DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR LATVIA

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ABBREVIATIONS and CURRENCY EXCHANGE RATES

EC	European Commission
ECB	European Central Bank
EIB	European Investment Bank
ERMII	Exchange Rate Mechanism II.
EU	European Union
EUR	Euro
FCMC	Financial and Capital Markets Commission
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Income
IAIS	International Association of Insurance Supervisors
IFI	International Financial Institutions
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commissions
IT	Information Technology
LVL	Latvian Lats
MEI	Municipal and Environmental Infrastructure
MSME	Municipal and Small and Medium Enterprises
NBFI	Non Bank Financial Institution
NIB	Nordic Investment Bank
OECD	Organization for Economic Co-operation and Development
PPP	Public Private Partnership
SAMS	Bank of Latvia's interbank automated payment system
SME	Small and Medium Enterprises
TARGET	Trans-European Automated Real-time Gross Settlement Express Transfer
TC	Technical Cooperation
US$	United States Dollar

EXCHANGE RATES

EUR 1.0	LVL 0.7028
EUR 1.0	US$ 0.830

EXECUTIVE SUMMARY

The Republic of Latvia continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. In recent years Latvia has made substantial progress in transition and this Strategy document recognises the laudable success of Latvia and its economy. Some 75 per cent of economic activity is in the private sector and price and trade liberalisation, enterprise privatisation and effective financial sector reforms have taken place. As a performing market economy, there is an open foreign trade regime and no major constraints to foreign investment.

The macroeconomic environment remains broadly favourable, but rising inflation poses a challenge. The impact of EU accession has been positive in terms of trade and enterprise investment. The economy grew by 8.3 per cent in 2004, and has averaged annual growth of 7.5 per cent since 2000. Capital formation, exports and private consumption were major contributors to growth, although average inflation rose to 6.2 per cent in 2004. The trend in fiscal consolidation continued in 2004, when the national fiscal deficit decreased to 1 per cent of GDP, on the back of strong revenue performance. The current account deficit grew to 13 per cent of GDP in 2004, due largely to the import of capital goods. Net foreign direct investment (FDI) increased in 2004 to US$ 0.596 billion. Unemployment remains significant at about 10 per cent. Following the Lat re-peg to the Euro from the SDR in January 2005, Latvia was admitted to the European Exchange Rate Mechanism (ERM II) in May, further aligning the economy with that of the Eurozone.

Following the current government’s formation in November last year, efforts have been made in improving the business climate, fighting corruption and strengthening the prevention of money laundering and fraud. Nordic and German strategic investors in the main banks continue to strengthen the financial sector and to broaden the range of credit and banking products available to enterprises and consumers.

However, with respect to the Bank’s mandate, a small number of key transition challenges in Latvia have been identified and this strategy aims to address those challenges in order to further increase the competitiveness of the Latvian economy. The key transition challenges for Latvia are as follows:

Infrastructure and Environment

With extensive investment and operational needs, there is limited private sector participation in municipal sectors including district heating, water and sewage, and urban transport, and in the development of state transport infrastructure. Energy efficiency is a concern. There are remaining energy inefficiencies related to municipal-owned heating networks and buildings and some privatised industrial enterprises. In energy generation, Latvia remains somewhat reliant on fuel and power imported from neighbouring countries, particularly Russia and Lithuania.

Enterprise Sector

Further improvements in the business environment are needed, including more extensive and consistent enforcement of laws and reduction in corruption. Corporate governance, strategic development potential and market competitiveness are relatively weak, while tax evasion and the negative aspects of the business environment are eroding the long-term sustainability of the enterprise sector.

Financial Sector

Financial institutions need to ensure that the risk of money laundering is eliminated from their operations and that they all operate according to international best practice. Financial intermediation remains low, particularly to the SME sector and there is a lack of equity and mezzanine capital to support economic growth.

As of 31 October 2005 the Bank had signed a cumulative total of 24 projects for Latvia with a total project cost of €0.95 billion, including Bank financing of €0.30 billion, or 32 per cent. The private/state sector portfolio ratio stood at 73/27.

While expectations of new business in 2005 and 2006 are modest, the Bank can continue to play a role over the strategy period by focusing selectively on areas where it is additional and where it can address the remaining transition challenges. These include providing equity and cross-border financing, promoting public private partnerships and strengthening corporate governance and good business practice.

In addressing the transition challenges, the Bank's activities in Latvia will be based on the following operational objectives:

- Support large, complex or sensitive transactions that would benefit from the Bank's expertise in project structuring, corporate governance and mobilising co-financing;
- Support the expansion of local companies, particularly in cross-border projects, for example into or from Russia or other CIS countries;
- Promote SME and municipal financing and energy efficiency through financial intermediaries, enhanced where appropriate with EU or other donor support;
- Encourage the development of local capital markets, for example in investing in the local securitisation of mortgage loans.

The Bank will continue to ensure that all EBRD operations in Latvia meet sound banking principles, have transition impact, are additional and are subject to the Bank's Environmental Procedures and incorporate, where appropriate, Environmental Action Plans.

1. THE BANK'S PORTFOLIO

1.1 Overview of activities to date

As of the end of October 2005, the Bank's cumulative commitments in the Republic of Latvia (including regional projects) had reached €303 million representing 0.7% of the Bank's net cumulative commitment volume. The Bank helped to mobilise a further €651 million of co-investment, representing a multiplier of 2.1.

The table below gives an overview of the Bank's current portfolio in Latvia by sector as of end of October 2005. Totalling €108 million, it represented 0.7% of the overall Bank portfolio. The private/state ratio stood at 72/28 and the non-sovereign/sovereign ratio stood at 90/10. The non-sovereign ratio was higher than the private sector ratio because the municipal projects have been executed as corporate loans without state or municipal guarantees.

Table 1: Current Portfolio by Industry (including regional projects) (as of 31 October 2005)

Sector	**No of Projects**	**EBRD finance** (€ million)	**Portfolio share** (%)
Industry and Commerce	**0.7**	**16.0**	**15%**
Agribusiness	0.7	12.6	
Property Tourism and Shipping	0.0	3.3	
Telecom Informatics & Media	0.0	0.1	
Financial Institutions	**2.8**	**58.8**	**54%**
Bank Equity	0.0	0.0	
Bank Lending	0.2	14.8	
Non Banking Financial Institutions	1.2	29.3	
Equity Funds	1.4	14.7	
Infrastructure	**2.3**	**33.5**	**31%**
Transport	1.0	12.1	
Municipal & Environment Infrastructure	1.0	18.5	
Energy Efficiency	0.3	2.9	
Power & Energy	0.0	0.0	
TOTAL	**5.7**	**108.3**	**100%**
of which debt	2.4	78.9	73%
of which equity	3.3	29.4	27%
of which guarantee	0.0	0.0	0%
of which private	3.5	78.4	72%
of which state	2.3	29.9	28%
of which direct	3.3	69.6	64%
of which regional	2.4	38.7	36%
of which non-sovereign	4.7	96.9	90%
of which sovereign	1.0	11.4	10%

While a number of projects were developed in 2004, for external reasons such as change of ownership, management or strategy, or delays in accessing expected EU co-financing, projects were postponed to 2005 and consequently there were no new commitments signed by EBRD specifically for Latvia. However Latvia was included as one among several target countries by some regional projects.

The largest portion of the current portfolio (54%) relates to Financial Institutions, a reflection of the EBRD’s significant role in providing early and on-going support to banks, SMEs, the insurance sector, leasing and equity funds. Infrastructure represents 31% of the portfolio, indicating the Bank’s extensive work with municipal enterprises (particularly water treatment), and road, rail and air transport. Projects in Industry and Commerce sub-sectors represent 15% of the portfolio, reflecting the scarcity of large direct investments for the Bank in Latvia.

1.2 Implementation of the previous country strategy

The previous Latvia Strategy has been implemented in an increasingly competitive environment with term credit liquidity readily available from local banks and country risk declining with Latvia’s accession to the EU. Consequently within this small rapidly developing market, the Bank has had to be innovative in identifying market niches that satisfy the Bank’s mission. Financing SMEs through financial intermediaries and upgrading municipal infrastructure have continued to be core niches for the Bank in Latvia. The 2003 country strategy outlined the following strategic priorities for the Bank in Latvia:

Infrastructure: focus on financing state-owned and municipal entities, to support priority investment needs, while facilitating private sector participation.

Energy: work with the electricity utility to encourage the establishment of separate entities for power generation, transmission and distribution, and with the gas utility to strengthen Latvia's position in the domestic and regional gas distribution market.

Enterprise Sector: 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, including those seeking to expand cross-border, particularly into or from Russia and other CIS countries.

Financial Sector: develop products that are currently not well supplied to the financial sector, such as equity, and a broader range of SME finance.

From 2004 the Bank has signed three projects for Latvia (including regional projects), representing total commitments of approximately €7 million. The new projects have been regional equity funds with small allocations to Latvia.

On-going efforts by the Bank to participate in new infrastructure projects in Latvia during the strategy period have not been successful. While the focus has been on identifying large or complex projects needing structuring assistance and co-financing from EU structural and cohesion funds, the local authorities have been slower than expected in defining investment priorities, in building administrative capacity and in preparing project proposals. Consequently a number of municipal and national infrastructure projects in the pipeline for 2004 have been postponed to 2005 or later. PPP structures have also been slow to develop and in this field the Bank has much to offer, but with conditions attached.

In the energy sector the local commercial banks and other banks have been able to satisfy cheaply the credit needs of a variety of projects, while the Bank has maintained policy dialogue with key counterparts, relating particularly to the pan-Baltic and Baltic Sea regional dimension of market liberalisation, energy supply and distribution.

A number of financial sector projects, either as credit lines or equity capital investments, are being developed for later in 2005 or 2006. Significant recent changes in shareholding structure or business strategy have delayed the earlier expected conclusion of some of these projects.

The previous Strategy had identified growing demand for SMEs expanding cross-border into Russia, Belarus or Ukraine. While these opportunities have been slower than expected to materialise, they have also tended to be too small for direct financing by the Bank. The smaller projects have been financed more efficiently from the Bank's SME credit lines provided to local banks or as investments from pan-Baltic equity funds.

1.3 Transition Impact of the Bank's Portfolio and Lessons Learnt

1.3.1 Relevance and transition impact of previous country strategies

Infrastructure and Environment

In 2000 the Bank provided a follow-on loan to the Riga Water company. The transaction was very innovative because the Bank designed and developed a new instrument in the form of a municipal support agreement (MSA) which committed Riga City to maintain certain operational conditions with respect to water supply and wastewater treatment, while not being classified as a state or municipal guarantee. At the same time, the MSA gave comfort to EBRD as lender. In 2004 EBRD attracted a club of local commercial banks and syndicated out US$ 20m of the Bank's exposure to Riga Water. The commercial banks also took comfort in the fact that the MSA was included in the financing package. The overall progress in regulatory reform and commercial restructuring of Riga Water is very good, with the exception of limited private sector participation. Overall *moderate* transition impact in the MEI sector from 2000. Remaining transition challenges in MEI have been rated small to medium (see Annex 5).

Energy

During the past five years the Bank has maintained intensive and on-going policy dialogue with the government concerning the urgent need for investments in improving the safety of the hydro-electric dams systems on the Daugava River. EBRD TC money was spent on feasibility studies, investment plans, engineering designs, scenario modelling and other technical assistance. With substantial EU structural funds now available, Latvenergo is currently finalising their €100 million investment plans for improving dam safety, primarily along the same lines recommended by the Bank during the past five years. However, the Bank will not participate in financing the investments because Latvenergo can source funds more cheaply from other financial institutions. Significant other EBRD TC monies have been spent on assisting the Ministry of Economy in establishing and implementing an independent public utilities regulator. Overall *minimal* transition impact in the energy sector from 2000. Remaining transition challenges in the energy sector have been rated medium to large (see Annex 5).

Enterprise Sector

Since 2000 the Bank's only involvement in the agribusiness sector in Latvia has been through its regional project with the Kesko retailer from Finland. The Bank financed the food retailer's business through the acquisition and development of retail properties and the financing of retail operations. The transition impact derived from market expansion through linkages to local suppliers and distributors and increased competition in food retailing and wholesaling was deemed minimal. The expansion to smaller cities proved difficult due to strong commercial pressures and problems with obtaining appropriate building licenses. Overall *minimal* transition impact in the enterprise sector from 2000. Remaining transition challenges in the enterprise sector have been rated negligible to small (see Annex 5).

Financial Sector

Since 2000 the Bank has been successful in reaching SMEs through the EU/SME facility. Although only two banks (SEB Latvijas Unibanka and Rietumu Banka) and one leasing company (Unilizings) participated in the facility, they extended loans amounting to almost €60 million and leases amounting to over €18 million. All these investments were supported by TC for institution building. SEB Unibanka, which benefited from a follow-on loan, also managed to down-scale to a smaller average loan amount and higher credit officer productivity without compromising portfolio quality. Given SEB Unibanka's extensive branch network, over 90 per cent of loans have been in cities and towns outside of the capital. Unilizings was similarly successful. In Rietumu Banka the average loan amounts and subsidy ratios are still quite large given the nature of the economy. In addition, Latvia benefited from the €30 million credit line which the Bank provided to the Hansa Capital leasing company based in Estonia, under which €18 million was allocated to Latvia.

The Bank has provided environmental risk management training to a number of banks in Latvia, including the Latvian Investment Bank, Latvijas Zemes Banka, Rigas Komercbanka, Latvijas Unibanka and Rietumu Banka. The training has helped the banks adopt effective environmental due diligence procedures and manage environmental issues associated with their and their customers' operations.

Equity funds targeted the Baltics later than in Poland, Hungary or the Czech Republic, and the Bank has been active in Latvia since the late 1990s through a number of regional pan-Baltic private equity funds (such as the Baltic PPF, Baltic Small Equity Fund, Baltic Investment Fund I and II, Baltic Investment Fund III, Baltic SME Fund, and the Askembla Growth Fund). Of these funds' total 70 investee companies, 32 are in Estonia, 22 are in Lithuania and 16 are in Latvia. Equity funds have found it more difficult to find attractive investment opportunities and have thus made relatively fewer investments in Latvia as compared to Estonia and Lithuania. Nevertheless, some of these investments have achieved attractive returns. Given the size of the country, most of the realised exits so far have been via trade sales.

The Bank's involvement since 2000 in the NBFI sector has been limited to two projects. An equity investment in the country's leading insurance group was plagued by management misconduct that led to the dismissal of management, although the company continues to be the market leader. The Bank applied considerable effort in identifying the issue, proposing a solution and monitoring its implementation. The Bank has also been active in the leasing sector under the EU SME framework with Unilizings, mentioned above.

Overall *moderate/significant* transition impact in the financial sector from 2000. Remaining transition challenges in the financial sector have been rated negligible to medium (see Annex 5).

Overall assessment and rating

The Bank's Strategies for Latvia from 2000 addressed the evolving needs of the Latvian economy, which is characterised by the very high proportion of SMEs among corporate entities and by under-developed municipal infrastructure throughout the country. However a number of larger projects did not materialise for the Bank as expected because local commercial banks were able to provide long-term debt financing sooner and cheaper than anticipated, or the government was slow in prioritising its investment needs and in mobilising resources for accessing EU funds.

From 2000 the Bank's role in the transition of the economy in Latvia has been *minimal/moderate*.

Policy dialogue

Following the Russia crisis in 1998, the Bank has maintained effective policy dialogue with the Bank of Latvia, and from 2001 with the Financial and Capital Markets Commission, relating to strengthening financial regulation and reducing the risk of money laundering. Since 1999 the Bank has maintained policy dialogue with the Public Utilities Regulator relating to optimising tariff pricing models while providing for much-needed capital investment.

