	5133	TurnAround Management Programme - Zunda III	34,718	1997	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1998-02-05	5744	TurnAround Management Programme - Sparta Knitwear	47,089	1998	Disbursing	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1998-12-32	5134	TurnAround Management Programme - RBS Skal	59,903	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1998-12-33	5744	TurnAround Management Programme - Velme II	57,949	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1999-01-02	5744	TurnAround Management Programme - Jana Seta Printers	59,065	1999	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1999-01-04	5744	TurnAround Management Programme - Remus Construction	60,000	1999	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1999-02-06	5744	TurnAround Management Programme - JSC Lauma II	59,868	1999	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1999-03-07	5744	Turnaround Management Programme: AS Limbazu Piens	58,580	1999	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1999-07-11	5744	Turnaround Management Programme - Kvadra Pak	60,000	1999	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1999-07-13	5744	Turnaround Management Programme - Spilva SIA	57,755	1999	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1999-10-18	5744	TurnAround Management Programme (TAM) - SIA Simeks SMS Ltd	52,979	1999	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2000-02-04	5744	TurnAround Management Programme (TAM) - JSC Rebir II	59,711	2000	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2000-05-10	5744	Continuation TAM Programme in the Baltic States - SIA Firma Ave MTP	50,632	2000	Committed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2000-06-14	5744	TurnAround Management Programme (TAM) - Cido Partikas Grupa	56,943	2000	Disbursing	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2000-06-15	5744	TurnAround Management Programme (TAM) - Resekne Piena Konservu Kombinats	52,170	2000	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2000-07-17	5744	TurnAround Management Programme (TAM) - A/S Preses Nams	60,000	2000	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	

BTAF-2000-08-20	5744	TurnAround Management Programme (TAM) - JSC Lindeks	53,292	2000	Disbursing	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2000-08-21	5744	TurnAround Management Programme (TAM) - Kvadra Pak II	43,581	2000	Committed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2000-08-23	5744	TurnAround Management Programme - JSC Lauda	56,170	2000	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2000-09-24	5744	TurnAround Management Programme - AS Dobeles Dzirnavnieks	18,228	2000	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2000-10-26	5744	TurnAround Management Programme (TAM) - Reaton Ltd	59,851	2000	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2001-02-04	5744	TurnAround Management Programme (TAM) - Langa SIA	44,044	2001	Disbursing	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2001-08-09	5744	TAM Programme - Spilva II	59,853	2001	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-95-10-11	5144	TurnAround Management Programme - advisory services contract - OlainePharm	49,996	1995	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-95-10-13	5144	TurnAround Management Programme - advisory services contract - Valmeira Glass Factory	49,355	1995	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-95-11-20	5144	TurnAround Management Programme - advisory services contract - Aurora	32,646	1995	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-95-11-26	5144	TurnAround Management Programme - advisory services contract - Grindex	48,663	1995	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-01-04	5144	TurnAround Management Programme - advisory services contract - REF	44,648	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-03-11	5144	TurnAround Management Programme - advisory services contract - JSC Lauma	79,821	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-04-18	5144	TurnAround Management Programme - advisory services contract - Zunda training	50,000	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-04-21	5144	TurnAround Management Programme - advisory services contract - REMUS training	48,253	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-04-22	5144	TurnAround Management Programme - advisory services contract - Laima training	41,370	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-04-25	5144	TurnAround Management Programme - advisory services contract - ROG	41,198	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-06-29	5144	TurnAround Management Programme - Spodriba	49,823	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-06-31	5144	TurnAround Management Programme - advisory services contract - JSC Lauma training	48,468	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-06-32	5144	TurnAround Management Programme - Uzvara	44,629	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-07-33	5144	TurnAround Management Programme - Kaija	45,561	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-07-34	5144	TurnAround Management Programme - advisory services contract - GSM	47,261	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	