During the past two years the Bank has shared experience with the Latvian Ministry of Economy in their development of SME related policies. These include innovative approaches such as accessing EU structural funds to support the establishment of privately-managed small equity funds to provide much-needed capital to growing SMEs.

In 2004 legal technical assistance was provided by the EBRD for the development of Latvia's concession law. This was followed in 2005 with complementary legal technical assistance being provided by EBRD to help develop the PPP law which would make implementation of PPP projects more efficient and transparent. An assessment of the best practices of implementation of PPP projects in Europe forms part of this legal transition project.

1.3.2 Selected lessons learned

The Bank's experience in Latvia in recent years has resulted in a variety of lessons learned, the most important of which are the following:

Well structured **non-sovereign financing to state or municipal-owned companies**, including private sector participation where appropriate, helps to apply commercial discipline to the borrowers and also reduces budget pressures in the public sector.

However in a small country like Latvia, working with **regional municipalities** outside the capital city implies very small and often labour-intensive projects which are likely to have a large transition impact in their home town or city, but limited transition impact on a national scale.

Transparency, robust **corporate governance** and high standards of business conduct are essential elements in an emerging economy where good models of behaviour are often limited. However the considerable time and effort required in managing each equity investment over several years, including Board participation, should not be underestimated.

Attention and support provided to local banks through the EU/EBRD SME programme helped to change the attitude of banks to **smaller SME lending** and thus increased the availability of medium-term financing to this segment.

EBRD’s early **equity participation in local banks** and other non-banking financial institutions contributed successfully to the development of the financial sector, including attracting credible foreign strategic investors from Nordic countries and Germany, encouraging a lending culture and broadening the range of financing instruments available for customers.

1.4 Financial performance of the existing portfolio

Since 2003 the quality of the Latvia portfolio remained stable and satisfactory. The Latvia portfolio risk rating is 5.2, similar to that in 2003 (5.0). This compares with a risk rating of 5.4 for the Bank as a whole and 4.9 for Central Europe.

1.5 Mobilisation of co-financing

Overall mobilisation ratio (total project cost/EBRD financing) is 3.1. In 2004 the Bank sold US$ 20 million of its exposure to Riga Water to a syndicate of local commercial banks. The Bank's continuing support to the private equity industry focusing on SMEs is essential for raising second generation funds with majority private capital.

2. OPERATIONAL ENVIRONMENT

2.1 General Reform Environment

2.1.1 Political Environment

Since independence in 1991 Latvia's progress in its transition to a functioning market economy has been rapid and the implementation of structural reforms far-reaching. This has nurtured the development of a thriving private sector and one of the most open economies in Europe. By the end of the 1990s, most of the major privatisations had been completed. In recent years, the reform agenda has focused on the adoption of EU *acquis communautaire* and entry to the EU in May 2004. Since EU accession there has been some progress with finalising the privatisation of the remaining state-owned companies, including Lattelekom, the airBaltic airline and oil transit company Ventspils Nafta.

The political environment has been volatile. Following the collapse in Autumn 2004 of the short-lived government of Indulis Emsis, a new administration was formed in December 2004 under Aigars Kalvitis, of the People's Party, as Prime Minister. The coalition also includes the New Era party of former Prime Minister Einars Repse, the ZZS of Indulis Emsis and the First Party. This coalition of broadly centre-right parties commands an absolute majority in parliament, but its size and the ideological differences among its partners are likely to lead to delays in the approval and implementation of further structural reforms. Progress has been made in Latvia's policy towards its mainly Russian-speaking minority. Earlier this year Latvia ratified the Framework Convention for the Protection of National Minorities which came into force from 1 June. Nevertheless, relations with Russia remain difficult. Latvia formally joined NATO in March 2004.

Curbing corruption, reducing tax evasion and fraud and tightening the enforcement of anti-money laundering laws remain crucial priorities. A National Programme for Preventing and Combating Corruption was launched by the Corruption Prevention and Combating Bureau and anti-money laundering legislation, including further amendments in April this year, has put Latvia in line with EU requirements. As a result, the business environment has improved significantly from previous years. However, the implementation of new legislation remains slower than expected and from early 2005 two Latvian banks have been included in the US Treasury's list of Financial Institutions Identified as "Primary Money Laundering Concerns." The IMF has also called on the government to amend the law on insolvency in order to better guarantee creditors' rights, and to streamline public procurement procedures.

2.1.2 Macroeconomic conditions relevant for Bank operations

Latvia's economy expanded by 8.3 per cent in 2004 and by 9.5 per cent year-on-year in the first half of 2005, the fastest pace among the new EU member countries. Growth was mostly driven by trade and the construction sector, which expanded by 17.1 and 16.0 per cent respectively in the first half of 2005, followed by transport and communication at 15.2 per cent and manufacturing at 3.7 per cent. Low interest rates and longer available maturities for local bank loans fuelled domestic demand. Booming demand is expected to continue in 2005, fuelled by credit expansion, real wage growth and increasing net EU funds. However, real convergence is still a long way away, as Latvia is the least affluent of the new EU members in Central Europe and the Baltics. Latvia's GDP per capita remains below its peer group in the region and stands at about 40 per cent of the EU-15 average in PPP terms. Furthermore, growth composition points to an uneven distribution of activity across sectors and geographic regions, with services accounting for over 70 per cent of the economy and the Riga region generating most of the country's GDP.

Unemployment has been declining steadily since 2000 and was below 10 percent by mid-2005 – of which long-term unemployment was less than half. Regional differences in unemployment and shortages of skilled labour remain. Long-term unemployment is concentrated among older workers, high-school drop-outs and low-skilled workers made redundant by enterprise restructuring. Vocational education and training systems need updating in order to equip the workforce with skills relevant to the private sector needs. The government has started to pursue active labour market policies in order to address skills mismatches. A large share of EU fund financing is earmarked for human capital development. Active labour market initiatives are also provided by the Latvian Investment and Development Agency, the business development agency of the Ministry of Economy. Further reforms are needed to address regional disparities and low labour force mobility.

Latvia's strong economic performance continues to be accompanied by increasing inflation. Consumer prices rose steeply in 2004 and exceeded 7 per cent by year end. Annual average inflation in 2004 stabilised at 6.2 per cent and is expected to remain above 6 per cent in 2005. Determinants of such acceleration were in part one-off supply side factors and included administrative changes related to EU accession, increases in food prices as a result of a poor harvest, depreciation against the euro and global increases in commodity prices. Underlying measures of inflation have also deteriorated. Excluding unprocessed food, energy, and regulated items, core inflation peaked in late 2004 and remained high at 5 percent by mid-2005. In addition, continued credit growth fuelled domestic demand. In response, the Central Bank raised its refinancing rate by 50 basis points in March and November 2004 to reach 4 per cent. The authorities are aware of the risk to EU convergence that higher inflation poses and have established a high-level working group including the Ministry of Finance, the Ministry of Economy and the Bank of Latvia to address the issue.

Following the Lat re-peg to the Euro from the SDR in January 2005, Latvia was admitted to the European Exchange Rate Mechanism (ERM II) in May. The central rate per EUR was set at 0.702804 Latvian lats. Latvia decided to maintain the current exchange rate system allowing the Lat to float against the EUR ±1%. Underpinned by sufficient reserves, fiscal prudence and structural reform, Latvia's exchange rate arrangements are adequate to allow for EMU membership and adoption of the Euro as the national currency, which is currently planned for early 2008. Spreads on euro-denominated bonds have narrowed to 20 basis points. Additional measures have been undertaken to address reserves' vulnerability to exchange rate risk.

The general government deficit decreased to 1.0 per cent of GDP in 2004. This reflected the increase in tax revenues on the back of high growth rates of the economy and came in spite of the reduction in the corporate tax rate from 19 to 15 per cent last year. On the expenditure side, EU- and NATO-related costs turned out to be lower than budgeted. For the period through 2007 the government's convergence programme projects general government deficits below 2 per cent of GDP. Given growth projections and the limited risk of major changes in tax policy, this appears achievable. However, a pro-cyclical fiscal stance is expected in 2005 as EU funds will finance a 25 per cent increase in government spending. The IMF's recommendation to balance supply-enhancing EU-financed investment and the effects of higher public spending on demand with a neutral fiscal stance was considered politically infeasible. The prudent fiscal policy pursued in recent years resulted in relatively modest levels of general government debt (14.7 per cent of GDP by the end of 2004). Public debt is expected to remain at similar levels in 2005.

The current account deficit increased to 13.0 per cent of GDP in 2004, up from 8.2 per cent in 2003, but is expected to fall to 10 per cent in 2005 on the back of a declining trade deficit. The magnitude of the 2004 increase depended mostly on one-off factors, such as the purchase of large hydro turbines and ships and the effect of EU accession. Imports of capital and intermediate goods continue to flow in at a strong rate, reflecting the restructuring of enterprises and infrastructure. Exports (mostly wood and wood products) also grew at a fast pace in 2004 in value terms. Foreign direct investment (FDI) coverage of the deficit declined to 34 per cent in 2004 down from 40 per cent in 2002. However, it is expected to bounce back to around 50 per cent in 2005 through higher investments in equity capital in commercial services and trade. Gross external debt is high at around 93 per cent of GDP, but assets owned by foreigners in the country account for 65 per cent of GDP.

Improved compliance with EU accession requirements has strengthened Latvia's banking system. In 2004, it included 23 banks of which nine (eight subsidiaries and one branch) are foreign, accounting for 49 per cent of total banking assets and 50 per cent of total banking capital[1]. Foreign owners include Swedish, Finnish, German, Russian and Ukrainian banks. The sector is less concentrated than elsewhere in the region, with only 49 per cent of the market share belonging to the three largest banks. However, the other banks are smaller niche banks that mainly service foreign clients. Regulation and financial supervision have been tightened. A unified regulatory agency, the Financial and Capital Market Commission (FCMC) was established in 2001. The volume of non-performing loans continued to decline and was under 1.1 per cent of total loans at the end of 2004, down from 6.2 per cent in 1999. In addition, banks' provision to non-performing loans (NPLs) at around 99 per cent is prudent. Although non-resident deposits have traditionally been important in the sector, they now play a more minor role and only smaller institutions are still heavily reliant on them.

[1] Total share of foreign capital in paid-up banking capital was 57.8 per cent.

Favourable interest rates and fast economic growth resulted in a continued expansion of credit growth at about 36 per cent in real terms in 2004, mainly fuelled by mortgage and corporate lending. In addition to low interest rates, the rapid increase in mortgage loans has resulted from the high levels of bank competition and rising real estate prices. This trend is likely to continue in 2005, albeit at a slower pace, since the rapid expansion of the real estate market will be somewhat offset by rising global and domestic interest rates. Credit quality has so far not been affected, as indicated by declining NPL ratios, but this requires close monitoring.

2.1.3 Transition Success and Transition Challenges

Latvia has made remarkable progress in transition in the last decade. In many areas of structural reforms the country took the lead among the transition economies. The transition indicator scores published in the 2005 Transition Report indicate that Latvia is, on average, among the most advanced in transition in the new EU member states under the seven categories measured. In three categories – price liberalisation, trade and foreign exchange liberalisation and small-scale privatisation – Latvia has already achieved standards of a well functioning market economy.

Nevertheless, a number of transition challenges remain. The 2005 Assessment of Transition Challenges (ATC) highlighted the following challenges for Latvia. Please refer to the ATC Snapshot table in Annex 5 for individual sector-by-sector ratings and to the table on comparative Structural Change Indicators in Annex 6 for more detailed transition indicators.

Infrastructure

The liberalisation of the ***power*** sector is in progress. Latvenergo is being unbundled, although its privatisation is not envisaged. The Latvian parliament in May 2005 adopted a new law aimed at finalising market liberalisation according to EU requirements. As a result, industrial consumers and rival suppliers gained free access to the state-owned Latvenergo's transmission grids. As of July 2007, Latvian consumers will be able to choose an electricity supplier within the EU. The law also obliges Latvenergo to install high-voltage power lines for industrial consumers at its own expense as of January 2006. Latvia will also have to increase the share of its energy consumption produced from renewable resources from 45 to 49 per cent by 2010. Tariffs are cost reflective and there is an independent regulator.

As for the ***MEI*** sector, there is some limited private sector participation in district heating and urban transport, but water services are still operated by publicly owned (commercialised) companies. The multi-sector regulator has brought tariffs closer to costs.

The basic institutions for the ***energy efficiency*** sector are in place. The country has ratified the Kyoto protocol and will become a participant in the European carbon market. As a new EU member, Latvia is part of the Emissions Trading System (ETS). The market driven management of energy is still to develop. An autonomous multi-sector regulator sets energy tariffs to provide economic incentive for energy efficiency.

The fixed-line **telecommunications** operator Lattelekom was partly privatised in 1994 and granted a long-term exclusivity arrangement. The early termination of this agreement led to a dispute over compensation between the state and the strategic investor, TeliaSonera. After a three-year arbitration case, a settlement was agreed in 2004. Although this dispute has not delayed the opening up of the fixed-line sector, it has delayed the sale of the state's remaining 51 per cent stake in the fixed-line operator. Effective competition is still lagging behind. This is due to the uncertain regulatory environment, particularly regarding the implementation of tariff rebalancing, universal service obligations and interconnection charges. Although the Public Utilities Commission has already issued a number of licences, the market remains controlled by Lattelekom.

In ***railways***, operating and policy setting functions have been separated and core railway businesses have been partly unbundled while ancillary services have been divested. The Ministry of Transport recently announced plans to restructure Latvian Railways into three independent companies (infrastructure, freight and passengers) by the end of 2005. Infrastructure access is granted legally and some independent operators have been licensed. A number of regulatory agencies (licensing, pricing and safety issues) have been established. In ***roads***, construction and design companies have been privatised. Road user indirect charges have increased, but still do not cover operating costs. A toll bridge is being considered for the Daugava River in Riga. National road networks are in relatively poor condition.

Specialised Industries

Although significantly improved by the EU accession process, the business environment for ***general industry*** in Latvia is still in need of further reforms. Curbing corruption and smuggling, reducing tax evasion and VAT fraud and tightening enforcement of anti-money laundering laws remain crucial transition priorities. Following pressures from the international community, measures have recently been initiated to strengthen the anti-money laundering enforcement authorities, although implementation is slow.

In ***agribusiness*** the land market continues to function poorly. Over 80 per cent of arable land belongs to private farms, but restructuring of farms is still necessary, particularly with numerous very small land plots and highly fragmented ownership. Agribusinesses have been fully privatised, but as in other accession countries new owners still have to reduce costs, improve efficiency and upgrade hygiene standards in order to become internationally competitive. Although credit to the agricultural sector is growing only slowly, Latvia's very profitable banking system is gradually willing to lend due to the increased profitability of the agricultural sector.

Privatisation of the ***natural resource*** sector has made some progress, as the government has recently decided to sell its 38.6 per cent stake in Ventspils Nafta via the Riga Stock

Exchange. Gas 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 the introduction of third party access to gas networks were rejected by the Parliament in November 2002. Despite increases in natural gas tariffs from July 2003, gas tariffs still remain below those in the other Baltic and accession countries.

The ***real estate*** sector is developing fast, including new types of property and financing instruments. Activity in the construction sector increased 14 per cent in Latvia in the first quarter of 2005, compared to the first quarter of 2004, the fastest growth in the European Union, according to Eurostat. There is little state interference in the sector however some corruption still persists relating to the granting of licences and permissions by municipal authorities.

In general Latvian industry faces the on-going challenge of meeting more stringent environmental requirements through the implementation of EU Integrated Pollution Prevention and Control Directive, requiring them to meet the environmental standards that can be achieved with the use of Best Available Techniques.

Financial institutions

The basic regulatory framework in the ***banking*** sector is in place. Foreign-owned banks, a minority within the 23 banks in the country, hold approximately half of the total bank capital. Restructuring of the sector has been completed, and the industry is almost entirely in private hands (only 5.9 per cent of the banks' total paid-up share capital was owned by the state at the end of 2004). Consolidation is lower than elsewhere in the region, with only 49 per cent of the market share belonging to the three largest banks. Domestic credit to the private sector is expanding rapidly.

In the ***non-bank financial sector***, insurance legislation and regulation almost fully meet IAIS standards with active on-site inspections by the regulator. The size of capital markets is very small compared to other EU members and insurance penetration is also small. The leasing sector, on the other hand, is thriving, driven primarily by vehicle leasing. There are both mandatory and voluntary privately managed pension funds.

Although the ***private equity fund*** sector remains small and behind its neighbours, there is increasing interest from private investors in Nordic countries. However, the sector needs to increase its visibility, including by generating attractive returns and offering a broader range of financial instruments, also for earlier stage growth companies.

SMEs continue to suffer from a lack of finance and a lack of institutional capacity. Starting a business is costly: it takes 7 different procedures, an average of 18 days at a cost equal to 4.2 per cent of gross national income per capita. No centralised credit registry is in place, but there is a private credit information bureau that provides information on 0.6 per cent of the SME population. Collateral and bankruptcy legislation are supportive of SME lending and the cost of registering collateral is low. Since 2000, commercial banks and leasing companies have extended loans or leases to SMEs, often under dedicated IFI-supported credit lines.

2.2 Access to Capital

There are virtually no restrictions on cash and capital flows to and from Latvia and both current and capital account transactions have been fully liberalised. In 2000, the Bank of Latvia introduced real-time gross settlement system SAMS (the inter-bank automated payment system), which provides for sound and effective settlements in the interbank market of Latvia and monetary policy operations of the Bank of Latvia. Upon Latvia joining the Economic and Monetary Union and introducing the euro possibly in 2008, the Bank of Latvia has plans to participate in the single European TARGET system.

The household credit market (consumer loans, credit cards and mortgage loans) is developing fast. The ratio of household debt to GDP continued to rise very rapidly, increasing to 18.8 per cent in 2004, from 12.8 per cent in 2003. The number of insolvency applications rose by 31 per cent in 2003, but the ratio of insolvency applications to new enterprises established increased slightly to 20 per cent. The household debt to GDP ratio remains very low by comparison with emerging market countries and with other EU members. However, the proportion of bankruptcies to new enterprises has increased somewhat, compared to the previous 2 years.

Leasing has been the fastest growing method of financing consumer durables and transport equipment. Three banks directly offer leasing services, in addition to other banks which have leasing subsidiaries, and there are a number of small non-bank enterprises which also offer consumer lease financing. The Lat volumes outstanding with the leasing subsidiaries of banks and non-banks are estimated at about 2 per cent of GDP.

FDI flows increased significantly in 2004, rising to US$ 596 million or 4.4 per cent of GDP in 2004, up from 2.3 per cent the year before. However, only one third of total FDI is equity (22 per cent growth in 2004). The component of FDI that is growing fastest has been reinvested earnings (tripling in 2004) and inter-company lending, which primarily go to existing businesses. FDI has picked up after the EU accession when the share of greenfield investment projects increased. Most of the investment went to the real estate sector, followed by the transportation and communications industry and the power sector. Leading investors include Sweden and Germany, followed by Denmark, the Netherlands, the US and Russia. FDI is expected to increase further in 2005 as a result of higher investments in equity capital in commercial services and trade.

The Riga Stock Exchange has not served as an effective primary source of capital for corporations; trading is limited to a few companies and trading volumes are very low. However with common ownership by OM/HEX (Sweden/Finland) of the stock exchanges of Stockholm, Helsinki, Tallinn, Riga and Vilnius, a larger and more liquid capital market that spans Nordic and Baltic markets has been created. Consequently, primary capital market activity is expected to increase in the coming years. Private pension funds and life insurance companies are beginning to accumulate pools of household savings, but absolute volumes remain low.

Starting from 2004 the State Treasury has actively worked on changing the primary auction system for domestic government securities - transferring the initial placement of government domestic securities from the Bank of Latvia to the Riga Stock Exchange. The first such auction by the Riga Stock Exchange was undertaken on 6 July 2005.

2.3 Legal Environment

In recent years Latvia has made significant reforms to its legal framework, which has led to major improvements in the country's legal environment. Latvia joined the European Union (EU) on 1 May 2004. Despite the success of the country towards the establishment of a market-oriented economy and stable democratic institutions, further efforts are needed to overcome remaining challenges.

Latvia is a parliamentary democracy where separation of powers and independence of the judiciary are recognised. However, there are important issues that need be addressed by the authorities. Although the judiciary is legally independent, deficiencies regarding training and resources for the courts generate problems and a lack of confidence from the business community. However, as regards personal freedoms and human rights, Latvia is considered to be performing well, which affects positively the economic and legal environment.

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. Alignment of Latvian laws with EU laws (both pre- and post-EU accession) helped to improve the quality of the legal environment in the country. However, as described in Annex 10, there are challenges that ought to be addressed, in particular in the areas of concession law, insolvency law and judicial procedures.

3. STRATEGIC ORIENTATIONS

3.1 Bank's Priorities for the Strategy Period

Given the success of the transition in Latvia to date, in response to the few remaining transition challenges identified, and considering the Bank's ability to address them, the main focus of the Bank's activities during the strategy period will be the following:

- In the infrastructure sector the Bank will support the upgrade of state transport infrastructure and municipal infrastructure, particularly in regional cities and towns, while actively promoting energy efficiency and the use of renewable energy;
- In the enterprise sector provide primarily equity investments to companies with projects requiring extensive restructuring or corporate governance support, environmental investments or cross-border investments, for example into or from Russia or other CIS countries.;

- Where appropriate, the Bank will support the privatisation of remaining partially state-owned enterprises in sectors including telecommunications and district heating;
- In the financial sector continue to work with selected financial intermediaries on providing long-term equity and debt funding primarily to the SME sector.

The Bank will be responsive to other opportunities that may arise, but will concentrate on the priorities outlined above.

3.2 Sectoral Challenges and Bank Objectives

In line with the transition challenges identified above and in Annex 2, the EBRD will focus on the following sectoral priorities.

3.2.1 Infrastructure and Environment

Transition Challenges

There is limited private sector participation in municipal sectors including district heating, water and sewage, and urban transport, and also in state transport infrastructure. There are remaining energy inefficiencies due to heat losses from municipal-owned heating networks and buildings and from some privatised industrial enterprises. Latvia remains somewhat reliant on energy imported from neighbouring countries, particularly Russia and Lithuania.

Operational Priorities

- Encourage and support private sector participation in the financing of municipal infrastructure and in state transport infrastructure, relating particularly to large, complex or sensitive projects. This could be achieved with a variety of private public partnerships, including privatisation where appropriate, for example in district heating. Where possible these projects will be complemented with EU funding.
- Include greater energy efficiencies in project design, implementation and operations.
- Support the development of alternative energy sources.

3.2.2 Enterprise Sector

Transition Challenges

Corporate governance, strategic development potential and market competitiveness are relatively weak. There is an apparent lack of a coherent government strategy to invest in education, science and technology in order to identify and develop Latvia's core competencies for the future. While in the shorter term, tax evasion and VAT fraud are eroding the long-term sustainability of the enterprise sector.

Operational Priorities

- Provide primarily equity investments to companies with potential but that require restructuring or corporate governance support, environmental investments or cross-border investments, for example into or from Russia or other CIS countries. Cross-border investments, for example, are envisaged in the manufacturing sector, wood processing or retail and distribution and where expanding enterprises seek the Bank's ability to share CIS country risk, provide long-term funding and to strengthen corporate governance in new markets;
- Support the privatisation where appropriate of remaining partially state-owned enterprises in sectors including telecommunications and district heating.

3.2.3 Financial Sector

Transition Challenges

All financial institutions in Latvia need to ensure that the risk of money laundering is eliminated from their operations and that they operate according to international best practice in preventing money laundering, fraud and other financial crimes. Meanwhile as a growth opportunity, financial intermediation remains low, particularly to the SME sector. However there is a lack of equity and mezzanine capital to support growth of the financial sector and the consequent economic growth.

Operational Priorities

- Where appropriate, strengthen banks' corporate governance and business practices. This shall be achieved, for example, through active participation on a bank's supervisory board;
- Provide long-term capital to selected mid-tier banks that lack a strategic owner;
- Provide medium to long-term credit lines to selected financial institutions to provide funding primarily for corporate lending;
- Selectively commit capital to new equity funds, particularly those which focus on SMEs, for whom access to equity capital for expansion continues to be very limited.

4. CO-OPERATION WITH OTHER IFI's

European Union (EU) – The EU committed a total of €1,336 million in cohesion and structural funds for the period 2004-2006. The total Cohesion funds in the period 2000-2006 attributable to Latvia from EU amount to €710 million: this is split between current projects (ISPA €310 million) and projects for 2004 - 2006 under the cohesion fund. At the beginning of 2005, 25 projects were approved and moving into implementation (€555 million of which EU funds €310 million). Structural funds amount to €625 million and are allocated to the following priority areas: promotion of territorial cohesion; promotion of enterprises and innovation; development of human resources and promotion of employment; development of rural areas and fisheries as well as technical assistance. The Bank has worked extensively with the EU in relation to the SME Finance Facility which the EU has supported and the Bank has implemented as SME credit lines to SEB Latvijas Unibanka, Rietumu Banka and Unilizings. During 2005 the Bank has been working actively with the EC in developing the new JEREMIE and JASPER programmes for new EU member states, which will be implemented starting in 2006.

The International Monetary Fund (IMF) – Latvia joined the IMF in May 1992. The latest Stand-by facility expired in December 2002 with all performance criteria met. There are no further current or projected obligations to the IMF. The Article IV consultations are held on the standard 12-month cycle. Latvia has been the recipient of a number of technical assistance missions, focusing on the fiscal framework and management, the monetary and banking systems, including financial sector supervision, and on statistical issues.

The World Bank – Since Latvia joined the World Bank in 1992, the institution has provided financing for 25 operations in Latvia for a total of US$360 million in lending. No new loans have been made since December 2000. World Bank projects have financed reforms in the public administration, the social and health sectors, as well as the regulatory systems for banking and public utilities. Given the differing objectives and sectoral priorities of the respective institutions, the Bank has not collaborated on any concrete projects with the World Bank in Latvia.

The International Finance Corporation (IFC) – The IFC has supported Latvia's transition to a market economy through financing and technical assistance programs since the country became an IFC member in 1993. Since then, IFC has invested US$51 million from its own account and mobilized US$35 million in syndications from other banks in five projects in the financial, hotel business, wood processing, telecom, and retail sectors. In addition, the IFC completed a number of donor-funded technical assistance projects to improve the investment climate, develop the leasing sector, private pension plans, and private health care and provided advisory services to newly privatized companies. Currently the IFC maintains an energy efficiency guarantee programme with two banks in Latvia. The Bank has not collaborated on any concrete projects with the IFC in Latvia.

The European Investment Bank (EIB) – Since 1992, the EIB has committed a total of €521 million for projects in Latvia, mainly for infrastructure (energy, roads, rail-corridors, airport, water systems) and small and medium-sized enterprises (SMEs) through global loans to banking intermediaries. EIB's priorities in Latvia are to support projects that help integrate the economy into the EU Single Market and contribute to the application of European standards as developed in the acquis communautaire. The Bank has worked with EIB in Latvia in co-financing long-term municipal infrastructure projects such as upgrading the treatment plant of the Riga Water utility. Co-financing on selected large or complex infrastructure projects is envisaged in the future. On 29 September 2005 a loan agreement was signed between the Government of the Republic of Latvia and the EIB for the Cohesion and Structural Funds Programme Loan. In the framework of the respective agreement the EIB will provide financing of € 150 million.

The Nordic Investment Bank (NIB) – Latvia became a member of the Nordic Investment Bank in January 2005. However, the NIB has been active in the country since its independence through the Baltic Investment Programme (BIP). Later, the NIB financed investment loans for major individual projects in energy efficiency, water utility and power generation sectors. In 2003, the NIB issued a LVL 5.0 million (€7.8 million) bond in the Latvian capital market. In recent years, the NIB has established two loan facilities totalling € 4 million for women entrepreneurship. The loan agreements with the intermediary banks Hansabanka and Mortgage & Land Bank of Latvia (Hipoteku banka), were signed on 24 February 2004 in Riga. The Bank has collaborated on a number of environmental projects (water supply and wastewater treatment) with NIB in Latvia and on a selective basis this is envisaged to continue.

Kreditanstalt für Wiederaufbau (KfW) – KfW has provided financing in Latvia to support the private enterprise sector through SME development. In addition, KfW has financed projects for improving energy efficiency through building rehabilitation. In Latvia, KfW has also contributed to the Transform programme, a consulting programme financed by the German federal government to support reform in Central and Eastern Europe. The Latvian programme will be completed this year. While the Bank and KfW are both partners in the SME Finance Facility, the Bank has not collaborated on any concrete projects with KfW in Latvia.