TAMEC-96-08-35	5144	TurnAround Management Programme - advisory services contract - Brivais Vilnis	46,842	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-08-36	5144	TurnAround Management Programme - advisory services contract - Tartu Instruments	34,929	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-08-37	5144	TurnAround Management Programme - advisory services contract - Latvijas Udensceli	9,039	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-09-38	5144	TurnAround Management Programme - Livanu Stikls	68,809	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-96-11-46	5144	TurnAround Management Programme - advisory services contract - CS Turiba	46,540	1996	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-97-02-14	5144	TurnAround Management Programme - advisory services contract - Rigas Vagonu Rupnica	29,292	1997	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-97-02-15	5144	TurnAround Management Programme - Jelgava Sugar	59,810	1997	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-97-02-16	5144	TurnAround Management Programme - advisory services contract - Kometa	47,765	1997	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-97-02-17	5144	TurnAround Management Programme - Rita	50,000	1997	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-97-03-21	5144	TurnAround Management Programme - advisory services contract - Latvijas Keramika	49,310	1997	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-97-03-22	5144	TurnAround Management Programme - advisory services contract - Baltija Furniture	44,746	1997	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-97-04-23	5144	TurnAround Management Programme - advisory services contract - JSC Starburadze	47,435	1997	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-97-05-28	5144	TurnAround Management Programme - advisory services contract - JSC Dzintars	26,125	1997	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-97-07-42	5144	TurnAround Management Programme - Kaija	48,454	1997	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-98-02-02	5144	TurnAround Management Programme - Jana Seta (II)	81,919	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-98-02-03	5144	TurnAround Management Programme - JSC Olaine chemical	37,688	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-98-03-07	5144	TurnAround Management Programme - AS Rebir	33,989	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-98-05-11	5144	TurnAround Management Programme - Baltic Dairy Corporation	43,806	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-98-05-12	5144	TurnAround Management Programme - Teika Mebelu Fabrika	48,200	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-98-05-13	5144	TurnAround Management Programme - Ogre II	21,412	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-98-06-14	5144	TurnAround Management Programme - JSC Staburadze	55,457	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-98-06-15	5144	TurnAround Management Programme - Rita	41,066	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
TAMEC-98-06-18	5144	TurnAround Management Programme - JSC Dzintars	16,347	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	

ECP98-2000-12-77	16241	BAS Programme in the Baltics	231,904	2000	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1999-12-22	5743	Micro-BAS Programme - Project Officer	16,476	1999	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2000-02-03	6964	Business Advisory Services (BAS) Programme - Subsidies	868,262	2000	Disbursing	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1998-03-13	4773	Business Advisory Services - National Fund Director	4,620	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1998-03-14	4773	Business Advisory Services - project officer	3,564	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1998-03-15	4773	Business Advisory Services - Assistant to National Fund Director	2,112	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1998-07-21	5743	Baltic Micro Business Advisory Services Programme - project officer	19,348	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1998-07-24	5743	Baltic Micro Business Advisory Services Programme - subsidy account	552,742	1998	Disbursing	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-1998-07-26	5743	Baltic Micro Business Advisory Services Programme - operating expenses	12,531	1998	Closed	Advisory Services	Manufacturing	PE/ESE/TurnAround Management Group	Non-Banking	N	
BTAF-2003-08-01	5397	RAF Avia Financial 3	0	2003	Committed	Project Implementation	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	Y	713,000
EC-1992-12-64	959	Energy sector emergency investment programme - project management unit	328,786	1992	Closed	Project Implementation	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	33,647,000
EC-1992-12-65	950	Energy sector emergency investment programme - energy emergency planning group	173,952	1992	Closed	Advisory Services	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	