ANNEX 1: COMMITTED PROJECTS PER YEAR

Year	Op Name	Direct/Regional	Total Project Value	EBRD Finance	Debt	Equity
1992	Latvia Energy Sector Emergency Investment Project	Direct	34.4	27.2	27.2	0.0
1992	**1**		**34.4**	**27.2**	**27.2**	**0.0**
1993	Riga International Airport Rehabilitation Project	Direct	9.6	8.7	8.7	0.0
1993	**1**		**9.6**	**8.7**	**8.7**	**0.0**
1994	Investment Bank of Latvia (equity)	Direct	7.9	1.4	0.0	1.4
1994	Daugava Riga Radisson Hotel	Direct	35.6	10.0	10.0	0.0
1994	First NIS Regional Fund	Regional	0.6	0.3	0.0	0.3
1994	Road Project - Latvia	Direct	26.9	8.3	8.3	0.0
1994	**4**		**71.0**	**20.0**	**18.3**	**1.7**
1995	Hansabanka (Formerly Latvijas Zemes Banka)	Direct	8.0	4.7	4.7	0.0
1995	MBA Loan Project (guarantee)	Regional	0.1	0.0	0.0	0.0
1995	Baltic Investment Fund	Regional	5.8	1.4	0.0	1.4
1995	Latvijas Unibanka (credit line)	Direct	10.2	9.1	9.1	0.0
1995	**4**		**24.0**	**15.2**	**13.8**	**1.4**
1996	PPF - Baltic - initial capital (Latvian SRP)	Direct	0.0	0.0	0.0	0.0
1996	Eurovision - Latvia	Direct	0.7	0.7	0.7	0.0
1996	Hansabanka (Formerly Zemes Banka (equity))	Direct	1.8	1.8	0.0	1.8
1996	Daugava Hydro Schemes Upgrade Project	Direct	58.2	19.5	19.5	0.0
1996	Latvijas Unibanka (equity)	Direct	7.6	7.6	0.0	7.7
1996	Riga Environment Project	Direct	77.5	13.2	13.2	0.0
1996	New Europe Insurance Ventures	Regional	2.2	0.6	0.0	0.6
1996	Pirma Banka (equity)	Direct	4.4	4.4	0.0	4.4
1996	Valdemara Centrs SIA	Direct	16.3	5.5	5.5	0.0
1996	**9**		**168.8**	**53.4**	**39.0**	**14.6**
1997	Latvia GSM Mobile Communications Project	Direct	82.0	17.8	17.6	0.2
1997	Saules Banka (credit line)	Direct	3.8	3.8	3.8	0.0
1997	Hansabanka (sub debt)	Direct	3.3	3.3	3.3	0.0
1997	Baltic Small Equity Fund	Regional	3.1	1.6	0.0	1.6
1997	Baring Communications Equity	Regional	1.9	0.4	0.0	0.4
1997	**5**		**94.2**	**26.9**	**24.7**	**2.2**
1998	Pirma Banka (revolving credit line)	Direct	7.4	7.4	7.4	0.0
1998	Innova/98 LP	Regional	2.0	0.4	0.0	0.4
1998	Ventspils Port Rail Terminal Project	Direct	92.7	17.0	17.0	0.0
1998	MBA Loan Project II (guarantee)	Regional	0.0	0.0	0.0	0.0
1998	**4**		**102.1**	**24.8**	**24.4**	**0.4**
1999	Ventspils Port Multi-Purpose/Intermodal Terminal	Direct	15.5	3.5	3.5	0.0
1999	Pirma Banka (equity + debt)	Direct	81.3	4.4	0.0	4.5
1999	Latvijas Unibanka (syn loan)	Direct	30.0	10.0	10.0	0.0
1999	Energy Efficiency and Emissions Reduction Fund	Regional	10.7	3.0	0.0	3.0
1999	**4**		**137.5**	**20.9**	**13.5**	**7.5**
2000	EU/EBRD Phase I - Ext. - Latvijas Unibanka	Direct	10.0	10.0	10.0	0.0
2000	Baltic Investment Fund III	Regional	18.5	3.4	0.0	3.4
2000	Riga Water Company Corporate Loan	Direct	137.4	19.3	19.3	0.0
2000	**3**		**165.9**	**32.7**	**29.3**	**3.4**
2001	DIF - RAF Avia	Direct	2.4	0.7	0.0	0.7
2001	DVI, Inc. (debt)	Regional	1.1	0.3	0.3	0.0
2001	BALTA Insurance Group (equity)	Direct	32.8	9.2	0.0	9.2
2001	EU/EBRD Phase I - Baltic SME Fund	Regional	5.5	1.0	0.0	1.0
2001	EU/EBRD Phase II - Latvijas Unibanka II	Direct	10.0	10.0	10.0	0.0
2001	Fiesta	Regional	13.7	7.6	7.6	0.0
2001	Kesko Baltics	Regional	15.7	5.5	5.5	0.0
2001	Pleskodale	Regional	5.8	3.8	3.8	0.0
2001	**8**		**87.0**	**38.0**	**27.1**	**10.9**
2002	EU/EBRD Phase II - Rietumu Bank	Direct	2.3	2.3	2.3	0.0
2002	Askembla Growth Fund	Regional	14.5	5.0	0.0	5.0
2002	Heitman Central Europe Property Partners Fund II	Regional	3.8	1.1	0.0	1.1
2002	Danfoss Debt Facility for Industrial Energy Projects	Regional	0.3	0.1	0.1	0.0
2002	**4**		**20.9**	**8.5**	**2.4**	**6.1**
2003	EU/EBRD Extension 4 - Hansa Capital	Regional	9.9	5.0	5.0	0.0
2003	EU/EBRD Phase II ext. - Unilizings	Direct	15.0	15.0	15.0	0.0
2003	**2**		**24.9**	**20.0**	**20.0**	**0.0**
2004	Polish Enterprise Fund V	Regional	0.9	0.9	0.0	0.9
2004	Europolis II	Regional	9.0	2.3	1.7	0.6
2004	**2**		**9.9**	**3.2**	**1.7**	**1.5**
2005	Emerging Europe Convergence Fund II	Regional	3.6	3.6	0.0	3.6
TOTAL	**52**		**953.6**	**303.0**	**250.0**	**52.9**

ANNEX 2: NET CUMULATIVE BUSINESS BY INDUSTRY

Sector Business Group (SIC)	Sector Team (SIC)	No. of Projects	Total Project Value	EBRD Finance	Debt	Equity	% Share of Commitments
Energy	Energy Efficiency	0.3	11	3	0	3	1%
	Power and Energy	2.0	93	47	47	0	15%
Sub-total Energy		**2.3**	**104**	**50**	**47**	**3**	**16%**
Financial Institutions	Bank Equity	4.0	103	20	0	20	7%
	Bank Lending	5.2	85	59	59	0	20%
	Equity Funds	1.3	55	18	0	18	6%
	Non Bank Financial Instituti	1.2	61	30	20	10	10%
Sub-total Financial Institutions		**11.8**	**304**	**128**	**81**	**47**	**42%**
Infrastructure	Municipal & Env Inf	2.0	215	33	33	0	11%
	Transport	4.0	147	38	38	1	13%
Sub-total Infrastructure		**6.0**	**362**	**71**	**71**	**1**	**23%**
Specialised Industries	Agribusiness	1.2	35	17	17	0	6%
	Property and Tourism	2.1	65	19	17	2	6%
	Telecoms Informatics & Me	1.2	85	19	19	1	6%
Sub-total Specialised Industries		**4.4**	**184**	**55**	**53**	**2**	**18%**
LATVIA TOTAL		**24.4**	**954**	**303**	**250**	**53**	**100%**

ANNEX 3: PIPELINE STOCK

LATVIA	Concept Review Stock	Final Review Stock	Board Approval Stock	Pipeline Stock	Number of Operations
LATVIA	125.0	0.0	0.0	125.0	3.0
DEBT	125.0	0.0	0.0	125.0	2.0
EQUITY	0.0	0.0	0.0	0.0	0.0
PRIVATE	20.0	0.0	0.0	20.0	2.0
STATE	105.0	0.0	0.0	105.0	0.0
Non-Sovereign	125.0	0.0	0.0	125.0	2.0
Sovereign	0.0	0.0	0.0	0.0	0.0
Energy Efficiency	0.0	0.0	0.0	0.0	0.0
Natural Resources	0.0	0.0	0.0	0.0	0.0
Power and Energy	0.0	0.0	0.0	0.0	0.0
Energy	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Bank Equity	0.0	0.0	0.0	0.0	0.0
Bank Lending	20.0	0.0	0.0	0.0	1.0
Equity Funds	0.0	0.0	0.0	0.0	0.0
Non Bank Financial Institutions	0.0	0.0	0.0	0.0	0.0
Financial Institutions	**20.0**	**0.0**	**0.0**	**20.0**	**1.0**
General Industry	0.0	0.0	0.0	0.0	0.0
General Industry	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Municipal & Env Inf	105.0	0.0	0.0	0.0	2.0
Transport	0.0	0.0	0.0	0.0	0.0
Infrastructure	**105.0**	**0.0**	**0.0**	**105.0**	**2.0**
Agribusiness	0.0	0.0	0.0	0.0	0.0
Property and Tourism	0.0	0.0	0.0	0.0	0.0
Telecoms Informatics & Media	0.0	0.0	0.0	0.0	0.0
Specialised Industries	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

The pipeline is at an early stage with three operations in the Financial sector and MEI sector having been Concept Reviewed by the Operations Committee. These comprise a syndicated loan to Rietumu Banka, a corporate loan to Liepaja Water company and a framework road renovation agreement with the Ministry of Transport. Subject to the clients' needs, final approvals, negotiations and documentation, at least one of these operations is expected to be signed by year end 2005, with the others following in 2006. There are a number of other operations that are expected to enter the formal pipeline in 2006.

ANNEX 4: SELECTED ECONOMIC INDICATORS

	1999	2000	2001	2002	2003	2004	2005
						Estimate	*Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP	3.3	6.9	8.0	6.4	7.2	8.3	7.5
Private consumption	4.3	6.3	7.3	7.4	8.6	8.9	na
Public consumption	0.0	-1.9	0.3	2.4	2.5	1.4	na
Gross fixed capital formation	-6.8	10.2	11.4	13.0	7.4	21.1	na
Exports of goods and services	-6.4	12.0	6.9	6.3	4.3	8.9	na
Imports of goods and services	-5.2	4.9	12.6	4.5	13.3	15.5	na
Industrial gross output	-2.4	5.4	8.7	8.8	9.4	9.3	na
Agricultural gross output	-3.3	11.5	6.4	4.4	1.0	4.0	na
Employment			*(Percentage change)*				
Labour force (end-year)	-1.6	-2.9	0.9	1.5	0.3	-1.6	na
Employment (end-year)	-1.8	-2.8	2.2	2.8	1.8	1.1	na
			(In per cent of labour force)				
Unemployment (end-year)	14.3	14.4	13.1	12.4	10.6	9.8	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	2.4	2.6	2.5	1.9	2.9	6.2	6.4
Consumer prices (end-year)	3.3	1.9	3.0	1.5	3.6	7.3	6.0
Producer prices (annual average)	-4.0	0.6	1.7	1.0	3.2	8.6	na
Producer prices (end-year)	-1.1	1.0	1.8	0.8	4.1	11.3	na
Gross average monthly earnings in economy (annual average)	5.7	6.2	6.5	8.7	11.2	9.6	na
Government sector			*(In per cent of GDP)*				
General government balance	-5.3	-2.7	-2.1	-2.3	-1.2	-1.0	-1.7
General government expenditure [1]	41.0	37.2	34.9	35.7	35.0	36.0	na
General government debt	12.1	12.9	15.0	14.2	14.6	14.7	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	8.0	27.9	20.8	21.0	21.1	27.0	na
Domestic credit (end-year)	15.2	44.3	36.2	39.8	39.2	40.2	na
			(In per cent of GDP)				
Broad money (M2, end-year)	23.6	27.2	29.8	32.8	35.8	39.1	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinancing rate	4.0	3.5	3.5	3.0	3.0	4.0	na
Interbank market rate[2]	2.7	3.3	5.4	2.7	3.2	3.5	na
Deposit rate (short-term, under 1 year)	4.2	4.2	5.7	3.2	3.0	3.3	na
Lending rate (short-term, under 1 year)	12.5	11.8	9.9	7.4	5.4	7.5	na
			(Lats per US dollar)				
Exchange rate (end-year)	0.6	0.6	0.6	0.6	0.5	0.5	na
Exchange rate (annual average)	0.6	0.6	0.6	0.6	0.6	0.5	na
External sector			*(In millions of US dollars)*				
Current account	-654	-372	-626	-625	-910	-1,766	-1,502
Trade balance	-1,027	-1,044	-1,335	-1,479	-2,003	-2,781	-2,772
Merchandise exports	1,889	2,080	2,243	2,545	3,171	4,221	4,978
Merchandise imports	2,916	3,123	3,578	4,024	5,174	7,002	7,750
Foreign direct investment, net	331	400	114	250	256	596	622
Gross reserves, excluding gold (end-year)	840	851	1,149	1,241	1,432	1,909	na
External debt stock[3]	3,821	4,702	5,571	7,043	9,343	12,689	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	2.8	2.6	3.2	3.1	2.8	2.8	na
			(In per cent of exports of goods and services)				
Debt service	14.3	14.8	20.5	15.8	19.8	19.9	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	2.4	2.4	2.4	2.3	2.3	2.3	na
GDP (in millions of lats)	4,224	4,686	5,168	5,689	6,318	7,333	7,882
GDP per capita (in US dollar)	3,010	3,250	3,484	3,924	4,743	5,854	na
Share of industry in GDP (in per cent)	21.8	20.7	20.4	20.3	20.4	20.6	na
Share of agriculture in GDP (in per cent)	4.3	4.9	4.7	4.5	4.3	5.3	na
Current account/GDP (in per cent)	-9.1	-4.8	-7.6	-6.8	-8.2	-13.0	-10.5
External debt - reserves (in US$ million)	2,981	3,851	4,422	5,802	7,911	10,780	na
External debt/GDP (in per cent)	52.9	60.9	67.6	76.5	84.5	93.5	na
External debt/exports of goods and services (in per cent)	131.1	142.8	162.3	185.5	198.9	211.4	na

[1] General government expenditure includes net lending.

[2] Weighted average interest rates in the interbank market.

[3] Includes non-resident currency and deposits, liabilities to affiliated enterprises and liabilities to direct investors.

ANNEX 5: RATINGS FROM THE 2005 ASSESMENT OF TRANSITION CHALLENGES

LATVIA	Structure	Institutions	Conduct	Comments
Agribusiness	*Small*	*Small*	*Small*	Poorly functioning land market. The smaller, fragmented agro-processors still need to improve efficiency and standards. Improvements to distribution and traceability are necessary. Banking sector slowly extending credit.
Banking	*Negligible*	*Small*	*Medium*	Regulatory framework in place though with a restricted secured transactions law. Large number of small niche banks servicing primarily CIS markets. Foreign-owned banks hold around half of total bank capital. Domestic credit to private sector (as % of GDP) is high. The risk of money laundering remains a concern.
Energy Efficiency	*Medium*	*Medium*	*Medium*	The country has ratified the Kyoto Protocol and participates in the European carbon market. The market driven management of energy is still to develop. An autonomous multi-sector regulator sets energy tariffs to provide economic incentive for energy efficiency.
General Industry	*Small*	*Small*	*Small*	The business environment still needs to be improved. Curbing corruption, reducing tax evasion and VAT fraud and tightening enforcement of anti-money laundering laws remain crucial transition priorities.
MEI	*Small*	*Medium*	*Medium*	There is some limited private sector participation in district heating and urban transport, but water services are still operated by publicly owned (commercialised) companies. The multi-sector regulator has brought tariffs closer to costs.
MSMEs	*Medium*	*Small*	*Medium*	Starting and administering a small business is costly and seed and expansion capital is scarce. No credit registry in place, but a private credit information bureau exists. Collateral and bankruptcy legislation supportive of MSME lending. Cost of registering collateral is low.
Natural Resources	*Small*	*Small*	*Small*	Gas market opening is blocked by a single dominant supplier, Latvijas Gaze, which is now 100 per cent in private hands. Despite increases in natural gas tariffs from July 2003, gas tariffs still remain below those in the other Baltic and accession countries.
NBFIs	*Negligible*	*Small*	*Medium*	Insurance markets legislation and regulation almost meet IAIA standards with only a few remaining shortfalls. The size of capital markets is very small compared to other CEB countries and insurance penetration is also small. There are both mandatory and voluntary privately managed pension funds. Leasing sector is thriving, driven mainly by vehicle leasing.
Power	*Large*	*Small*	*Small*	Latvenergo is being unbundled, but privatisation is not envisaged. Details of the liberalisation of the market are being prepared. Tariffs are cost oriented and there is an independent regulator. However Latvia remains reliant on energy imported from Russia and Lithuania.
Private Equity Funds	*Medium*	*Small*	*Medium*	Although the private equity fund sector remains small and behind its neighbours, there is increasing interest by private investors from Scandinavian countries. Increased business activity by equity funds, including offering a broader range of financial instruments, is needed to improve the visibility of the sector.
Property + Tourism	*Small*	*Small*	*Negligible*	Full tradability of land except for foreigners. The real estate sector is developing fast, including new types of property as well as more financing instruments. There is little state interference in the sector however corruption at municipal level remains a real concern.

Telecoms	*Small*	*Small*	*Small*	The dominant fixed line operator was partly privatised very early with a long term exclusivity, whose early termination led to a dispute between the state and the strategic investor. Although this dispute has not delayed market opening, it has delayed the sale of the state's remaining 51% stake. Effective competition is lagging somewhat behind due to an uncertain regulatory environment. A number of fixed line licences have been issued, but the market remains dominated by the majority state-owned operator.
Transport	*Medium*	*Medium*	*Medium*	In railways, operating and policy setting functions have been separated and core railway businesses have been partly unbundled. Ancillary services have been divested. There are plans to restructure Latvian Railways into three independent companies (infrastructure, freight and passengers) by the end of 2005. A number of regulatory agencies have been established. In roads, construction and design companies have been privatised. Road user charges have increased, but still do not cover operating costs. A toll bridge is being considered for the Daugava River in Riga. National road networks are in relatively poor condition.

ANNEX 6: COMPARATIVE STRUCTURAL CHANGE INDICATORS

	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Slovakia	Slovenia
Liberalisation								
Share of administered prices in CPI (in per cent)	10.9	26.9	17°	14.3°	19.8	1.2°	19.9	16.7°
Number of goods with administered prices in EBRD-15 basket	1.0	3.0	2.0	2.0	1.0	0.0	2.0	1.0
Share of trade with non-transition countries (in per cent)	80.6*	72*	84*	65.5	63.6	81.7	66.1	77.7
Share of trade in GDP (in per cent)	125.4	125.8	113.9	82.3	93.7	69.8	138.6	100.2
Tariff revenues (in per cent of imports)	0.2°	0.1*	na	0.4°	0.5	1.5*	0.5*	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.0
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3
Privatisation								
Privatisation revenues (cumulative, in per cent of GDP)	21.9	7.5	31.1	5.3	13.4	14.5	35.0	4.7
Private sector share in GDP (in per cent)	80.0	80.0	80.0	70.0	75.0	75.0	80.0	65.0
Private sector share in employment (in per cent)	70*	na	na	76.0	na	72*	na	na
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	4.0	4.0	4.0	3.7	4.0	3.3	4.0	3.0
Enterprise and markets								
Budgetary subsidies and current transfers (in per cent of GDP)[1]	9.3	1.8	20.2	5.1	0.4	2.5	1.6	1.5*
Share of industry in total employment (in per cent)	29.7	25.2	33.3*	19.7	20.7*	22.3	29.2	36.3*
Change in labour productivity in industry (in per cent)	10.8	3.9*	7.6*	8.2	14.1*	11.9	2.9	8.8*
Investment/GDP (in per cent)	35.7	29.3	22.5	32.6	21.9*	22.0	na	25.3*
EBRD index of enterprise reform	3.3	3.7	3.7	3.0	3.0	3.7	3.7	3.0
EBRD index of competition policy	3.0	2.7	3.0	2.7	3.0	3.0	3.0	2.7
Infrastructure								
Fixed-line (mobile) penetration rate (per 100 inhabitants)	36.0 (96.5)*	33.9 (72.3)*	33.4 (78.3)	28.3 (52.9)*	25.3 (66.6)	31.9 (45.1)*	24.1 (68.4)*	40.7 (87.1)*
Internet penetration rate (per 10,000 inhabitants)	274.4*	498.9*	357.8*	178.8*	203.8*	203.8*	212.2*	214.8*
Railway labour productivity (1989=100)	69.9*	267.3*	133.9*	129.9*	67.8*	106*	60.5*	150.3*
Electricity tariffs, USc kWh (collection rate in per cent)	8.4 (na)*	6.5 (na)*	11.4 (99)*	7.1 (99)*	9.4 (90)*	9.8 (na)*	10.9 (na)*	na
GDP per unit of energy use (PPP in US dollars per kgoe)	3.2**	2.8**	4.7**	4.1**	3.7**	3.9**	3.1**	4.5**
EBRD index of infrastructure reform	3.3	3.3	3.7	3.0	2.7	3.3	3.0	3.0
Electric power	3.3	3.0	4.0	3.3	3.3	3.3	4.0	3.0
Railways	3.0	4.3	3.3	3.3	2.3	4.0	3.0	3.0
Roads	2.3	2.3	3.3	2.3	2.3	3.0	2.3	3.0
Telecommunications	4.3	4.0	4.0	3.0	3.3	4.0	3.3	3.0
Water and waste water	4.0	4.0	4.0	3.3	3.3	3.3	2.7	3.3
Financial sector								
Number of banks (foreign-owned)	35 (26)*	7 (4)*	39 (29)	23 (10)*	13 (7)*	58 (46)*	21 (16)*	22 (6)*
Asset share of state-owned banks (in per cent)	3*	0*	7.4*	4.1*	0*	25.7*	1.5*	12.8*
Non-performing loans (in per cent of total loans)[2]	5*	0.5*	3.8*	1.5*	2.6*	25.1*	9.1*	9.4*
Domestic credit to private sector (in per cent of GDP)	17.7*	33.7*	42.3*	38.8*	19.9*	17.8*	25*	43.2*
Stock market capitalisation (in per cent of GDP)	17.8*	41.5*	18.7*	9.6*	17.2*	17.3*	7.6*	17*
EBRD index of banking sector reform	4.0	4.0	4.0	3.7	3.7	3.7	3.7	3.3
EBRD index of reform of non-bank financial institutions	3.7	3.3	4.0	3.0	3.0	3.7	2.7	2.7

[1] Subsidies to enterprises and financial institutions, including the Czech Consolidation Agency.

EBRD rates as of mid 2005. Remaining data is for 2004, unless otherwise specified.
°Data for 2005
*Data for 2003.
**Data for 2001

ANNEX 7: POLITICAL AND SOCIAL ASSESSMENT

Political context

Latvia was part of the Soviet Union from 1940 to 1941 and again from 1944 to 1991. During that period, a dramatic change occurred in the demographic make-up of Latvia: between 1935 and 1989 the Latvia share of the population dropped from 77% to 52% and the share of ethnic Russians and other eastern Slavs rose from 10% to 42%. Latvia regained political independence in 1991 and was formally recognised as an independent state by the Soviet Union on 6 September 1991. Upon re-gaining its political independence, Latvia reverted to a revised version of its 1922 Constitution establishing a multiparty parliamentary democracy with a 100-seat Parliament (Saeima) and a President elected by Parliament. Guntars Ulmanis, a leading figure in the Farmers' Union, held the presidency for two consecutive terms till 1999 when he was replaced by Vaira Vike-Freiberga, an independent. She was elected in June 2003 for a second four-year term. Deputies are elected to Parliament under a system of proportional representation. The first post-independence parliamentary elections were held in June 1993, with a 90% voter turnout. The electorate consisted of those who had been citizens of the pre-Second-World-War Latvian republic and their descendants. Since a law on citizenship and naturalisation had not yet been passed, nearly a third of the population (mainly the ethnic Russians) did not take part.

A large number of political parties, some of them new and politically inexperienced and built round personalities rather than political programmes, is one of the main reasons for the relatively short duration of the country's coalition governments. However, despite frequent changes of government, since independence there has been a strong consensus in favour of joining NATO and the EU. The longest-lived government since Latvia regained independence has so far been that of Andris Berzins, former Mayor of Riga, whose coalition, consisting of his Latvia's Way, the People's Party, For Fatherland and Freedom-Latvian National Independence Movement (FFF-LNIM) and the New Party, was in office from May 2000 until the regular parliamentary elections in October 2002. A pro-business, centre-right government, led by Einars Repse, former Governor of the Bank of Latvia, the country's central bank, came into power in October 2002. Repse had campaigned on an anti-corruption platform and had during the election campaign sought to distance himself from parties and personalities in power over the previous few years and perceived as being tainted by corruption. His cabinet consisted of his own New Era party, which had won the highest number of seats, the First Party, the populist Union of Greens and Farmers (ZZS) and the FFF-LNIM. The first three of those parties were all formed in early 2002, with the result that the government was dominated by businessmen, academics and civil servants, most of them with little previous experience of politics. The centre-right People's Party, a participant in previous governments and led by the former Prime Minister Andris Skele, was excluded despite the fact that it had won the third-largest number of seats. Tensions within the ruling coalition – some of them allegedly to do with Repse's leadership style but possibly also to do with the coalition's junior partners' concern that Repse's anti-corruption measures could weaken their power bases – led to the collapse of the government in February 2004. A new coalition was formed in March 2004 by Indulis Emsis, of the Union of Greens and Farmers, which also included the People's Party and the First Party. It collapsed in 0ctober 2004 after only seven months in power due to disagreements over the 2005 budget. A new government came to power in December 2004 led by Aigars Kalvitis of the People's Party. It takes in the People's Party, New Era, the Union of Greens and Farmers and the First Party. It commands a majority of 69 in the 100-seat Saeima. The coalition is holding together despite differences in political outlook and preferences: the People's Party and New Era lean towards liberal economic policies while the Union of Greens and Farmers and the First Party favour state intervention and subsidies. The coalition's cohesion is helped partly by the effect of the robust economic growth on personal incomes and the decrease in unemployment. The coalition is likely to stay together till the next parliamentary election due in late 2006.

International relations

The chief aim of Latvia's post-independence foreign policy has been integration into the EU and NATO. In November 2002 at NATO's summit in Prague, Latvia was invited, together Estonia and Lithuania and four other former Communist states, to join NATO and became, together with them, a full member in March 2004. Latvia applied to join the EU in 1995 but was invited to start membership negotiations only in December 1999. In 2002 it was accepted, along with nine other applicants, for membership in May 2004. Public support for EU membership was confirmed in a referendum held in September 2003 when 67% of those participating voted in favour. Latvia has ratified the EU's Constitutional Treaty. Latvia has been criticised by the European Commission for lagging behind the other new member states in implementing the Schengen Agreement, which lays down the conditions for unfettered travel between EU members. Originally scheduled for membership for the Schengen area in 2007, Latvia is unlikely to meet all the requirements by that time. Latvia maintains close neighbourly relations with Estonia and Lithuania within a number of regional bodies as well as bilaterally. Strong defence links are maintained with those two. Ties with the Nordic countries, which had helped Latvia since independence, are close.

Despite the fact that economic ties between Latvia and Russia are substantial, political relations with Russia remain strained over a number of issues including a bilateral border treaty, ready since 1997 but not yet signed. The blockade of the crude oil pipeline by Russia to the port of Ventspils is also seen as a means of unfriendly pressure by the Kremlin. New tensions in Latvian-Russian relations surfaced in the first half of 2005 over Russia's invitation to top European leaders including those of the three Baltic countries to attend the celebrations in Moscow on 9 May 2005 of the sixtieth anniversary of the victory over Nazi Germany. Presidents of Estonia and Lithuania refused unless Russia offered an apology for its policy towards the three countries, especially after their re-incorporation into the Soviet Union in 1944. Latvia's President attended but used her presence in Moscow to criticise the lack of any apology for the then Soviet policy. For its part, Russia continues to criticise Latvia's language laws maintaining that they are discriminatory towards the country's large Russian minority.

Integrity issues

The recently released 2005 Transparency International's Corruption Perceptions Index ranks Latvia 51st among the 159 countries surveyed according to the degree to which corruption is perceived to exist among public officials and politicians. Consequently Latvia is aligned with Costa Rica, El Salvador and the Mauritius. Although this represents an improvement from the 2004 ranking, when Latvia was in 57th position, corruption remains a problem as Latvia continues to be perceived as one of the most corrupt countries in Central Europe, second only to Poland. A recent report commissioned by the US Department of State documents illegal appropriation of funding in the health care and pharmaceutical sectors, extortion by insolvency administrators, illegalities in the City Council of Daugavpils, and cases of bribery during the recent election of the mayor of Jurmala[2]. The report also points to new possible sources of corruption, such as the large influx of EU funds. Financial fraud and money laundering also remain major concerns and two small Latvian banks (Multibanka and VEF Banka) have been included in the US Treasury's list of Financial Institutions Identified as "Primary Money Laundering Concerns." Following international pressure in recent years, Latvian authorities have initiated several measures to fight corruption and reduce the risk of fraud and money laundering. A National Programme for Preventing and Combating Corruption was launched by the Corruption Prevention and Combating Bureau, and new anti-money laundering legislation has brought Latvian laws into line with EU requirements. A new system for regulating the funding of political parties and campaigning costs was tried out in practice in the local elections in March 2005. However, the implementation of this new legislation remains slow as there are still very few convictions in the courts of perpetrators.

Although the law prohibits trafficking in persons, trafficking in women and girls remains a problem. According to the US State Department's 2005 Country Report on Human Rights Practices in Latvia, the number of investigations into crimes related to trafficking increased in 2004.[3] Latvia is primarily a source and transit point for trafficked victims. The main countries of destination are Germany, Denmark, Switzerland, and England. Trafficking occurred also within the country, and women from poor districts were often trafficked for sexual exploitation to Riga, Liepaja, and Ventspils. The government is aware of the problem and has taken steps to address the issue. In March 2005, the Cabinet approved the National Action Plan to Combat Trafficking in Persons. The definition of trafficking has been expanded to include internal trafficking and penalties for sexual exploitation have been increased. However, lack of resources and competing budget priorities have limited the government's ability to provide direct assistance to trafficking victims. Currently, most assistance to trafficking victims comes from local NGOs.

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[2] Providus (2005). *Report on Corruption and Anticorruption Policy in Latvia. 2005 First semi-annum.* Available at http://www.policy.lv/index.php?id=103009&lang=en

[3] US Department of State (2005). *2004 Country Reports on Human Rights Practices: Latvia.* Available at http://www.state.gov/g/drl/rls/hrrpt/2004/41691.htm

Social conditions

Population. Latvia's population stood at 2.32 million in 2004, 13% less than in 1990. The principal causes have been emigration and falling birth- rates. About one-third of the country's population lives in Riga and another one-third in the rural areas. The population is relatively elderly, with around 20% over the retirement age. Under Soviet rule, the ethnic composition of the population changed significantly – partly owing to the mass deportations of the Latvians and partly owing to the immigration of Russians and other eastern Slavs. Before Latvia became part of the Soviet Union, 77% of the population was Latvian, but by 1989 that was down to 52%. Net emigration of non-Latvians has brought the share of ethnic Latvians up to 58,6% in 2004. But the Latvians are still less than 50% of the population in four of the country's seven largest cities, including the capital, Riga. Approximately 1 million residents are of non-Latvian ethnicity, including 677,000 ethnic Russians, 92,000 ethnic Belorussians, 61,000 ethnic Ukrainians and 58,000 ethnic Poles. (The country's Jewish community was destroyed during the Holocaust - as was most of the Romany community.) More than 78% of the country's inhabitants are citizens, including more than 450,000 persons who belong to national or ethnic minorities. Under Western (and Russian) pressure, the 1994 citizenship law, under which naturalisation each year was to be limited to specific age groups, starting with the youngest, was dropped. Under a new law adopted by parliament and by a referendum in 1998, brackets were abolished, all children born in Latvia since independence were automatically entitled to citizenship and the naturalisation procedures and tests – particularly for older people - were simplified. The pace of naturalisation has accelerated since the 1990s and by 30 September 2005 the number of naturalised citizens had increased to 101,736. The biggest stumbling block to naturalisation is lack of knowledge of Latvian language, especially in areas where Russian-speakers are the majority of the population. This is being remedied in a number of ways by the Latvian government with financial help from the EU and the US.