EC-1992-12-66	1005	Energy sector emergency investment programme - commercial accounting systems for main energy utilities	481,764	1992	Closed	Advisory Services	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	
EC-1992-12-67	955	Energy sector emergency investment programme - energy conservation awareness campaign	189,000	1992	Closed	Advisory Services	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	
EC-1992-12-68	983	Energy sector emergency investment programme - wood harvest, distribution and conversion study	183,950	1992	Closed	Project Preparation	Energy	BG/Op. Teams/Russia HQ	Russia & Central Asia	Y	
EC-1994-02-06	1427	Privatisation programme - privatisation advice	584,496	1994	Closed	Project Implementation	Community/Social Services	BG/Op. Teams/Central Europe Front Office	Central Europe	N	
EC-1994-11-52	1828	Latvenergo recapitalisation - financial advice	464,802	1994	Closed	Project Preparation	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	
ECP-1995-12-41	2854	Post-privatisation Fund (Latvia / Lithuania) fund investment portfolio - investment development and implementation	963,816	1996	Closed	Project Preparation	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	Y	15,000,000
FIN-1996-03-01	3312	Energy operations - technical adviser	81,911	1996	Closed	Advisory Services	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	N	
FIN-1998-06-02	5684	PAS Gutta Baltic juice manufacturer	139,943	1998	Closed	Project Preparation	Manufacturing	BG/Op. Teams/Agribusiness	Specialised Industries	Y	
FIN-2001-02-03	17683	Baltic Pulp Mill Company - Project Advisor to the Government of Latvia	44,367	2001	Closed	Project Preparation	Agriculture, Forestry, Fishing	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	
HOL-1997-11-08	4618	Pirma Latvijas Komercbanka twinning programme	121,274	1997	Closed	Project Preparation	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	Y	6,952,000
JAP-1993-12-63	889	Daugava river hydropower plants - technical and economic feasibility	749,361	1993	Closed	Project Preparation	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	31,082,000

JAP-1997-12-43	4293	Project Evaluation Department's special evaluation of the Latvia energy sector emergency investment project	18,966	1997	Closed	Advisory Services	Community/Social Services	PE/Project Evaluation	Non-Banking	Y	
NORG-1993-11-10	709	Transport project preparation/environment	9,917	1993	Closed	Project Preparation	Transport, Storage	BG/Op. Teams/Transport	Infrastructure	Y	9,480,000
NORG-1995-07-02	2685	Latvian banking sector - Bank Baltija	5,764	1995	Closed	Advisory Services	Finance, Business	BG/Op. Teams/Central Europe Front Office	Central Europe	N	
SWE-1992-09-07	774	Baltic Sea environmental programme (Phase II) - forestry sector restructuring	9,063	1992	Closed	Sector Work	Agriculture, Forestry, Fishing	BG/Op. Teams/Central Europe Front Office	Central Europe	N	
SWE-1993-01-01	619	Refurbishment of Andrejsala Co-generation Plant - Phase I - pre-feasibility study	223,593	1993	Closed	Project Preparation	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	N	
SWE-1993-01-02	1444	Construction management for heavy fuel oil import facilities	246,768	1993	Closed	Project Implementation	Transport, Storage	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	
SWE-1993-07-08	774	Forestry sector Master Plan - supervisory assistance	20,961	1993	Closed	Sector Work	Agriculture, Forestry, Fishing	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	
SWE-1993-07-09	1022	Energy emergency investment programme - procurement advicer	138,008	1993	Closed	Project Implementation	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	
SWE-2000-02-02	10003	Pirma Banka - Work-out Expert	67,916	2000	Closed	Project Implementation	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	Y	8,518,000
SWE-2001-11-17	22946	Latvia Hydropower Dam Safety Act	179,100	2001	Disbursing	Project Implementation	Energy	BG/Op. Teams/Power and Energy	Energy	Y	
TAI-1993-10-13	709	Transport project preparation - economic evaluation	8,383	1993	Closed	Project Preparation	Transport, Storage	BG/Op. Teams/Transport	Infrastructure	Y	
UK-94-06-04PS	1437	Latvian Shipping Company - legal advice	84,398	1994	Closed	Project Preparation	Transport, Storage	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	
UK-94-06-06PS	1437	Latvian Shipping Company - privatisation advice	180,190	1994	Closed	Project Preparation	Transport, Storage	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	
UKB-1994-07-09	1427	Privatisation programme - legal advice	181,360	1994	Closed	Project Implementation	Community/Social Services	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	
UKC-1997-05-07	4221	Assistance in Reform of Legislation on Secured Transactions	46,418	1997	Closed	Advisory Services	Community/Social Services	GC/General Counsel/Legal Transition	Non-Banking	N	
UKC-1999-05-04	6402	AS Lauma project preparation	36,671	1999	Closed	Project Preparation	Manufacturing	BG/Op. Teams/Central Europe Front Office	Central Europe	Y	
		Report Total Euro Amount:	**13,306,906**								**106,794,000**
		No of Commitments:	**131**								