Education Nine years is the length of compulsory education in Latvia, starting with four years of primary education from the age of seven. However, normal primary and secondary programme lasts 12 years. Latvian became the state language in 1988 but the implementation of compulsory Latvian-language instruction in schools began only in September 2004. Low funding affects the quality of teaching in state schools. In 2003/04, 312,489 pupils attended regular primary or secondary schools. Enrolment in universities and other institutions of higher education has more than doubled since independence. Latvia has five universities and 52 institutions providing specialised higher education. In 2003/04 126,000 students were in higher education compared with 46,000 in 1990/91. More and more students are having to pay for their own education owing to shortage of public funds. The already established emphasis on sciences and technical subjects has been broadened to respond to the shortage of graduates in business, law and information technology. Retraining programmes have been established for long-term unemployed and are being expanded.

Health. A decline in living conditions following the collapse of communism coupled with a shortage of funds for the healthcare system, has led to a rise in infant mortality rates immediately after independence to 18.5 per 1,00 live births in 1995, but fell back to 9.4 per 1,000 in 2003 (compared with 5 per 1,000 in the EU). Life expectancy in 2003 was 76.9 years for women and 65.9 years for men. Since independence there has been a rise in poverty-related diseases such a tuberculosis. Reported cases of HIV have risen from 8 in 1990 to 2,710 in 2003. Alcoholism and poor nutrition are a major problem, especially in rural areas. Private healthcare is rapidly growing but the public healthcare system, on which most people still rely, is suffering from low funding levels. Healthcare expenditure rose from 2.6% of GDP in 2000 to 3.9% in 2003. Since 1996 the emphasis in healthcare has shifted away from hospital-based treatment to primary healthcare. In early 1998 a bill was adopted making private healthcare insurance compulsory and introducing a system of charges for state healthcare. The State Health Insurance Fund, financed through income tax, is still the main healthcare system because employees' health insurance plans are only starting to be implemented.

Labour issues

Union membership is about 30% of the total workforce of one million. The main trade union body is the Latvia Confederation of Free Trade unions (LBAS), with 28 branch trade unions and professional employees' union representing over 250,000 workers. Trade unions have the right to bargain collectively and are generally freed of government interference in their negotiations with employers. Collective agreements are common and are negotiated by industry or company. Strikes take place but are infrequent and of short duration.

ANNEX 8: ENVIRONMENT

The objectives of environment and sustainable development of Latvia are defined in the National Environmental Policy Plan (2004) and Strategy for Sustainable Development of Latvia (2002). The main goals include the following:

- significant improvement of environmental quality in territories that pose an increased risk for human health, and the stability of ecosystems while sustaining environmental quality in the rest of the territory;

- protection of existing biodiversity and landscape characteristics of Latvia;

- sustainable use and constant increase of the efficiency of the utilisation of natural resources;

- integration of environmental policy into all branches and fields of life (the national economy in general, and in the strategic plans of its various branches, in legislation and public awareness), thus establishing the basis for sustainable development;

- build a stable economy capable of ensuring the social needs at the same time safeguarding the rate of the economic growth does not exceed the rate of the environmental pollution and consumption of resources;

- Latvia must gradually change from beneficiary of international aid to a country that is able to ensure its needs and necessities by own means, and even provide assistance to other countries where needed;

- Latvia must procure that market economy mechanisms serve the sustainable development;

- Latvia must ensure social participation in the sustainable development processes.

The environmental policy and sustainable development strategy are realised with help of legislation system and institutional framework. During Latvia's EU accession process the national legislation has been harmonised with environmental legislation of the EU, and specific tasks in environmental protection for the transitional period till 2012 have been defined. Latvia essentially had implemented the *acquis* in all areas of environment policy by its accession in May 2004. A small number of transitional arrangements have been agreed in Latvia's EU Accession Treaty regarding matters of environment, as follows:

- recovery and recycling of packaging waste until 2007;
- emissions of volatile organic compounds from storage of petrol until 31 December 2008, with intermediate targets, for certain installations in Latvia;
- integrated pollution and prevention control until 31 December 2010 (instead of 2007 for Member States) for certain installations in Latvia;
- treatment of urban waste water until 2015;
- quality of drinking water until 2015. Considering the heavy investment costs of the achievement of full compliance with the requirements of the EU Drinking

Water Directive (98/83/EC) and Urban Waste Water Treatment Directive (91/271/EC), a transitional period has been agreed so as to allow compliance being achieved gradually according to the priorities set in the Directives.

Ensuring compliance with the *acquis* requires significant investments, but also brings significant benefits for public health and reduces costly damage to forests, buildings, landscapes and fisheries. A strong and well-equipped administration at national, regional and local level is imperative for the application and enforcement of the environment *acquis*. Since EU accession, Latvia's environmental policy has been considering the Sixth European Community Environment Action Programme 2001-2010, which includes the main solutions of environmental problems.

Since 1 May 2004 Latvia has started an environmental impact assessment of the plans and programmes (Strategic Environmental Impact Assessment; SEA), in accordance with the requirements of Directive 2001/42/EC on the assessment of the effects of certain plans and programmes on the environment. Its purpose is to assess possible environmental impacts of the implementation of plans and programmes (developments plans of the national economy and its branches, strategies, spatial development plans etc.), to involve the public in the discussion and decision making, and to develop proposals for the prevention or minimisation of possible adverse effects of these plans and programmes ensuring the goals of sustainable development will be met. Latvia is implementing strategic environmental impact assessment step by step. It is carried out for those plans and programmes which may have significant impact on *Natura* 2000 territories. 12 regional plans have been subject to SEA to date.

Conclusion

The national environmental policy plan and other policy documents have been developed having regard to sustainable development. Environmental legislation has been harmonised with that of European Union. The sustainable development (environmental, social and economic) objectives have been established and these are being integrated into national and regional development plans through strategic assessments. Achievement of the sustainable development goals require for significant additional investment from public and private sector.

ANNEX 9: BILATERAL ASSISTANCE

Commitment Number	TC OPID	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name	Business Group	Linked to Inv.
AGML-98-12-01PS	6165	EBRD 2000 Annual General Meeting - Riga, Latvia	AGML	361,428	361,428	18/12/98	Closed	Carter N.	Community/Social Services	SG/Front Office/Manag. & Front Office	Non-Banking	N
BTAF-1994-02-04	1427	Privatisation programme - accountancy advice	BTAF	310,785	310,785	01/02/94	Closed	Shapiro P.	Community/Social Services	BG/Op. Teams/Central Europe Front Office	Central Europe	N
BTAF-1994-04-06	1343	Rigas Kommerc Banka (RKB) - operational and financial audit and due diligence	BTAF	66,990	66,990	15/04/94	Closed	Lambert J.	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N
BTAF-1994-04-07	1367	Baltic Investment Programme - training programme in feasibility studies for Latvia	BTAF	172,388	172,388	15/04/94	Closed	Pilipovic-Chaffey D.	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N
BTAF-1994-04-10	1680	TurnAround Management Programme - Juglas Manufaktura	BTAF	49,997	49,997	15/04/94	Closed	White J.	Manufacturing	BG/Op. Teams/Early Stage Equity	Financial Institutions	N
BTAF-1994-05-11	1343	Rigas Kommerc Banka (RKB) - preparation of medium-term strategy	BTAF	35,000	35,000	15/05/94	Closed	Lambert J.	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N
BTAF-1994-06-14	1628	Latvian Investment Bank - board representation	BTAF	69,221	69,221	15/06/94	Closed	Cicognani M.	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N
BTAF-1994-08-20	1680	TurnAround Management Programme - LATVIJAS KERAMIKA	BTAF	43,363	43,363	20/08/94	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1994-09-24	1680	TurnAround Management Programme - BALTIJA	BTAF	53,542	53,542	20/09/94	Closed	White J.	Manufacturing	BG/Op. Teams/Early Stage Equity	Financial Institutions	N
BTAF-1994-09-25	1680	TurnAround Management Programme - REMUS	BTAF	55,859	55,859	20/09/94	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1994-11-27	1680	TurnAround Management Programme - Grindex	BTAF	58,289	58,289	20/11/94	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1994-11-28	1680	TurnAround Management Programme - Brivais Vilnis	BTAF	49,777	49,777	20/11/94	Closed	White J.	Manufacturing	BG/Op. Teams/Early Stage Equity	Financial Institutions	N
BTAF-1995-01-02	1680	TurnAround Management Programme - LareLini	BTAF	27,603	27,603	01/01/95	Closed	White J.	Manufacturing	BG/Op. Teams/Early Stage Equity	Financial Institutions	N
BTAF-1995-03-04	1680	TurnAround Management Programme - Livanu Stikls	BTAF	44,170	44,170	01/03/95	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1995-03-07	1680	TurnAround Management Programme - Asote	BTAF	42,003	42,003	01/03/95	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1995-04-13	1381	Business Advisory Services - operating expenses for Riga	BTAF	81,283	81,283	02/04/95	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1995-06-20	1381	Business Advisory Services - subsidies disbursement	BTAF	812,349	812,349	20/06/95	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1995-07-23	1381	Business Advisory Services - local project director	BTAF	10,498	10,498	20/07/95	Closed	Cicognani M.	Manufacturing	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N
BTAF-1995-08-28	1381	Business Advisory Services - local project officer	BTAF	6,989	6,989	25/08/95	Closed	Cicognani M.	Manufacturing	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N
BTAF-1995-09-31	1381	Business Advisory Services - administrative secretary	BTAF	5,225	5,225	20/09/95	Closed	Cicognani M.	Manufacturing	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N
BTAF-1995-09-32	1381	Business Advisory Services - office equipment and furniture	BTAF	24,248	24,248	20/09/95	Closed	Cicognani M.	Manufacturing	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N
BTAF-1995-10-34	1680	TurnAround Management Programme - Cezijs	BTAF	17,365	17,365	10/10/95	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1995-10-36	1381	Business Advisory Services - office lease for local Business Advisory Services office	BTAF	60,713	60,713	10/10/95	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1995-10-39	1680	TurnAround Management Programme - Alfa	BTAF	55,556	55,556	10/10/95	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1996-05-07	5254	Business Advisory Services - project officer	BTAF	14,194	14,194	16/05/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1996-07-10	5256	Business Advisory Services - national fund director (extension of BTAF-95-07-23)	BTAF	16,286	16,286	12/07/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1996-08-11	5583	TurnAround Management Programme - Velme	BTAF	49,346	49,346	05/08/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1996-09-13	5257	Business Advisory Services - administrative assistant	BTAF	7,172	7,172	12/07/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1996-09-14	5133	TurnAround Management Programme - Tukums Dairy	BTAF	47,690	47,690	18/09/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1997-06-11	5133	TurnAround Management Programme - Jana Seta	BTAF	28,082	28,082	23/06/97	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1997-10-17	5133	TurnAround Management Programme - Zunda III	BTAF	34,718	34,718	06/10/97	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1998-02-05	5744	TurnAround Management Programme - Sparta Knitwear	BTAF	47,089	47,089	05/02/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1998-03-13	4773	Business Advisory Services - National Fund Director	BTAF	4,620	4,620	10/03/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1998-03-14	4773	Business Advisory Services - project officer	BTAF	3,564	3,564	10/03/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1998-03-15	4773	Business Advisory Services - Assistant to National Fund Director	BTAF	2,112	2,112	10/03/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1998-07-21	5743	Baltic Micro Business Advisory Services Programme - project officer	BTAF	19,348	19,348	23/07/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1998-07-24	5743	Baltic Micro Business Advisory Services Programme - subsidy account	BTAF	552,742	552,742	23/07/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N

Commitment Number	TC OPID	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name	Business Group	Linked to Inv.
BTAF-1998-07-26	5743	Baltic Micro Business Advisory Services Programme - operating expenses	BTAF	12,531	12,531	23/07/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1998-12-32	5134	TurnAround Management Programme - RBS Skal	BTAF	59,903	59,903	07/12/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1998-12-33	5744	TurnAround Management Programme - Velme II	BTAF	57,949	57,949	22/12/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1999-01-02	5744	TurnAround Management Programme - Jana Seta Printers	BTAF	59,065	59,065	28/01/99	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1999-01-04	5744	TurnAround Management Programme - Remus Construction	BTAF	60,000	60,000	29/01/99	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1999-02-06	5744	TurnAround Management Programme - JSC Lauma II	BTAF	59,868	59,868	05/01/99	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1999-03-07	5744	Turnaround Management Programme: AS Limbazu Piens	BTAF	58,580	58,580	22/03/99	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1999-07-11	5744	Turnaround Management Programme - Kvadra Pak	BTAF	60,000	60,000	01/07/99	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1999-07-13	5744	Turnaround Management Programme - Spilva SIA	BTAF	57,755	57,755	21/07/99	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1999-10-18	5744	TurnAround Management Programme (TAM) - SIA Simeks SMS Ltd	BTAF	52,979	52,979	11/10/99	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-1999-12-22	5743	Micro-BAS Programme - Project Officer	BTAF	16,476	16,476	16/12/99	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2000-02-03	6964	Business Advisory Services (BAS) Programme - Subsidies	BTAF	1,010,445	1,010,445	07/02/00	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2000-02-04	5744	TurnAround Management Programme (TAM) - JSC Rebir II	BTAF	59,711	59,711	15/02/00	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2000-05-10	5744	Continuation TAM Programme in the Baltic States - SIA Firma Ave MTP	BTAF	60,000	51,876	24/05/00	Disbursing	McPhee J.	Manufacturing	BG/Op. Teams/TAM/BAS Programme	SEEC	N
BTAF-2000-06-14	5744	TurnAround Management Programme (TAM) - Cido Partikas Grupa	BTAF	56,943	56,943	16/06/00	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2000-06-15	5744	TurnAround Management Programme (TAM) - Resekne Piena Konservu Kombinats	BTAF	52,170	52,170	19/06/00	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2000-07-17	5744	TurnAround Management Programme (TAM) - A/S Preses Nams	BTAF	60,000	60,000	24/07/00	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2000-08-20	5744	TurnAround Management Programme (TAM) - JSC Lindeks	BTAF	53,292	53,292	02/08/00	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2000-08-21	5744	TurnAround Management Programme (TAM) - Kvadra Pak II	BTAF	59,931	59,931	07/08/00	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2000-08-23	5744	TurnAround Management Programme - JSC Lauda	BTAF	56,170	56,170	15/08/00	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2000-09-24	5744	TurnAround Management Programme - AS Dobeles Dzirnavnieks	BTAF	18,228	18,228	08/09/00	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2000-10-26	5744	TurnAround Management Programme (TAM) - Reaton Ltd	BTAF	59,851	59,851	31/10/00	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2000-12-28	5743	Business Advisory Services - Aigars Strautins, Project Officer	BTAF	19,990	19,990	07/12/00	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2001-02-04	5744	TurnAround Management Programme (TAM) - Langa SIA	BTAF	59,700	59,700	16/02/01	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2001-08-09	5744	TAM Programme - Spilva II	BTAF	59,853	59,853	14/08/01	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
BTAF-2003-08-01	5397	RAF Avia Financial 3	BTAF	12,182	12,182	08/08/03	Closed	Moore T.	Finance, Business	BG/Op. Teams/Private Equity	TAM/BAS/Other	N
EC-1992-12-64	959	Energy sector emergency investment programme - project management unit	ECP	328,786	328,786	20/12/92	Closed	Dyvik E.	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	N
EC-1992-12-65	950	Energy sector emergency investment programme - energy emergency planning group	ECP	173,952	173,952	20/12/92	Closed	Dyvik E.	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	N
EC-1992-12-66	1005	Energy sector emergency investment programme - commercial accounting systems for main energy utilities	ECP	481,764	481,764	20/12/92	Closed	Dyvik E.	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	N
EC-1992-12-67	955	Energy sector emergency investment programme - energy conservation awareness campaign	ECP	189,000	189,000	20/12/92	Closed	Dyvik E.	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	N
EC-1992-12-68	983	Energy sector emergency investment programme - wood harvest, distribution and conversion study	ECP	183,950	183,950	20/12/92	Closed	Noro H.	Energy	BG/Op. Teams/Russia HQ	Russia & Central Asia	N
EC-1994-02-06	1427	Privatisation programme - privatisation advice	ECP	584,496	584,496	03/02/94	Closed	Riley-Pitt J.	Community/Social Services	BG/Op. Teams/Central Europe Front Office	Central Europe	N
EC-1994-11-52	1828	Latvenergo recapitalisation - financial advice	ECP	464,802	464,802	04/11/94	Closed	Krivicky G.	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	N
ECP-1995-12-41	2854	Post-privatisation Fund (Latvia / Lithuania) fund investment portfolio - investment development and implementation	ECP	963,816	963,816	02/01/96	Closed	Moore T.	Non-classifiable Establishments	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N
ECP98-2000-12-77	16241	BAS Programme in the Baltics	ECP	231,904	231,904	08/12/00	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N

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FIN-1996-03-01	3312	Energy operations - technical adviser	FIN	81,911	81,911	27/03/96	Closed	Amos P.	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	N
FIN-1998-06-02	5684	PAS Gutta Baltic juice manufacturer	FIN	139,943	139,943	26/06/98	Closed	Leibowitz G.	Manufacturing	BG/Op. Teams/Agribusiness	Specialised Industries	N
FIN-2001-02-03	17683	Baltic Pulp Mill Company - Project Advisor to the Government of Latvia	FIN	44,367	44,367	22/02/01	Closed	Gutnik S.	Agriculture, Forestry, Fishing	BG/Op. Teams/Central Europe Front Office	Central Europe	N
HOL-1997-11-08	4618	Pirma Latvijas Komercbanka twinning programme	HOL	121,274	121,274	10/11/97	Closed	Moore T.	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N
JAP-1993-12-63	889	Daugava river hydropower plants - technical and economic feasibility	JAP	749,361	749,361	01/12/93	Closed	Dolan P.	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	N
JAP-1997-12-43	4293	Project Evaluation Department's special evaluation of the Latvia energy sector emergency investment project	JAP	18,966	18,966	18/12/97	Closed	Pippingskold T.	Community/Social Services	PE/Project Evaluation	Non-Banking	N
NORG-1993-11-10	709	Transport project preparation/environment	NORG	9,917	9,917	01/11/93	Closed	Nordin L.	Transport, Storage	BG/Op. Teams/Transport	Infrastructure	N
NORG-1995-07-02	2685	Latvian banking sector - Bank Baltija	NORG	5,764	5,764	01/07/95	Closed	Harfield J.	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	SWE	9,063	9,063	01/09/92	Closed	Makela T.	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	SWE	223,593	223,593	28/01/93	Closed	Dyvik E.	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	N
SWE-1993-01-02	1444	Construction management for heavy fuel oil import facilities	SWE	246,768	246,768	28/01/93	Closed	Dyvik E.	Transport, Storage	BG/Op. Teams/Central Europe Front Office	Central Europe	N
SWE-1993-07-08	774	Forestry sector Master Plan - supervisory assistance	SWE	20,961	20,961	01/07/93	Closed	Riley-Pitt J.	Agriculture, Forestry, Fishing	BG/Op. Teams/Central Europe Front Office	Central Europe	N
SWE-1993-07-09	1022	Energy emergency investment programme - procurement advicer	SWE	138,008	138,008	09/07/93	Closed	Dyvik E.	Energy	BG/Op. Teams/Central Europe Front Office	Central Europe	N
SWE-2000-02-02	10003	Pirma Banka - Work-out Expert	SWE	67,916	67,916	04/02/00	Closed	Moore T.	Finance, Business	BG/Op. Teams/Financial InstitutionsA	Financial Institutions	N
SWE-2001-11-17	22946	Latvia Hydropower Dam Safety Act	SWE	199,000	199,000	29/11/01	Closed	Peter E.	Energy	BG/Op. Teams/Power and Energy	Energy	N
SWE2-2005-04-01	35970	Latvia: Concessions/PPP Law Development advice	SWE2	50,000	0	29/04/05	Committed	Zverev A.	Community/Social Services	GC/General Counsel/Legal Transition	Non-Banking	N
TAI-1993-10-13	709	Transport project preparation - economic evaluation	TAI	8,383	8,383	01/10/93	Closed	Nordin L.	Transport, Storage	BG/Op. Teams/Transport	Infrastructure	N
TAMEC-95-10-11	5144	TurnAround Management Programme - advisory services contract - OlainePharm	TAMEC	49,996	49,996	01/10/95	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-95-10-13	5144	TurnAround Management Programme - advisory services contract - Valmeira Glass Factory	TAMEC	49,355	49,355	01/10/95	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-95-11-20	5144	TurnAround Management Programme - advisory services contract - Aurora	TAMEC	32,646	32,646	01/11/95	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-95-11-26	5144	TurnAround Management Programme - advisory services contract - Grindex	TAMEC	48,663	48,663	01/11/95	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-01-04	5144	TurnAround Management Programme - advisory services contract - REF	TAMEC	44,648	44,648	01/01/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-03-11	5144	TurnAround Management Programme - advisory services contract - JSC Lauma	TAMEC	79,821	79,821	01/03/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-04-18	5144	TurnAround Management Programme - advisory services contract - Zunda training	TAMEC	50,000	50,000	01/04/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-04-21	5144	TurnAround Management Programme - advisory services contract - REMUS training	TAMEC	48,253	48,253	01/04/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-04-22	5144	TurnAround Management Programme - advisory services contract - Laima training	TAMEC	41,370	41,370	01/04/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-04-25	5144	TurnAround Management Programme - advisory services contract - ROG	TAMEC	41,198	41,198	01/04/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-06-29	5144	TurnAround Management Programme - Spodriba	TAMEC	49,823	49,823	01/06/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-06-31	5144	TurnAround Management Programme - advisory services contract - JSC Lauma training	TAMEC	48,468	48,468	01/06/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-06-32	5144	TurnAround Management Programme - Uzvara	TAMEC	44,629	44,629	01/06/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-07-33	5144	TurnAround Management Programme - Kaija	TAMEC	45,561	45,561	01/07/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-07-34	5144	TurnAround Management Programme - advisory services contract - GSM	TAMEC	47,261	47,261	01/07/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-08-35	5144	TurnAround Management Programme - advisory services contract - Brivais Vilnis	TAMEC	46,842	46,842	01/08/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-08-36	5144	TurnAround Management Programme - advisory services contract - Tartu Instruments	TAMEC	34,929	34,929	01/08/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N

Commitment Number	TC OPID	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name	Business Group	Linked to Inv.
TAMEC-96-08-37	5144	TurnAround Management Programme - advisory services contract - Latvijas Udensceli	TAMEC	9,039	9,039	01/08/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-09-38	5144	TurnAround Management Programme - Livanu Stikls	TAMEC	68,809	68,809	01/09/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-96-11-46	5144	TurnAround Management Programme - advisory services contract - CS Turiba	TAMEC	46,540	46,540	01/11/96	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-97-02-14	5144	TurnAround Management Programme - advisory services contract - Rigas Vagonu Rupnica	TAMEC	29,292	29,292	01/02/97	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-97-02-15	5144	TurnAround Management Programme - Jelgava Sugar	TAMEC	59,810	59,810	01/02/97	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-97-02-16	5144	TurnAround Management Programme - advisory services contract - Kometa	TAMEC	47,765	47,765	01/02/97	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-97-02-17	5144	TurnAround Management Programme - Rita	TAMEC	50,000	50,000	01/02/97	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-97-03-21	5144	TurnAround Management Programme - advisory services contract - Latvijas Keramika	TAMEC	49,310	49,310	01/03/97	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-97-03-22	5144	TurnAround Management Programme - advisory services contract - Batlija Furniture	TAMEC	44,746	44,746	01/03/97	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-97-04-23	5144	TurnAround Management Programme - advisory services contract - JSC Starburadze	TAMEC	47,435	47,435	01/04/97	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-97-05-28	5144	TurnAround Management Programme - advisory services contract - JSC Dzintars	TAMEC	26,125	26,125	01/05/97	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-97-07-42	5144	TurnAround Management Programme - Kaija	TAMEC	48,454	48,454	21/07/97	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-98-02-02	5144	TurnAround Management Programme - Jana Seta (II)	TAMEC	81,919	81,919	06/02/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-98-02-03	5144	TurnAround Management Programme - JSC Olaine chemical	TAMEC	37,688	37,688	06/02/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-98-03-07	5144	TurnAround Management Programme - AS Rebir	TAMEC	33,989	33,989	19/03/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-98-05-11	5144	TurnAround Management Programme - Baltic Dairy Corporation	TAMEC	43,806	43,806	05/05/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-98-05-12	5144	TurnAround Management Programme - Teika Mebelu Fabrika	TAMEC	48,200	48,200	08/05/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-98-05-13	5144	TurnAround Management Programme - Ogre II	TAMEC	21,412	21,412	06/05/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-98-06-14	5144	TurnAround Management Programme - JSC Staburadze	TAMEC	55,457	55,457	17/06/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-98-06-15	5144	TurnAround Management Programme - Rita	TAMEC	41,066	41,066	17/06/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
TAMEC-98-06-18	5144	TurnAround Management Programme - JSC Dzintars	TAMEC	16,347	16,347	18/06/98	Closed	McPhee J.	Manufacturing	PE/ESE/TurnAround Management Group	SEEC	N
UK-94-06-04PS	1437	Latvian Shipping Company - legal advice	UK9404	84,398	84,398	13/05/94	Closed	Riley-Pitt J.	Transport, Storage	BG/Op. Teams/Central Europe Front Office	Central Europe	N
UK-94-06-06PS	1437	Latvian Shipping Company - privatisation advice	UK9406	180,190	180,190	13/05/94	Closed	Riley-Pitt J.	Transport, Storage	BG/Op. Teams/Central Europe Front Office	Central Europe	N
UKB-1994-07-09	1427	Privatisation programme - legal advice	UKB	181,360	181,360	01/07/94	Closed	Krivicky G.	Community/Social Services	BG/Op. Teams/Central Europe Front Office	Central Europe	N
UKC-1997-05-07	4221	Assistance in Reform of Legislation on Secured Transactions	UKC	46,418	46,418	09/05/97	Closed	Dahan F.	Community/Social Services	GC/General Counsel/Legal Transition	Non-Banking	N
UKC-1999-05-04	6402	AS Lauma project preparation	UKC	36,671	36,671	27/05/99	Closed	Gutnik S.	Manufacturing	BG/Op. Teams/Central Europe Front Office	Central Europe	N
		Country Total Euro Amount:		**13,572,547**	**13,514,422**							

ANNEX 10: ASSESSMENT OF LATVIA'S COMMERCIAL LAWS

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws "on the books" (also referred to as "extensiveness") and the actual implementation of laws (also referred to as "effectiveness"). All available results of these assessments can be found at www.ebrd.com/law. This annex presents a summary of the results for Latvia, accompanied by critical comments of the Bank's legal experts who have conducted the assessments.

Capital Markets

The principal legislation governing capital markets is composed of the Law on the Financial and Capital Market Commission (the "Law on FCMC"), adopted in June 2000 and amended in November 2001; the Financial Instruments Market Law, adopted in November 2003 and amended in April 2005; the Investment Management Companies Law, adopted in December 1997 and amended in 2000, 2002 and 2004; the Investor Protection Law, adopted in November 2001 and amended in November 2003 and the Commercial Law, adopted in April 2000 and amended in 2000, 2001, 2002 and 2004.

The Financial and Capital Market Commission (the "FCMC") was established on 1 July 2001 in accordance with the Law on FCMC as the single market regulator. The FCMC is an autonomous state institution, with 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. The operational independence of the FCMC is guaranteed through specific definition of its regulatory objectives, the availability of regulatory powers and self-sufficiency in its financing.

The Financial Instruments Market Law replaced the Securities Act. The Act regulates the public circulation of financial instruments, the operation and oversight of the regulated market, the arrangements for investment services providers registered in the EU and European Economic Area to provide services in Latvia, and the cooperation between regulatory agencies in Latvia and EU member States.

On 1 May 2004, Latvia joined the EU aligning its national legislation with the relevant *Acquis Communautaire*, although transitional arrangements until the end of 2007 have been agreed with the EU concerning credit unions, bank deposit guarantees and the investor compensation scheme. Following its Accession to the EU, Latvia joined the Exchange Rate Mechanism 2 in May 2005, the obligatory waiting room for the Euro zone, while the scheduled date for joining the European currency is planned for January 2008.

According to the EBRD Securities Markets Legislation Assessment conducted in 2004, the country was found to be in "medium compliance" with the Objectives and Principles of Securities Regulation published by the International Organization of Securities

Commissions (IOSCO) showing major weaknesses in Self-Regulatory Organisations (SROs) legislation, and Investment Service Providers areas.

An update of the assessment has been recently prepared and the preliminary results seem to confirm the 2004 results. Among the new legislation enacted in 2004-2005, it is worth noting the new Riga Stock Exchange Rules on Listing and Trading of Financial Instruments on Exchange Regulated market, which entered into force in October 2004 as part of the measures intended to integrate the Riga Stock Exchange into the OMX Exchanges system, which controls and operates the stock exchanges in Latvia, Lithuania, Estonia, Finland and Sweden. The new rules set stricter requirements for issuers wishing to list financial instruments on the Stock Exchange. In July 2005, the Law on Financial Conglomerates, which transposes the EU Directive 2002/87, the so-called Financial Conglomerates Directive, was also enacted, extending the supervisory powers of the FCMC.

Company Law and Corporate Governance

The primary legislation governing corporate governance related issues includes the Commercial Law and the Financial Instruments Market Law.

The Commercial Law was enacted in 2000, and amended in 2000, 2001, 2002 and 2004. The Commercial Law fully replaced the Joint Stock Company Law from 1 January 2005. Joint stock companies established after 1 January 2002 had to comply with the provisions of the Commercial law, while companies established prior to 1 January 2002, had a transition period until 1 January 2005 to comply with all requirements set forth in the Commercial Law.

According to the Commercial Law, commercial activities in Latvia can be performed through partnerships (general or limited) or capital companies (limited liability or joint stock companies).

Joint stock companies are organised under a two-tier system. Members of the supervisory board (council) are appointed by the general meeting of shareholders, while the council is in charge of appointing and recalling the members of the board of directors.

In May 2005 amendments to the Criminal law were passed introducing the concept of criminal liability for legal persons. By virtue of the amendment legal persons can be held criminally liable where, in the interest of the legal person a crime has been committed by a representative of that legal person. A legal entity found guilty under the Criminal Law can be subject to mandatory liquidation, restriction on certain rights, confiscation of assets, fine and liability to remedy the damage.

According to the results of the EBRD's 2004 Corporate Governance Sector Assessment, under which corporate governance related “laws on the books” were assessed, Latvia was rated as having achieved “high compliance”, when compared to the OECD Principles of Corporate Governance.

In 2005, the EBRD launched a survey for testing the effectiveness of corporate governance (how the law works in practice). A case study dealing with related-party transactions was designed. The case study investigated the position of a minority shareholder seeking to access corporate information in order to understand if a related-party transaction was indeed entered into by the company and on how it was possible to obtain compensation in case damage was suffered. Effectiveness of legislation was then measured according to four principal variables: institutional environment, enforceability, complexity and speed. The survey showed some deficiencies in all variables. Actions available to minority shareholders are generally clearly provided for by the legislation but case law offering guidance to legal provisions is not always available. The time needed to conclude the proceedings is usually limited (around 8 months for disclosure and 1 year for redress) although it may be quite easy for the defendant to delay the procedure. Finally enforceability of judgements might be a problematic issue and courts and prosecutors are not deemed well experienced and competent in corporate cases.

Therefore, despite the fact that Latvia has in place good laws concerning corporate governance issues, continuing efforts still need to be made to improve the effective implementation and enforcement of existing legislation.

Concessions

Latvia has a well developed and clearly spelt out policy framework promoting Public Private Partnership ("PPP") and an established institutional infrastructure for PPP implementation. Its legal framework, however, needs improving and the government is working on this.

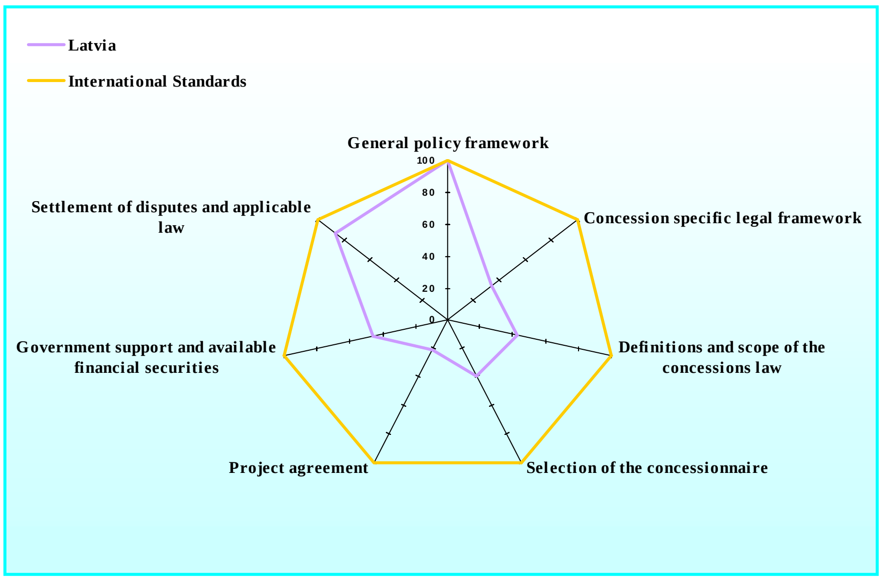
The Latvian Concession Law (the "Concession Law") was adopted in 2000. It is regarded as too general and not too clear. Under the Concession Law both domestic and foreign entities as well as associations may bid for a concession contract, However, where a foreign entity successfully bids for a concession, it will need to establish a corporate presence in Latvia before the concession will be issued. According to the Concession Law, concessions may be granted by way of a tender or auction and the Concession Law contains rules governing procedure for these.

Among positive features of the Concession Law, there is a reference to a "non-discrimination" principle, and the provision for publication of a concession award. As far as government support provisions are concerned, the Law refers to "guarantees of a conceding authority to a concessionaire regarding financial and commercial risks".

The Concession Law requires much improvement in order to constitute a sufficiently solid legal basis for the development of PPP in Latvia. As it stands, the Concession Law only seems to apply to agreements expressly entitled "concession". The sectors/types of infrastructure/services where the Concession Law is applicable are somewhat vaguely defined as "concession resources". Therefore, the scope of its application needs to be improved. It is not clear from the Concession Law whether a concession may be granted by a direct negotiation/contract. No option for a court appeal or international arbitration is currently provided for dispute resolution. Nor does the Concession Law provide for a so-called “stability clause” which would guarantee the application of the regime effective on the day the agreement came into force in the event of subsequent change to the law. The selection procedure also needs to be further developed, in particular by inclusion of rules on the pre-selection procedure, unsolicited proposals and direct negotiations. The Concession Law is rather restrictive as far as financial guarantees are concerned (e.g. prohibition of pledge of concession resources). Many issues related to a project agreement are deemed "conditions for granting concessions" (e.g. termination, tariffs), and it is unclear whether such conditions can be negotiated or not.

Quality of concession legislation –Latvia (2004)

Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the ‘web’, the more closely concessions laws of the country approximate these standards.



Source: EBRD Concessions Sector Assessment 2004

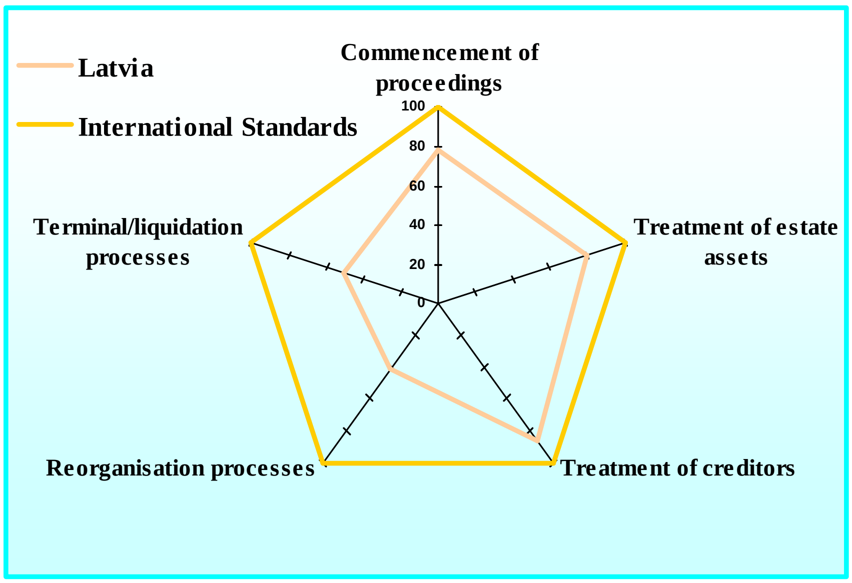
The recent EBRD Concession Laws Assessment undertaken to evaluate the applicable regime throughout the EBRD’s 27 countries of operations (the laws on the books only rather than how they work in practice), revealed that Latvian laws overall had “low compliance” with internationally accepted standards in this sector. As can be seen from the above chart, there exists a well developed policy framework and rules covering settlement of disputes in concession-related arrangements are fairly extensive. However, most other areas, in particular, rules covering project agreements and availability of financial instruments and state support need to be dramatically improved in order to meet the requirements of a modern legal framework facilitating private sector participation.

The Latvian Government is concerned with the situation and has initiated the drafting of a new Concession Law. The EBRD is engaged in providing assistance with this and the draft new law is expected to be presented to the Parliament by the end of 2005.

Insolvency

Bankruptcy and insolvency are governed by the Law on the Insolvency of Undertakings and Companies (as amended, 2003) (the "Insolvency Law"). This law scored "low compliance" when compared with international standards in the EBRD's 2003 Sector Assessment Survey.

Note: The extremity of each axis represents an ideal score, i.e., corresponding to the international standards such as the World Bank's Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Draft Legislative Guidelines for Insolvency Law, and others. The fuller the 'web', the more closely insolvency laws of the country approximate these standards.



Source: EBRD Insolvency Sector Assessment Project, 2003/4

As the above graph reveals, this law is deficient in many key areas of insolvency. Specifically, the Insolvency Law does not provide sufficient clarity in the definition of 'insolvency' to prevent potential abuses by creditors. In addition, the law grants insufficient supervisory powers to courts in restructuring processes.

As is common in insolvency legislation in EBRD countries of operations, the Insolvency Law is particularly deficient in addressing other issues of reorganisation. A meaningful reorganisation scheme should allow for the compromising of obligations, in a timely fashion, to facilitate recovery. Under the current Latvian scheme, virtually no ongoing financing during restructuring will be available and there is no requirement for restoration plans to be independently assessed. Both of these issues must be addressed. Finally, given Latvia's increasing business relationships with neighbouring countries, it would be worthwhile for the law to address the issue of cross-border insolvency proceedings (although, admittedly, this is not as pressing an issue as the other deficiencies discussed herein).

Although the Insolvency Law does possess some positive elements, such as detailed provisions on the avoidance of fraudulent, pre-bankruptcy transactions, there are serious concerns as to whether these provisions could be effectively implemented. The EBRD 2004 Legal Indicator Survey on Insolvency which examined the 'effectiveness' (or how the law works in practice) of insolvency regimes in both creditor-initiated insolvencies and debtor-initiated insolvencies revealed severe deficiencies in the practical implementation of insolvency law in Latvia. For both debtors and creditors, the process is too slow, too expensive, unduly complex and lacking in both predictability and transparency.

The poor access that debtors receive when trying to use the law to restructure their business suggests not only weakness in the legislation but structural obstacles that makes a reorganisation (and therefore business continuity) extremely unlikely.

All of these factors, together with the law's deficiencies, militate against the insolvency regime functioning properly as a 'stick' to induce debtors to act in good faith and as a 'carrot' to induce insolvent debtors with businesses that are fundamentally viable, to try to promote the rescue of such businesses.

Secured Transactions

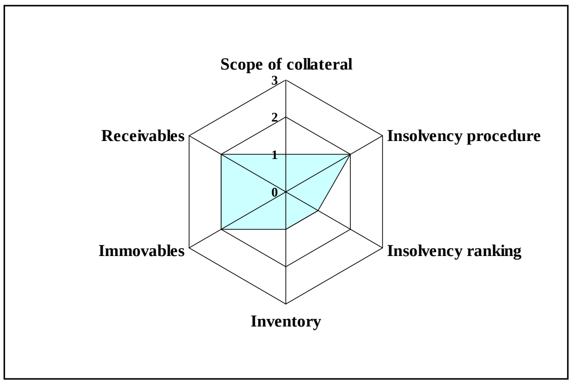
Secured transactions law has been reformed in 1998-99 to introduce a market-oriented, flexible and transparent system in the form of the "commercial pledge", governed primarily by the Law on Commercial Pledge. The commercial pledge can be granted over movable (tangible or intangible) assets, specifically or generally described. Only enterprises (incorporated legal persons) can grant a commercial pledge. Individuals, partnerships and other unincorporated associations could grant a commercial pledge but the pledge would have to be limited to vehicles, aircraft, an enterprise as a pool of assets, and shares in companies and bonds – this restriction is mostly to avoid the commercial pledge to be used for consumer loans. When the whole enterprise is pledged, it does not include the enterprise's real estate or vessels.

Commercial pledges must be registered with the Commercial Pledge Register, a database which is 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 days. Details of commercial pledges over registered assets are available on-line after agreement with the Register: www.ur.gov.lv. For assets whose titles are registered in separate registries, a registration of the pledge will also be made in these registries.

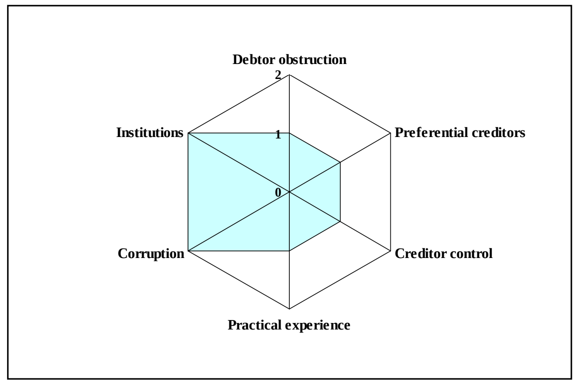
Generally speaking, the legal framework serves well commercial needs. There are however a few areas of uncertainty or complexity. First, the registration process would benefit from being simplified by not requiring presentation of the pledge agreement. Moving to this so-called “notice” system would mean that registration could happen in minutes, rather than days. Secondly, enforcement although generally efficient, suffers from not well functioning court system and from a serious problem of corruption. This was revealed in a survey run by the EBRD in 2003 on the Obstacles to charge enforcement process (see graph below).

Obstacles to charge enforcement process – Latvia (2003)

Scope



Process



Note: The fuller the ‘web’, the more serious the problems are in each of the respective categories. “Process” factors measure the impact that specific obstacles would have on the enforcement proceedings. “Scope” factors give an indication on how effective enforcement would be when conducted on various types of collateral and in the case of debtor insolvency.

Source: EBRD Legal Indicator Survey 2003

Telecommunications

The telecommunications sector is currently governed by the Law on Electronic Communications of 2004 (the “Communications Law”) and is regulated by the Public Utility Commission (SPRK). The Ministry of Transport maintains responsibility for sector policymaking. The Communications Law and related regulations aim to transpose the latest European Union (EU) regulatory framework into domestic law. SPRK was established in September 2001 by the Law on Public Services Regulators of June 2001. SPRK is a multi-sector regulator responsible for regulating energy, telecommunications, post and railway, financed from a levy on operators. Under the terms of the Communications Law, SPRK will continue to supervise the market whilst a new Electronic Communications Agency will deal with licensing and regulatory issues.

According to SPRK, at the end of 2004 the total number of fixed telephone subscribers was 631,000, of which 90% were digitised. SPRK also reports that by the end of 2004 more than 300 licenses and authorisations had been issued, including a significant number to operators planning local or international voice telephony, though the majority have yet to begin significant operations. However, while Lattelekom (incumbent former monopolist operator) remains the largest fixed line service provider, mobile substitution is nonetheless having a significant competitive impact and fixed-line competition is coming from cheaper international calls, with long-distance and local call competition is becoming more prevalent.

While the mobile sector is well established, with the number of mobile users in Latvia being reported as 1.68 million (equating to a penetration rate of 73%) at end of July 2005, there has been limited competition in this market segment until the arrival of a new operator in 2005. It remains to be seen what impact this new operator will have on the market. All three (LMT, Tele2 and Bite GSM) also possess UMTS licences, though such services remain to be launched in Latvia. One company operates CDMA 450 services and there are also some service providers and Mobile Virtual Network Operators (MVNOs) operating in the market.

In 1993, a TeliaSonera-controlled consortium took a 49% stake in Lattelekom. The share purchase was made on the basis of a 20-year monopoly on fixed telephony until 2013. Subsequent reforms by the government as part of accession to both EU and World Trade Organisation resulted in the halving of this monopoly to January 2003 by the 2001 Law on Telecommunications, leading to a dispute between the state and TeliaSonera. This long running dispute impacted upon the introduction of a number of reforms and was only settled by agreement of the parties in 2004. Consultations between the Government and the Lattelekom shareholders on the privatization of the remaining share of Lattelekom are still in the process. Concrete proposals on the matter may appear towards the end of 2005.

Though Latvia has made significant progress in harmonisation with EU standards, difficulties appear to have been encountered in the implementation of these measures. There have been criticisms from the European Commission with respect to the completion of transposition of the 2002 framework, notably with respect to tariff rebalancing, the apparent absence of new market analysis provisions and excessive (non-cost oriented) rates for some interconnection products. Similarly, there have been questions as to the adequacy of resources of the regulatory authorities to deal with the issues before them. Additionally, the decision to take a phased approach to the introduction of carrier selection and pre-selection (January and July 2006 respectively) and setting the deadline for number portability for 1 December 2005 will likely have an impact upon the level of competition possible in the marketplace. While a number of these issues have since been addressed, for meaningful competition to take hold in Latvia it is crucial that the authorities fully implement all relevant regulatory mechanisms as soon as possible (particularly with respect to access and interconnection) and that such implementation be supported by robust and pro-active regulatory intervention in the appropriate areas of the market.

The government should also ensure that the structure, powers and resources of the regulatory authorities are sufficient to efficiently regulate a competitive marketplace in accordance with EU standards.